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HOW TO GIVE

India's Gold

A BETTER GLOW...

... Yet make it part of
"Make in India" movement

Gold is one of the oldest industries in India employing almost 3.5 million people.

But its growth and employment potential could get adversely affected if two things don't happen:

- adoption of good manufacturing and trade practices
- the government's ability to bring hidden gold into the economic mainstream

Compiled by the AsiaConverge Policy Team • March 2016

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www.asiaconverge.com

March 2016

Gold has always fascinated man. Whether as ornament. Or as part of royal or priestly vestments. Or merely as another form of money. Gold has held its allure.

In India, as in China and a few countries in the Middle East, gold has often been considered as auspicious. Each family must own some gold. Whether it is at the time of marriage, or childbirth,or circumcision, or even auspicious days like *Akshaya Tritiya*, gold has assumed a significant position in the lives of most Indians.

Not surprisingly, India has embraced gold through centuries – as investment, as a hedge against inflation, as something sacred that households must have. If the family cannot afford gold, it opts for the next best – silver. That is why silver is often referred to as the poor man's gold.

Each person – as he or she starts his or her own family – must try and add to the gold that he or she has inherited.

This is what the Indian goldsmiths do. They do not normally hedge gold. If a family has one kilo of gold, and the gold has to be used for making jewellery, must promptly be replenished with fresh purchases. While doing so, they ensure that the metal sold is always higher than the current price at which it is purchased. Thus the little reserve of gold that the goldsmiths have is seldom financed by debt. They lend money. But they do not borrow money, except in times of crisis. The concept of hedging is relevant to mitigate risk. The Indian goldsmith has collected gold without taking any risk – except that of theft or plunder, and government legislation.

As India's population grew, the number of families that wanted to own a bit of gold kept increasing. Today, gold ownership in private hands is estimated at 20,000-25,000 tonnes. But if we take into account of the huge amount of gold that the business families lock up in their private vaults the figure touches around 100,000 tonnes!

For decades, governments have pondered over schemes that could help bring some of this privately hoarded gold into economic activity. But they mostly failed because of several reasons.

First, for almost six decades, gold was treated as a commodity, hence it was managed by the ministry of consumer affairs. It is only during the last decade that gold has been treated as an investment – albeit a non-financial investment, like land and real estate. There is an urgent need to treat gold as a financial investment.

Second, most governments have looked to high net worth individuals (HNIs) and temple trusts for garnering gold deposits. But a larger amount is held by low and middle-income families. If the government is serious about bringing private (unregistered and largely unknown) gold into the economic mainstream, it must tap the low and middle-income families first.

Finally, the government needs to enforce honesty and fair trading practices among the gold traders in India. Unless this is done, India's reputation as an exporter will continue to plummet.

Together, these three measures can revitalise the gold industry and can even strengthen the Indian economy.

R.N. Bhaskar
Principal Researcher
AsiaConverge

WHAT HAS ALREADY BEEN DONE
1

1990
Gold Control Act abolished

1992
Import of gold streamlined – prior to 1992 gold was brought into India largely through unauthorised channels

1992
A variant of a gold deposit scheme introduced, but meets with little success

1993
Standing Committee on Gold and Precious Metals was set up by the RBI to evolve an integrated national gold policy

Gold import into India has almost always invited restrictions. The first restraint came in 1765, when the East India Company acquired the rights to collect taxes. The Company had largely ceased importing gold and silver which it used to pay for merchandise which had to be shipped back to the UK. Now local gold and tax collections were used to finance wars in India.

The first Gold Deposit Scheme was introduced in 1965 (the 1965 Gold Bond Scheme). The scheme was not a runaway hit because few had faith in the government's ability to honour its debt commitments. Nonetheless, thanks to a decent rate of interest, and tax immunity for gold depositors, it was more successful than the current gold deposit scheme.

Then came the Gold Control Act. The first version in 1962 banned forward trading in gold. Thereafter, in 1963, production of gold jewellery above 14 carat fineness was banned. In 1965, a gold bond scheme was launched with tax immunity for unaccounted wealth. Finally came the Gold Control Act of 1968. It prohibited citizens from owning gold bars and coins. It actually brought free movement of gold to a standstill; put restrictions on ownership of gold and actually drove the gold trade underground. With that came a surge in trade malpractices which remain quite rampant even today.

This Act was abolished in 1990. Gold import was liberalised. From official imports of almost nil (smuggling was the preferred route), gold imports began swelling. But import duty rates were mostly high. In 1992, the government liberalised gold import for NRIs (5 kg could be imported duty-free by each NRI), import duties were pegged at 15 per cent.

In September 1992 another gold deposit scheme was launched, but met with limited success.

Ditto with the 2015 gold deposit scheme!

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WHAT HAS ALREADY BEEN DONE 2

1997

Shri S.S. Tarapore, Chairman, **Committee on Capital Account Convertibility** (CCAC) submits report

KEY RECOMMENDATIONS:

- Liberalization of import and export of gold which could curb smuggling
- Development of gold-related financial instruments
- development of markets for physical and financial gold
- Encouragement of banks and non-banks to participate in gold markets

WHAT HAS ALREADY BEEN DONE 3

Feb 2013

K.U.B. Rao, Adviser, Department of Economic and Policy Research, RBI Report of the Working Group to Study the Issues Related to Gold Imports and Gold Loans NBFCs in India

KEY RECOMMENDATION:

- Setting up of the Bullion Corporation of India

2015

- Gold deposit scheme
- Sovereign gold bond scheme

By the mid-nineties, most policy makers had come to the view that a liberal import duty was good for the country. It made smuggling of gold unattractive.

Experts agree that any import duty of over 4-5 per cent only encourages smuggling.

Smuggling is dangerous for two reasons. First, smuggling is financed by ill-gotten funds. It pushes up the demand for such funds, and actually accelerates the corrosion of the official currency – in this case the Indian Rupee.

Second, smuggling, when it becomes rampant, allows for the building of channels which take care of the entire logistics chain – right from the loaders in Dubai, to the boats that bring in the contraband to the landing points in India, and even to the extent of identifying officials who would be willing to let the contraband slip into the country undetected. Once these channels are established, they get used for other contraband as well – including drugs and arms for terrorists. The sooner such channels are made un-remunerative, the better.

That is why committee after committee (appointed by the government) argued in favour of liberalised imports.

Moreover, as gold is akin to money – highly fungible – and has the potential to promote gold jewellery exports from India in a big way, these committees made a strong case for a separate regulatory mechanism for overseeing the entire gold trade – from imports to domestic use to exports.

That is why they recommended a separate regulatory body – *The Bullion Corporation of India* – on the lines of SEBI, AMFI, and IRDA. The amounts involved in the gold trade warranted such a move.

WHAT HAS ALREADY BEEN DONE 4

2013

Key role of the Bullion Corporation of India as envisaged by the K.U.B. Rao report:

- A developmental and operational institution (preferably under the RBI) for financing and refinancing domestic usage of gold
- Import, export, trade, lend, borrow gold
- Deal in, and create rules for, gold derivatives
- Work towards ensuring gold standards are respected across the industry

The most important report on gold appears to be the one made by the RBI. This was titled *Report of the Working Group to Study Issues related to Gold Imports and Gold Loans NBFCs in India*. It was chaired by K.U.B. Rao (hence the report is also popularly referred to as the K.U.B. Rao report) and was submitted to the government in February 2013.

In fact, much of the analysis done by this committee has tremendous relevance for the Indian gold industry even today. *(Excerpts of this report can be found on pages 44-50).*

This committee too argued in favour of liberalised import of gold, more vibrant financial structures in India – with the help of non-banking financial companies (NBFCs) for financing and refinancing domestic usage of gold. It wanted proper rules for creating gold derivatives.

Most critically, it wanted the industry to adopt gold standards which would lend the entire trade credibility both in India and overseas.

But, it stated quite forcefully, that this entire gamut was best handled by a separate body – *The Bullion Corporation of India* (BCI) – which could look at all aspects of gold, and create proper rules that could ensure both fair play and growth for the industry. Such a body would be manned by professionals who are sector specialists. It would be on the same lines as other financial bodies that the government had already created – like NABARD for the agricultural sector, or SIDBI for the promotion and development of the small scale sector in the country.

Since it would be a financial regulator and administrative body, it would be answerable to the RBI and the finance ministry.

This would allow for the formation of steady and credible long term policies which could both regulate and promote the trade.

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WELL-KNOWN
Fact 1

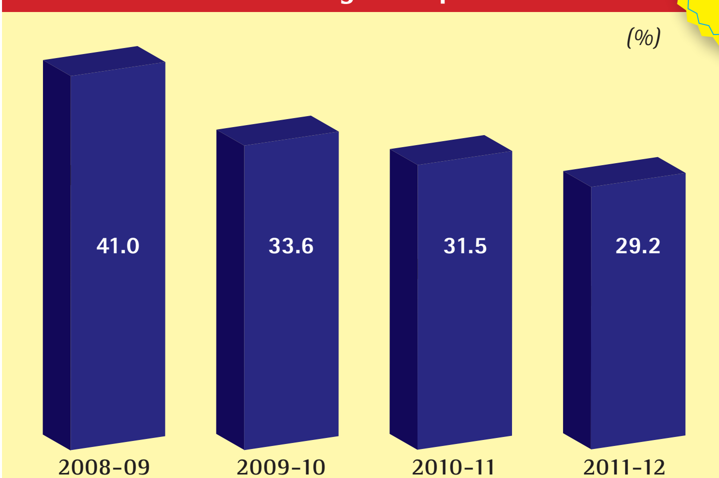
Global gold supply and India's demand for gold

Year	Global Gold Supply (Tonnes)	Gold Demand from India (Tonnes)	Growth of Global Gold Supply (%)	Growth of Demand from India (%)
1999	4,206	486	–	–
2000	9,704	462	-11.0	-4.9
2001	3,764	471	1.6	2.0
2002	3,667	467	-2.6	-0.9
2003	3,953	367	7.8	-21.3
2004	3,426	537	-13.3	46.1
2005	4,034	792	17.7	47.5
2006	3,559	707	-11.8	-10.5
2007	3,554	716	-0.1	1.3
2008	3,657	679	2.9	-5.1
2009	4,146	743	13.4	9.4
2010	4,274	871	3.1	17.2
2011	4,030	975	-5.7	11.9
2012	4,130*	1,079*	2.5	10.7

Source : World Gold Council and Estimations From DGCI&S Date; $ Calendar year; @ Financial year; KUB Rao Report

Share of export of gold jewellery in total gold import

WELL-KNOWN
Fact 2



Source : KUB Rao Report

There are some aspects of the trade about which there is little dispute.

The first is that India has emerged as the largest importer of gold in the world – except for a few years when China took the #1 position.

Second, demand from India has kept growing, except for some stray years when import declined, only to make up for this slowdown in the subsequent years. Today, almost 25 per cent of global gold production finds its way to India.

Third, growth in world production of gold has been slower than the growth of demand from India.

But, while gold imports kept growing, gold exports kept declining. Much of this decline has been due to two reasons:

First, the domestic market for gold is far more attractive. The demand for gold jewellery and coins keeps growing. This is both because India's population has been growing at around 1.67 per cent per year, but more because of the rising purchasing power of the Indian consumer.

Given the tremendous attraction of gold – for religious, social or investment purposes – the domestic market has been buoyant.

Second, domestic gold traders often indulge in malpractices to enhance their profits. Most of them cheat on the purity of gold. Whenever investigations have taken place, gold sold at 18 carat has been found to be of lower purity than what is stated.

The second reason has resulted in giving the Indian gold trade a very bad name both within the country and overseas.

This needs to be addressed urgently.

WELL-KNOWN
Fact 3

Gold affects CAD adversely

Gold Imports and Current Account Balance

Items	2007-08	2008-09	2009-10	2010-11	2011-12
Current Account Deficit *(US $ billion)*	-15.7	-27.9	-38.2	-46.0	-78.2
Current Account Balance as a Ration of GDP *(%)*	-1.3	-2.3	-2.8	-2.7	-4.2
Gold Imports *(in $ billion)*	-16.7	20.7	28.6	40.5	56.2
Gold Exports* *(in $ billion)*	3.0	4.2	4.3	6.1	7.0
Gold Imports *(Net Value in $ billion: 3-4)*	13.7	16.5	24.3	34.4	49.2
Gold Imports as % of GDP	1.3	1.7	2.1	2.4	3.0
Net Gold Imports as % of GPD	1.1	1.3	1.8	2.0	2.7
Gold Imports as a ration of CAB	106.4	74.2	74.9	88.0	71.9
Net Gold Imports as ration of CAB	87.3	59.1	63.6	74.8	62.9

**: Imputed Figure consists of 15% of exports of 'gems and Jewellery'; Source : KUB Rao Report*

WELL-KNOWN
Fact 4

Gold import by banks – declining trend

Imports of gold by the nominated banks*

Financial year	Imports of bars by the nominated banks (tonnes)	Imports of coins by the nominated banks (tonnes)	Total imports by the nominated banks (tonnes)*	Total imports of gold (tonnes) **	Total imports by the nominated banks as per cent of total gold imports	Gold coins imported by banks as per cent of total gold imports of nominated banks	Gold coins imported by banks as per cent of total gold imports
2009-10	541	6	547	851	64.3	1.1	0.7
2010-11	625	9	634	970	65.4	1.4	0.9
2011-12	580	23	603	1,079	55.9	3.8	2.1

** Date fro the nominated banks completed by Reserve Bank (DBOD) from their monthly Statements. ** DGCI&S Date; Source KUB Rao Report.*

Surging gold import and slowing gold export have put India in a spot. Its current account deficit (CAD) has been uncomfortably high, thanks both to oil and gold imports.

The country thus has three options.

The first is to accelerate the availability of recycled gold, so that domestic demand can be met through domestically available gold for some time. Promoting gold deposits is one way out. But most gold deposit policies have not been customer-friendly. More needs to be done in this direction.

Second, efforts must be made to increase export of gold jewellery. But this will not be possible unless there is an increased confidence in the gold supplied by the Indian traders – both to overseas as well as domestic customers. This should be a priority concern for any policymaker.

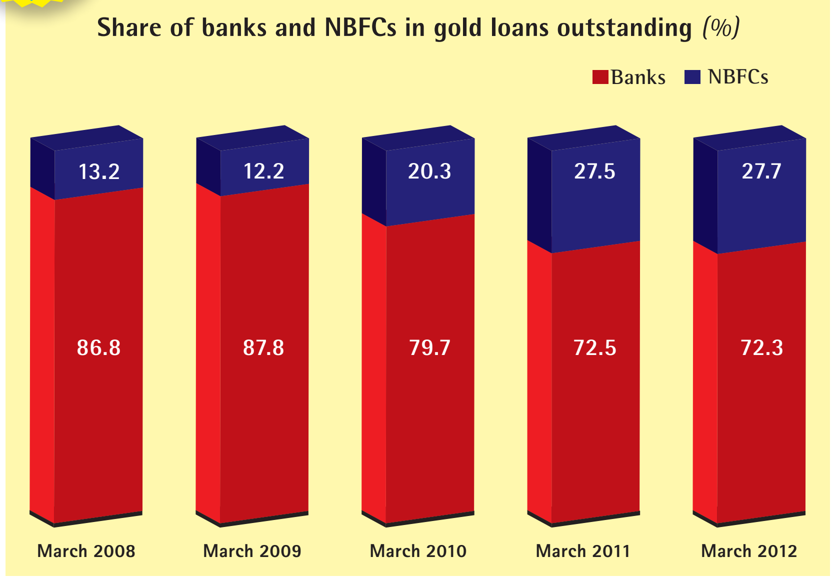
The third is, unfortunately, the route most policymakers often think of first. Ban gold imports, or make import of gold more expensive.

They often forget that any import duty rate of over 4-5 per cent only encourages smuggling – which is far more dangerous than plain import of gold. Official gold import adds to the asset base of the country. Bans and high import duty rates do not curb gold demand. On the other hand, they promote illegal channels.

What is also quite well known is that NBFCs have begun to play a major role in gold trade in India. This was because most Indian banks were stodgy, both unwilling and incapable to match the flexibility of NBFCs. Moreover, Indian NBFCs were governed by a less rigid regulatory structure than banks. But today, whether it is gold loans (Muthoot Finance Ltd. and Manappuram Finance Ltd. have become household names), or providing finance for the trade to execute orders, NBFCs play a predominant role.

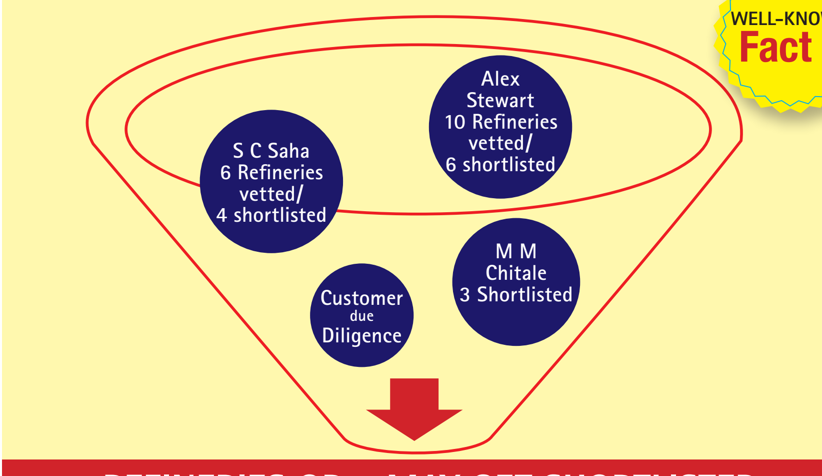
WELL-KNOWN Fact 5

Gold loans by NBFCs – increasing trend



Source: W orking Group calculations based on data from Commercial Banks and major Gold; Loans NBFCs; KUB Rao Report.

WELL-KNOWN Fact 6



2 REFINERIES OR 3 MAY GET SHORTLISTED

That is why, the new regulatory entity (will it be the BCI?) has to ensure that NBFCs are also encouraged to remain relevant to this trade. Yet the role of banks will be equally crucial, as it is imperative that the primary financial bodies do not get marginalised. Policies will have to be structured by the proposed BCI to ensure this.

An NCDEX study on gold refineries exposes the erosion of standards in the industry. In this context it may be worth underscoring the fact that if the refinery is bad, the enforcement of standards in the gold trade becomes all the more difficult.

Hence it is imperative to first find out if India's refineries are up to the challenge.

The NCDEX study shows that of the scores of refineries that dot the country, barely 100 are large enough to warrant a scrutiny. An acknowledged global expert – Alex Stewart – could find only six of them worth considering as credible refineries.

When subjected to a further scrutiny by S.C. Saha, one of the leading authorities on gold in India, the list was further whittled down to four. A financial due diligence of these four pruned the number to three.

Unless refineries adopt good manufacturing and trade practices, cleaning up the rest of the gold business will be very difficult.

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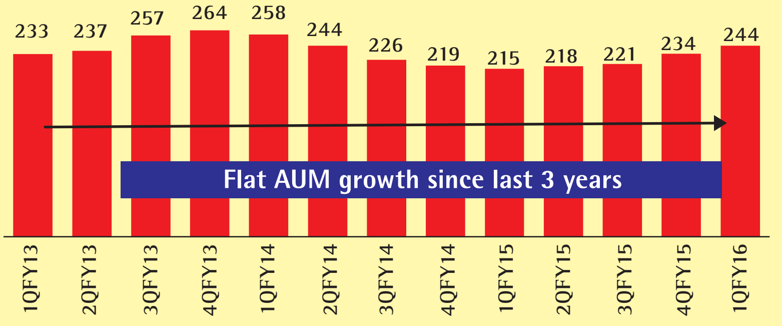
LITTLE KNOWN **Fact 1**

Loans against gold haven't increased much during the past 3 years, but . . .

AUM growth stagnant for the last three years

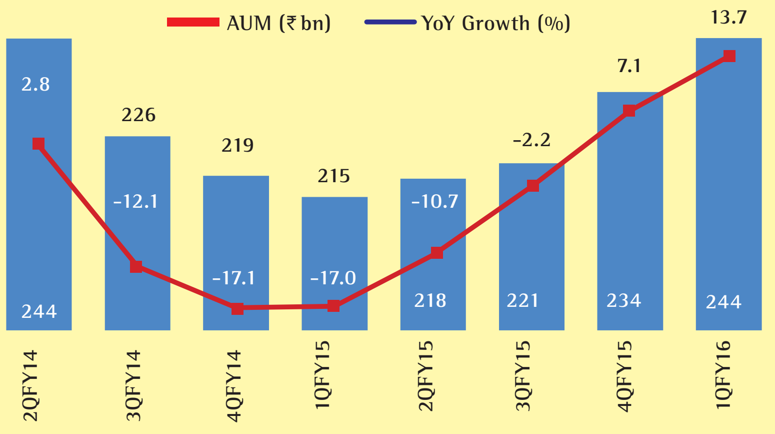


Source: Company, MOSL

LITTLE KNOWN **Fact 2**

. . . business has begun perking up for gold loan companies lately

AUM growth has bottomed out



Source: Company, MOSL

It could have been the restrictions that the RBI imposed on cash against gold loans, or it could have been the fall in gold prices – or it could be both. Whatever the reason, gold loans did not increase substantially during the past three years.

But a revival of loans against gold appears likely.

One reason could be the worsening conditions on the agricultural front. The failure of monsoon in some parts of the country, and unseasonal rains have hurt the rural community. It would, therefore, not be surprising to see gold loans continue to rise.

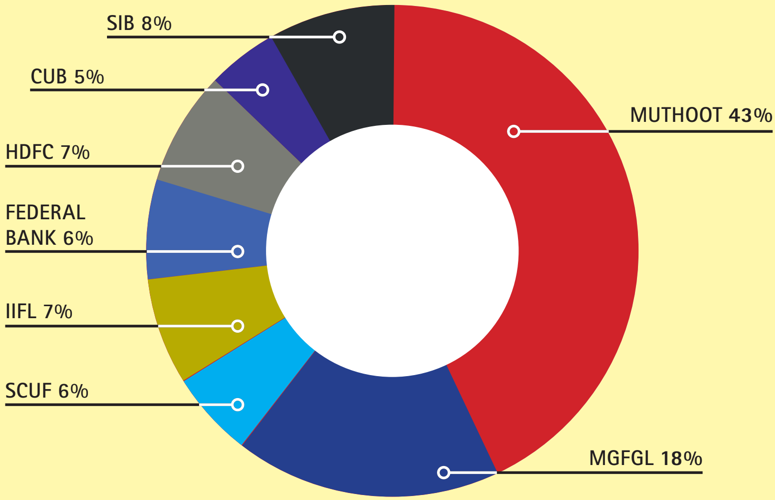
But gold loans have a problem. Most local pawn shops charge a very high rate of interest. And most of them steal some gold from the pawned ornaments by smelting and recasting them. The consumer therefore loses at both ends. Not only he pays a higher rate of interest, but also unwittingly loses some of his gold at the time of redemption.

Cleaning up of such practices could help the rural community tremendously.

The private sector has been a dominant force in the gold loan market

LITTLE KNOWN **Fact 3**

Muthoot Finance remains the largest player (FY15)



Source: MOSL

LITTLE KNOWN **Fact 4**

- The private sector caters to the small income person, and this (small income) person actually supports the gold market
- Therefore, if policies have to be made, they should not exclude the person who purchases small quantities of gold
- That is why the profile of the small gold purchaser becomes critically relevant

As pointed out earlier, private players have become the most dominant players in the loans-against-gold market. State owned Indian banks may not be able to match the personal touch, the flexibility and the customer service that private banks offer.

Yet allowing the banks to get marginalised may not be a good idea.

We thus arrive at a situation where policies need to be crafted

a) To protect the small consumer from being cheated by pawn shops and unscrupulous gold loan players.

b) To work out ways in which the banks remain relevant.

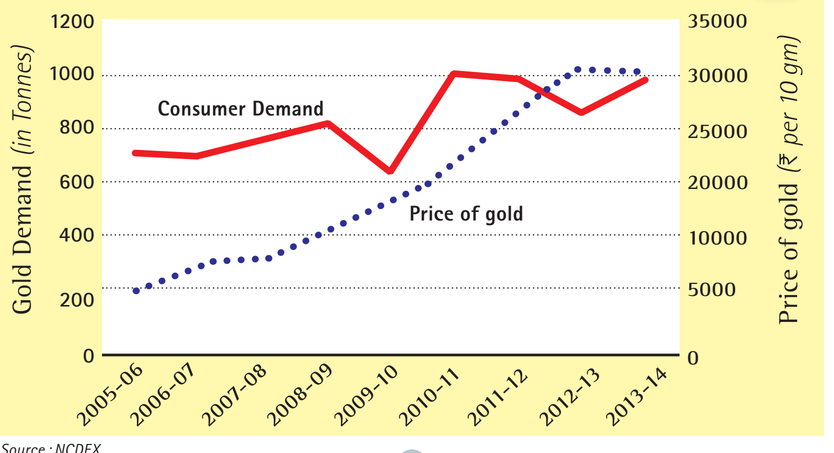
c) To develop policies that make smuggling of gold unattractive.

LITTLE KNOWN **Fact 5**

- What hurts gold consumers most is being cheated on the quality of gold sold
- Even mortgaged gold is often re-smelted and recast, after extracting some amount of gold
- The biggest blow to India's reputation in the gold export market is the willingness of gold traders to cheat on quality
- If quality standards were enforced rigorously, customers would benefit; good manufacturing practices could get reinforced, and the country's reputation salvaged in the gold markets

LITTLE KNOWN **Fact 6**

Demand Inelasticity of Gold in India



Source : NCDEX

Gold policymakers often forget that gold demand has proved to be quite inelastic. Charging high import duties, or banning the import of gold will not help. At best, the trade goes underground.

This can be seen from the fact that any increase in gold prices has not caused gold demand to slump.

It is this factor which should persuade India's policymakers to seek out ways which prevent gold demand to be met through smuggling.

A strict vigil at air and sea ports may not be the best solution, as a lot of gold still reaches Indian shores through the vast and porous coastline of India.

The only way to make smuggling unattractive is to ease import duty rates.

Critics, who say that this will open the floodgates to gold import, forget that price has seldom been the determining factor for gold demand.

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PROFILE OF THE GOLD PURCHASER 1

- The average gold pledged with loan companies is around 16 grams per borrower
- The number of large borrowers is very small
- Adjusted for higher value loans, around 60% of the people pledge less than 16 grams
- Similarly, 40% of customers pledge less than 10 grams

PROFILE OF THE GOLD PURCHASER 2

- Studies show that customers on an average pledge not more than 50% of their gold. Therefore, an average household keeps around 20-30 grams of gold
- The number of large value borrowers is not large – only 3-5% of the total number of borrowers
- The percentage of default is around 3% of the disbursed amount

What is the profile of the average gold consumer?

Government officials may be tempted to look at wealthy people as being responsible for the surge in gold demand.

But it is more likely that the demand may come from low income people, each desirous of owning a few grams of gold.

Even an average demand of 10 grams per family will result in an incremental demand of around 120 tonnes annually. Most small families have holdings of 20-30 grams.

This is because India has a population growth rate of around 2 per cent. That gives the country an additional population of around 24 million each year. Statistically, that would be 12 million couples. Even if half this number does not opt for gold, the incipient incremental demand could be as high as 60 tonnes. Add to this additional purchases by existing families, and you realise that the domestic market for gold will always be vibrant.

The relevance of the small holder is brought out by studies done by gold loan companies. Sources confirm that most of the loans are taken by people who are willing to pawn not more than 10 grams of gold.

Most people do not pledge all the gold they have. At best they mortgage 50 per cent of the gold in the family, the rest is retained for sentimental and religious reasons.

Obviously, when the government introduces a gold deposit scheme where the minimum gold to be deposited is 30 grams, it seeks to exclude the largest owner of gold in the country. Policies need to be crafted to address this as well.

One more finding is that small borrowers of money against gold do not normally default on repayments.

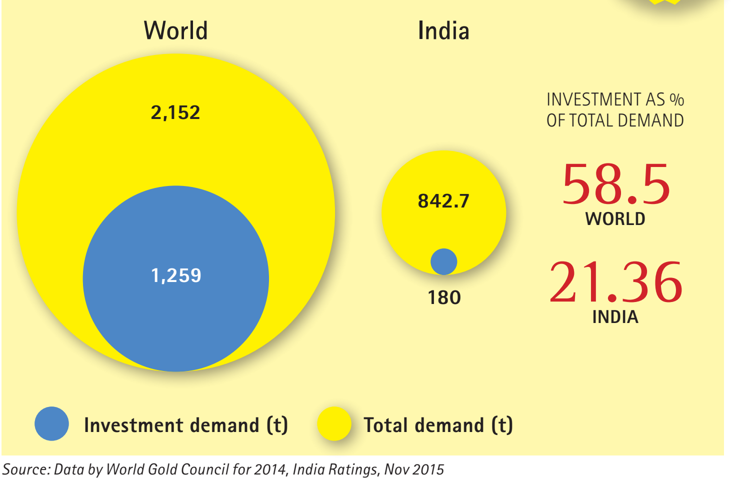
PROFILE OF THE GOLD PURCHASER 3

The biggest purchaser is the small income person – who needs gold

- As a cultural need
- As financial security
- As status symbol
- As an informal credit rating statement

PROFILE OF THE GOLD PURCHASER 4

Investment Demand for Gold as % of Total Demand



Source: Data by World Gold Council for 2014, India Ratings, Nov 2015

Gold plays various roles for the small-income person in the unorganised sector. It works as an informal credit rating system. A person who sports a gold chain around his wrist or neck, is indirectly announcing to his community that he is financially solvent, and can be trusted with small loans.

Unfortunately, this small-income person often borrows from the unorganised market at rates of over 2 per cent a month. If there could be a mechanism where he could safely offer his gold as collateral for short term loans – often to tide over a business need or social festive compulsions (like a child's marriage), he could benefit in two ways: (i) a lower rate of interest; and (ii) a safer way to mortgage and redeem the gold pawned without being cheated of the gold purity by unscrupulous practitioners of the trade.

In sharp contrast, investment gold accounts for barely 21 per cent of total demand. Currently, the gold deposit scheme is targeted at this small segment, this needs a re-look.

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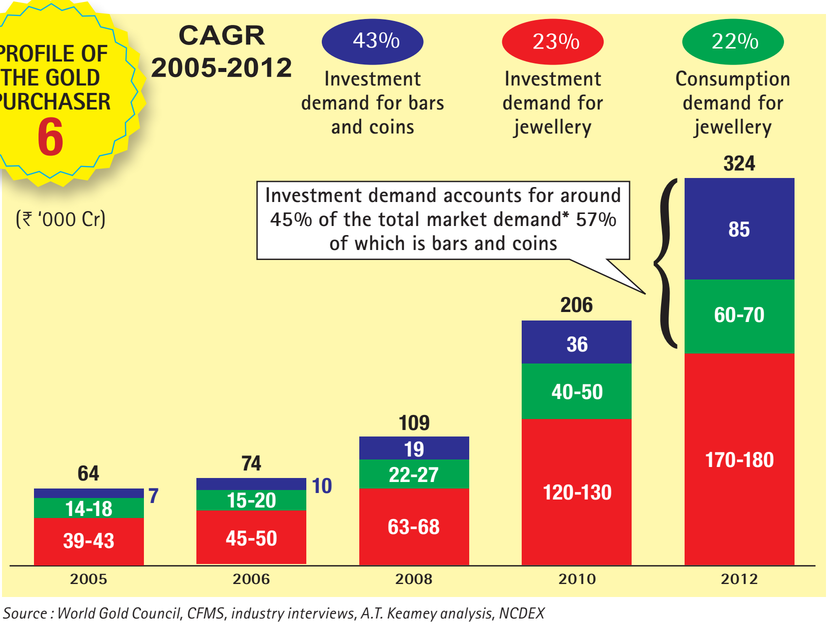
PROFILE OF THE GOLD PURCHASER 5

Domestic gold demand and supply balance sheet *(in tonnes)*

Supply	2010	2011	2012	2013
1. Mine Production	2.8	2.3	1.7	1.6
2. Gold Supply from Scrap	81.0	59.0	113.0	101.0
3. Total Supply (1+2)	**83.8**	**61.3**	**114.7**	**102.6**
Demand				
4. Jewellery	685.0	667.0	618.2	607.4
5. Industrial Fabrication (5.1 +5.2)	15.7	14	11.5	12.1
5.1 Of which Electronics	2.5	2.5	2.4	2.4
5.2 Of which Other Industrial Uses	13.2	11.5	9.1	9.7
6. Retail Investment (6.1 + 6.2)	348.9	368	312.2	362.1
6.1 Of which Bars	266.3	288	205.9	265.8
6.2 Of which Metals and Imitations Coin	82.6	80	106.3	96.3
7. Total Demand	1049.6	1049	941.9	981.6
8. Domestic Deficit (Demand – Supply) (7-3)	**965.8**	**987.7**	**827.2**	**879**

Source : Author's calculations based on the data extracted from GFMS, Thomson Reuters, NCDEX

PROFILE OF THE GOLD PURCHASER 6



Source : World Gold Council, CFMS, industry interviews, A.T. Keamey analysis, NCDEX

Gradually, most Indians are beginning to learn that purchasing jewellery may not be the best way to invest in gold.

This can be seen from the growth rates – there has been a 43 per cent compounded average rate of growth between 2005 and 2012 in investment in gold. Investment jewellery as a vehicle for investment is only 22 per cent. This can be reduced, by educating consumers why investment jewellery as investment will actually result in losing the 8-15 per cent “making charges” that most jewellers factor into the price of the item purchased.

Will that hurt the gold jewellery business? Not really, if its image is improved, and good manufacturing practices are introduced. The gold jewellery that Indians stop purchasing will be available for the global export market, where India’s share has been declining year after year.

Moreover, if the government allows the trade to get a decent margin, even on investment gold – gold bars, coins and biscuits – there is no reason why the gold business should get harmed, especially because the Indian population still produces around 12 million new families each year. That is without counting incremental demand from existing families.

IMPLICATIONS

- Gold is thus not merely a household consumption item. It is a financial investment as well, and must be treated as such
- Fortunately, the RBI which once treated gold as a commodity, now regards it as an investment
- But it is a non-financial investment – at par with real estate
- This is unfair as gold is fungible, and can be used anywhere in the world. Even the RBI uses gold as its financial reserves

RECOMMENDATION 1

- Just like SIDBI looks after small industry loans, and NABARD looks after agriculture, there is an urgent need for a specialised bank for gold. That would be the *Bullion Corporation of India*, which should look after all matters relating to gold, under the RBI's supervision
- Classify gold as a financial investment
- That would bring it under FICN (Fake Indian Currency Notes) rules
- Section 489-A - Counterfeiting currency-notes or banknotes

(Whoever counterfeits, or knowingly performs any part of the process of counterfeiting, any currency-note or bank-note, shall be punished with [imprisonment for life], or with imprisonment of either description for a term which may extend to ten years, and shall also be liable to fine).

In fact, there is another reason for optimism.

For several decades, gold was treated as a mere commodity. It, therefore, came under the purview of the ministry of consumer affairs. Except for a few policy announcements like import duty rates, the finance ministry did not bother to look at the way in which the gold market developed.

But lately, gold has been brought under the purview of the finance ministry. It is now regarded as an investment.

But it is classified as a non-financial investment, which does not do justice to the role gold plays in society and the economy. It needs to be treated as a financial investment. This could be done, and monitored, by the new gold monitoring entity – the BCI.

One of the immediate implications of gold being regarded as a financial investment is that it comes under the purview of the RBI. It is treated as money.

And just as fraudulent notes invite the provisions of FICN (Fake Indian Currency Notes), gold could also be subjected to the same stiff requirements of FICN.

The provisions under FICN allow for life imprisonment and make the act of fraud a non-bailable offence.

The government could first begin applying this rule to refineries, so that they do not palm off sub-standard gold to the trade. It could also be extended to gold traders who must then use the refinery's certificate while guaranteeing the purity of the metal.

It will take a few months before some of these provisions could also be extended to cover jewellers as well.

But none of this will be possible if gold is not treated as a financial investment.

RECOMMENDATION 2

- Allow gold imports only through designated parties, Reserve a 50% share for banks. Their role is crucial
- Import by designated parties should be at not more than 1% customs duty
- The wholesale trade (more than ~25 kg per transaction) gets it at a 2% markup (or at 3% over the international prices)
- This will break the smuggling channels. Smuggling is dangerous because a channel could be used to smuggle in arms. It also corrodes the local currency

RECOMMENDATION 3

This ensures several things:

- Gold purchased through banks (at a markup of 3% for the wholesale trade and 5% for the retail) is cheaper than the 10% import duty for non-channel import
- Effectively, gold begins to come in only through approved channels
- The approved importers make 2% profit with which they pay the refiner to certify all gold export/import coming into or going out of the country

One of the best ways to clean up the import of gold is by allowing designated parties – select banks and NBFCs – to import gold at not more than 1 per cent import duty.

This gold can then be sold to large traders at a markup of not more than 2 per cent. These large traders could be defined as those who purchase not less than 25 kg of gold in one instalment (the figure could be raised to 50 kg gradually). True, some smart small players will join hands and ensure that their aggregate purchase is more than 25 kg, but it does not really matter.

The wholesale trade can then sell it to retailers with a markup of another 2 per cent. Thus the final markup for the retail consumer could be not more than 5 per cent.

This will result in purchase through designated entities more profitable because the 10 per cent import duty on gold will still remain in force for imports through non-designated parties.

At 1-3 per cent markups, procurement through legitimate channels will be more profitable than through the smuggled route. Overnight, the smuggling market could be made quite irrelevant.

Moreover, it leaves each level of the trade with a margin of 1.5-2 per cent – even for the designated importers. This margin could be used to defray costs to be paid to refiners who charge at best 0.1 per cent for refining and assaying charges.

The possibility of making profits also encourages each party to compete with every other player in the market.

Most of all, the supply side gets cleaned up and the scourge of smuggling gets reduced enormously.

It could pave the way to the creation of a world-class gold-bourse in India.

RECOMMENDATION 4

- The trade is assured of a 2% margin at the very minimum even if it sells biscuits and coins
- The customer benefits because he then gets uncontaminated gold
- Since exported gold also invites the provisions of FICN, more care is taken in ensuring that substandard gold is not exported
- Since gold is now a financial investment, it cannot invite excise or VAT which states have often tinkered with

RECOMMENDATION 5

- This puts the responsibility of maintaining standards directly under the *Bullion Corporation of India* and the RBI. BIS (Bureau of Indian Standards) alone cannot do it
- To ensure that standards are maintained, no gold is sold without a certificate from an approved/ empanelled gold refinery
- If substandard gold is found, or has been sold, both the trader and the refiner invite FICN penalties
- This way, the refiners too begin to enforce quality and to prevent misuse of their certification

This will increase the confidence of the consumer in gold bars, biscuits and coins, which bear the refinery's certificate.

The application of FICN strengthens the legal mechanism under which gold standards could be enforced. BIS cannot do this by itself.

Since gold is now a financial investment, it cannot attract VAT or any other state levies as money cannot be taxed. It insulates gold from the state governments' temptation to impose sales taxes on this metal.

It also allows customers to migrate from jewellery purchased as investment to coins, biscuits and bars.

The market for jewellery will not get adversely affected because there will always be some demand from the 12 million couples who embark on creating their own families each year.

It makes refineries quasi-monitors of the quality of gold that customers purchase thus paving the way for the trade to regulate itself eventually.

RECOMMENDATION 6

- Create a taxpayer ledger which lists out any transaction done against a PAN number. This register should be accessible as a web page
- Send out alerts whenever a PAN registration is made for purchase of gold
- This will minimize fraudulent use of PAN numbers
- Similarly, create a taxpayer ledger for transactions or references to the AADHAR card. This too should be available on a notified website

RECOMMENDATION 7

- The government has already made hallmarking mandatory. This involves use of a specific series of codes through which a jeweller can be identified (http://www.bis.org.in/cert/hallbiscert.htm)
- Add an alphanumeric serial number for the jewellery item, which should also get labeled. These could then be put up
- All the registry numbers with the details of the jewellery item and its image could be put up on a hallmarking website. This will minimize theft of gold from an ornament when it is given for mortgage or for polishing.

Insisting on PAN card declaration for gold jewellery purchases of over ₹2 lakh is good. (*see page 79*).

But there is a danger. PAN card details can be misused. For instance the jeweller might use the same PAN number against another purchase that the original customer might not have made. The hapless customer may then be targeted by the tax authorities for having made gold purchases far in excess of what was actually made by him.

One solution is to send out SMS and email alerts to a customer against any registration of any purchase against his PAN card. This would be similar to the way credit card companies and banks send SMS and email alerts for any transaction done against that card/account.

There should also be a listing of all purchases and registration – for purchase of gold or registration of mobile phone connections – done against any PAN card. This listing should be put up on a designated website, accessible to the customer through the use of an identification process. This practice – in place for TDS statements – should be extended to PAN card registrations also.

This way, suspect transaction can be noticed, and promptly reported by individuals. Even if the tax authorities do not respond, the person can show the documentation of his protest to protect himself.

Extend this to Aadhar cards as well.

There is a need for web-listing of all hallmarked items (Hallmarking is now mandatory) Listing them on a website – with unique serial numbers – would go a long way towards minimizing fraudulent practices, and also aid consumer confidence.

Customers can then cross-check details. It can be used to verify if any gold has been ‘stolen’ from ornaments after they have been redeemed, or collected from a jeweller where it was given for polishing.

CONCLUSION 1

- Gold is crucial to India – culturally, financially and as an economic activity – because it supports a workforce of 3.5 million people
- Gold can find a huge export market, if the domestic slur on trade practices is addressed
- The crucial step is to

i) Treat it as a financial investment

ii) Make FICN norms applicable to sub-standard gold.

Gold is crucial to the Indian economy. It employs 3.5 million people.

Instead of looking at it as an expenditure, it should be viewed as an investment. If harnessed properly, it could be used as a collateral by the government to get private loans at very concessional rates indeed, should such a need arise in the future.

If the trade gains respectability, it will be sought after by consumers overseas, thus allowing the country to benefit from gold exports.

But for all this to happen, two things need to be done:

(i) Treat gold as a financial investment; not a non-financial investment as is the case today.

(ii) Allow the provisions of FICN to be extended to gold as well. It will provide for the legislative framework for enforcing proper hallmarking.

CONCLUSION
2

iii) Have a duty structure that breaks smuggling

iv) Make gold refineries part of the certification process. Hence they too come under the purview of the Bullion Corporation of India

v) Set up the Bullion Corporation of India as soon as possible, as recommended by the RBI committee set up under the chairmanship of K.U.B. Rao in 2013

There are some other things that could be done.

Allow for a differentiated import duty structure which allows for designated players to import gold at not more than a 1 per cent import duty. They in turn could sell to bullion wholesalers at a 2 per cent markup, thus helping defray administrative costs (including the cost of getting the imported consignment certified by select refiners). The wholesale trade could sell coins, bars and biscuits to anyone in the retail trade at a 2 per cent markup.

Such a mechanism will ensure that the entire trade benefits.

It also ensures that smuggling of gold will be no longer profitable.

Since import of gold is now official, new measures could be introduced for promoting export of gold.

And yes, one more thing. The BCI could also put into place policies which would allow for gold mining. Preliminary reports suggest that India can easily produce some 100 tonnes of gold each year from mines that have been identified, but not yet auctioned off for mining.

That will provide India with a little more respite.

CONCLUSION
3

Make the use of PAN card and AADHAR cards safer for customers. Send out alerts whenever such cards are used to register a facility or a purchase.

Create a web page registry for such transactions/registrations, so that a person can check up the list and report any fraudulent use of his PAN/AADHAR card.

Create a web page listing of all hall-marked items, displaying details and even the image. This will be enormously useful as a single reference point.

The government has a right to tax.

But it also has an obligation to protect.

Protection against misuse of PAN/AADHAR cards is urgently required. Anecdotal narration of incidents leads us to believe that there is a rampant misuse of PAN/AADHAR cards for acquiring mobile phone SIM cards, and also for registering high value transactions.

Such misuse can be minimized by

Sending out SMS and email alerts to the card owner against every registration of PAN/AADHAR cards. Banks and credit cards companies send out such alerts for every transaction. The government should do this for PAN/AADHAR cards.

Putting all such registrations on a client ledger which a person can access on a website after identifying himself – this is already being done by the government for TDS registrations.

Another measure that could help cleanse the gold trade by minimizing sub-standard gold being peddled is by creating a registry of all hallmarked jewellery. Thus if a jeweller shows a jewellery item that is claimed to be hallmarked, it must have a corresponding entry on the webpage. A customer could use these details from cross checking the purity of the ornament each time it is taken back from a pawn shop or a jeweller.

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Annexures

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xii http://solitaireinternational.com/Article.aspx? qstr=ffe86a6a-a453-4d0d-a7c3-d7816cded522 **Sanjiv Arole: Will The Gold Monetisation Scheme Click?**

xiii http://solitaireinternational.com/Article.aspx? qstr=dbaf4a85-8f54-426b-96d1-ae9a5ad021fe **Sanjiv Arole: Is India Ready For Sovereign Gold Bonds?**

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Reports of the Working Group to study the Issues Related to Gold Imports and Gold Loans NBFCS in India

Reserve Bank of India

February 2013

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Reserve Bank of India

Working Group to Study the Issues Related to Gold Imports and Gold Loans NBFCs in India

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RESERVE BANK OF INDIA
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January 31, 2013

Adviser **LETTER OF TRANSMITTAL**

DEPR.DNFS.6229/75.26.001/2012-13

Dr. Urjit Patel
Deputy Governor
Reserve Bank of India
Central Office
Mumbai – 400001.

Dear Sir:

Report of the Working Group to Study the Issues Related to Gold and Gold Loans NBFCs in India

Please refer to the constitution of a Working Group vide Memorandum dated April 4, 2012 to Study the Issues Related to Gold and Gold Loans NBFCs by the Reserve Bank of India. The Working Group is pleased to submit its final Report for the consideration of the Bank. The Working Group sincerely thanks the Bank for entrusting this responsibility to us.

With kind regards,

Yours sincerely,

(K.U.B.Rao)
Chairman

(S.M.N.Swamy) Member	(Vivek Deep) Member	(Ashok Sahoo) Member
(Ravishankar) Member	(G. Jagan Mohan) Member	(S.K. Pable) Member
(Rohit Das) Member	(A. Karunagaran) Member Secretary	

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हिंदी आसान है, इसका प्रयोग बढ़ाइए

Chapter 3A - Proposal for setting up Bullion Corporation of India - A Concept Paper

A. Context:

3.51 In 1992, the proposal for setting up a 'Gold Bank' was mooted by the then Finance Minister Dr. Manmohan Singh in his Budget Speech of February 1992. But, the proposal was not implemented. With structural changes in the economy, sources of economic growth and distributional pattern of income, gold continues to maintain its supremacy in the savings spectrum. With considerable changes in policy related to gold over the past 20 years, the proposal for setting up a Bullion Corporation of India (BCI) needs to be revisited and activated. It is widely believed that postponing the setting up of the BCI is detrimental to the gold dynamics in the economy, as one major reason for setting up of the BCI is to reduce the demand for gold imports through greater activation of the domestic idle gold. There has been a strong intellectual support for the creation of the Bullion Corporation of India. IBA has also supported the idea.

B. Need for a Dedicated Institution to Mobilise Idle Gold Stocks:

3.52 India is the largest gold importer in the world. It imported approximately $ 56 Billion worth of gold in 2011-12. India is a leading gold jewellery consumer as well as gold jewellery exporter. However, the market for gold in India is not efficiently organised. Gold is the medium in which both a common man and financial institutions have faith as a store of value in India. Since the demand for gold spurts from all the sections of the society, absence of a specialised institution dedicated to gold puts the gold investors to disadvantage as there are no two-way reasonable quotes available. Further, almost 400 tonnes of scrap gold that enters the system every year does not lead to an appropriate price discovery. There is also no institution that takes a holistic view on the demand for and supply of gold through organised channels. While a rich menu of gold-backed financial instruments are available abroad, in India there is no institution that focuses on conceiving and introducing such products. As much as gold is used as an ornament and a vehicle for storing wealth, gold has also emerged as very important collateral to raise both consumption and productive loans in India. Given the insatiable demand for gold from the Indian residents, there is a strong need for creating an institution to facilitate the activation of dealing in domestic idle gold and to provide liquidity and refinance to institutions/banks. Cross-country experience indicates the existence of some form of institutional mechanism to deal in gold stocks. Bullion Bank is one such example. Bullion banks are essentially investment banks that function as wholesale suppliers dealing in large quantities of gold. The bullion banks conduct the financial transactions and ownership transfer takes place in the records of the depository. If BCI is established in India, it would facilitate the activation of idle domestic gold and thereby reduce gold imports.

3.53 Against this backdrop, this concept paper outlines the broad contours of the modalities of establishing the BCI.

C. Key Objective of setting up of the Bullion Corporation of India

3.54 To create a unique developmental and operational institution that undertakes a wide range of functions related to gold imports, exports, financing, refinancing and domestic usage of gold. The BCI would develop gold market through innovative gold products and create a large pool of domestic recyclable gold. The BCI would provide liquidity for gold trading and operations.

D. Proposed Functions of the Bullion Corporation of India

3.55 The BCI would be empowered to undertake wide-ranging activities related to the entire spectrum of gold economy. The BCI will be a 'backstop facility' for refinancing to other agencies engaged in imports as well as gold loans. The BCI will recycle domestically available gold stock in all forms. This would minimise the import of gold and ensure that the gold resources are deployed in the best interests of growth and development of the country. The BCI will facilitate that the gold bought and sold in India is of high quality comparable to international standards. It will assist in creation of gold-backed and gold-related products. The BCI will undertake gold metal trading; financing and physical metal distribution and evolve innovative products to activate the idle domestic stock of gold.

- Provision of a 'b
  against the collateral of gold.
- It will assist in assaying facility of international standards by employing highly trained professionals, which can meet the standards set by the London Bullion Market Association.
- Issuance of gold bonds *in lieu of* collection of gold stocks.
- Provision of storage and safekeeping facilities for bullions with international standards;
- Ensuring close coordination with other international bodies such as World Gold Council, London Bullion Market Association (LBMA) etc. Similarly with the domestic institutions such as Bombay Bullion Association (BBA), and Gems and jewellery exporters council.

- The following Derivative Products related to gold also can be developed and provided :

  - Spot, Forward and Options trading, Metal leases, consignments and loans, Physical Delivery Forward rate agreements;
  - Metals certificate programs, Coins, Jewellery, inventory financing, and Custodial services,
  - Depository services, location swaps, structured notes, hedging programs.

E. Framework of the Bullion Corporation of India

3.56 (1) The Reserve Bank of India may establish Bullion Corporation of India Limited (BCI) as a Public Limited Company under the Companies Act with an intended objective of mobilisation of idle gold in the domestic economy in order to reduce the demand for imports of gold.

3.57 (2) The BCI may establish offices, branches or agencies at any place in India or abroad, as considered necessary by and approved by RBI.

3.58 (3) The BCI should be a market institution and be regulated by RBI.

i. Capital

3.59 The initial capital for setting up of the BCI may be provided by the RBI and select commercial banks and institutions. The authorised capital of the BCI could be Rs.2000 crore and the paid up capital could be Rs.1000 crore. Initially the RBI should subscribe a minimum of 51 per cent of the capital and financial institutions 49 per cent; to the extent banks and institutions prefer to subscribe less, the RBI would take up the gap. In a sense, the RBI's model on Discount and Finance House of India (DFHI) Ltd. and Securities Trading Corporation of India (STCI) may be followed.

3.60 The proposed framework does not entail fiscal cost to the Government. The Reserve Bank would consider hive off its stake in stages, once the institution stabilises its operations and gains the confidence of the public and investors.

ii. Management Structure

3.61 The Board would be constituted by the shareholders of the BCI. There would be a non-Executive Chairman and a full time Managing Director who would be the CEO. The Board members would be drawn from the capital subscribers and the board may also include eminent experts from the domains of accounting, economics, finance, trade, industry, banking and insurance. The RBI could, in the initial period, appoint the Chairman and some directors but this function would be ceded, as RBI divests its shareholding. In the DFHI model, the RBI Deputy Governor was the Chairman and subsequently the nominee of the dominant shareholder becomes the Chairman. In the case of STCI, *ab initio*, the Chairman was not a serving Deputy Governor but an outsider appointed initially by the RBI. The Managing Director should be appointed by the Board.

3.62 The managerial functions of the BCI are akin to other developmental financial institution, *viz*.;

(1) The proposed BCI can function based on the directions provided by its Board of Directors;

(2) The general superintendence, direction and management of the affairs and business of the Bullion Corporation of India should be in the Board of Directors, which should exercise all powers and do all acts and things, which might be exercised or done by the Bullion Corporation of India;

(3) The Board, in discharging its functions, should act on business principles with due regard to public interest;

(4) The Chairman would attend the matters relating to the Board; and

(5) The Managing Director as directed by the Chairman and the Board will have general superintendence, direction and management of the affairs and business of the BCI.

प्रेस प्रकाशनी PRESS RELEASE

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October 30, 2015

Sovereign Gold Bond 2015-16

The Reserve Bank of India, in consultation with Government of India, has decided to issue Sovereign Gold Bonds. The Bonds will be issued on November 26, 2015. Applications for the bond will be accepted from November 05, 2015 to November 20, 2015. The Bonds will be sold through banks and designated post offices as may be notified. The borrowing through issuance of the Bond will form part of market borrowing programme of Government of India.

It may be recalled that Honourable Finance Minister had announced in Union Budget 2015-16 about developing a financial asset, Sovereign Gold Bond, as an alternative to purchasing metal gold. The features of the Bond are given below:

Sl.No.	Item	Details
1.	Product name	Sovereign Gold Bond
2.	Issuance	To be issued by Reserve Bank India on behalf of the Government of India.
3.	Eligibility	The Bonds will be restricted for sale to resident Indian entities including individuals, HUFs, trusts, Universities, charitable institutions.
4.	Denomination	The Bonds will be denominated in multiples of gram(s) of gold with a basic unit of 1 gram.
5.	Tenor	The tenor of the Bond will be for a period of 8 years with exit option from 5th year to be exercised on the interest payment dates.
6.	Minimum size	Minimum permissible investment will be 2 units (i.e. 2 grams of gold).
7.	Maximum limit	The maximum amount subscribed by an entity will not be more than 500 grams per person per fiscal year (April-March). A self-declaration to this effect will be obtained.
8.	Joint holder	In case of joint holding, the investment limit of 500 grams will be applied to the first applicant only.
9.	Frequency	The Bonds will be issued in tranches. Each tranche will be kept open for a period to be notified. The issuance date will also be specified in the notification.

10.	Issue price	Price of Bond will be fixed in Indian Rupees on the basis of the previous week's (Monday–Friday) simple average of closing price of gold of 999 purity published by the India Bullion and Jewellers Association Ltd. (IBJA).
11.	Payment option	Payment for the Bonds will be through electronic funds transfer/cash payment/ cheque/ demand draft.
12.	Issuance form	Government of India Stock under GS Act, 2006. The investors will be issued a Stock/Holding Certificate. The Bonds are eligible for conversion into de-mat form.
13.	Redemption price	The redemption price will be in Indian Rupees based on previous week's (Monday-Friday) simple average of closing price of gold of 999 purity published by IBJA.
14.	Sales channel	Bonds will be sold through banks and designated Post Offices, as may be notified, either directly or through agents.
15.	Interest rate	The investors will be compensated at a fixed rate of 2.75 per cent per annum payable semi-annually on the initial value of investment.
16.	Collateral	Bonds can be used as collateral for loans. The loan-to-value (LTV) ratio is to be set equal to ordinary gold loan mandated by the Reserve Bank from time to time.
17.	KYC Documentation	Know-your-customer (KYC) norms will be the same as that for purchase of physical gold. KYC documents such as Voter ID, Aadhaar card/PAN or TAN /Passport will be required.
18.	Tax treatment	The interest on Gold Bonds shall be taxable as per the provision of Income Tax Act, 1961 (43 of 1961) and the capital gains tax shall also remain same as in the case of physical gold.
19.	Tradability	Bonds will be tradable on exchanges/NDS-OM from a date to be notified by RBI.
20.	SLR eligibility	The Bonds will be eligible for Statutory Liquidity Ratio.
21.	Commission	Commission for distribution shall be paid at the rate of 1% of the subscription amount.

Ajit Prasad
Assistant General Manager

Press Release : 2015-2016/1047

Related Documents
Circular
GoI Notification
Forms : Form A, Form B, Form C, Form D, Form E, Form F
FAQs

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RESERVE BANK OF INDIA
www.rbi.org.in

RBI 2015-16/218
IDMD.CDD.No.939/14.04.050/2015-16 October 30, 2015

The Chairman & Managing Director
All Scheduled Commercial Banks
(Excluding RRBs)

Dear Sir/Madam,

Sovereign Gold Bonds, 2015-16

It has been decided by the Government of India, as per their Notification F.No. 4(19)-W&M/2014 dated October 30, 2015, to issue Sovereign Gold Bonds, 2015 ("the Bonds") with effect from November 05, 2015 to November 20, 2015. The Government of India may, with prior notice, close the Scheme before the specified period. The terms and conditions of the issuance of the Bonds shall be as follows:

1. **Eligibility for Investment**:

The Bonds under this Scheme may be held by a person resident in India, being an individual, in his capacity as such individual, or on behalf of minor child, or jointly with any other individual. "Person resident in India" is defined under section 2(v) read with section 2 (u) of the Foreign Exchange Management Act, 1999.

2. **Form of Security**

The Bonds shall be issued in the form of Government of India Stock in accordance with section 3 of the Government Securities Act, 2006. The investors will be issued a Holding Certificate (Form C). The Bonds shall be eligible for conversion into de-mat form.

3. **Date of Issue**

Date of issuance shall be November 26, 2015.

The investors can apply for the Bonds in receiving offices from November 05, 2015 to November 20, 2015. The issuance can be closed by Government of India earlier than November 20, 2015 with a prior notice.

4. **Denomination**

The Bonds shall be denominated in units of one gram of gold and multiples thereof. Minimum investment in the Bonds shall be 2 grams with a maximum subscription

आंतरिक ऋण प्रबंध विभाग, केंद्रीय कार्यालय, केंद्रीय कार्यालय भवन, शहीद भगतसिंह मार्ग, 23वीं मंजिल, मुंबई - 400 001, भारत
फोन : (022) 2266 1602-04, फैक्स : (022) 2264 4158, 2270 5125, ई-मेल : cgmidmd@rbi.org.in
Internal Debt Management Department, Central Office, Central Office Building, 23rd Floor, Shahid Bhagat Singh Marg, Mumbai-400 001, India
Telephone: 022 2266 1602-04, Fax :(022) 2264 4158, 2270 5125, Email : cgmidmd@rbi.org.in

of 500 grams per person per fiscal year (April – March). In case of joint holding, the limit applies to the first applicant.

5. **Issue Price**

Price of the Bonds shall be fixed in Indian Rupees on the basis of the previous week's (Monday – Friday) simple average closing price for gold of 999 purity, published by the India Bullion and Jewellers Association Ltd. (IBJA).

6. **Interest**

The Bonds shall bear interest at the rate of 2.75 per cent (fixed rate) per annum on the amount of initial investment. Interest shall be paid in half-yearly rests and the last interest shall be payable on maturity along with the principal.

7. **Receiving Offices**

Scheduled commercial banks (excluding RRBs) and designated Post Offices (as may be notified) are authorized to receive applications for the Bonds either directly or through agents.

8. **Payment Options**

Payment shall be accepted in Indian Rupees through Cash or Demand Drafts or Cheque or Electronic banking. Cheque or draft should be drawn in favour of the bank / post office (Receiving Office), specified in paragraph 7 above and payable at the place where the applications are tendered.

9. **Redemption**

i) The Bonds shall be repayable on the expiration of eight years from the date of issue. Pre-mature redemption of the Bond is allowed from fifth year of the date of issue on the interest payment dates.
ii) The redemption price shall be fixed in Indian Rupees on the basis of the previous week's (Monday – Friday) simple average closing price for gold of 999 purity, published by IBJA.

10. **Repayment**

The receiving office shall inform the investor of the date of maturity of the Bonds, one month before its maturity.

11. **Eligibility for Statutory Liquidity Ratio (SLR)**

The investment in the Bonds shall be eligible for SLR.

12. **Loan against Bonds**

The Bonds may be used as collateral for loans. The Loan to Value ratio will be as applicable to ordinary gold loan mandated by the RBI from time to time. The lien on the Bonds shall be marked in the depository by the authorized banks.

13. **Tax Treatment**

Interest on the Bonds shall be taxable as per the provisions of the Income-tax Act, 1961. Capital gains tax treatment will be the same as that for physical gold.

14. **Applications**

Subscription for the Bonds may be made in the prescribed application form (Form 'A') or in any other form as near as thereto stating clearly the grams of gold and the full name and address of the applicant. The receiving office shall issue an acknowledgment receipt in Form 'B' to the applicant.

15. **Nomination**

Nomination and its cancellation shall be made in Form 'D' and Form 'E', respectively, in accordance with the provisions of the Government Securities Act, 2006 (38 of 2006) and the Government Securities Regulations, 2007, published in part III, Section 4 of the Gazette of India dated the 1st December, 2007.

16. **Transferability**

The Bonds shall be transferable by execution of an Instrument of transfer as in Form 'F', in accordance with the provisions of the Government Securities Act, 2006 (38 of 2006) and the Government Securities Regulations, 2007, published in part III, Section 4 of the Gazette of India dated the 1st December, 2007.

17. **Tradability in Bonds**

The Bonds shall be eligible for trading from such date as may be notified by the Reserve Bank of India.

18. **Commission for distribution**

Commission for distribution shall be paid at the rate of rupee one per hundred of the total subscription received by the receiving offices on the applications received and receiving offices shall share at least 50% of the commission so received with the agents or sub-agents for the business procured through them.

19. All other terms and conditions specified in the notification of Government of India in the Ministry of Finance (Department of Economic Affairs) vide number F. No.4(13) W&M/2008, dated the 8th October, 2008 shall apply to the Bonds.

Yours faithfully,

(Chandan Kumar)
Deputy General Manager

Encls.: As above.

November 03, 2015

CARE Ratings
Professional Risk Opinion

Gold loan NBFCs: Better placed to handle Gold Price Risk

Gold Price Movements

Past few months have seen high volatility in gold price thanks to the market's expectation on US central bank's policy on interest rate. The fear of moving away from close to zero interest rates in the US market has resulted in the fall of gold prices significantly in USD terms during the period from May 2015 to September 2015. However, same has reversed its direction since US Central Bank's decision on the interest rate in September 2015. At the same time, INR depreciation against USD meant that lower gold price variation in rupee terms. During the period mentioned above, the gold price in India dropped marginally from Rs.2,453/gm (May 04, 2015) to Rs.2,387/gm (September 30, 2015) after touching a low of Rs.2,249/gm on August 06, 2015. During past few years also, gold price has seen periods of high volatility. After continuous increase in the price from April 2007 to August 2012 with periods of little volatility, gold price peaked in September 2012. Since September 2012, gold price witnessed declining trend and increased volatility. The price movement of gold for the past few years is shown below.

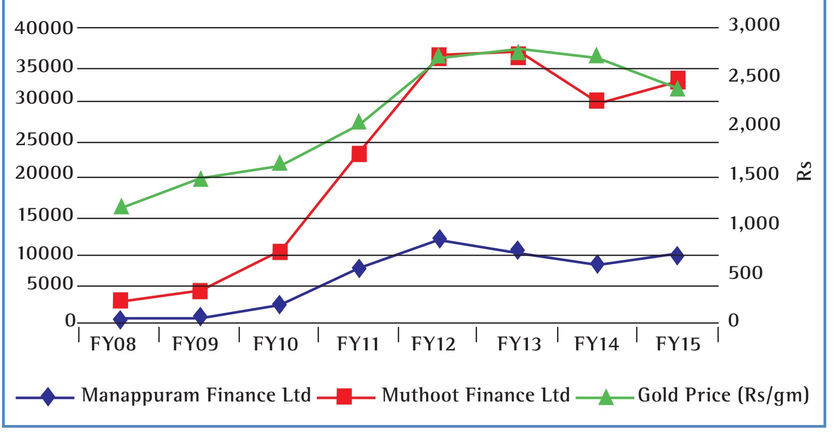
Movement in the Gold Price

Source: www.nseindia.com, Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES)

Gold Loan NBFCs AUM moved in trend with movement in gold prices

Domestic market has seen emergence of many players in the gold loan NBFC industry in the last decade, with few companies crossing assets under management (AUM) of Rs.100 billion in FY12. With gold price increasing continuously during the period from 2007 to mid of 2012, large players in the industry also reported continuous growth in AUM during that period. Subsequently in tandem with decline in the gold prices, AUM of these companies has seen some decline. Following chart captures movement of AUM of top two listed players.

Movement in AUM of large gold loan NBFCs and gold price



Unlike other NBFCs, gold loans NBFCs give much more emphasis on the value of security as compared to cash flow of borrower. This is due to highly liquid nature of the security (gold) offered, possession of security and absence of issues like distress sale affecting the realisable value. Furthermore, the belief that sentimental value attached with gold jewellery would result in borrower repaying his money to get back his gold has been viewed as major positive factor. Though this has been true for larger part of the period (2007 to 2012) & larger part of borrowers, industry started seeing addition of Non-Performing Assets (NPA), initiation of recovery proceedings and consequent under recovery of underlying security in subsequent periods. Some of the players reported losses in few quarters of FY13, as a result of asset quality deterioration.

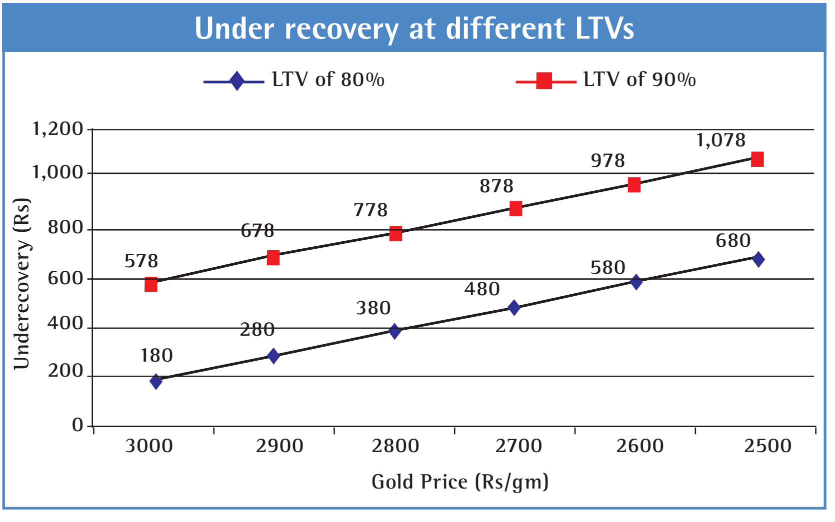
Steep correction in gold prices after peaking in September 2012 resulted in high LTV (Loan to Value) loans becoming vulnerable with realisable gold value going below loan amount. With fall in prices, many of the borrowers (mainly those who had borrowed at higher LTV) chose to default rather than repay loans and get back their gold jewellery which had reduced in value. As the loans which were extended during the peak of gold prices started showing delinquencies and recovery actions resulted in under recovery/loss.

For e.g. a loan which was disbursed at LTV of 80-90% at gold price of Rs.3,000 per gram becomes out of the money (loan outstanding higher than value of underlying security) as the gold price starts falling. Table below shows the loan outstanding at the end of one year & at the time of recovery (assuming recovery process starts at the end of one year). As it can be seen below, at higher LTV, losses had been higher even in a scenario of no change in gold price.

(Rs.)

Loan to Value Ratio	80%	90%
Loan per gram	2,400	2,700
Interest @ 26% p.a	**624**	**702**
Loan Outstanding (at the end of one year)	3,024	3,402
Add: Interest foregone during recovery period	**156**	**176**
Loan Outstanding (at the time of recovery)	3,180	3,578
Under Recovery/Loss (Assuming realisation of Rs.3,000 per gram)	**180**	**578**

Chart below shows the extent of under recovery at different gold price points. The loans with higher LTV faced significant losses and many gold loan NBFCs had to report losses/under recovery in many quarters during FY13.



In view of the volatile movements in gold price and losses/under recovery faced by the industry, RBI revised guidelines on LTV in March 2012 when it capped LTV for Gold Loan NBFCs at 60%. Later it revised the same to 75% in the month of January 2014.

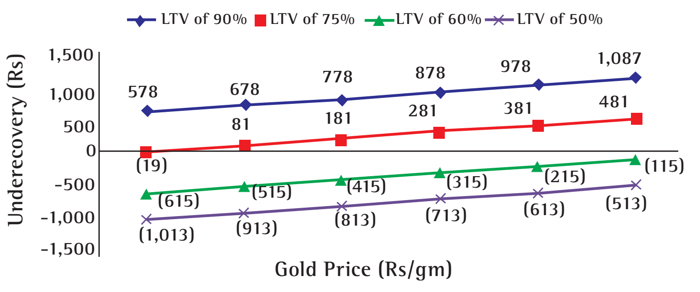
Gold Loan NBFCs: Mitigating Market Price Risk through different ways

Though gold price remained less volatile during the period from June 2014 to May 2015, due to the reasons stated at the beginning (expectations on fed policy rate), volatility has increased subsequently. However, the industry has changed its strategy in the recent past to mitigate gold price risk.

Preference to Lower LTV

Initially, the gold loan NBFCs were lending at LTV of greater than 90%. This came down subsequently with RBI capping LTV ratio. In the past one and half year, many NBFCs have started offering loans at relatively lower interest rates for the loans having lower LTV. While this has affected the business volumes and yield to an extent, it results minimisation of credit loss. Lower the LTV, higher the cushion between amount of loan outstanding and realizable value of collateral. E.g. a loan offered at 50% LTV (gold price of Rs.3,000 per gram) remains 'in the money' even at the end of one year even when gold price falls to Rs.2,500 per gram. Chart below shows the extent of under recovery in loans at different LTVs at various price points. As it can be observed from this, lower LTV ensures under recovery is significantly reduced/avoided.

Extent of under recovery at different LTVs



Note: The values inside the parenthesis indicate the collateral value in excess of outstanding loan amount including interest.

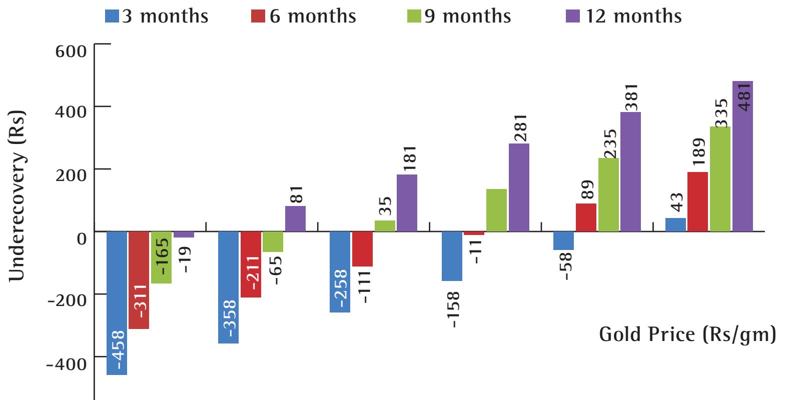
The business volumes of the gold loan NBFCs have been impacted in the past few years (FY13-14) due to falling gold prices & cap in LTV, resulting in de-growth in the loan portfolio.

Launch of Shorter Tenure loans & Periodical collection of interest

Though the loans are backed by highly liquid collateral (gold) resulting in relatively higher recovery and low loss given default, the price risk associated with the collateral impacts the ultimate recovery. Even assuming price remains stable, effective tenure of loans also impacts the under recovery. In order to reduce risk arising from the same, NBFCs have been focusing on extending short-term loans, i.e., three months, six months and nine months loans. Relatively lower tenure ensures that at any point of time, value of security is higher than obligation of borrower and losses are minimized on timely recovery through auction.

Chart below shows the extent of under recovery for three, six and nine-month loans as against loan with tenure of one year. As it can be observed from the chart, under recovery from shorter tenure loan is significantly lower than loans with one year tenure.

Under recovery in loans with different tenure



Note: The values inside the parenthesis indicate the collateral value in excess of outstanding loan amount including interest.

Entities with these risk mitigations placed better to handle gold price risk

The gold loan NBFC industry has gone through a phase of consolidation in the past few years on account of slew of regulatory changes by RBI following significant fall in gold prices. At the same time these companies have evolved and adopted various risk mitigation strategies like offering relatively more loans at lower LTVs, offering short-term products like three/six/nine month loans against traditional one-year products along with periodical collection of interest to ensure that loans are in the money. As a result they are better placed to handle the gold price risk as compared with the past.

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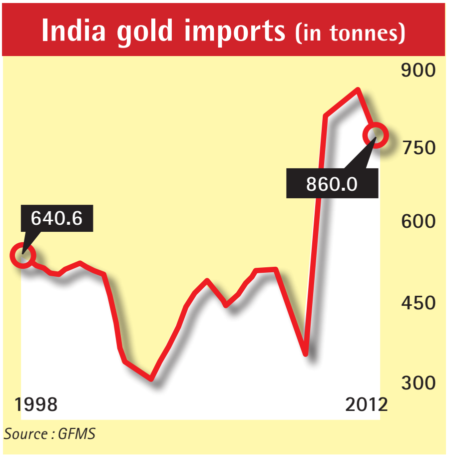
http://www.dnaindia.com/money/column-policy-watch-from-gold-to-dust-if-thegovernment-has-its-way-1855442

POLICY WATCH From gold to dust, if the government has its way

Monday, 1 July 2013 - 12:44pm IST | dna | R.N. Bhaskar

P. Chidambaram (PC) is in a flap. As Union finance minister, he has to keep a soaring, vexatious, current account deficit (CAD) under control. But three things continue to frustrate his efforts. First is the surge in imports without a corresponding surge in exports. The second is the fall in foreign inflows. And the third is payment for gold.



Sadly, he has targeted gold. He has almost banned loans against gold. He has raised duties on the yellow metal from 2 to 8 per cent. And he is threatening to make gold imports more difficult.

Maybe, he should look beyond gold. First, because it is a ₹3,50,000 crore industry in India, employing around 35 lakh people, with some 300,000 registered outlets. Any move that hurts this sector could have grave political and social implications. Second, because people buy gold on account of sentiment – backed by tradition – which duties and laws will not change. Moreover, people have more faith in gold than in any other currency, especially the Indian rupee.

One of the reasons for the rupee's decline is the manner in which the government's splurging debased its value. The rupee weakened also because of policies that slowed infrastructure building, or new factory openings. In the name of clearances – whether for land, environment, security, spectrum or even mine allocations – productivity declined, and the rupee became weaker. PC's policies are, therefore, likely to hurt the 'aam aadmi' the most. He has forgotten that the rural poor generally keep their savings in gold and silver. By asking banks not to give loans against gold, he will hurt them, forcing them to borrow from moneylenders instead. As a result, today you can mortgage your house, your factories, even your car; but not your gold. Very unfortunate!

Have PC's curbs worked? On paper, yes. But ask jewellers. They will tell you that gold sales continue – unabated. Instead of being imported officially, gold smuggling has increased.

Maybe, PC should try another method. He should co-opt gold-owners instead. After all, India is the world's largest holder of gold – over 25,000 tonnes – though in private hands. Can the government create a scheme by which it can mobilise, say 20 per cent of this gold – through bonds, incentives or anything else – and then re-sell this to the domestic trade? Gold imports will automatically stop because domestically available gold at 2 per cent VAT will be cheaper than the gold imported at 8 per cent duty. That 2 per cent VAT could be passed on to depositors as interest.

Private gold would then become productive. As collateral for cheaper forex loans, it could benefit India. The savings could also be shared with gold depositors. That would help improve the cad provided the government goes about creating more jobs, and cuts back on the splurging.

But that requires vision. And integrity.

So, is gold going to go back to becoming an underground trade – like it was before the Gold Control Act got abolished? It would seem so, unless better counsel prevails.

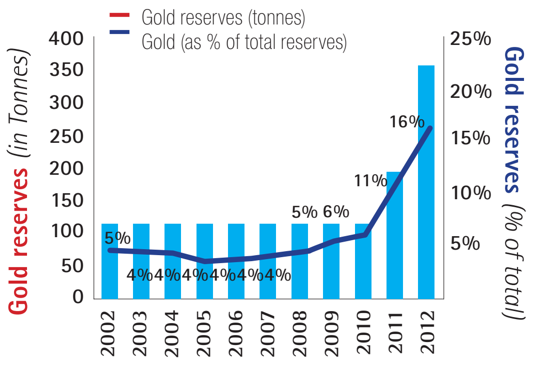
http://www.dnaindia.com/money/report-policy-watch-here-s-what-fm-could-learnfrom-turkey-about-gold-1962499

POLICY WATCH Here's what FM could learn from Turkey about gold

Sunday, February 16, 2014 - 06:00 IST | dna | R.N. Bhaskar

As predicted by dna almost eight months ago, (http://www.dnaindia.com/money/1855442/column-policy-watch-fromgold-to-dust-ifthegovernment-has-itsway), smuggling of gold into India has continued. While on paper the current account deficit (CAD) appears to have been addressed, the smuggling of gold has ended up causing immense damage – it has further undermined the Indian rupee. It could hurt India's security as well.

Turkey central Bank gold reserves 2002-12, tonnes and % of total reserves



Source : IMF. WGC, Oliver Wyman analysis

Both smuggling and legal imports use up foreign exchange. The only difference is that smuggling has to be paid for clandestinely. That puts a premium on the US dollar, which must be purchased illegally, thus eroding the value of the local currency faster than legal import could. Worse still, once smuggling routes get strengthened, they will be used to smuggle in arms or drugs as well. P. Chidambaram (PC), the finance minister – who was also home minister earlier – should have known that.

As a result the biggest beneficiaries will now be politicians and other powerful people who want to convert their ill-gotten gains held in dollars into rupees just before elections. In fact, as this column has argued, what matters is not the CAD, but the manner in which fiscal policies are managed.

(http://www.dnaindia.com/money/1889455/report-policy-watchhow-come-the-rupee-wilted-when-the-aussie-stood-firm-vsthe-greenback)

By the last week of January, PC himself was compelled to admit that gold smuggling had indeed continued unabated into India, reaching volumes of 3 tonnes a month. The acknowledgment was absurd, because World Gold Council (WGC) estimates put gold smuggling at 150-200 tonnes – but nearer the top of the range – during 2013.

As a token of 'remorse' PC even reduced the import duty on gold by 2 per cent from 10 per cent. He also stated that the time had come to review gold import restrictions by March end. The timing would be most convenient for politicians, right?

In fact, India could learn a lesson from what Turkey did when it was faced with a ballooning cad, and with more people preferring to invest in gold than in the local currency (*see chart*). In 2011, that country's central bank recognised gold as part of commercial banks' required liquidity reserves. Banks, in turn, began introducing innovative gold-related products. People could now invest in gold – either as gold accounts, or as ETFs, which could be encashed either in currency or volume for volume.

The result? There was a growth in commercial banks' deposits. There was a sustained growth in commercial banks' credit. 'Under-the mattress' funds began flowing into the economy. It increased the rate of household savings in the financial sector. Sale of substandard gold declined. But more importantly, it gave a fillip to Turkey's Anatolia region which had a history of gold fabrication for 5,000 years.

Turkey had already set up the Istanbul Gold Exchange in 1995, and had allowed by 2002 the setting up of gold refineries close to key banks. The new reforms rode piggyback on the infrastructure that was already in place.

This was in spite of Turkey having a CAD of some $77 billion – almost 10 per cent of its GDP in 2011.

Now compare this with what India did.

First, it choked off supply of gold to a ₹3,50,000 crore industry employing around 35 lakh people and with some 300,000 registered outlets in the country. The government actually forced it to seek out smuggled gold. There was no way a piece of legislation could take away the faith people have in gold, for traditional and economic reasons. The rupee was weakening, primarily on account of the government's own policies.

Second, by ordering banks and non-banking financial companies (NBFCs) to stop loans against gold, even this small supply of gold was blocked. It was ironic that in a country where vehicles, houses, raw material, finished goods and almost every other asset could be mortgaged against loans, loans against gold was made illegal. It reminded one of Mohammed bin Tughlaq who bankrupted the treasury with his mad-hatter schemes.

The results are there for everyone to see. The Indian rupee keeps weakening. Its economy continues to falter. And the only ones who have lined their pockets at such times are smugglers and well-connected people who are now richer in rupee terms.

http://www.dnaindia.com/india/report-convert-india-s-gold-rushinto-a-vibrant-industry-1980330

POLICY WATCH Convert India's gold rush into a vibrant industry

Monday, 21 April 2014 - 4:48am IST | Mumbai | dna | R.N. Bhaskar

By now, India's policymakers are possibly patting themselves on the back for ensuring a slowdown in official gold imports to levels last seen in 2005. They boast that – by imposing an import duty of 10 per cent – they could (a) reduce the import of gold, and (b) bring the current account deficit (CAD) under control.

But the decline is illusory. It masks gold that got smuggled into India (*see table*). And it continues, unabated. Smuggling, in turn, has undermined the Indian economy and, specifically, the Indian rupee. Already, hawala premiums have gone up to 4 per cent. More serious is the possibility of gold smuggling attracting large smuggling syndicates, which could lead to the creation of a well-stocked and well-oiled pipeline. When such a pipeline is established, it is difficult to shut it down. Thus, even if the government were to restore duty-free import of gold, this pipeline will be used to smuggle in narcotics or, worse, even arms. Such a situation should be avoided.

Recent pronouncements by the government indicate that it is now willing to ease gold import duties. But removing import duty altogether could be a big mistake. The turbulent economic climate in India, and the world, could cause a surge in gold import again, compelling the government to re-impose high import duty rates. Such an on-again-off-again policy is not desirable, either for the trade or for governance.

One way out would be to marginally ease import duty to say 8 per cent. But the government should allow gold to be made available from designated domestic banks by paying a surcharge of under 4 per cent of the prevailing market price. That would reduce smuggling, since 4 per cent is lower than 8 per cent. Moreover, banks could now

India's lust for Gold *Figures In tonnes*

Year	2001	2005	2010	2012	2013	2014*
Gold imported officially	551	826	971	983	933	115
of which gold as bars & coins	84	135	348	312	362	
Gold estimated to have been smuggled in				102	200	
Recycled gold	83	94	81	117	101	
Total gold consumption	**702**	**709.1**	**1006.5**	**864.2**	**974.8**	

Notes (a) Smuggled data are estimated, but could be much higher,
(b) investment includes temple gold it dose not indude gold for round-tripping and stocking
**First three monthis' estimate*

Source : Thomson Reuters CMS, WGC, and market sources.

encourage a healthy domestic gold market.

To make this happen, the government would have to introduce a variant of the Turkish model (http://dnai.in/c5pd). The government could allow designated banks to invite domestic gold deposits in the form of biscuits, bars and coins. If temple managements agree, gold lying with them could be melted, recast into bars or biscuits, certified, and deposited with banks. After all, India has a huge horde of over 25,000 tonnes of gold with individuals and with temples (http://dnai.in/bwzp).

For every tonne of gold deposit that the banks garner, the government could allow them to import duty-free a percentage of the gold deposits. In many ways, this would be similar to the reps (Replenishment Export Permits) that the government had introduced in the late 1980s to spur exports and earn desperately needed foreign exchange. Except this time, it would be a gold-for-gold scheme.

The banks could then offer this gold to the trade after levying a surcharge of under 4 per cent. The banks would enjoy a spread, which could be used to pay a 1 per cent interest annually to gold depositors. And the trade could benefit as it could get gold readily from Indian banks at half the import duty. Considering that India consumes almost 700 tonnes of jewellery annually, the trade will need this gold at low duty rates.

But such a strategy can succeed only if the gold trade is also involved. For instance, registered gold dealers and refiners could be given a small (0.5 per cent) incentive for bringing gold deposits to the bank. Refiners could be partners with the bank to certify the quality of gold biscuits and bars (as counterfeit gold sometimes comes in through import channels too).

This would reduce smuggling. Banks could draw out the gold stashed away in vaults and lockers to facilitate economic growth. The trade, the government, the banks and the customers would all benefit. It must be remembered that India's gold jewellery trade is larger than the country's entire FMCG trade on an annual basis, and employs around 35 lakh people. And the gold industry could even look at the export market if the gold supply and export gets liberalised.

It would reinforce the old principle – that any policy which makes all segments benefit is a better one than one which makes only the government earn.

AsiaConverge

http://www.dnaindia.com/analysis/column-policy-watch-thekey-to-turkey-s-success-2055430

POLICY WATCH The key to Turkey's success

Monday, 26 January 2015 - 6:30am IST | Mumbai | dna | R.N. Bhaskar

Supply of gold from recyled old gold (all figures in tonnes)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
India	79	82	79	83	112	132	107	94	80	73	90	115	81	59	113	101
China	22	26	24	22	27	29	35	42	45	42	70	116	133	131	142	145
Turkey	52	56	56	92	60	64	62	68	83	72	199	217	122	78	72	56
World	1108	620	620	749	874	991	881	902	1132	1005	1316	1735	1711	1659	1634	1242
INVESTMENT IN GOLD BARS AND COINS																
India	116	101	103	104	88	86	101	136	196	213	223	17	349	368	312	362
Turkey	33	38	25	-7	-28	22	6	12	5	15	28	36	115	134	127	159
Total Gold Consumption in 2013 India: 716 • Turkey: 302 • China: 978 • World: 3770																

Source : GFMS, WGC

Turkey is the fourth-largest consumer of gold (dwarfed only by India, China and the US). But it is the one country most gold players have been watching for the past few years. India should be studying it too. (http://www.dnaindia.com/money/report-policy-watch-here-swhat-fm-could-learn-from-turkey-about-gold-1962499)

In many ways, Turkey is similar to India. Gold plays an integral part of the social fabric. It is given as a gift at weddings, at the birth of a child, and even after the circumcision ceremony. Like Indians, Turkish people love gold and put some of their savings into purchasing the yellow metal.

But unlike India, Turkey has witnessed a drop in its bullion imports. But this was possible only on account of several measures the country undertook since 2007. It permitted banks to import gold.

Gold refineries were attached to banks, so that the gold that was deposited with banks could be assayed or refined, or both. By 2011, according to the World Gold Council (WGC) an innovative central bank policy incentivised commercial banks to create a range of gold-backed banking products to mobilise Turkey's stock of "under the pillow" gold that millions of people have collected in their homes and bank lockers over decades.

Policymakers have now successfully seen around 250 tonnes of gold ($10.4 billion) drawn into the financial system and put to work supporting Turkey's economy. And it allowed banks to designate 30 per cent of their required reserves in gold deposits.

Since Turkey practises Islamic banking, depositors of this gold do not get interest on the amount of gold deposited. They instead become participants in the profits earned on this gold. This gold is lent out to goldsmiths who, in turn, fabricate jewellery. They payback for the gold at a pre-negotiated price, or replace it with gold – volume for volume – plus a bit more as previously negotiated. This has allowed the trade to get gold from the banks which get it through imports but supplemented by gold coming from depositors, and through refiners. Some of the refineries are lbma and Comex certified, thus making the bars and coins they produce acceptable by other countries as well. In 2012 alone, gold fabrication, consumption and recycling added at least $3.8bn to Turkey's economy.

At the same time, it has encouraged people to invest in gold — not just in jewellery. People can purchase gold from banks, through the Internet, and also through gold ATM machines. Gold is made available in denominations ranging from just 1 gram (gm) to 500gm, though larger quantities can be purchased from either the banks or from gold refineries.

Gently, the trade has taught its people to give gifts of gold, instead of gold ornaments, thus making their investments more fungible, without sacrificing the traditional concept of owning gold ornaments as well. In fact, some major transactions are carried out in gold. For instance, a gold retail shop in Turkey's Kapalicarsi or the Grand Bazaar – which has been in existence since 1461 – was sold for 135 kg of gold.

Turkey, today, allows any citizen from any country to gift gold to a resident in Turkey through the Internet. You can purchase the gold through any Turkish bank website as an e-commerce transaction. The person in Turkey gets a text on his/her mobile, with a code, which when fed into a gold ATM, hands over the metal to the recipient of the gift. Significantly, it has also improved the fortunes of its 3.5 million gold artisan workforce, which has begun increasing its market share in the export of gold jewellery.

Like Turkey, India too has the "under the pillow" gold, estimated to be anywhere between 22,000 tonnes to 25,000 tonnes. This gold, if brought into productive use, could actually reduce India's import of gold. For instance, the government could channelise all gold import through designated Indian banks at an import duty rate of not more than 2.5 per cent.

Banks, in turn, could offer this gold to gold refiners and the trade at an additional 2 per cent duty. The cumulative 4 per cent levy on gold import would disincentivise smugglers who find sneaking in gold very profitable, thanks to the current 10 per cent import duty.

As any student of economics will tell you, smuggling not only increases an appetite for gold, it also corrodes the value of the domestic currency. More worrisome is that once smuggling channels are set up, they could also be used for smuggling drugs and worse still, arms by terrorists. Hence it is imperative for any government to ensure that gold import duties are never allowed to exceed 5 per cent.

Refiners and designated banks could also invite gold deposits against participatory profit sharing, as in Turkey, or a simple interest rate of 1 per cent. If India could also allow banks to designate some – say 10 per cent – of their reserves (SLR and CRR) in gold, it would let the demand for gold jewellery to be met through gold deposits, temple gold, and even gold from refineries. Only the incremental amount would have to be imported.

Currently, almost 100 tonnes of gold required by the Indian gold trade come through recycling annually (*see chart*). This, say gold traders, could easily swell 4-5 times. The biggest benefit would go to India and China who control over 50 per cent of global demand for gold. It would also allow the 35 lakh people engaged in the gold trade to gain easy access to gold. Coupled with the strict implementation of hallmarking, it could help clean up the gold trade in India – just as was done in Turkey.

http://www.dnaindia.com/analysis/column-policy-watch-banking-on-yellowmetal-2066895

POLICY WATCH Banking on yellow metal

Monday, 9 March 2015 - 5:00am IST | Mumbai | dna | R. N. Bhaskar

The gold policy announced by Arun Jaitley, Union finance minister, is both path-breaking and meaningful. First, take the maths. India imports around 800-1,000 tonnes of gold annually. Some of it gets re-exported (as jewellery). But if you take 800 tonnes, and multiply this with a figure of ₹25,000 per 10 grammes, you arrive at a whopping figure of ₹200,000 crore (*see chart alongside*).

Second, look at the industry structure. Much of this gold goes into making jewellery, some even gets exported. But some of it – around 300 tonnes each year – comes into India as gold bars, biscuits and coins. These are often referred to as investment gold. Then there is recycled gold which contributes almost 100 tonnes (15 per cent) to India's annual gold demand. Globally, it enjoys a higher share of over 30 per cent of the 176,000 tonnes of annual demand. (http://www.gold.org/download/file/3713/bcg_the_ups_and_downs_of_gold_recycling_mar_2015.pdf).

This could be scrap that jewellers are left with while converting this metal into jewellery. It could be gold from pawnbrokers, or it could be temple gold. For instance, just last year, the Tirumala Trust (which runs the famous Tirupati group of temples) deposited 1.8 tonnes of gold with the State Bank of India. This gold is eventually melted down, refined and recycled.

Globally, gold is also recovered from discarded electronic items, contributing to 10 per cent of annual consumption. Now any type of gold can be deposited with banks. If all goes well, the benefits could be staggering. This is because India's horde of gold in private hands is the largest in the world. The government estimates this to be 20,000 tonnes, though many in the trade put this number at 25,000 tonnes.

Will people be willing to deposit gold with Indian banks?

Yes, if the bold innovations announced by Turkey a few years ago are any indication. (http://www.dnaindia.com/money / report-policy-watchheres-what-fm-could-learn-from-turkey-about-gold-1962499).

In just four years, Turkey has managed to persuade people to part with a total of around 500 tonnes (25 per cent) of gold from an estimated 2,000 tonnes of gold in private hands, which Turkey calls under-the-pillow gold. India could easily mop up at least 10 per cent of its own under-the-pillow gold. (http://www.dnaindia.com/analysis/ column-policy-watchthe-key-to-turkey-s-success-2055430HYPERLINK; "http://www.dnaindia.com/analysis/ column-policy-watch-the-key-toturkey-s-success-2055430).").

That would allow the government to give to the Indian gold trade the 800-odd tonnes its needs each year from domestic sources for the next two years. It will mean forex savings of ₹200,000 crore each year. If one assumes a 5 per cent cost for purchasing this gold (interest plus insurance plus freight), India could be saving another

New Policy savings

All figures in ₹ Crore per annum	Savings	Expenses
Import costs*	2,00,000	
Interest on borrowing at 5%	10,000	
1% interest on gold deposits		2,000
1.5% bank commissions		3,000
Total	2,10,000	5,000
Minimum net savings for country	2,05,000	

Note: DNA estimates of ₹25,000 per 10 gm x 800 tonnes of annual import

Where will gold deposits come from?

Temple gold – guesstimated at around 10 tonnes each year;

India annual imports of investment gold (bars, biscuits & coins)over 350 tonnes;

We already recycle around 100 tonnes of gold each year

The rest would come from gold inventories with jewellers, and from other gold owners, who want to earn a 1% interest on gold deposits

Measures yet to be taken

1 Allow banks to import gold, not any other designated parties (including STC and MMTC), so that banks can make up the shortfall in gold deposits with imported gold and supply gold to the trade in India.

2 Banks should be allowed to import gold at 2% duty, and provide it to the trade at 2.5%. With the import duty for everyone else staying at 10% and the banks supplying gold at international price plus 2.5%, the trade will begin purchasing gold from banks, and not from the global markets. It will break the back of smuggling. This will also prevent erosion of the value of the Indian rupee.

3 Banks may charge 2.5% on gold deposited with them when selling gold to domestic traders. This way, the banks will be able to finance the 1% interest on gold deposits, pay 0.5% to gold refiners, and 1% to cover their own costs (margins on deposited gold resold must be higher than on imported gold). It will give banks an additional source of income, possible only if they mobilise gold deposits.

4 Make all gold deposits coming to banks go through refiners who are Comex/LBMA certified. This will upgrade Indian refineries, and make them world class. It will make Indian hallmarked gold acceptable the world over

5 This will allow the government to enforce rigorous hallmarking with severe penalties for fraud – because tampering with the Ashoka *chakra* coins tantamount to defacing national emblems etc.

₹10,000 crore annually.

Even after adjusting for the 1 per cent interest to be paid to gold depositors, 0.5 per cent to approved refiners, and accounting for the bank's own margins, the cost would be under ₹5,000 crore, less than ₹10,000 crore for importing the gold into India. However, such a scheme can work only if people have confidence in the gold the banks sell, and the honesty with which they assay the gold brought in as deposits.

(http://www.dnaindia.com/india/report-convert-india-s-gold-rushinto-a-vibrant-industry-1980330HYPERLINK; "http://www.dnaindia.com/india/report-convert-india-s-gold-rushinto-a-vibrant-industry-1980330).").

That is why it is imperative that, as in Turkey, banks play a critical role. Import of gold and gold deposits should be through banks only – not even MMTC or STC.

Second, banks must align themselves with LBMA/Comex certified gold refineries. These certifying agencies invariably audit business practices, and examine the manner in which gold inventories are kept, regularly. They ensure that the gold refined is never substandard; the penalties for not abiding by these globally respected norms can be harsh and swift.

Third, the government should also open a window for people to declare their concealed gold – against payment of prescribed penalties – failing which the consequences could be painful, as they would include imprisonment (outlined in the budget speech last fortnight).

Guaranteed quality, and easy access, will make the Ashoka symbol on the gold coins a rage with customers. First, because they will be available at a discount to the Krugerrand (South Africa) or the Swiss gold bars and biscuits (because domestic sourcing and availability will mean lower transportation and insurance costs). Second, because they are backed by LBMA/Comex certification. If standards are maintained, and rigorously enforced across the country through hallmarking, India will soon become a gold hub, far more vibrant than the gold souks of the Middle East. The gold jewellery trade already employs over 35 lakh people. This number could double, as the trade is encouraged to become vibrant and healthy.

Over a period of time, Indian consumers will also learn that converting gold into jewellery involves making charges. They will soon begin putting their surplus money – after meeting the requirements for tradition-bound events like marriage and childbirth – in gold coins and biscuits. That will gradually draw out more gold from Indian homes as deposits. And the ghost of smuggling could finally get exorcised.

Will that hurt Indian jewellers? Not really. Scrupulous hallmarking will catapult this industry into healthier exports and better premiums. After years of being merely an import market, India could become an export hub too. Instead of fattening the foreigner, the government is finally promoting the Indian. The budget proposals could make gold smuggling unattractive. And they could usher in fresh vision; allowing the markets to create more gold-related products to suit various investment needs. India could easily emerge as the ultimate global destination for gold as well as for gems and jewellery industry.

http://www.freepressjournal.in/gms-needs-polishing-for-brighter-glow/

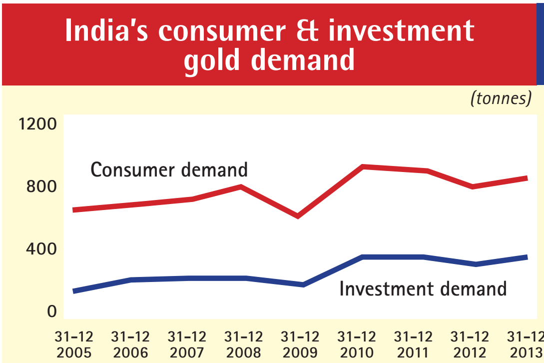
Policy Watch Gold Monetisation scheme needs polishing for brighter glow

By R.N. Bhaskar | Nov 19, 2015 12:00 am

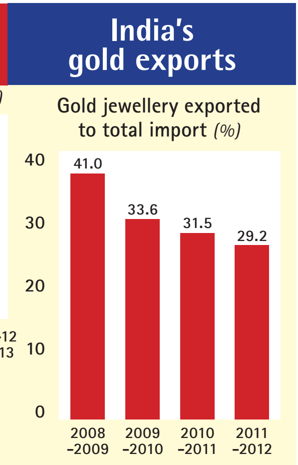
It is heartening to see the government pushing the GMS (Gold Monetisation Scheme). After decades, the government has finally become quite serious about mobilising the huge reserves of gold lying in the hands of its citizens. This is one scheme where almost everyone benefits – the government, the trade and the common man. The last category has three choices: (i) he can purchase gold coins and thus avoid the twin risks of paying for "making charges of 10-15 per cent, and of buying substandard gold; (ii) he can deposit the gold with banks and get back the gold after a limited period – volume for volume; or (iii) he can invest in Sovereign Gold Bonds – purchasing at least 1 gram of gold, subject to a maximum of 500 grams – getting a certificate for such a purpose which can then be dematerialised (like most shares and mutual funds).

Both the deposit and the bond are likely to be exempted from income tax and capital gains tax. If that happens they will be more attractive than gold ETFs (exchange traded funds), because they also offer an annual interest rate of around 2.75 per cent. The total figure for India is very large. Estimates by the World Gold Council (WGC) put this at around 22,000 tonnes – the largest in the world. But many in the trade believe that the figure could be closer to 25,000 tonnes. Much of this remains in private hands, largely unproductive. But as Turkey showed, such gold can also be made productive by introducing suitable gold deposit schemes.

The benefits are many. First, the government can use domestic gold to finance investments at lower costs and also reduce the foreign exchange outflow involved in the import of gold. Moreover, the locally sourced gold can then be recycled. These schemes could also



Source: GFMS, Thomson Reuters, NCDEX; Gold import figures sourced from DGCI&S and Gems and Jewellery Exports Promotion Council; The RBI's KUB Rao Report of the Working Group to study the issues related to gold imports and gold loans NBFCs in India, February 2013



help the government wean away customers from owning physical gold which lies idle in lockers.

Second, the trade gets an assured supply of gold domestically without incurring import duty costs. Third, these schemes could actually prod the entire jewellery industry into introducing good manufacturing practices. The gold trade in India, except for a few players – is notorious for short-changing its customers, by palming off to them poorer quality of gold than what is claimed. Unless hallmarking is made mandatory, with very stiff penalties for violation of gold standards, India will not become a global player in gold.

On the contrary, gold exports have continued to fall year after year (*see chart*).

But there is one flaw that the government needs to redress urgently. Its gold deposit scheme requires customers to give to the bank at least 30 grams of unalloyed gold. This makes the gold deposit scheme appeal more to temples and trusts and high-net-worth individuals.

It ignores common folk. Remember, more than 80 per cent of the gold is purchased as jewellery. Anecdotal evidence from gold loan companies suggests that most Indian consumers own less than

30 grams of gold. The fact is that a large percentage of people who borrow money against gold offer not more than 10 grams of this metal to gold loan companies. It is thus reasonable to assume that over 70 per cent of gold lies with small-income people.

This is further reinforced by data which shows that investment gold (in the form of coins, biscuits and bars) has seldom exceeded 21 per cent of total gold consumption in any year.

One way for the government to help the small borrower against pawning gold is by allowing other financial bodies – like regional banks, NBFCs and micro-finance institutions – to mobilise gold deposits of 1 gram or more. You could incentivise them to earn some commissions on such gold deposits, which they can then aggregate and later deposit with the larger banks who accept deposits of 30 grams or more.

This will help the small borrower in several ways. As such financial institutions have better access to small depositors and borrowers they could help wean people away from local pawn brokers. Most local pawn shops cheat small borrowers in two ways – first they charge usurious rates of interest; second, they allegedly 'steal' gold from the ornaments pledged after furtively smelting and re-making them. Using regional and other institutions as aggregators for small gold deposits could be enormously helpful.

There are three other areas which the government needs to address. First, there is the need to introduce the Bullion Corporation of India (BCI) recommended by the RBI in 2013. Second, there is an urgent need for enforcing hallmarking. Without it, India's gold trade will always be viewed with suspicion. Third, the entire gold trade needs to be incentivised into supporting all such schemes. There appears to be little for the trade.

But more on these issues later.

http://www.freepressjournal.in/bringing-more-transparency-in-gold-trade/805277

POLICY WATCH Bringing more transparency in gold trade

By RN Bhaskar | Mar 17, 2016

During the last two months, the gold trade has been agitated enough to go on strike and down shutters on at least two occasions. It has been protesting against the government's newly introduced policies relating to this trade.

The first strike was to protest against the rule that PAN card details must be given when purchasing gold or gold ornaments. PAN is the acronym for Permanent Account Number that each income earning person is required to have, irrespective of whether he or she is required to pay tax or not. The trade wanted the disclosure of PAN details to be made optional. This author has been against any such move (http://www.freepressjournal.in/gold-trade-when-cats-begin-chanting-hymns-rn-bhaskar/783251). Despite the agitation, the rule for disclosing PAN details remains in force.

The second time the trade downed shutters to protest against levy of a 1% excise duty on gold jewellery, for firms that have a turnover of over ₹12 crore for the first year and over ₹6 crore from the second year onwards. The trade is against this because of perceived grievances. Both agitations are unfair. But they do raise some issues that need to be looked into.

The government has hitherto exercised its right to levy taxes. But this right must be dovetailed with the obligation to also protect taxpayers. The right to tax must accompany the obligation to protect. The finance ministry often ignores this cardinal rule.

Take the PAN card issue first. Disclosing PAN card details is understandable. But what does a customer do when a small gold shop in a small village decides to allow his PAN card details to be fraudulently used for registering purchases by other customers who do not want to use their own PAN cards? How does the first customer even know that his PAN card details have been misused?

One way to prevent this is by the finance ministry following procedures that every bank and credit card company adopt – sending sms and email alerts to each customer – each time his or her PAN card details are used. At the same time, just as the tax authorities do with tax deducted as source (TDS), each tax payer must be allowed to access a web-page listing all the transactions registered against his PAN card.

If there is a mismatch, the customer can at least record his protest, and document any such misuse. Remedying this misuse is something the tax department will then have to put in place. The same measure must be adopted even for Aadhar cards.

This is because horror stories abound about how PAN and Aadhar cards are being misused by agents peddling credit cards and mobile phone connections. Such misuse and malpractice could even extend to gold purchases. Real time alerts, and web registers, can thus become the first steps the finance ministry needs to put in place before such documentation is demanded from shops and establishments. They will help minimize fears of fraudulent practices.

The gold trade is also sore about the levy of excise duty. But discussio0ns with knowledgeable sources suggest that many of the fears being aired are misplaced.

First, the finance ministry has already clarified that excise inspectors will not have to visit the shops of goldsmiths. Hence allegations of the government introducing an inspector raj are quite unfounded.

Another allegation is that the discretionary power inspectors have to assess the value of jewellery could lead to many disputes. The gold trade has listed out some 21 stages involved in deciding what the value of a piece of jewellery ought to be (see chart). But this fear can be easily addressed. All that is required is to adopt one of two means. One would be to stick to the valuation given by the jeweller in his invoices/receipts. The other would be to take the metal value of the piece of jewellery and add in a presumptive value added of say 15%. Either of these two norms will make the levy of excise duty that much simpler, and hassle-free.

At best, the trade could ask the government to allow them to pay excise duty in the same way as they pay service tax – once in three months, rather than on a daily or weekly basis. There is no reason to believe that the government will not accede to such a demand. But there is one more issue that the government needs to work on. It relates to hallmarking of jewellery which has now been made compulsory. Since each hallmarked jewellery item must have a unique code which indicates the quality (caratage) of gold/silver used and the jeweller's code (http://www.bis.org.in/cert/hallbiscert.htm), all that is now needed is to give a unique serial number of the item of jewellery thus hallmarked. This list of unique serial numbers – along with the image and details of the relevant jewellery – could be put up on the webpage.

Thus the data of the jewellery item is made available to both the customer and the excise inspector. The former can use it to protect himself. This becomes relevant if a customer suspects that a jeweller has removed some gold at the time of polishing the ornament, or when a mortgaged ornament is redeemed.

Unfortunately, for too long, the jewellery trade in India has thrived by adopting practices that are anti-consumer and even anti-nation. For the first time, the government has brought in measures like hall marking and registration of PAN details that could begin the process of cleaning up the trade.

The government now needs to go a step further. It needs to introduce measures that protect customers and tax payers from misuse of their PAN and Aadhar cards. It also needs to introduce measures that track items of jewellery.

Such measures could usher in more transparency and more professionalism in the gold trade that employs over 3.5 million people. over 70 per cent of gold lies with small-income people.

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But more on these issues later.

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