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Banking on Mutual Funds

Indian investors have always believed in bank deposits. Now mutual fund houses are trying to woo them through customised schemes. BY DIPAK MONDAL

RAJAT BARAN

Mutual funds, or MFs, are trying hard to wean away the conservative Indian investor from bank deposits. MFs, over the last decade have emerged as a popular investment option, as they offer a wide array of products aimed at investors with varied risk appetites and investment objectives. But still, over 40 per cent of household savings, according to a Karvy Private Wealth report, find their way into bank deposits. The MF industry, which has been able to tap just about 3.8 per cent of household savings till now, is planning to bite into that pie with greater product diversification and innovation.

Several companies have launched a slew of products with risk profiles and tenures. *Money Today* does an in-depth analysis of schemes that offer some interesting alternatives to the bank-obsessed investor. Here is a look at the fare on offer.

Liquid Funds vs Savings Accounts

The primary objective of having a savings account with a bank is to ensure that your surplus cash remains safe and completely liquid. Along with this, you also earn a yearly interest of 3.5 per cent. Liquid schemes of funds come very close to such accounts.

Such schemes are often used by high net worth individuals, or HNIs as savings accounts. Money in a liquid fund can be redeemed within a day of submission of a withdrawal application. These funds invest in money market instruments — certificates of deposit, commercial paper, treasury bills, government securities and other debt papers with maturities of up to 91 days.

Besides being liquid in nature, these funds offer higher and more tax-efficient returns than your savings accounts. While you earn an annual interest of 3.5 per cent in savings account, by investing in liquid funds you make 5.5 per cent on an average. You can invest for as short a period as one day. No exit load is charged for withdrawal.

Abhinav Angirish, founder and managing director, Abchlor Investment Advisors, says: "One can invest in liquid funds for very short periods — a day or a fortnight. No banks would allow you to open a savings account for such a small period. The interest rate is also higher than that offered by a savings account."

How liquid funds beat savings accounts: The net asset value, or NAV, of liquid funds are declared even on Saturdays and Sundays. Besides, the investment is done on the previous day's NAV. These two features attract a large number of investors to such funds.

Consider a situation where you have received a large sum on a Friday to be used for a certain purpose on Monday. So, instead of keeping the money in your bank, you can invest it in a liquid fund at Thursday's NAV and earn a decent return.

Another strategy used by investors to benefit from liquid MFs is to invest a certain amount in a liquid fund and systematically transfer it to an equity fund. This strategy helps you gain from the liquid fund as well as from the equity fund.

A similar approach is used by Bharti AXA liquidity scheme to woo investors. The daily gains from Bharti AXA Liquid Fund and Treasury Advantage Fund are transferred to Bharti AXA Equity Fund or Bharti AXA Focused Infrastructure Fund.

Prateek Agrawal, head, equity at Bharti AXA Investment Manager, says: "The average annual return given by liquid funds is between 5 and 5.5 per cent. If you transfer only the daily gains from liquid funds to equity funds, it will not only give capital protection benefits but also high equity returns."

But so far, these funds are mostly used by institutions and HNIs for parking their short-term surplus money. However, financial planners say retail investors should also look at these funds to make smart gains.

Tax implications and expenses: There is no getting away from tax on dividend income which is 25 per cent for liquid funds and 12.5 per cent for other debt funds. Also, capital gains tax is applicable on liquid funds, as it is for all debt funds. In a typical debt fund, the long-term capital gains tax without indexation is 10 per cent, while it is 20 per cent with indexation. Short-term capital gains tax is

40% of household savings in India go into **bank fixed deposits, bonds and savings accounts**

3.8% of the country's total household savings is invested in different mutual funds schemes

While you earn annual interest of 3.5 per cent on your deposits in savings account, you make 4 to 7 per cent in liquid funds.

Top 10 MIPs in terms of 5-year returns

Scheme Name	RETURNS (%) 1 YEAR	3 YEARS	5 YEARS
Reliance MIP(G)	6.49	12.82	11.52
Canara Robeco MIP(G)	7.82	8.39	11.51
HDFC MIP-LTP(G)	8.76	10.07	11.11
ICICI Pru Child Care & Study Plan	10.67	8.11	10.62
Birla SL MIP II-Savings 5(G)	5.42	10.98	9.69
HSBC MIP-Savings(G)	4.37	6.70	9.66
Birla SL Monthly Income(G)	6.30	7.60	9.64
L&T MIP(G)	4.53	5.50	9.36
UTI MIS Adv(G)	4.91	6.73	9.29
LICMF Floater MIP-A(G)	6.00	6.38	9.28

Source: Accord Fintech

Top 10 FMPs in terms of 3-year returns

Scheme Name	RETURNS (%) 1 YEAR	3 YEARS	5 YEARS
Tata FIPF B3-Reg(G)	2.05	7.07	8.99
Tata FIPF C3-Reg(G)	1.28	5.61	6.52
Tata FIPF B2-Reg(G)	1.84	5.45	6.25
Tata FIPF A2-Reg(G)	1.95	5.67	5.91
FT FTF VIII-60M-A(G)	-3.37	6.23	5.17
FT FTF IV-60M(G)	-2.93	6.34	4.65
Tata FIPF A3-Reg(G)	1.90	5.80	4.64
FT FTF VI-60M(G)	-3.16	6.30	4.51
Tata FIPF C2-Reg(G)	0.73	0.69	4.44
Tata FIPF A1-Reg(G)	0.13	0.04	3.50

Source: Accord Fintech

deducted based on your income tax slab. Indexation here means adjusting your tax liabilities to inflation. The fee charged by liquid funds is usually lower — it ranges from 1 per cent to 1.5 per cent of the corpus invested.

Fixed Maturity Plans vs Fixed Deposits

According to the RBI, around ₹48 lakh crore is invested in bank fixed deposits, or FDs, in the country. And the typical FD investor is hard to please — he is conservative and is not only looking for capital protection but also guaranteed returns. But, the nature of the MF beast is such that it cannot completely guarantee returns. However, some funds have come out with schemes that have very low-risk portfolios and often generate better returns than FDs, even though they do not guarantee capital appreciation.

Fixed maturity plans, or FMPs, are closed-ended debt funds which hold debt paper with maturity periods lower than or equal to their own. This, along with closed-ended nature, minimises the interest rate risk.

How FMPs score over FDs: The closed-ended nature of an FMP ensures that the fund holds the debt papers till maturity and hence the returns are almost guaranteed. The average annual return from FMPs over the past three years, however, has not been too high, ranging from 6.5 to 7 per cent, but more than half of the available plans, with maturity periods of more than three years, have delivered over 7 per cent returns.

There is a lot to choose from with FMP maturity periods ranging from three months to five years.

Tax-efficiency is another positive feature. Fund houses often launch FMPs which have maturities of just over a year — 370 or 390 days. FMPs with such maturity periods help investors benefit from double indexation (*See Benefit of Double Indexation*), where capital gains are adjusted for inflation twice, once in the year of investment and then at the time of maturity.

The disadvantage: The closed-ended nature of FMPs can prove to be a spoiler for investors, as they cannot redeem their investments prematurely. The only way to get out of an FMP is to sell the units on a stock exchange. However, transaction volumes for FMPs are abysmally low, making the funds virtually illiquid.

In case of FDs — barring the ones used for tax savings under Section 80C — investors can make premature withdrawals by sacrificing a bit of interest income, which is just 1 per cent less in case of premature withdrawals. Alok Singh, head, fixed income, BNP Paribas Mutual Fund, says FMPs were closer to FDs in their former avatar when early exits were allowed. "With the ban on withdrawal before maturity, FMPs certainly are less attractive."

"You can invest in liquid funds even for a day or two. **You can't open a savings bank account for such a short period."**

ABHINAV ANGIRISH,
Founder and MD, Abchlor Investment Advisors

Capital Protection Funds vs Bank FDs

Capital Protection Funds are closed-ended schemes with tenures ranging from one to five years. These funds invest a large portion (up to 90 per cent) of their portfolio in good quality debt paper with maturities similar to tenures of the schemes, and the rest in equity instruments. While the money invested in debt instruments

tries to recover the principal amount, the return from the portion in equity adds to it, giving capital protection and good returns.

However, investment in these funds cannot be redeemed prematurely and hence liquidity is a concern.

Kalpen Parekh, deputy Chief Executive Officer, IDFC Mutual Fund, says: "Capital protection funds have recently been offered and investors are keen on them. FMPs have been more popular as they invest only in debt instruments and offer similar risk and return profile like conventional debt instruments. In the last six months, FMPs have added around ₹50,000 crore of assets between retail and corporate investors."

MIPs vs Bank Monthly Income Schemes

Mutual funds have been pitching monthly income plans, or MIPs, as a source of regular income for investors against the monthly income schemes, or MIS, of banks. MIPs are debt-oriented hybrid funds with over 65 per cent of portfolio invested in debt instruments and the rest in equities.

These schemes pay regular dividends. Bank schemes are FDs with interest paid in monthly installments.

Mutual funds MIPs try to offer returns which are better than bank FDs with the help of their exposure to equities. While interest on bank FDs ranges from 6 to 9 per cent, MIPs have given an average return of between 6 and 7 per cent over the past five years with the better performing funds giving between 10 and 12 per cent.

"Equity exposure of MIPs makes them more attractive in terms of returns than monthly schemes of banks. Market risk also increases with the equity component," says Anil Rego, Chief Executive Officer, Rights Horizon, a Mangalore-based financial planning firm.

"Equity exposure of MIPs makes them more attractive than **bank monthly income schemes in terms of returns"**

ANIL REGO,
Chief Executive Officer, Rights Horizon

However, investors must remember that dividend payouts in MIPs are subject to availability of funds. If the scheme is making a loss, it is possible that the fund house may not pay dividend. In 2008, many MIPs skipped monthly dividend payments due to adverse market conditions.

Dividends on MIPs are taxable at 12.5 per cent. One way to escape the dividend distribution tax is to go for a growth plan and choose a systematic withdrawal option.

Under systematic withdrawal, you can either withdraw the capital appreciated portion or a predetermined amount. Any withdrawal within a year of investment though invites a 1 per cent exit load.

Recurring Deposits vs SIPs in Mutual Funds

How often do you go for goal-based savings such as putting a sum aside for your children's education or marriage, for buying a car or for a holiday abroad? Banks offer recurring deposit schemes, where a small amount can be saved every month to create funds to meet future goals.

Interest rates in recurring deposits are the same as FDs and the maturity period varies from one to five years.

But if you find the interest rates not very attractive, you can try out a systematic investment plan, or SIP, of a good equity fund. The returns are generally higher, but they are riskier too.

"It is possible that at the time when you need the money, equity markets may have fallen sharply and your investment may have shrunk," says Dewang Shah, an independent financial planner.

The above mentioned schemes are well-thought out and smartly carved to tap a larger chunk of Indian household savings. But analysts do not see them as perfect replacements for traditional banking products. Most MF products have risks involved, which make many risk-averse investors quite wary. How the still-nascent MF sector addresses the issue, remains to be seen. ◆

Courtesy: Money Today

Taxation of mutual funds & fixed deposits

	EQUITY FUND	DEBT FUND	FIXED DEPOSITS
Tax on dividend	Nil	25% on liquid funds' 12.5% on any other debt funds	NA
Long-term capital gains tax	Nil	10% without indexation, 20% with indexation	As per income gains tax slab
Short-term capital gains tax	15%	As per income tax slab	As per income capital tax slab
TDS	NA	NA	Applicable when interest income exceeds ₹10,000

Source: Scheme information documents