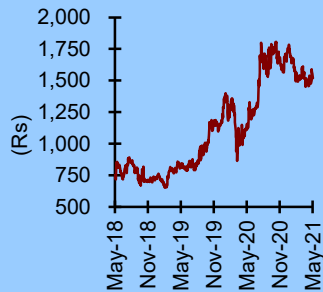


Sector update

MCX



Indian exchanges

Gold exchange initiative gains momentum

SEBI has released a consultation paper ([Link](#)) on proposed framework for a gold exchange in India and draft SEBI (Vault Managers) Regulations. In the consultation paper, SEBI has sought opinion on the modalities of operations of the exchange, registration of the vault managers (VMs) as SEBI intermediaries, and issuing regulations for the VMs. This follows up the government decision to notify SEBI as the regulator of the entire ecosystem of the proposed gold exchange including vaulting, assaying and gold quality, and delivery standards. In a similar way, the government recently notified that International Financial Services Centre (IFSC) in GIFT City, Gujarat, will be able to regulate: 1) bullion spot delivery contract, and 2) bullion depository receipt with underlying bullion financial products and services. ([Link](#))

Key points to look forward is the role that the current exchanges will play in any new gold exchange in terms of possibility of joint or exclusive operations. It will also usher an important role for depositories, VMs, and clearing corporations. Liquidity management for the new exchange will be an important aspect and the consultation paper attempts to address concerns on logistics, taxation, fungibility and storage along with clear demarcation of roles of each stakeholder.

- ▶ **Government thrust on setting up a gold exchange has several structural targets including:** 1) to create a vibrant gold ecosystem in India commensurate with India's large share in global gold consumption. The proposed gold exchange would lead to efficient and transparent domestic spot price discovery, assurance in the quality of gold, and promotion of India gold delivery standards. 2) Increase active retail participation, greater integration with financial markets, and augment greater gold recycling in the country. 3) Enable India to become a price setter of gold globally in line with the huge domestic demand.
- ▶ **Two working groups were made by SEBI in this regard, who submitted reports on the nature and flow of the traded instrument on 27th Apr'21.** The terms of reference for the first working group involved understanding the transaction flow from physical gold to electronic receipt and back to physical gold, role of each entity in the transaction flow, storage and handling capacity of existing vaults, clearing and settlement, risk management, taxation, etc. Terms of reference for the second working group involved understanding the various sources from where the gold is channelised for trading in the physical market, determining financial requirements for setting up vault managers (VMs), understanding the safety and security features followed by the VMs, and understanding the mechanism of verification.
- ▶ **Nomenclature of the instrument:** It is considered that the instrument may be termed '**Electronic Gold Receipt**' (EGR).
- ▶ **Proposed flow of transactions in the gold exchange:** After extensive consultations, discussions with various stakeholders and considering the recommendations made by the two working groups, the entire transaction in the proposed gold exchange has been divided into three tranches as detailed in the inside pages.

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First tranche: Conversion from physical gold to Electronic Gold Receipt (EGR)

A common interface will be developed between the Vault Managers (VMs), depositories, stock exchanges and clearing corporations. The source of supply of the physical gold, to be converted into EGRs, shall be the fresh deposit of gold, coming into the vaults, either through imports or through domestic refineries accredited by stock exchange/s. The existing deposit of gold lying in the vaults, which meets the aforesaid source criteria and has never been out of the vaulting infrastructure, may be transferred to the instant vault for conversion into EGR. *The depositor (or owner of the gold) intending to convert his/her physical gold into EGR and trade on the stock exchange/s, shall ensure delivery of such gold to the VM.* The VM shall then record relevant information, in the common interface and shall create the EGR. *The VM shall ensure that no EGR is created without the presence of physical gold in the vaults.* Based on the information of EGR/s, *the Depository shall assign appropriate ISIN to EGR to make it tradeable on the stock exchange/s.* The standard operating guidelines with well-defined timelines shall be put in place for creation of EGR and flow of information from VM to depository / stock exchange / clearing corporations. *The EGR shall reflect either in the existing demat account or new account of the depositor maintained with the depository participant.* The VM and the depository shall regularly reconcile the data. Additionally, *the depository shall inspect the physical gold in the vault/s at frequent intervals.*

Second tranche: Trading of EGR/s on stock exchange/s

The stock exchanges, on receipt of information pertaining to the EGR/s from the depository on a daily basis, shall list the EGR and allow trading. The clearing corporation shall settle the trades executed on the stock exchange/s, by way of transferring EGR/s and cash to the buyer and seller of EGR/s respectively. The clearing corporation shall inform the depository and the stock exchange, regarding the change in beneficial owner of the EGR at the end of the trading day

Third tranche: Conversion from EGR to physical gold

Beneficial owner intending to obtain physical gold against the EGR/s shall be required to surrender the EGR/s. The VM after delivering the gold to the beneficial owner shall extinguish such EGR/s and request the depository to cancel the entry of said extinguished EGR from the DP account of the beneficial owner. The depository shall simultaneously send the information about the extinguished EGR to the stock exchange and clearing corporation to carry out necessary revisions in the records. *The information with respect to the list of valid EGRs shall at all points in time remain reconciled in the records of VMs, depositories, stock exchanges and clearing corporations.* If there are any disputes related to the quality of physical gold, during the withdrawal of physical gold, the same would be dealt with by obtaining quality report from an independent assayer.

SEBI has asked for opinion on whether it will be a single exchange or multiple exchanges

The existing stock exchanges may be allowed to deal in EGRs either through a separate segment or as a new asset class in an existing segment. However, setting up a new stock exchange exclusively for EGR has advantages such as single Gold Delivery Standard, reduced market fragmentation, improved liquidity, single reference price, etc. However, it will be time consuming and will: 1) require fresh investments in setting up new stock exchanges and clearing corporations, 2) require fresh registration of members of stock exchanges, 4) increase compliance cost and may not be viable being based on a single product, i.e., gold available for trading.

Product denomination for trading and conversion of EGR into physical gold: SEBI has sought views on the trading and conversion denominations.

To begin with, the EGR of 1-kg, 100-grams and 50-grams denomination may be available with the stock exchange/s with same denomination for trading of EGR and conversion of EGR into physical gold. In order to attract more players to this market, EGR with smaller denominations such as 10-grams and 5-grams may also be allowed, for trading purposes. Considering delivery and logistics aspects, conversion of such smaller denomination of EGR/s into physical gold, may be permitted only when the beneficial owner has accumulated, say, at least 50 grams (or multiples thereof) of physical gold in the form of EGR/s. Since EGR is created on the backing of physical gold, the question may come that how such EGR of 10 grams (or 5 grams) of gold be created in first place when delivery of 10 grams of physical gold is not to be permitted. To resolve this, they may consider that, at the time of deposit of physical gold, the depositor shall indicate the denomination of EGR to be created (which shall not be changed subsequently).

Trading and validity period of EGRs

Since EGRs will be notified as 'securities', all features of trading as applicable to other securities would be made applicable to EGR as well. Also, considering the EGRs as equivalent to any 'securities' traded on the stock exchange/s, a perpetual life period of EGR is being considered. Such perpetual life period of EGR may also promote the instrument for investment purpose. *However, the storage charges levied by the VM for the physical gold, lying in the vaults against such EGR/s, shall have to be borne by the EGR holder.* The VMs are traditionally known for safe storage and transfer of physical gold and not as much for storage of physical gold for longer (or perpetual) duration. *Hence, the storage charges levied by the VMs may be higher as compared to the bank locker charges where, alternatively, the EGR holder can safely keep the physical gold. However, the gold stored in bank lockers shall not be available for trading on the stock exchange/s.* SEBI has sought opinion on: (1) whether all trading features generally ascribed to 'securities' traded on the stock exchange/s be also applied to EGRs? (2) Considering the storage charges of the physical gold, whether there should be perpetual validity for EGR?

Fungibility of EGR and inter-operability between Vault Managers (VMs)

It is being considered that EGR may be made 'fungible' and 'inter-operability between Vault Managers' may be allowed. Fungibility means that the EGR, so created by the VM/s, shall not be linked with the unique bar reference number of the physical gold, i.e., gold deposited against EGR1 can be delivered against surrender of EGR2 (for the same contract specifications). 'Inter-operability between Vault Managers' means that physical gold deposited at one location and with one VM, can be withdrawn from a different location of same or different VM (depending on the availability of physical gold).

Delivery centres

In commodity derivatives market, there is a practice of having a base delivery centre and additional delivery centre/s. Such delivery centres are known in advance to the market participants and disclosed in the contract specifications by the stock exchange/s. Additionally, there is also a mechanism of charging premium / discount based on the location of physical delivery. It is being considered that similar model of base delivery centre and additional delivery centre/s may be adopted for the delivery location of physical gold in the proposed framework.

Storage (vaulting) and delivery charges – Levy and collection

The storage or vaulting charges, as levied by the VMs, shall be paid by the beneficial owner of the EGR as at the end of the trading day, whereas the delivery charges shall be borne by the beneficial owner of EGR opting for withdrawal of the physical gold. It may not be possible for VMs to collect storage charges and delivery charges from each EGR holder, or beneficial owner opting for withdrawal of physical gold respectively. It is being considered that the storage and delivery charges shall be collected by the depository participant from the beneficial owner of EGR/s to be deposited with the depository for onward payment to the VMs. The request of the beneficial owner of EGR/s, intending to withdraw the physical gold, shall be sent to the VM only upon payment of storage/delivery charges by such beneficial owner to the depository.

Regulating gold logistics and assaying

Currently, in commodity derivatives market, LBMA approved refiner's gold or BIS 'Refined Gold and Silver Bars for Good Delivery' standards are being accepted for physical delivery of gold. It is understood that assaying is mostly not resorted to in case of imported gold or LBMA-approved refiner's gold. However, after BSE, NSE and MCX have (recently) allowed BIS standard gold also to be delivered on the commodity derivatives platform, there may be need for assaying of gold by the buyer. *Therefore, considering that assaying may not be a regular activity in case of physical delivery of gold, it is not being considered to register 'assaying agencies' as SEBI intermediaries. Such 'assaying agencies' may be empanelled by the VMs or any other suitable entity*

in the proposed framework. Presently, in the commodity derivatives market, the physical movement of gold is the responsibility of the owner of the gold for which he/she avails the services of vault service provider (for safe and secure transportation). As far as the choice of vault service provider or the choice of vehicle used for such transportation is concerned, SEBI or the clearing corporations do not have any role to play in the same. It is being considered that the same may be followed in the gold exchange also with SEBI not having jurisdiction over logistic services.

Taxation and incentives to create liquidity in trading of EGRs

Securities Transaction Tax (STT) will be applicable to trading of EGR on stock exchange platform as it is applicable to trading of any other 'securities'. Additionally, Goods & Services Tax (GST) may also be applicable during the conversion of EGR to physical gold, i.e. at the time of withdrawal of physical gold from the vaults. Further, due to the buyer and seller possibly being from different states, there may be issues with regard to levy of SGST. In view of this, it is being considered that IGST alone shall be made applicable at the time of withdrawal of gold from the vault/s.

SEBI Regulation for Vault Managers, 2021

As stated in the foregoing, SEBI will regulate the VMs as part of the gold ecosystem. It is proposed to regulate the gold-exchange-related business of the VMs thereby not hindering their non-gold-exchange business.

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