

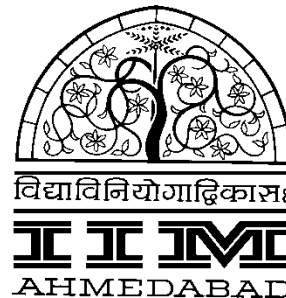
Gold Monetisation Scheme for India

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Monetising Gold: The Specifics

Despite introduction of variety of measures to reduce the CAD (higher import duties, 80:20 quota for imports, restrictions on gold related lending & coin sales) India still reported 3rd highest demand for gold in 2013 at 25.2% of world demand.

In Q2 of 2014 India reports the highest demand for gold in the world (26%) as China has reduced its demand.

Demand for gold in India is not restricted to the well to do as the poor too prefer gold as a form of saving for four reasons:

- Purchasing gold allows for small amounts to be accumulated at different intervals.
- Gold is not easily lost or destroyed. In fact, as jewellery it can be worn by women and passed on from a generation to the next.
- Gold is lightweight compared to its value.
- Gold is easily divisible into small units which can be liquidated in times of need.

Important parameters from point of view of **individuals** who may consider depositing gold:

- Purity verification in presence of the individual
- Purity verification by an international accredited laboratory or government backed one.
- Confidentiality, minimum paperwork, and nomination facility for gold on deposit.
- Flexibility on amount of gold deposited in a gold deposit account.
- Withdrawal of deposit in the form of gold or cash and interest also to be credited in the form of gold in the gold deposit account.

Integrity of valuation process is crucial for success of a gold monetization scheme.

Approved assayer who has credibility in ascertaining the quantity of fine gold tendered by an individual is of utmost importance .

Traditional jewellers do not have standardized testing tools and the accuracy of scales used leaves a wide margin of error.

Marketing to create awareness about product like gold deposit scheme essential – people prefer fixed deposits followed by gold coins/bullion and real estate. Gold is stored at home or in bank lockers.

Banks lacked the following capabilities that are crucial for mobilizing gold for productive purposes:

- Valuation – establishing the purity of gold in a transparent and efficient manner within a defined time frame.
- Storage & Distribution – a well developed logistics to prevent fraud and tampering and which enables inventory tracking.
- End-to-end customized ERP software.

Requirement at this juncture:

An organization with a **core competence** of world class refining and minting that can be leveraged to deliver on a gold monetisation scheme.

Ability to **assay metals** and associated **logistics** of moving metals in a secure manner across locations.

MMTC-PAMP India Pvt. Ltd.

This is a joint venture between MMTC Ltd. and PAMP SA, Switzerland, the world's largest independently owned precious metals refiner.

MMTC-PAMP India Pvt. Ltd. was incorporated in 2008 and has set up the **world's most advanced gold and silver refining minting plant** that became fully operational in end March 2012.

PAMP is one of only three 'Approved Good Delivery Referees' of both the London Bullion Market Association (LBMA) and London Platinum and Palladium Market (LLPM) that is responsible for the testing of samples, the provision of reference samples, and other functions in support of the Good Delivery system.

MMTC-PAMP has been accredited as an LBMA Good Delivery Gold Refiner just two years after the start of production – a record for any refinery in the London market history

In its joint venture PAMP ensures that the MMTC-PAMP laboratory in India functions in compliance with high standards by training chemists to work in accordance with the Swiss Precious Metals Control Law (LCMP) and with the directives issued by the Central Office for Precious Metals Control in Bern (BCMP).

Its state of the art assay laboratory is equipped with services such as the ICP, Spark Spectrometer, and precise wet lab and quality control instrumentation and is manned by experienced Chemistry Masters trained extensively at the PAMP assay laboratory in Switzerland.

Proposal:

MMTC has retail outlets in all the regions of India

Time for the Government of India that is a co-owner of this world class entity to throw its weight behind **MMTC-PAMP opening purity verification centres** in various locations around India that can assay the gold that is brought by individuals who wish to participate in a gold monetisation scheme

Purity Verification Centre –

Objective:

To provide customers with a world class facility for purity determination in a defined time frame.

Facility to book an appointment online or through mobile apps for assaying.

Gold brought by customer to be verified in her presence so as to provide confidence.

Should have an online software for posting the results of the assaying and to auto credit metal accounts.

Equipment:

- A hand-held X-ray fluorescence (XRF) analyser to conduct a preliminary quick shot verification to identify the karat of the gold. If the customer is satisfied with this initial verification then she can give the ok to proceed.
- Accurate weighing in Mettler-Toledo balances to be calibrated daily with check weights.
- Induction melting furnace(s) to ensure better homogeneity during melting so as to improve purity testing. This involves a process that can take up to 15 minutes and minimizes the formation of slag.

Equipment:

- Molten metal is then to be poured into specially designed moulds, then cleaned by pickling and its purity verified by a high performance XRF machine which has the accuracy of $\pm 0.1\%$ for homogenized metal.

Logistics:

- The centres should be connected with the refinery with a full-fledged logistics department that has integral insurance cover for metal movement throughout the country.

Identification and KYC norms –

- For many families gold is part of the family inheritance for generations.
- In many instances gold is purchased from unorganized goldsmiths who do not provide ownership documents or a purchase trail.

Current minimum cap on gold deposits at 500 gm excludes many middle income households

- Minimum cap on gold deposits can be reduced to 50 gm and/or gold deposited valued up to INR 1 million.

Only identity & address proof should be required for deposit of gold under 50 gm/INR 1 million.

Deposits exceeding 50 gm should include KYC requirements and include PAN declaration.

KYC to be implemented to improve confidence in the system and to introduce transparency.

Since metal account is to be an add-on to a savings account, KYC documentation will be simplified.

- Returns offered on gold deposit schemes hitherto have been unattractive.

SBI from Sept 2010 offers 0.75% p.a. for 3 years and 1% for 4 to 5 years with interest calculated in gold currency and payable in equivalent rupees.

Possible to pay 2 to 3 per cent annual grammage return to make scheme attractive.

Recommended return is feasible given that banks will be allowed to use these gold deposits to meet their domestic currency reserve requirements.

- Period of deposits that SBI offers of 3 to 5 years should also be changed to provide flexibility to customers.

Minimum deposit can be for a year with multiples of one year extensions to provide flexibility to depositor.

Period of deposits can be 1 to 7 years.

Premature payment with a penalty after a lock in period of 1 year could be continued.

Bank can also offer loan facility to depositor higher than 60% LTV ratio since collateral is gold of verified purity

- **After the assay** at the Purity Verification Centre the **depositor** is **immediately credited with a fine metal balance** in her bank metal account.

In the earlier system the depositor had to wait for 90 days to receive a certificate of gold content as the assay was done after the material reached the India Government Mint.

Under the current recommendation the individual can view her account online and verify the metal credit that has been uploaded after the purity has been ascertained.

All back end logistics (transport of gold, storage, and insurance) **should be managed by MMTC-PAMP rather than by banks** that do not have the expertise on this count.

Purity verification centre receives scrap metal that it transfers to the refinery which in turn refines the metal within a limited period of say seven days.

Refined metal can then be transferred and assigned to the bank loco MMTC-PAMP.

Metal is now available with the bank for lending and it can also begin to pay interest on the corresponding deposit made by the customer from this time onwards (< 7 days).

Accounting Flows

Physical Movement

**MMTC-PAMP
Depository**

**MMTC-PAMP
Depository**

Debit Bank's
metal a/c

Deliver
retail
metal

**Borrower/
Jeweller**

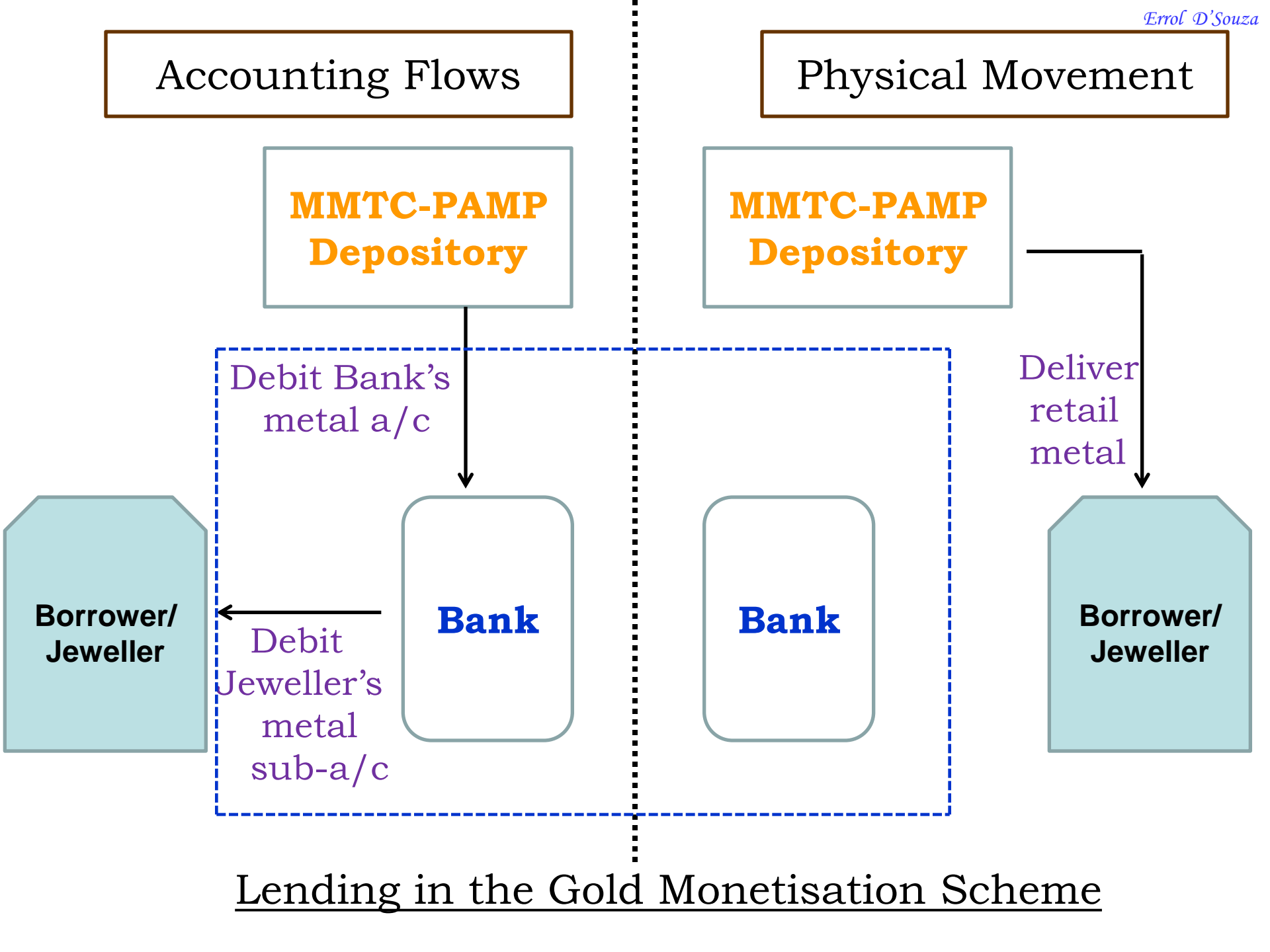
Debit
Jeweller's
metal
sub-a/c

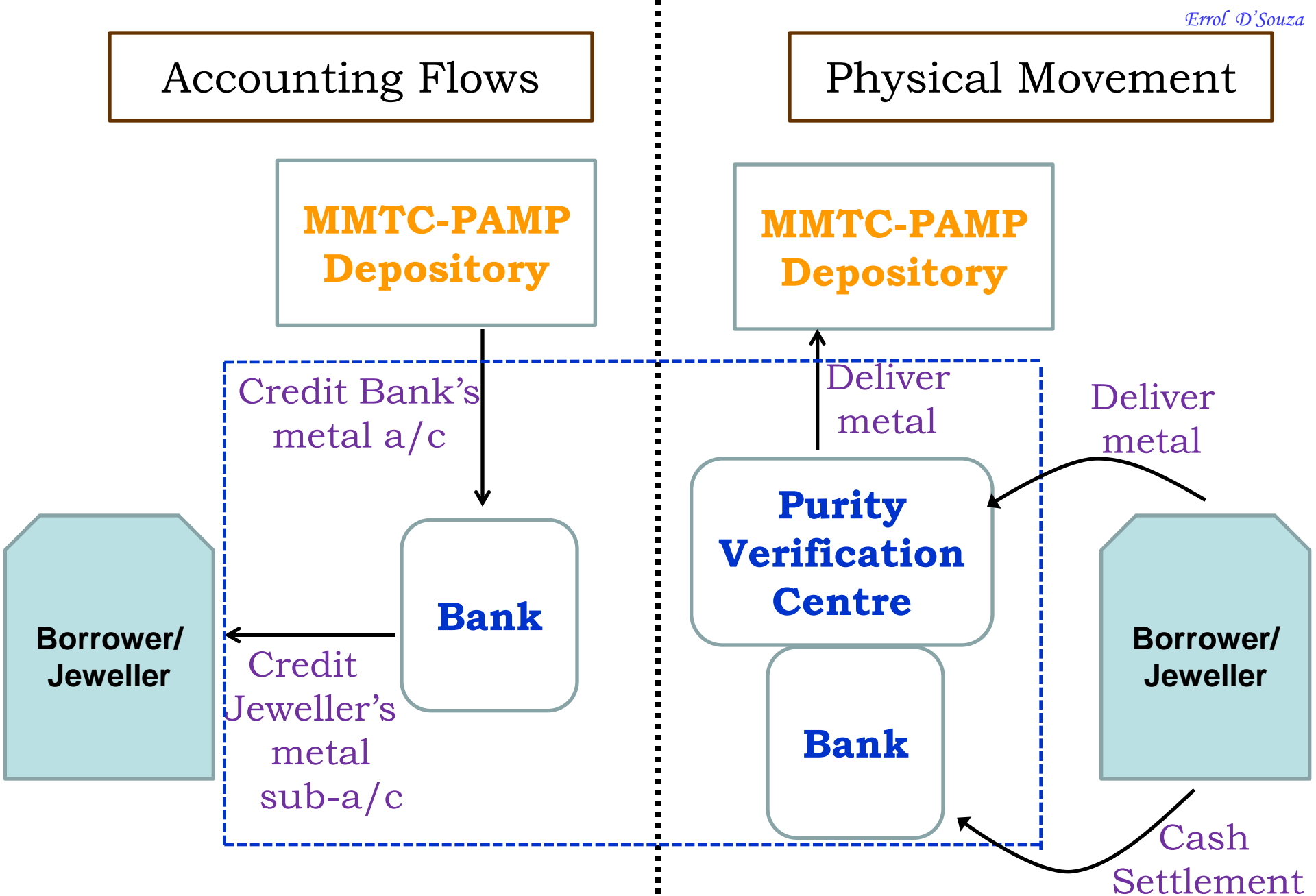
Bank

Bank

**Borrower/
Jeweller**

Lending in the Gold Monetisation Scheme





Redemption in the Gold Monetisation Scheme

Banks handle the **currency side of the transaction** and **MMTC-PAMP** provides the **entire infrastructure related to the precious metal part of the transaction** allows each side – banks and the refinery – to leverage their competencies whilst providing value to customers in a transparent and credible manner.

Achilles heel of the earlier Gold Deposit Scheme was related to the delivery of the physical gold.

Now MMTC-PAMP maintains dedicated Brink's vaults and storage at various locations. This creates an all-India loco stock that would facilitate lending by banks to jewellers.

Physical gold is now transported across locations which requires some minor **taxation issues to be addressed** —

- Since banks will purchase gold to settle gold loans and **metal stocks will be generated at various locations** it would require that **depository vaulting services be exempted from service tax.**

As a corollary, redemption of gold deposits will involve the movement of the precious metal. The delivery charges for all metal movement should also be exempt from service tax.

- Purchase of gold by the banks will depend on its availability which could be either inter-state or within the state.

For inter-state purchases Central Sales Tax (CST) is liable to be levied on the transaction and in turn banks will then charge VAT to the jeweller. **To facilitate movement of the gold across locations it would be important to exempt CST** for the purposes of the monetisation scheme.

- At the time of making a deposit the **depositor** will usually **not** be **in a position to provide evidence that customs duty has been paid on the gold** she is depositing. (A jeweller providing gold scrap for refining gives a declaration that customs duty has been paid failing which there is an excise charge that is incurred.)

For households who have gold handed down for generations or who have purchased it from small jewellers there will be no paper trail available as to the customs payments on the import of the gold.

Hence, gold deposited under a monetisation scheme should be **exempt from the payment of excise** (currently 1 per cent).

Banks had shown little interest in gold monetisation schemes as they were not part of their core activities and they lacked facilities to melt the jewellery and test it for its purity.

All-India accredited assayer overseeing this part of the scheme reduces the cost to customers and the banks. Also, transactions will be in demat form.

For banks to be incentivized further it is recommended that they be given the option of using some of the gold deposited into their accounts to fulfil their domestic currency reserve requirements.

Table 3: Suggested Reserve Option Coefficients across various tranches of the Reserve Option Ratio for Gold in India

Reserve Option Ratio Tranches	Gold Reserve Option Coefficient
0 to 20 per cent	1.0
20 per cent to 25 per cent	1.3
25 per cent to 30 per cent	1.5

Safekeeping contract could be signed between RBI and MMTC-PAMP allowing for maintenance of required reserves in a designated gold vault at MMTC-PAMP.

Then, since customer's gold is already at MMTC-PAMP all it involves is a demat transaction.

20,000 tons of gold lying unproductive in the country and yet banks are marginally involved in the monetisation of gold.

Currently gold imports tied to level of exports – the 80:20 rule.

To incentivize banks further they could be issued an increased entitlement to import gold the better their performance in the proposed gold monetisation scheme.

Data to implement this can be provided by MMTC-PAMP on a quarterly basis showing bank-wise receipt of deposit metal.

Within first month of scheme in place it is possible to collect 15 tons of gold with 10 assaying centres.

By end of first year this can be scaled up to 40 tons of gold per month.

Possible by end of first year to collect 100 to 150 tons of gold from the scheme.

This amounts to 12.1 per cent to 18.2 per cent of the gold imported into the country in the last year.

It also equals 0.5 per cent to 0.75 per cent of the estimated 20,000 tons of gold lying unproductive in the country.

Cost of funds for the scheme of 4.9 per cent to 6.95 per cent compares favourably with the 8 per cent to 10 per cent cost of dollar borrowing from external sources – next slide.

Cost of Funds for Gold Monetisation Policy

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Cost of Assaying		
a) Purity Verification Centre	0.1% - 0.2%	
b) Refining Cost	0.5% - 0.75%	
c) Logistics Cost	0.5% - 0.75%	
d) Refiner Administrative Costs	0.5% - 0.75%	
SUB-TOTAL		1.6% - 2.45%
Cost of Banks		
a) Gold price hedging costs	Nil	
b) Operational expenses	0.3% - 0.5%	
c) Interest paid to depositor	2.0% - 3.0%	
d) Risk premiums	1.0% - 1.5%	
SUB-TOTAL		3.3% - 4.5%
TOTAL COST		4.9% - 6.95%