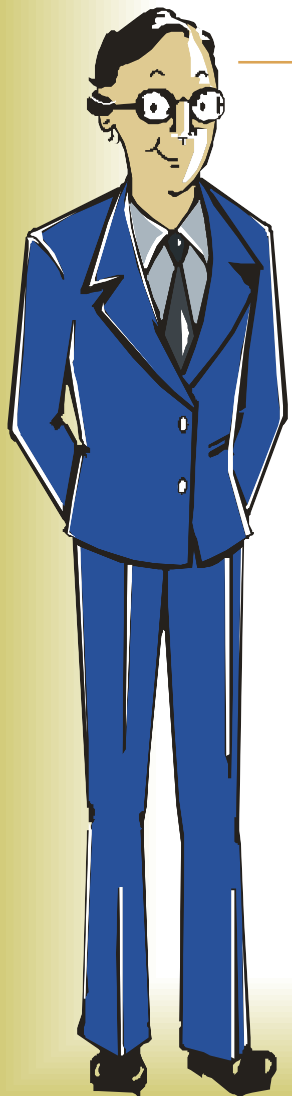
FMP Vs. FD – By Prof. Simply Simple

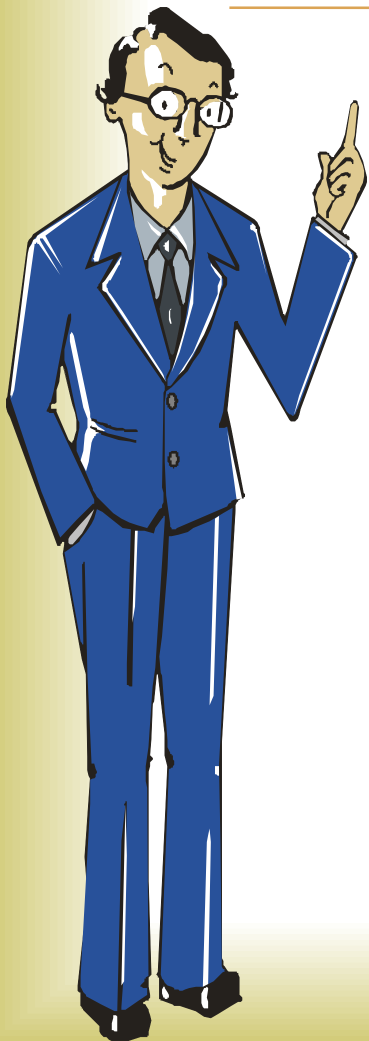
- A common feature of both FMPs (Fixed Maturity Plans) and FDs (Fixed Deposits) is that investors know in advance how much return they will earn on maturity
- The difference here is that while the returns on FDs are assured, returns on FMPs are in line with market yields
- FMPs are actually close-ended debt funds with fixed maturity offering a market-related yield. The keyword here is 'market related'
- That means, on maturity there is a possibility of actual returns deviating from the returns expected
- On the other hand, returns are guaranteed by an FD and investors are assured of receiving the same on maturity (assuming there is no default in payment of principal amount and interest)

Why do FMP yields vary?



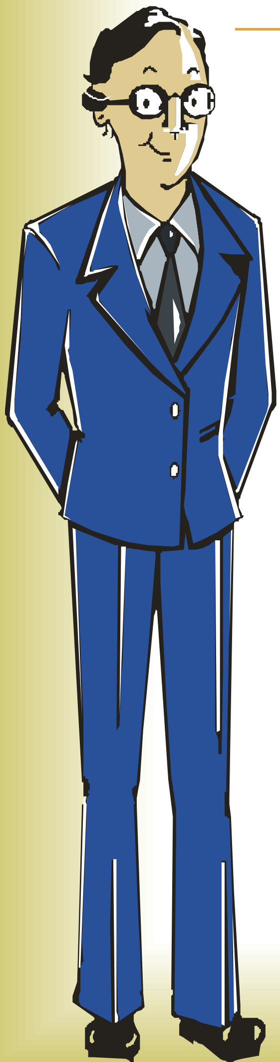
- FMP yields do not normally vary by a significant margin
- For the same tenure, the yields on debt instruments (with comparable credit ratings) are usually in a range, which is why FMPs of similar tenure have comparable yields
- The difference in yields between two FMPs arises out of the risk taken on in the portfolio – an FMP having top rated instruments in its portfolio would deliver comparatively less than an FMP with lower rated papers
- Higher return means that the fund manager has been taking on more credit risk in the portfolio

Varying tax treatment



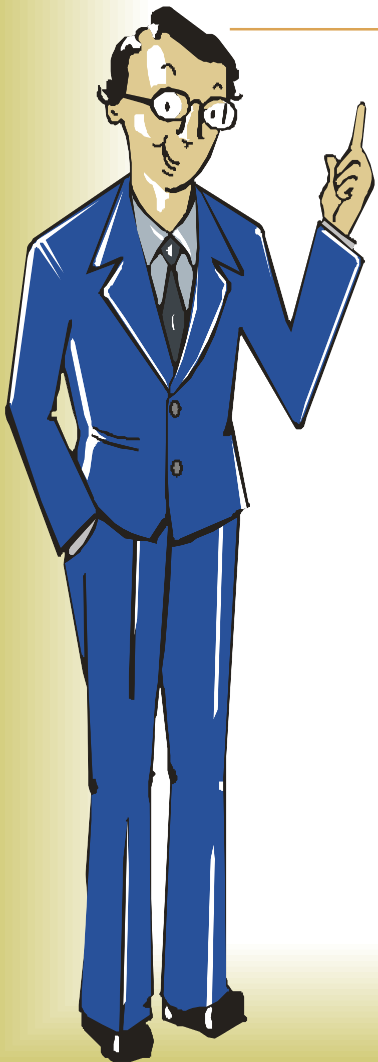
- The tax treatment on interest income for both FMPs and FDs are different
- Interest income from FDs is added to the investor's income and is taxable at the applicable tax slab for that investor. Interest from FDs is categorized as **'Income from other sources'** under Income Tax laws
- In the case of FMPs, tax implication depends on the investment option – Dividend or Growth.
- In Dividend option, investors have to bear dividend distribution tax , whereas in the Growth option returns earned are treated as capital gains (short-term or long-term depending on tenure of the investment)
- Due to indexation benefit, FMPs end up becoming more tax efficient than an FD as indexation lowers tax liability

In a nutshell



- Given the fact that returns from an FMP are not assured, FMPs are generally considered riskier than an FD
- But FDs also have their own share of risks as they are usually rated
- The credit rating of an FD is an indicator of the degree of risk associated with it
- For instance, a rating of ‘AAA/FAAA’ offers the highest level of safety. So, an FD carrying a credit rating lower than this carries higher risk

What should investors do?



- For a competitive return with minimum risk , both FMPs and FDs are viable investment options
- To choose between them, investors need to take into account their risk profile and investment objective, among other factors
- For instance, while FMPs may appeal to investors willing to take a little risk for that extra return, FDs will find favour with investors who are satisfied with a lower but assured return

Hope you have now understood the difference between FMP and FD