RBI's Retail Direct Scheme: Emerging challenges

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Diversifying the investor base for sovereign securities has been a key focus area for a while. A larger and expanding market borrowing program as well as the requirement to develop the bond market calls for a more diversified investor base. Towards this objective, the RBI Retail direct scheme was introduced in Nov 2021 to enable retail investors to access Government securities in a transparent and cost-effective manner. Interestingly, this has broadly coincided with the time the interest rate cycle has shifted with most central banks including RBI tightening monetary policy from 2022 onwards.

Awareness towards investment in government securities at the retail level remains limited. This is amply demonstrated by the lower share of AUM under MF schemes investing solely in government securities. As per the category wise ownership of government securities, Mutual fund ownership remains modest at less than 3% as on March 23. The prevalence of small savings schemes that are a direct claim on central government (with coupon indexed to G sec yields) as well as traditional preference towards Bank FD's could be reasons towards lower direct investments in government securities. The sovereign gold bond scheme announced in November 2015 provides another avenue for accessing sovereign exposure. However, these bonds provide a credit risk free (being sovereign borrowings) exposure to gold prices with a nominal coupon as well. The cumulative issuances under the SGB amount to Rs 45243 crs as on March 23, with FY23 issuances of around Rs 6551crs.

Apart from the drawbacks of less awareness, availability of alternate credit risk free instruments, transaction access so far has been cumbersome for government securities. The retail direct scheme provides an efficient and cost-effective (no transaction charges) way to access the government securities market. Apart from secondary market trading, one can access the primary market through the noncompetitive bidding route for Treasury bills as well as central and state government securities.

Statistics from the Retail Direct Scheme show that as on July 03rd 2023, the total number of accounts opened were 87795. The total holdings stand at Rs 1606 crs, of which Treasury Bills account for Rs 780 crs and dated Central Government securities at Rs 549crs. The platform has seen primary market subscriptions amounting to Rs 2340 crs and secondary market traded volumes of Rs 385 crs. While these numbers are encouraging, there is scope to further improve the volumes and participation. However, it is essential to address some key challenges for the segment to pick up.

1. Adequate awareness:
Building awareness remains an ongoing exercise. In a rising interest rate scenario, capital market instruments are quick to reprice based on current market dynamics. Currently treasury bills trade between 6.72% to 6.85% for tenors between 3 months to 1 year. On a relative basis these credit risk free instruments provide higher yield than most bank FD's that range from 5.25% to 6.80% for similar tenors. Aside from the special deposit schemes offered, current market yields on sovereign securities are competitive. Similarly tighter spreads on AAA corporates over both Government securities and SDL's, especially at the long tenors should logically create more interest towards sovereign securities. While the RDS website offers a snapshot of market yields on sovereign securities, the lack of awareness can be a factor. Perhaps a more frequent and visible investor awareness campaign through various media is a prerequisite.

2. Investor incentives:
Most efforts to develop bond markets in India have only focused on the supply side. This has taken various forms with more incentives/ nudges to increase the role of capital market instruments in the overall borrowing mix. At the same time various measures have been taken to improve transparency and improve disclosure. However, there has been little thought with respect to incentivizing demand, more so from the retail investors. Recent amendments to taxation of debt mutual funds have led to the removal of indexation benefits. At the same time over the last fiscal year, as interest rates moved up, index schemes with underlying exposure to government securities including SDL had seen a reasonable investor appetite. A visibility of predictable return alongside indexation benefits and liquidity alongside an exposure to credit risk-free assets were the key drivers.

The retail direct scheme can be made more attractive if there is some benefit given through taxation. The relative success of the sovereign gold bonds can be partly attributed to the exemption given for long term capital gains for holding these bonds through the tenor. This can take the shape of either a limited period benefit or with benefits capped for investment beyond a certain cutoff size or a combination of both.

Current taxation norms stipulate long term capital gains for listed bonds at 10% for a holding period that is minimum of 1 year. However, NDS which is the primary trading avenue for sovereign securities, does not get classified as an exchange and apparently trades conducted on the platform do not qualify for the favorable taxation. This is a change that can easily be incorporated.

3. Liquidity:
While government securities are the most liquid segment of the wholesale debt market, retail lot size trading on the NDS is still untested. At the same time, given that

most investors would prefer to hold bonds till maturity, lack of liquidity may not be a big constraint today. Higher awareness and adequate incentives should enable more participation and eventually lead to better liquidity.

While addressing the immediate issue around awareness, liquidity, and incentives, eventually measures to enable alternate access to sovereign securities are essential. The RBI annual report for FY23 does refer to the same with proposal to develop a mobile application for improving ease of access as one of the agenda items for FY24 pertaining to the RDS scheme. However, awareness and incentives remain the primary essentials to popularize the platform even as access norms are streamlined and made more user friendly.