

BANK FD vs NBFC FD

Bank Fixed Deposit or Non-Bank fixed deposit? Here is a Comparative Study to Help You Decide. In this rapidly changing world, securing our financial future must be our top priority.

Before mindlessly jumping into any scheme, one should gain insight into that scheme and thoroughly understand it. Here, we will be doing a comparative study of the fixed deposit (FD) schemes in both banking and non-banking sectors.

Fixed deposit, the most secure form of investing, has many types and many factors attached to it. This article will simplify the nuances of this investment instrument for you.

A clear idea of our financial goals is essential to get expected returns on investments. Therefore, nowadays, when nationalized banks are cutting their interest rates and inflation is rising, relying on only bank FDs for our needs is not a very practical idea. We have to compare the FDs provided by both, the banks and the NBFCs (Non-Bank Financial Companies), and to arrive at a conclusion for final investment.

What is a Fixed Deposit?

Fixed deposit is an instrument where banks and NBFCs allow customers to invest their money for a fixed amount of time and the financial institute pays interest on it. There are various types of fixed deposits:

Regular FDs	This is the most basic form of fixed deposit.
Tax Saving FDs	It helps to lower the actual intended tax.
Flexi FDs	It is a good option to gain interest when one's minimum savings balance goes beyond a pre-determined level; the extra balance gained is converted into an FD. This FD is credited back to your account when its balance goes below the fixed threshold.
Senior Citizen FDs	People over 60 years of age are given 1%-2% extra interest than normal on their FDs.
Shareholder FDs	They are exclusively for corporate, HFC, and NBFC.

Points to Remember

When considering an investment in the form of an FD, one must consider certain criteria.

1. Interest rate: It is the most important criterion, even a 0.5% difference can make a huge difference in the long-term return.

For example, you are creating an FD of INR 100000/- at the rate of 8% for five years, with instructions to reinvest the annual interest accrued. So, using the formula for compound interest:

$$A = P (1+r/n)^{nt}$$

Where,

P = Principal amount invested = 100000

r = Yearly rate of interest = 8%

n = Frequency of compounding = 4

T = Time period in years= 5

The return on your investment at the end of the deposit period will be around INR 146932.81/-. So, growth is approx. 47%.

2. Frequency of compounding: If the compounding fee is greater, the return will be more.
3. Cumulative or Non-cumulative: In cumulative FDs, you cannot remove the money. It is locked up to the contracted date. On the other hand, you can remove money in non-cumulative FDs. However, it is advisable to opt for the auto-cumulation option to get more interest.
4. The loan from compounding: It is also an option where rather than withdrawing the money, we can take a loan against it.
5. Withdrawal terms: Certain FDs do not allow premature money withdrawal in case of emergency, while some may allow it with the application of a penalty rate. The penalty rate impacts the final return. It is always advisable to opt for an FD whose penalty rate is reasonable; the lesser the penalty rate, the greater will be the return.

All FDs come under income tax. If you have a higher amount in a fixed deposit, TDS (Tax Deduction at Source) will be high. FDs are also helpful in tax relief under Indian income tax rules.

Bank Fixed Deposit

A bank is the most secure place to open an FD account. Bank FDs are at lower risks than any other equivalent option (some exceptions excluded). Your money is secure; in cases where the bank shuts operation entirely, a security deposit amount will be provided as compensation.

However, bank FDs may not always be an optimal choice. The interest rates are lower than NBFCs, especially in nationalized banks. But some cooperative banks provide good interest rates, especially for senior citizens. Also, premature withdrawal of a bank FD is difficult and the penalty charge applied highly affects the rate of interest in the total investment.

NBFC Fixed Deposit

According to the Companies Act (2013), a Non-Banking Financial Company (NBFC) principally deals in lending, investments (shares, stocks, bonds, debentures, securities), leasing, hire-purchase insurance, and/or chit funds by receiving deposits under any scheme or arrangement in one lump sum or installments. These exclude any companies involved in agricultural, industrial, trading, and construction and development activities.

The different types of NBFC are:

- **Asset Finance Company:** Company having its primary asset by supporting productive activity like heavy machines and automobiles.
- **A Investment Company:** These companies take money from investors and invest it in the market.
- **A Loan Company:** Gives financial assistance to individuals and businesses.
- **A Infrastructure Finance Company:** A loan company with $\frac{3}{4}$ parts or more of its total asset invested in infrastructure loans.
- **A Core Investment Company:** Company with 90% of its net asset invested in the equity share, bonds, loans.
- **A Micro Finance Company:** Company providing lower-income group financial support with fewer constraints in comparison to other sectors.
- **A Housing Finance Company:** Provides finance for housing.
- **A Mortgage Guarantee Company:** Provides financial assistance to borrowers against a mortgage.

Benefits of NBFC fixed deposits

1. Higher return on investment in NBFCs, especially in corporate fixed deposits.
2. Premature withdrawal terms and conditions are mostly flexible with some not even charge a penalty in the initial years of the FD.
3. FDs are lower at risk and higher return on investment than traditional bank deposits.
4. Flexible tenure than the traditional bank.
5. They provide flexible pay-out for non-cumulative and cumulative FDs.

Things to consider before investing in NBFCs

It is important to note the credit rating of these companies, especially when the investment is in corporate FDs. NBFCs are heavily dependent on banks, and if they report bankruptcy, the investors may lose their money.

An NBFC company rated at 'AAA' or an 'AA+' by ICRA, CIRIL, and similar other reputed regulating bodies is always the safest option to choose. Investors should also consider the NBFC's public image and performance before investing.

Remember, all that glitters is not gold. If a company is promising an unbelievable return on investment than most of its peers in the market, it may not be genuine. So be careful before any investment.

Final Words

Choosing between a Bank FD or an NBFC FD solely depends on the investor. Before investing

- Survey the market.
- Analyze the market.
- Read the terms and conditions provided by the bank or other rated financial institute thoroughly.

Remember that a diversified investment portfolio is the key to grow your money.