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Lock in interest rates for long term with G-secs

Direct retail investment facility should lead to better secondary market liquidity in gilts

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Earlier, retail investors could invest in government securities (G-secs) via their broker and stock exchanges. Now, they have the option to open a retail direct gilt (RDG) account with the Reserve Bank of India (RBI) and participate in both the primary and the secondary market for gilts.

Besides G-secs, they will also be able to invest in state development loans and sovereign gold bonds via this facility. The investment ticket size can be as low as ₹10,000.

More liquidity, improved access

Trust in G-secs is likely to rise.

"Investors will be more relaxed knowing that their money, which they are offering for a long tenure, will go straight to the RBI and into G-secs," says Prasanna Tantri, associate professor of finance, Indian School of Business.

Earlier, investors had to pay their brokers a brokerage of up to 0.06 per cent. This facility will have no fee (only a payment gateway charge).

The new system is likely to provide greater liquidity.

"Now that investors will get access to the RBI's odd-lot system, they should enjoy greater liquidity and better pricing in the secondary market," says Udbhav Rajeshbhai Shah, investment advisor, iFAST Global Markets.

Exiting a bond midway during its tenure could become easier. Secondary market liquidity was low in the broker-exchange system.

Buying older bonds could become easier.

"An investor may want to buy five-year bonds. But he may prefer the 2025 maturity paper instead of the 2026 paper. Now, buying the former from the secondary market should become easier. Earlier, the investor had to wait for the RBI to come up with that issue," says Shah.

This will allow investors to ladder their investments (use securities maturing at different intervals) to address interest-rate risk, or to get money back at regular intervals.

Lock in rates

G-secs allow an investor to lock in interest rates for up to 40 years. This proves especially advantageous at the peak of a rate cycle. The only other product that allows them to lock in rates for a very long period is insurers' immediate annuity plans.

"G-secs make a lot of sense for retirees wanting to create a risk-free income stream for the long term," says Deepesh Raghaw, founder, PersonalFinancePlan, a Securities and Exchange Board of India-registered investment advisor.

The 6.67-per cent G-sec maturing in 2050 is currently offering a yield of 7.17 per cent. The Life Insurance Corporation's Jeevan Akshay VII annuity plan pays a person aged 60 a rate of 5.5 per cent in the with-return of purchase price option.

Products catering to senior citizens like Pradhan Mantri Vaya Vandana Yojana (PMVVY) and Senior Citizens Savings Scheme, or SCSS (7.4 per cent return on both) have a limit on how much you can invest. No such cap exists in G-secs. PMVVY and SCSS allow investors to lock in rates for limited periods of 10 years and five years, respectively. Banks (barring a few) offer fixed deposits of up to 10 years. Debt mutual funds, Employees' Provident Fund, and Public Provident Fund don't allow investors to lock in rates at all.

Interest income from these bonds will be added to an investor's income and be taxed at slab rate. "If the retiree is in the zero or lower tax bracket, G-secs can work for him," says Raghaw.

What to watch out for

Understand the risk in these bonds.

"They have zero credit risk but they carry considerable interest-rate risk," says Ashutos Wakhare, trainer at National Institute of Securities Markets. You can tackle this risk by holding G-secs to maturity. Investor could suffer losses if they exit during the tenure of these bond in a rising rate environment. Another option for lowering risk, says Wakhare, is to stick to treasury bills that have a maturity of up to one year.

Tantri warns again investors using RDG and G-secs for short-term trading, as it could result in losses.

HOW G-SECS AND GILT FUNDS ARE TAXED

Holding period criteria for determining LTCG/STCG are different

- Interest income arising from G-Secs is taxable at slab rate
- If they are held for more than 12 months, they attract long-term capital gain (LTCG) tax at 10 per cent without indexation benefit or 20 per cent with indexation benefit (plus surcharge and cess)
- If they are held for up to 12 months, short-term capital gains (STCG) tax apply at the investor's slab rate
- Dividend from gilt funds is taxed at the investor's slab rate
- In case of gilt funds, capital gains will be treated as long term if the holding period is more than 36 months, and as short term if it is less
- The LTCG and STCG tax rates applicable to gilt funds are the same as to Go-Secs

Source: RSM India