Indian Bonds and the Retail Direct Scheme

What is Retail Direct Scheme

The Retail Direct Scheme allows retail investors to directly invest in ***government bonds*** and treasury bills through an online gilt account – also called Retail Direct Gilt Account (government bonds in India and many other commonwealth countries are called Gilts).

Having such an account allows investors to have access to both primary market (buying directly from the issuer, in this case RBI), and secondary market (where an investor can buy a bond at prevailing market price from others).

With a gilt account, one can invest in government treasury bills, government bonds of different maturities, sovereign gold bonds and state development loan (SDL) bonds. Any individual with a rupee savings bank account, Permanent Account Number (PAN), any valid official document for KYC purpose, a valid email id and a registered mobile number can open a Gilt account. One can also open a joint account with another eligible individual.

Non-residents of India (NRIs) who are eligible to invest in government securities under FEMA Act are also eligible to open an account under the scheme. No fee will be charged for opening and maintaining the account with RBI. However, fees for payment gateway, etc will be borne by the registered investor.

Should you opt for it?

Most retail investors would already have some exposure to government securities either through mutual funds, insurance plans or provident funds.

A direct access to the government bond market provides another channel to invest in these bonds and securities. The question one should ask here is whether it makes sense to directly invest in these securities. Apart from that One must also be aware of the risks associated with investment in G-secs.

“One needs to be mindful of liquidity risk and interest rate volatility as well, which is associated with fixed income investments,” says Lakshmi Iyer, CIO-Debt and Head Products, Kotak Mahindra Asset Management Company.

While the government securities have liquidity and interest rate risks, the ***credit risk*** (risk of default) is almost zero as they are backed by the government. However, since the government bonds have long-term maturity, they could be prone to volatility due to changes in interest rates.

Investors, meanwhile, can neutralise the interest rate risk by holding a government bond till maturity. Vishal Dhawan, an independent financial planner, says that investors in lower tax

brackets, looking to lock into long term rates and hold to maturity, can consider investing directly in G-secs.
There could also be liquidity risks associated with the bond market. While the government bond market does have enough liquidity, state bonds could suffer from risks which means inability to sell the bonds when one is in need of cash.

Taxation

Understanding taxation of gains made from bonds could be ***taxing*** for investors if they are investing directly. If a bond is held till maturity, the gains would be considered as interest income and taxed as per income tax slab.
However, if the bond is sold in the secondary market before maturity, then one will have to pay capital gains tax depending on the holding period. The taxation rules for sovereign gold funds are different from normal government bonds.
While allowing direct retail participation in G-secs is a welcome move, regulators must invest in creating awareness about investment in these options as most retail investors would not even tell the difference between a yield and coupon let alone the risks associated with these instruments.