FMP (Fixed Maturity Plan)

FMP (Fixed Maturity Plan) is a type of Mutual Fund which has a Fixed Maturity date and can have an indicative return on your investment. Usually FMP's are used by companies and large investors as a substitute to bank fixed deposits.

FMP's are close-end funds, means that you can enter when it is launched and exit when the term is over. banks.

Fixed Maturity Plans or FMPs, as we know them, have shown a huge interest among investors in last financial year. All mutual funds companies put together have been able to collect Rs 1.75 lakh crore only in FMPs. Even the recent cut in interest rates by RBI does not seem to have any impact on the attraction of this product. The primary reason for such a high interest is the multifold benefits FMP offers to investors.

Let's understand how investors can reap the benefits by investing in Fixed Maturity Plans:

What are FMPs?

Fixed Maturity Plans are closed ended debt mutual funds scheme whose time horizon is fixed. The period ranges from 30 days to 3 years. From these, 1-2 years FMPs have been the favorites among investors. Being a debt scheme, the objective of an FMP is to give steady returns with capital preservation like FDs. The investment portfolio comprises of Debt securities such as certificate of deposit and commercial papers of nearly the same maturity as the scheme. So if duration is of 1 year it will invest in debt papers which mature just before one year. Since FMPs are closed ended scheme one can invest during the NFO period only. Once the NFO is closed investor can neither invest nor redeem it through Mutual Funds like open ended scheme. The only option to exit from any FMP is through stock exchange where they get listed as mandated by SEBI. However, liquidity is a major issue.

Will I really get the Indicative Return in FMP?

FMP's invest money in fixed income instruments (like bonds, government securities, money market instruments etc). They invest in instruments that get matured at the same time as their schemes. Due to this investment strategy the final earning are predictable. Again, the returns are "indicative" not "guaranteed". FMP has negligible interest rate risk i.e. very low or negligible variation in indicative yield and actual yield.

The returns from FMPs are not assured like FDs but with hold till maturity strategy one can expect fixed returns from this instruments at end of the specific tenure. The companies do not give any indicative returns now as market regulator SEBI banned it in 2009. As the product benefits more when prevailing interest rate scenario is high in economy, currently FMPs are able to offer 9.25-9.50% returns to investors for 1-2 year horizon.

Tax Advantage

Fixed Maturity Plans scores high on tax advantage when they are compared to similar instruments like fixed deposits. In FDs the interest earned is added to income and taxed at individual personal income tax rate which reduces the returns substantially for investors in higher tax slab. Contrary to this FMPs have different tax treatment as the nature of income is different but is highly efficient.

1. **Dividend**: Dividends in FMPs are tax free in hands of investors. However, mutual funds companies have to pay a dividend distribution tax of 12.5% (plus surcharge & cess) before distributing it to investors. Thus, any investor who opt for this option pays tax of this amount on earnings, although indirectly. This is far lower when compared to FDs where interest earned is taxed at individual personal income tax rate.

2. **Capital Gains:** If any investor opts for growth option, he is subject to capital gains tax. Short term gains are taxed as per the tax slab while long term gains are taxed at 10% without indexation or 20% with indexation. The indexation benefit inflates the cost of purchase lowering long term gains tax liability. This fare far better than FDs where no such benefit is available.

3. **Double Indexation**: This is the catch in the product. By investing during the end of financial year (March) in FMPs with over a year tenure, investors are able to avail double indexation benefit as it covers two accounting period. However, there has been ambiguity over DTC doing away with this benefit.

What is the difference between FD and FMP?

FMP's do not offer an assured return like FD (Fixed Deposit). Unlike bank deposit, you may have to invest a minimum of Rs. 5,000 in an FMP. The main advantage of investing in FMP is its tax efficiency. The interest gained through an FD is added to your income while evaluating tax. Whereas for FMP's which is longer than an year, you can choose to take all gains as capital appreciation and the tax is merely 10% with indexation benefit or 20% with indexation. For FMP's with tenure less than a year, an individual can choose to receive the gains as dividends, which will be taxed at 12.5% only.

Here is a small comparison which shows the net yield to investors and how FMP score over FD

	Bank FD	FMP Without Indexation	FMP with Indexation
Investment Amount	100000	100000	100000
Assumed Net Yield to investors	9.00%	9.00%	9.00%
Time Horizon	13m	13m	13m
Amount at Maturity	109750	109750	109750
Interest/Long term capital gains	9750	9750	9750
Cost after Inflation	NA	NA	107000
Indexed Gain/loss	-	8125	2750
Tax Rate	30.90%	10.30%	20.90%
Tax on Interest/Capital Gains	3013	1004	-
Post Tax Income	6737	8746	9750
Post Tax Returns (Simple Annualized)	6.14%	7.97%	8.88%
*Assumed CII-7%			

Risk Involved

The investment option has some inherent risk which should be well known to investors. The primary of these is the Credit Risk which companies reduce by investing in highly rated instruments but investors should do their own analysis. The returns from FMPs also vary w.r.t. interest rates. When interest rates falls, yield from FMPs falls too. Also, unlike FDs, the returns from FMPs are not pre-known and the product has low liquidity.

The AMCs having good track record maintain the indicative yield and to avoid any possible credit risk, by taking exposure in the instrument like Bank CD's, AAA rated and AA rated CP's only. Hence there is rare possibility of any credit risk or interest rate risk.

Benefit of investing in FMPs score high when compared to similar instruments. However, one should analyze well the track record of fund house and previous FMPs portfolios before investing to minimize any risk which can impact your investment objective.