News: The Cabinet Committee on Economic Affairs approved launch of India’s first fixed income Exchange Traded Fund (ETF) comprising AAA-rated debt securities of state-owned companies.

Prelims and Mains focus: About ETFs and their advantages, key differences between ETFs and mutual funds

About the ETF launched

- Called Bharat Bond ETF, the fund will comprise a basket of bonds of companies including NHAI, NABARD, PFC and IRFC among others.

- The fund targets to raise around Rs 10,000 crore. The debt ETF provides a new option to conservative investors to own securities of government-owned companies along with the facility of liquidity as ETF units will be listed on exchanges.

- Retail investors can buy units of the ETF with a starting investment of Rs 1,000 per unit and it will have maturity of 3 and 10 years. The current yield on 10-year AAA-rated debt paper of state-owned companies is around 7.5-7.6 per cent while that of 3-year similar rated paper is quoting at 6.5-6.6 per cent. Investors can expect a post tax return of around 6.7-6.8 per cent, which is significantly higher than post tax return of around 5.5 per cent on fixed deposits with banks.

- Each ETF will have fixed maturity date and will track underlying index on risk replication basis. The bond ETF trading on the exchange will help in better price discovery of the underlying bonds.

- It is the lowest cost mutual fund product in India. Compared to buying units in debt mutual funds, the debt ETF will have a low transaction cost of 0.0005 per cent.

- Bond ETF will provide safety (underlying bonds are issued by CPSEs and other Government owned entities), liquidity (tradability on exchange) and predictable tax efficient returns.
Apart from the interest, investors can make capital gains on their units in the secondary market in a falling interest rate regime. In case the interest rate cycles reverses and turns upward, existing unit holders may have to bear capital losses on their holdings. For bonds that are held till maturity there is no risk of capital loss or gain.

As compared to fixed deposits, this instrument is tax efficient as bond ETFs are taxed with the benefit of indexation, which reduces the tax on capital gains for investor.

Bharat Bond ETF will provide an additional source of funding for firms to meet their borrowing needs, and thereby helping in deepening the bond market.

While there are a number of equity and gold ETFs in the market, there are no debt ETFs, barring the two government securities-based ETF that have not generated much investor interest.

Exchange Traded Fund

Note: To know the difference between ETFs and Mutual Funds click on the link below: