RBI's Retail Direct Scheme: Overview and Emerging challenges

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In the Bi-monthly Monetary Policy Meeting on the 5th of February 2021, RBI announced certain measures to deepen the financial markets as a part of its "Statement of Developmental and Regulatory Policies" document.

To encourage retail participation in the Government securities market, it decided to allow Retail Investors to Open Gilt Accounts with RBI and started the 'RBI Retail Direct' scheme (RBI RDS), as a one-stop solution to facilitate investment in Government Securities by individual investors.

The RBI Retail Direct facility aimed to improve ease of access by retail investors through online access to both primary and secondary government securities market. In effect, it wanted to be a one-stop solution to facilitate investment in Government Securities by individual investors

As stated on the 'RBI Retail Direct' website, the key highlights of the scheme are:

1. *Retail investors (individuals) will have the facility to open and maintain the 'Retail Direct Gilt Account' (RDG Account) with RBI.*
2. *RDG Account can be opened through an 'Online portal' provided for the purpose of the scheme.*
3. *The 'Online portal' will also give the registered users the following facilities:*
    1. *Access to primary issuance of Government securities*
    2. *Access to NDS-OM.*

The strength of the platform lies in the simplicity of design, ease of operations and zero fees or charges for opening and maintaining the RDG account as well as no requirement of paying fees/brokerage for primary and secondary market trades.

The scheme provides a very competitive avenue for individual investors to invest in the Government securities.

		10.10.22	**29.5.23**	***Change***	**26.6.23**	***Change***
Total No of Accounts opened		56,714	84,641	*27,927*	87,319	*2,678*
Total Primary Market subscriptions	Rs. Cr.	681.82	2146.94	*1465.12*	2272.98	*126.04*
of which T-Bills	Rs. Cr.	301.12	1383.55	*1082.43*	1487.98	*104.43*
Total Secondary Market traded volume	Rs. Cr.	138.89	354.16	*215.27*	376.69	*22.53*
of which Central Govt Sec	Rs. Cr.	125.29	314.7	*189.41*	338.62	*23.92*
Total G-Secs Held (as on)	Rs. Cr.	670.67	1564.01	*893.34*	1587.38	*23.37*
Sovereign Gold Bond Holding (as on)	Rs. Cr.	211.84	384.53	*172.69*	385.97	*1.44*

Source - RBI Retail Direct.
All data since inception 21.11.21

When you look at the data on its acceptance among investors (Table above), it is evident that in one year of its inception, it added 56,714 accounts which increased by 72% to 87,319 accounts over the next 9 months. The average ticket size of participation in the primary market stood at around Rs. 2.5 lakhs.

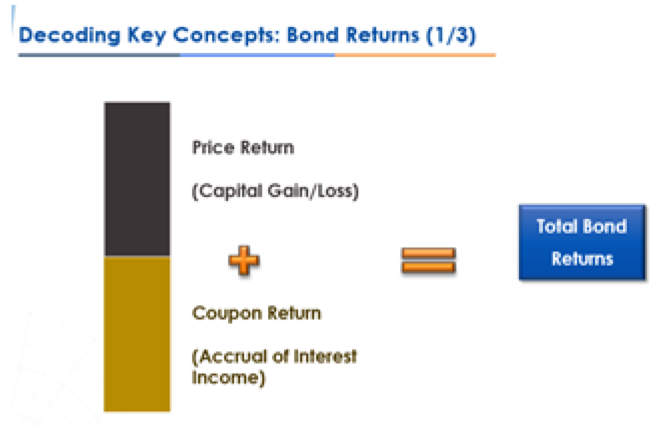
A surprising element of the primary market participation, almost 65%, is in Treasury Bills as on 26th June 2023, while in the Central Government G-Secs its barely 20%! Treasury Bills are short tenor instruments not exceeding one year and generally yield less than 3/5/10 year G-Secs. The ratio of T-Bills to total Primary Market Subscription has averaged 55% over the previous months. Furthermore, there hasn't been much increase in the subscription volumes in March 2023, when the 364-day T-Bill yield cut-offs peaked at 7.48%. On the contrary, almost 50% of the primary market subscription in T-Bills took place at yields less than 7%. It will be interesting to understand the reason for individuals buying T-Bills and if they realize the re-investment risk in an interest rate down cycle.

The data in Central Government Dated securities show a very different trend. When you reconcile the primary market subscription with the secondary market trading data and the final holding value, it appears that the dominant part of accretion to the holdings is coming from primary market subscriptions and not secondary market trades. The average daily trading volume in the secondary market between 29th May and 26th June 2023 at around Rs. 1 crore per trading day does indicate retail participation.

Incentive to invest

Investors broadly look for three things when they invest in debt securities – returns, safety and liquidity.

While on the safety parameter, Government bonds are the gold standard, on returns and liquidity they can, at times, be at a disadvantage to other alternatives.



Source – UTI MF

Bond returns are a function of price and coupon returns. On the return front, direct G-Sec investments are often at yields that are much lower than comparable high investment grade AAA bonds of PSUs & PFIs as can be seen from the table below.

Ticker	Name	TIME	Last Price
FBTB3M	T-Bill 3m	04/07/2023	6.68
FBTB6M	T-Bill 6m	04/07/2023	6.80
FBTB12M	T-Bill 12m	04/07/2023	6.82
GIND1Y	IGB 1Y	04/07/2023	7.00
GIND2Y	IGB 2Y	04/07/2023	7.04
GIND5Y	IGB 5Y	04/07/2023	7.09
GIND10Y	IGB 10Y	04/07/2023	7.12
AAA 3M	FIMMDA 3M Benchmark	04/07/2023	7.07
AAA 6M	FIMMDA 6M Benchmark	04/07/2023	7.25
AAA 1Y	FIMMDA 1Y Benchmark	04/07/2023	7.43
AAA 2Y	FIMMDA 2Y Benchmark	04/07/2023	7.72
AAA 5Y	FIMMDA 5Y Benchmark	04/07/2023	7.58
AAA 10Y	FIMMDA 10Y Benchmark	04/07/2023	7.59

Last Price = Yield in %. Source - Bloomberg

Even for senior citizens, the Senior Citizen fixed deposits offered by AAA rated banks are higher. This is an important consideration for retired people looking to maximize their post retirement income.

Bank	1 Year	3 Years	5 Years
Bank of Baroda	7.25%	7.55%	7.15%
Canara Bank	7.25%	7.00%	7.00%
Punjab National Bank	7.25%	7.50%	7.00%
State Bank of India	7.30%	7.00%	7.50%
Axis Bank	7.50%	7.75%	7.75%
HDFC Bank	7.10%	7.50%	7.50%
ICICI Bank	7.20%	7.50%	7.50%
Kotak Mahindra Bank	7.60%	7.00%	6.70%

As on 5.7.2023, Source - paisabazaar.com

This is not to say that there are no opportunities in the sovereign bond space – there have been occasions when the yields on 5 Year SDLs ranged between 7.50% to 7.75% (21.2.2023 to 15.3.2023) and offered better rates than a 5-year deposit with a bank. However, when you look at the data with RBI RDS, the additional participation in the primary market was only Rs. 17 crores. So, investing in the sovereign bonds is also challenged by the "timing" issue.

The table below compares various alternatives with direct investments in sovereign bonds for investors looking at returns with limited risk to capital.

Investment Option	Investment Horizon	Liquidity	Taxation
Fixed Income Mutual Funds	1 day onwards (No upper limit)	Can withdraw from Day 1 of investment, subject to applicable exit load, if any	Capital gains taxable only at redemption
Sovereign Bonds (RBI Retail Direct)	91 day to 40 years	Market dependent	Interest fully taxable as Income
Bank Term Deposits	7 days to 10 years	Premature exit with penalty	Interest fully taxable as Income
RBI Taxable Bonds	7 years, as specified by RBI	Lock-in for the investment period	Interest fully taxable as Income
Senior Citizens Savings Scheme	5 years	Premature exit after 1 year of holding with penalty	Interest fully taxable as Income
Tax Free Bonds	5 – 15 years	Lock-in for the investment period	Interest tax free*
Public Provident Fund	15 years	Partial Withdrawals, Conditional	Deduction u/s 80C & 10(11)*

*For more details on taxation consult your investment advisors. *Applicable to Investors in the old regime. Source – UTI MF*

To capture price return from capital gains (as interest rates decline and price of a bond increases) liquidity with the ease to sell the bond becomes important. While the benchmark and "on-the-run" securities are fairly liquid, the smaller size of securities (odd-lots) and State Development Loans (SDLs) become relatively less liquid.

This is evident when you look at the NDS-OM Odd Lot Market Watch and compare it with the Odd Lot Market Trades. For eg. On 5th July there were around Rs. 217 crores of G-Secs (excluding T- Bills) across a large range of securities on offer and the total traded volume was around Rs. 68 crores in 26 securities.

Conclusion

A question could be asked if buying a G-Sec over, say, a G-Sec Mutual Fund offers any superior advantage? When we look at the data on actively managed G-Sec Mutual Funds, we find that the median returns (after expenses) of the category have outperformed the CRISIL Dynamic Gilt Index over 3, 5 and 10 years with the outperformance of the top quartile funds being quite large. Even for passively managed 10 Year Constant Maturity funds the outperformance over the CRISIL 10 Year Index is meaningful (Table below).

GILT Category	**3 Years**	**5 Years**	**10 years**
Median Returns (19 Funds)	4.38	7.98	7.85
Crisil Dynamic Gilt Index	4.30	7.70	7.20
10y Constant			
Median Returns (5 Funds)	3.96	8.47	8.95
Crisil 10 y Gilt Index	3.20	6.70	6.10

As on 30.6.23. Source – ICRA MF Explorer. Direct Plan Fund returns are in %.
Past performance may or may not be sustained in future

Furthermore, on taxation while direct investments in G-Secs benefit from no TDS, the coupon is taxed as income. Mutual funds offer a benefit to investors by compounding the interest received and tax is paid only on redemption of the units. An efficient way of generating regular cashflow is through the use of a Systematic Withdrawal Plan (SWP).

The flexibility of liquidity even for small lots of Rs. 1000 at a transparent uniform price (NAV) is a big positive. While investors can buy G-Secs in sizes as small as Rs. 10,000 on RBI RDS, it is nearly impossible to sell such a small lot for liquidity requirements and if the on-the-run security when bought earlier is now no longer the benchmark security then the access to liquidity gets even more difficult.

Liquidity issues on NDS-OM have already been highlighted earlier, it would help if RBI can establish a market-maker mechanism for odd-lots (or become an aggregator like for the primary market subscriptions) to provide liquidity to investors. The G-Secs bought in the RDG Account can be used as collateral for borrowing, this could provide temporary liquidity and can be explored by RBI.

There are clear benefits of the RBI Retail Direct Scheme for investors who are very risk averse and prefer the comfort of a sovereign risk. Those who seek steady predictable income over a long-term horizon would prefer to hold bonds till maturity so as to avoid the interest rate risk on their investments.

To expand its reach and gain wider acceptance of the platform, the underlying securities need to be attractive vis-à-vis alternative investments. The investors need to be advised on the benefits of security diversification, looking at appropriate maturities and taking benefit of short-term opportunities that emerge in the sovereign market from time to time.

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Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.