Small saving schemes could lose sheen

Many investors are flocking back to small saving schemes as investors seek the safety of government instruments. With a host of ponzi schemes going under and taking thousands of crores of investors' money, people have again begun to warm up to instruments such as post office time deposits and National Savings Certificates (NSCs).

In 2013-14, collections from small savings schemes are back into positive territory. Before that, collections in these were losing to other investments such as fixed deposits (FDs) and fixed maturity plans. In 2011-12, for instance, there was a gross negative outflow of Rs 21,800 crore from all government saving schemes, show reports from the Reserve Bank of India. In 2012-13, these outflows shrunk to Rs 9,400 crore. Inflows this financial year are expected to be in positive territory, at around Rs 1,100 crore.

Experts say investors are revisiting these schemes because they don't want to take market risks. Says Hemant Rustagi, chief executive officer, Wiseinvest: "There are different kinds of investors and some don't want to take risk. For a majority of investors in India, there's the risk of losing capital. Definitely, small saving schemes have a place in the portfolio."

Even while current yields from small saving schemes are not that attractive, the safety factor is largely attracting more of people in the lower tax bracket. In some cases, these are better than bank deposits but the returns do not match consumer price inflation. For instance a one-year time deposit earns 8.2 per cent interest per annum, as compared to around eight per cent for FDs. Consumer price inflation is currently 9.67 per cent. Experts say while investors are getting a better rate, the risk of losing capital to inflation is not captured in these schemes.

The popular NSCs offer 8.5 per cent returns to investors and come with a lock-in of five years.

However, for a large number of investors, the trusted old savings could undergo a sea change if the Urjit Patel committee report on monetary policy is implemented. Interest rates on small savings have been changed infrequently in the past. The previous revision was on April 1, 2013, when the rates were cut by 10 basis points. The Patel committee says with these infrequent changes, small savings had acquired a competitive edge over bank deposits during the easing of monetary policy, as evident during 2009-10. In other words, when the Reserve Bank of India was cutting interest rates, small saving schemes were turning attractive for investors due to their higher return.

The report says annual resets for small saving rates continue to provide these a competitive edge. Therefore, the option of a half-yearly or quarterly reset should be implemented. "More frequent intra-year resets of interest rates on small saving instruments, with built-in automaticity linked to benchmark G-sec (government security) yields, need to be brought in. Also, the benchmark should be based on the average of the previous six months or even shorter intervals, so as to better capture changes in interest rate cycles within a year."

In other words, returns on small saving schemes could fluctuate every three months, according to market rates. It could mimic the 10-year government security, where the interest rate movement depends on demand and supply of 10-year bonds and the prevailing interest rate.

Naturally, this would affect the final yield of investors. For example, if benchmark interest rates such as the 10-year G-Sec begin to yield seven per cent, small saving schemes could also be reduced to close to seven percent, affecting the final returns of investors. Says Suresh Sadagopan, financial planner, Ladder7 Financial Advisories: "Obviously, the rates will go down in tandem with whatever the rates are in the market. That would make it unattractive as compared to a bank deposit or other fixed income instruments."

Others say the move will benefit investors if the rates go up but will not make small saving so attractive if these go down. Rustagi feels the rates should be reset only once a year. Says Rustagi, "The investors are already getting market rates, re-set every year. Changing it more frequently might not be wanted for now, especially considering a lot of these investors come to small saving for safety of their capital. In India, we don't have social security; investors also know the era of 12 per cent and 14 per cent returns is gone. So, the rates should be reset only on a yearly basis."

Among post office savings schemes, the Monthly Income Plan is a popular instrument but there's a cap of investment of Rs 4.5 lakh in a single account and Rs 9 lakh in a joint account. Says Rustagi, "It's one of those few instruments where the investor is getting a steady income. There's a cap here on investments but, nevertheless, investors who want a regular sort of income go for these instruments."

But experts say if you are in the highest tax bracket, then these schemes might not give you the optimum post-tax return, as compared to some other fixed income schemes. Says Rustagi: "It does not make sense for investors in the high tax bracket, as post tax returns are very low."

Among small saving schemes, the Public Provident Fund still holds pride of place because of its tax-free status. "PPF should be figuring in everyone's investment list because of its tax-free income," continues Rustagi.

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