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A Comparative Study on Fixed Deposits (FD'S) & Fixed Maturity Plans (FMP'S)

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ABSTRACT :

The current study focuses on the availability of Fixed Maturity Plans(FMP) and fixed deposits as a source of investment to all the investors who wishes to invest. Investment in Fixed Maturity Plans would be the better option for those who have good awareness, and Fixed Deposit(FD) is an investment product which allows you to invest lump of money for a fixed time period, at a fixed rate of interest and it is quite popular form of investing in India.

Keywords: FMP, FD, investment, fixed rate, investors

INTRODUCTION
FIXED DEPOSITS(FD):

Fixed deposits are a high-interest-yielding Term deposit and offered by banks in India. The most popular form of Term deposits are Fixed Deposits. To compensate for the low liquidity, FDs offer higher rates of interest than saving accounts.The longest permissible term for FDs is 10 years. Generally, the longer the term of deposit, higher is the rate of interest but a bank may offer lower rate of interest for a longer period if it expects interest rates, at which the Central Bank of a nation lends to banks ("repo rates").

FIXED MATURITY PLANS(FMP):

Fixed maturity plans, or FMPs as they are popularly called close-ended funds with a fixed tenure and invest in a portfolio of debt products whose maturity coincides with the maturity of the product. Fixed maturity plans (FMP) floated by mutual funds requires a thorough due diligence process on the part of the investor before committing any money to the plans. They are closed-ended funds, which mean that an investor can invest in them only when they are open for purchase. This is only during NFO (New Fund Offer) period. To redeem the investment, the investor needs to wait for the plan to mature or pay exit load.

Being close ended funds, fixed maturity plans offer flexibility to their fund managers and let them plan on their exact investments even at the IPO stage. This helps the investors to know in advance the yields that they can earn at IPO stage approximately.

REVIEW OF LITERATURE:

Ravi kumar in 2010 says that, With its feature of guaranteeing assured returns, the traditional investment of fixed deposits has become a vital part of every investor's portfolio. However, FDs, that were once considered as a plain vanilla product has now changed its identity by becoming more flexible along with several other benefits attached to them.Today, the banks are facing the era of completion. As a result, more and more attractive deals are coming up in the market in order to attract more investors. Listed below are some of these benefits of Fixed Deposits that one can enjoy.

1.Insurance.
2.No Penalties.
3.Breakable Deposits.
4.Flexible Tenures.

According to Narendra nathan, the tax benefits stand out for FMP's. Irrespective of the holding period, FMPs generate better post-tax yield. The length of the holding period matters, especially when one has to decide between growth and dividend options. Investors can go for the growth option if the holding period is more than a year, and for the dividend option if the holding period is less than a year. As per the current law, investors can claim double indexation benefit if the holding period is over three financial years ne can come across several FMPs with double indexation benefits.Though the FMPs are relatively less risky, investors should not treat these as dream products that offer high return with zero risk. While the structure eliminates interest rate and reinvestment risk, the credit risk (or the default risk) still exists. Since the fund houses are not allowed to give 'in

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dicative portfolios', there is no mechanism to make sure that the money will be invested only in high quality papers. While bank FDs come with deposit insurance (for a holding of up to Rs 1 lakh), a similar facility is not available for FMPs. So one should only opt for reputed fund houses.

DEFINITION OF FIXED DEPOSIT & FIXED MATURITY PLAN

FIXED DEPOSIT:

In deposit terminology, the term Fixed Deposit refers to a savings account or certificate of deposit that pays a fixed rate of interest until a given maturity date. Funds placed in a fixed deposit usually cannot be withdrawn prior to maturity or they can perhaps only be withdrawn with advanced notice and/or by having a penalty assessed.

FIXED MATURITY PLAN

A closed-end fund that invests in debt and money market instruments of the same maturity as the stated maturity of the plan. The focus of a fixed maturity plan is to provide a stream of income through interest payments,while exposing the investor to a lower level of risk.

COMPARISON BETWEEN FD & FMP:

A fixed deposit is a simple instrument: all you do is deposit money with a bank for the desired time period – a few months, a year, two years, or five. The bank pays a fixed interest rate on the deposit. You can either have the interest paid out regularly, or allow it to compound over the entire tenure of the deposit and receive both the interest and the principal on maturity.On the other hand, FMPs are closed-ended funds of various tenors – 369 days, 542 days, 1,100 days, you name it. Investments in FMPs are possible at the time of the fund offer alone. In an FMP, too, you have options with respect to dividend payout. But the dividends are subject to dividend distribution tax and there's no compulsion for them to be paid regularly either.So we can find both deposits and FMPs that fit into your investment horizon and are locked in for that time period. Now, neither an FD nor an FMP is meant to be particularly liquid. But a deposit can, should the need arise, still be broken and the funds accessed after paying a penalty.

On the other hand, while an FMP can be theoretically sold on the stock exchange, in practice, pulling out of an FMP before maturity is not possible.An FMP fund manager invests across debt instruments issued by banks, financial institutions and companies. Usually, the maturity profile of these instruments closely matches that of the FMP itself. At the time of the fund offer, an explanation of the types of instruments that will be invested in, a break-up of how much of the portfolio will be put in each segment and the minimum credit rating of instruments that the fund will look at may be explained. The aim of an FMP would be to generate returns superior to an FD through a combination of interest accrual and bond price appreciation. But even so, actual returns can differ from the indicative yields that are 'informally' given at the time of a fund's launch.If the fund manager happens to read the interest rate cycle wrong, or times the investments incorrectly, returns may suffer. If investments are made in higher credit-risk companies and they default, returns can take a blow. Sticking to fund houses that have a consistent record of good performance may address some of this risk.In this aspect, FDs beats FMPs by a mile, being among the safest instruments around. Interest rates are known beforehand and are steadily paid on time. Deposits up to Rs. 1 lakh are also insured.Following the tweaks made in the recent Budget, FMPs held for over three years qualify as long-term capital gains and are liable to be taxed at 20 per cent, with indexation benefits. Shorter holding periods attract short-term capital gains tax, which is levied at income tax slab rates. FDs are taxed at these slab rates. That brings FMPs of one- to three-year timeframes in line with FDs as far as taxes go. Until the Budget revision, FMPs scored over FDs in terms of returns.

REASONS FOR INVESTING IN FMP'S

One of the main drivers for investing in FMPs is the tax efficiency compared to other similar investments. However, to gain the tax advantage you should invest in FMPs of one-year tenure or more. If we invest in FMPs of less than one year, the gains will be added to our total income and taxed at the income tax slab we are in. On the other hand, if we invest in March of one year and stay invested till April of the following year, that is about 400 days, we get to enjoy double-indexation benefit. And what's even better, if after double indexation we witness a loss, we can also set off such losses against any other short- or long-term capital loss over the next eight years.

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REASONS FOR INVESTING IN FD's

Traditionally the most favored investment avenue in India, bank deposits continue to hold fort even today. Bank deposits do not have the excitement surrounding other investment avenues like equity shares or real estate investments. But bank deposits serve the purpose of preserving capital, which is the most wanted at certain times. The main reasons for investing in FDs are current income, capital appreciation, less risk, liquidity, convenience etc.

PROS AND CONS

1.A fixed deposit is a traditional savings instrument, an FMP is a closed-ended fund.
2.FD deposits up to Rs. 1 lakh are insured, FMPs are not.
3.FMPs can earn more interest than FDs, but come with greater risk.
4.Fixed deposits are taxable where as FMPs are not taxable.

CONCLUSION:

For holding periods of over three years, FMPs still win over FDs, especially for those in the 20 and 30 per cent tax brackets. With indexation benefit, even if inflation moderates sharply in the next few years, FMPs will still attract much lower tax than FDs.This compensates for the higher uncertainties in FMPs. But for investments with one- to three-year timeframes, FDs are a better bet. with the tax advantage stripped away, the returns of FMPs are hardly superior and involve more risk. FMPs can invest in instruments bearing higher credit risk and offering higher interest rates, and still attract returns higher than can be earned from FDs.

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