

Role of Banks in Gold Imports and Retailing Gold Coins

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Abstract

Approximately 56 per cent of the gold imported into the country is canalised by the nominated banks. The role of banks in gold is multi-fold. Banks provide loans against the collateral of gold jewellery; they canalise gold for the purpose of providing gold to the gold jewellery industry and also sell retail gold in coins through their branch network. However, banks are not authorised to finance purchase of gold. In this context, there are concerns that whether the import deals of banks in gold and sale of gold by banks through imports to individuals is feeding into the appetite for gold.

The research paper conducts an analytical study into the gold imports by banks and proliferation of gold schemes and measures taken for regulating bank and NBFCs finance for the purchase of gold and loan against surety of gold. The study explores the sale of gold coins by banks to individuals, buy back of gold coins from individuals by banks, Gold jewellery loans by commercial banks, permission for banks to use the future markets to hedge bulk gold purchases. The study reveals the impact of MGL* and rationale of application of Base- rate** on MGL.

Research Methodology: The research paper is based on analytical approach, wrote in APA style and secondary sources of data are used.

Keywords: Gold Imports, Retailing Gold Coins, Banks and Bullion Market Reserve Bank of India (RBI), Certified Gold Products, Financial Inclusion, Gold Monetization Scheme, Investment in Gold

Introduction

Gold is canalised into the country by authorised agencies like the Minerals and Metals Trading Corporation, State Trading Corporation and nominated commercial banks. Banks have been playing significant role in importing gold into the country and retailing gold coins through their branches. Approximately 56 per cent of the gold imported into the country was canalised by the nominated banks. The role of banks in gold is multi-fold. Banks provide loans against the collateral of gold jewellery; they canalise gold for the purpose of providing gold to the gold jewellery industry and also sell retail gold in coins through their branch network. However, banks are not authorised to finance purchase of gold. In this context, there are concerns that whether the import deals of banks in gold and sale of gold by banks through imports to individuals is feeding into the appetite for gold. Therefore, whether the large scale participation of banking sector in the gold imports and related activities is fuelling the demand for gold is a question needs to be reviewed.

2. Importance of Gold in an economy

Despite the sharp recent price rise, in India, demand for gold has sustained, not only as a component of safe savings but also due to its social and cultural importance. (Mishra R and Mohan G 2012). The role of a liberalized and developed gold market in the interest of consumers is being increasingly realized and efforts are underway for integrating the gold market with financial markets (Reddy, 1997, 2002, Thorat, 1997, Bhattacharya, 2002)³.

3. Objective of the study

The study examines role of banks and NBFCs in import of gold and retailing of gold coins in India. It discovers the schemes under which gold is imported in india. The study reveals effect of base rate interest on MGL (Metal Gold Loan).

4. Research Methodology

The paper uses a descriptive & analytical study approach to examine the import of gold by banks and retailing of gold and also goes on finding out the suggestions and measures to balanced investments in gold metal.

The study is based on Secondary data obtained from various reports available at RBI websites till period of 2005-12. Few scholarly research papers too are used as guiding instruments, mentioned in bibliography.

5. Gold Import Schemes

In terms of FED's Master Circular dated July 1, 2011 on import of Gold by Nominated Banks/Agencies; Gold can be imported in the following ways:

A. Import of Gold on loan basis

- i. By nominated agencies / authorised banks for on lending to exporters of jewellery
- ii. By EOUs and units in SEZ in the gem and jewellery sector for manufacturing and export of jewellery
- iii. The maximum tenor of gold loan would be as per current Foreign Trade Policy (2009-14), which is 270 days at present.

B. Direct Import of Gold

AD Category-I bank can open Letters of Credit and allow remittances on behalf of EOUs, units in SEZs in the gem and jewellery sector and the nominated agencies / banks for direct import of gold.

C. Import of Gold on Consignment basis

Gold may be imported by the nominated banks/agencies on consignment basis wherein the ownership of the goods will rest with the supplier and the importer (consignee) will be acting as an agent of the supplier (consignor). Remittances towards the cost of import shall be made as and when sales take place as per the provisions of agreement entered into between the overseas supplier (consignor) and nominated agency/bank (consignee).

6. Bank finance for the purchase of gold

Banks are advised to ensure that *no* advances should be granted against gold bullion to dealers and traders in gold if in their assessment such advances are likely to be utilised for purposes of financing gold purchases at the auctions and or speculative holding of stocks of bullion. There were no restrictions on extending working capital finance and packing credit to exporters of gold jewellery. Although there is no explicit prohibition on bank finance for the purchase of gold jewellery/coins, banks are generally not financing acquisition of gold, except, a few banks. ("The Optimum Price of Gold," The Wall Street Journal, January 7, 1998, p. A22.)¹

As regards loans against pledge of specially minted gold coins, through clarification dated April 5, 2011, banks were advised that specially minted gold coins sold by banks/other banks cannot be treated as

'bullion' or 'primary gold' and hence there is no objection to banks granting loans against such coins. (Aggarwal, R. and Soenen, L. A. (1988)²

7. Sale of gold coins by banks to individuals

A related concern is whether there is a case for banks to sell retail gold in the form of coins and medallions from the branch network? Whether, we should stop such retailing selling of gold? Since there is a demand for gold coins and medallions of different denominations by the members of public as a channel for investment and hedge against inflation, banks import gold coins. Since there has not been any macroeconomic concern, so far, we have allowed banks to import gold coins also along with gold bars. It would be important to note that unless the Foreign Trade Policy decides to levy higher duties and otherwise take steps to discourage gold consumption, especially among domestic users, the number of agencies for importing gold may not make much difference (Gold Demand Trends (2011)⁶.

8. Buy-back of gold coins by banks from individuals

Under the current situation of high current account deficit, status quo of giving only a sale quote for gold coins by the nominated banks may be considered. Subsequently, when the CAD declines to a sustainable level and as considered appropriate from time to time, Reserve Bank may permit banks to offer two-way quotes. Such of those banks that may opt for both buying and selling gold coins will have to manage the sum of consequential risks, which may not be different from other trading risks. IBA is also in favour of this measure. (Fei F. and Adibe K, (2010)⁴

9. Gold jewellery loans by commercial banks

Banks, in general, extended gold loans as part of the agricultural and priority sector loans till recent past. The major reason being that the security of maintaining the gold ornaments, ensuring the good quality of ornaments by appointing assayers/ valuers at all branches is found difficult. But the bankers candidly submitted that there is great scope for financial inclusion in extending gold loans and admitted that they lost a significant business opportunity to the NBFCs.

According to bankers, despite the gold price is on the increase, they take a bit conservative approach towards valuing gold ornaments pledged. At best, they follow a loan to value (LTV) ratio of 70 to 75 per cent, sometimes up to 80 per cent. There is no standard model followed in valuing the gold by bankers.

10. Permission for banks to use the futures markets to hedge bulk gold purchases

IBA feels that banks should be permitted to “cover” Bullion Sales through Futures Exchanges on a “matched” basis overnight and this should be permitted to be done on a “Delivery Basis.” (Ghosh, D., Levin, E. J. and Macmillan, P. (2002)⁵. This would imply that Banks will cover positions – either using Overseas Sources OR Local Sources – thus saving Foreign Exchange.

11. Metal Gold Loans

MGL is a loan segment of the Indian banking sector through which banks get exposed to gold apart from lending against gold. A unique feature of MGL is that it is a commodity loan extended in terms of metal, *i.e.*, gold, unlike other loans and advances of the banking sector. Presently, the Reserve Bank of India has nominated fourteen commercial banks to engage in the MGL business. There have been some representations to the Reserve Bank that MGL should be excluded from the purview of the base rate guidelines, as it is a commodity loan and as such it is different from regular rupee loan.

The MGL is a commodity loan extended by the banking sector in terms of gold to the domestic jewellers. It is a short-term loan with maximum maturity up to 180 days for domestic jewellery manufacturers and 270 days for exporters. There are two types of MGL prevalent in the Indian market, viz., overdraft facility and fixed rate MGL. Under overdraft facility, borrowers can repay the MGL at any time within the maximum period permitted by the Reserve Bank. Under the fixed rate MGL, the rate of interest and tenure of MGL is fixed. The rate of interest on MGL is calculated in terms of metal but the repayment is made in rupee terms. Under the overdraft facility, interest is charged only for the actual loan period, while under the fixed rate MGL, interest is charged for the full sanctioned loan period. The repayment of interest is in monthly instalments but usually the principal is repaid as a one-time payment at the then prevailing price of gold.

Present rate of interest on MGL

Presently, MGL interest rates are linked to the international gold lease rate. The international gold lease rate is determined on the basis of the Gold Offered Forward Rate (GOFO), which is set by the Market Making Members (contributors) of the London Bullion Market Association. GOFO is the rate at which contributors are prepared to lend gold on a swap against US dollars. The international gold interest rate, i.e., the interest rate charged by overseas suppliers of gold to Indian banks is presently in the range 1.75 per cent to 2.75 per cent.

GL and Base Rate: Crux of the Issue

The base rate system was introduced for the Indian banking sector with effect from July 1, 2010, which replaced the erstwhile BPLR system. This was aimed at enhancing the transparency of lending rates on the one hand and improving the monetary policy transmission to lending rates on the other. In this context, the guidelines on base rate prevented lending below base rate by banks. The only exceptions were DRI advances, loans to banks' own employees and loans to banks' depositors against their own deposits.

12. Conclusion:

Banking sector, as a formal channel, has been playing an important role in the gold imports and gold supply catering to the huge demand for gold. Their discontinuation from this role may not materially alter the demand for gold. This may possibly give rise to the participation of unauthorised channels entering the gold supply chain as the demand for gold will not come down. Besides, involving the banks in the supply chain management has the advantage of tracking the gold supply sources and the users of the gold.

There is a need to obviate risks associated in gold dealings of banks through permission for banks to use the futures markets to hedge bulk purchases. In this context, the IBA's request to permit banks to buy "synthetic gold" on the Futures Exchanges may be considered. As requested by the IBA banks should be permitted to "cover" Bullion Sales through Futures Exchanges on a "matched" basis overnight and this should be permitted to be done on a "Delivery Basis."

The general policy objective adopted by both the Government of India is to discourage households and firms to invest their money in gold so that these funds can be channelized into productive economic activities. This is an urgent need of the hour, as economic growth has slowed down substantially owing to a number of reasons. While the Government of India has already taken measures such as hike in import duty on gold to discourage gold imports, there is also a need to discourage the other gold import channel through banks, viz., metal gold loans, though it forms only a small portion of the total gold entering the country. This is because more than the volume of gold business affected, at a conceptual level, the policy on MGL cannot be in the opposite direction in comparison to the policy on gold import through other channels.

13. Suggestions:

- I. Banks may continue their role as nominated agencies in gold imports.
- II. Purchase of gold coins by banks from individuals.
- III. Bank finance to purchase gold may be prohibited.
- IV. Banks may expand their gold jewellery loan portfolio.
- V. Permission for banks to use the futures markets to hedge bulk purchases.

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