Tax-efficient fixed maturity plans a good investment option now

In the past few weeks, the fixed income landscape in the country has changed drastically. Following the unprecedented liquidity tightening measures by the RBI in response to the sliding rupee, short-term rates have jumped up sharply. This has increased the attraction for investments in short-term debt instruments, such as the one-year certificates of deposit and commercial paper.

The rates have risen to 9.5-10% for certain instruments, up to 150 basis points higher than that a month ago, when sliding interest rates had increased the preference for longer tenure instruments.

The fund houses have been quick to take advantage of the short-term rates, with nearly all AMCs launching fixed maturity plans (FMPs) of different tenures in the past month. Should you bite the bait and include FMPs in your portfolio? If so, how should you identify the right one?

Why invest in FMPs now

These plans invest in a mix of short-term options, such as money market instruments, certificates of deposit, commercial papers, and the like. Given that these are currently offering a yield of 9.5-10%, the funds are also likely to deliver a similar pre-tax return. The investors who lock in money at the current level should enjoy double-digit returns over a one-year horizon.

The uncertainty regarding the future interest rate movements makes FMPs a safer bet. The reversal in rates had played out to the hilt, giving a fillip to bond prices, especially those of longer duration. However, the recent RBI move to tighten liquidity has put a big question mark on the trajectory of rates. Debt funds, across categories, have taken a knock and there is a heightened element of risk.

FMPs, on the other hand, offer returns that are relatively predictable, though not guaranteed. These are closed-ended, or of a fixed tenure, where the fund invests in instruments with a maturity profile matching that of the fund, and the instruments are typically held till maturity. For instance, a one-year FMP will invest in fixed income instruments bearing the same maturity. As such, any gyration in interest rates in the interim period does not affect the value of the fund.

Hence, in an environment where the stability of the debt market is suspect, an FMP provides a safer way to navigate the uncertainty. Says Hemant Rustagi, CEO, Wiseinvest Advisors: "This is a good window for investors to lock in their money at higher yields through FMPs." They should supplement the riskier open-ended funds in their portfolios with more stable FMPs, he adds.

Besides, FMPs are more tax-efficient. The plans with a horizon of more than a year provide the benefit of indexation, where investors are allowed to adjust returns against inflation. If you invest in the growth option of a one-year FMP, your returns are taxed as capital gains at a rate of 20% with indexation, or 10% without indexation. In case of fixed deposits, the interest is clubbed with income and is taxed as per the specified slab rates. So, if you fall in a higher income tax bracket of 20% or above, an FMP would be a better choice than an FD. During periods of high inflation, the indexation benefit allows you to enjoy near-zero tax on capital gains. However, the gains from FMPs with durations of less than one year will be taxed at your applicable tax rate, bringing them at par with FDs.

Choosing the right FMP

Since these are closed-ended, you can only invest when an FMP is active, that is, it is launched as a new fund. However, availability should not be a concern, with nearly 50 new offers coming up in this month alone. Since this may make it difficult to zero in on the right plan, here are some thumb rules you can follow:

First, decide your investment horizon. Fund houses are offering FMPs of varying durations, typically one-year tenures, but also 30-day and 90-day variants, to take advantage of the sharp spike in short-term rates. There are also schemes with three- and five-year horizons. Opt for a fund whose tenure matches your investment term. Says Neeraj Chauhan, CEO, Financial Mall: "If you are risk-averse, go for a higher tenure product, which will enable you to lock in at high yields for a long period." He also suggests matching the tenure with a financial goal. So, if you plan to buy a car after a year, a one-year FMP will be ideal to help make the down payment.

It is critical to choose the tenure wisely since these funds have a lock-in period and you will not have access to your money for this duration. Even though these instruments are listed on the exchanges and are tradeable, the liquidity is very low. So you cannot sell whenever you want without having to compromise on price.

FMP new fund offers

Scheme	Tenure (days)	NFO opens	NFO closes
1-3 months			
Reliance FHF XXIV Series 14	**91**	23 Aug	**27 Aug**
IDBI FMP-Series III 90D (August 2013) J Reg	**90**	19 Aug	**21 Aug**
Religare Invesco FMP Series XX Plan A (90D)	**90**	20 Aug	**21 Aug**
1 year			
Kotak FMP Series 112 Reg	**370**	16 Aug	**20 Aug**
IDFC FTP Series 27 Reg	**369**	16 Aug	**20 Aug**
Reliance FHF XXIV Series 11	**369**	16 Aug	**20 Aug**
BSL FTP Series HL Reg	**366**	19 Aug	**20 Aug**
ICICI Prudential FMP Series 69 366 Days Plan G Reg	**366**	19 Aug	**20 Aug**
DSPBR FMP Series 110 12 Months Reg	**365**	16 Aug	**21 Aug**
DSPBR FMP Series 111 12 Months Reg	**365**	22 Aug	**27 Aug**
JP Morgan India Annual Interval Reg	**365**	5 Aug	**19 Aug**
IDBI FMP-Series III 203D (August 2013) J Reg	**203**	19 Aug	**21 Aug**
Reliance FHF XXIV Series 12	**187**	19 Aug	**26 Aug**
More than 1 year			
ICICI Prudential FMP Series 69 1821 Days Plan H Reg	**1,821**	19 Aug	**28 Aug**
JP Morgan India FMP Series 24 Reg	**1,800**	16 Aug	**30 Aug**
Kotak FMP Series 113 Reg	**1,094**	21 Aug	**29 Aug**
Reliance FHF XXIV Series 7	**1,094**	6 Aug	**20 Aug**
Reliance FHF XXIV Series 13	**1,092**	22 Aug	**30 Aug**
JP Morgan India FMP Series 23 Reg	**1,080**	16 Aug	**30 Aug**
SBI Debt Fund Series 36 Months 4 Reg	**1,080**	19 Aug	**22 Aug**
HDFC FMP 1001D Aug 2013 (1) Reg	**1,001**	12 Aug	**20 Aug**
Reliance FHF XXIV Series 10	**735**	16 Aug	**26 Aug**
ICICI Prudential FMP Series 69 693 Days Plan D Reg	**693**	7 Aug	**21 Aug**
DWS FMP Series 33 Reg	**685**	13 Aug	**20 Aug**
Reliance FHF XXIV Series 6	**628**	7 Aug	**21 Aug**
Religare Invesco FMP Series XX Plan B (601D)	**601**	22 Aug	**29 Aug**

Source: Value Research

The investors should also check the quality of the underlying paper in which the fund is invested. Opt for fund houses that typically invest in the highest quality instruments, such as AAA or AA rated corporate or PSU bonds. There is a high risk of default in the underlying paper if it has a lower rating. "Check that the underlying portfolio is investment grade, and also the sectors to which the portfolio is exposed," says Chauhan. While Sebi does not allow AMCs to show indicative portfolio or yield for FMPs, you can decide on the basis of past offerings.

(Economic Times)