Headline: What NSE equity savings index means for you	
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What NSE equity savings index means for you

Nifty Equity Savings index will make it easier to assess the performance of equity savings funds that invest in equity, debt and arbitrage opportunities

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On the back of rising popularity of equity savings mutual fund schemes, the National Stock Exchange (NSE) has launched a new index called Nifty Equity Savings index. This index now serves as the benchmark of an equity savings fund. An equity savings fund invests about 20-40% in equities, about 30-35% in arbitrage opportunities and the rest in debt.

Predictably, this index will consist a 35% exposure to Nifty 50 total returns index (TRI), 30% towards equity arbitrage (long position of Nifty 50 TRI and an equivalent short position in Nifty 50 Futures index), 30% towards Nifty Short Duration Debt index and 5% towards Nifty 1 day rate index.

Equity savings funds, which were first launched around 2014, have gained popularity among risk-averse investors, with assets worth around Rs20,000 crore as on March 2018, up from Rs4,648 crore as on December 2016-end and Rs1,090 crore as on December 2014-end (*see graph*).

It started off as an avenue to bypass a tax that Budget 2014 had imposed, but is now one of the official 36 categories of mutual funds that capital markets regulator Securities and Exchange Board of India (Sebi) has laid down in its ongoing scheme merger and re-categorisation exercise.

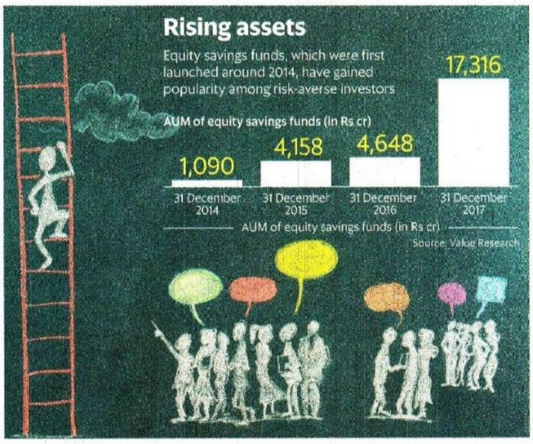
THE LURE OF EQUITY SAVINGS

There is a reason why equity savings funds appeal to risk-averse investors. Budget 2014 raised long-term capital gains (LTCG) tax on all debt funds to 20%. Until then, withdrawal from debt funds attracted a LTCG tax of either 10% (without indexation) or 20% (with indexation). Additionally, it increased the threshold to claim LTCG tax on debt fund investments to three years, from a year earlier.

This made so-called monthly income schemes or MIPs (hybrid funds that invest up to 10-25% in equities and rest in debt) a bit unattractive as redemptions before three years started to attract tax at income tax rates. Fund houses responded by tweaking their MIPs—enter equity savings funds. The trick is to ensure that the combination of equities and arbitrage investments should add up to at least 65% of the scheme's portfolio to make it eligible for equity taxation. At the time, equity funds were exempt from LTCG tax.

If you are a new equity investor but do not want to take much risk, equity savings funds are a good entry point

However, Budget 2018 has now imposed a 10% LTCG tax on equity funds, but they are still taxed lower than fixed deposits (FDs) and debt funds.



"Equity savings fund are better option for FD investors who wish to participate in equities but are worried about market volatility," said Parul Maheshwari, a Mumbai-based distributor.

While equity savings funds returned 10.09% in the past two years, traditional MIPs (debt-oriented funds) returned 8.94%. "On a post-tax basis, equity savings funds are superior than MIPs, as the latter incur debt funds' taxation," said Lakshmi Iyer, chief investment officer (debt) and head of products at Kotak Mahindra Asset Management Co. Ltd.

WHAT'S IN IT FOR YOU?

Sensing a business opportunity, Crisil Ltd too launched its equity savings index in April 2018; 35% of the fund's portfolio will be benchmarked to S&P BSE Arbitrage Rate index, 35% will be benchmarked to S&P BSE Sensex TRI and 30% to Crisil Short Term Bond Fund index.

The launch of benchmark indices is a business decision for firms, but what's in it for investors? The answer is standardisation. By law, fund houses are mandated to measure their performances against a benchmark index. For single asset classes, there are varieties available. But what does a scheme do if it invests in multiple asset classes, like an equity savings fund? It invests in equity, debt and also in arbitrage opportunities. In the absence of a ready cocktail, it creates its own mixture.

For instance, DSP BlackRock Equity Savings Fund's benchmark index is 30% Nifty 500 TRI and 70% Crisil Liquid Fund index. Aditya Birla Sun Life Equity Savings Fund's benchmark index is 30% of S&P BSE 200 index, 30% of Crisil Short Term Bond Fund index and 40% of Crisil Liquid Fund index. "A standardised index makes it easier for fund houses to compare their funds against and helps investors compare all funds in a uniform way," said Mukesh Agarwal, CEO, India Index Services and Products Ltd, an NSE group company.

If you are a first-time investor in equities but do not want to take much risk, equity savings funds are a good entry point. With equity taxation, one can expect around 8-11% returns.

EQUITY SAVINGS FUNDS

Equity savings funds invest about 20-40% in equities, 30-35% in arbitrage opportunities and the remaining in debt. They are meant to be an alternative to regular income type debt schemes and even fixed deposits, and are gaining popularity in recent times. This is because equity savings funds attract equity taxation which is lower than tax rates levied on debt funds and FDs.