Electronic Gold Receipt (EGR) – Financializing Gold

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Electronic Gold Receipt (EGR) was introduced as a financial instrument under the regulatory framework of Securities and Exchanges Board of India (SEBI) in India to facilitate the buying, selling and investment into gold in electronic form, aiming to bring transparency, wider patronage and convenience to gold transactions. This, it is felt is important for a country like India which has always seen a trust aspect associated with this asset class. Also, India having a large rural economy base, sees a lot of money from that populace directed towards gold from domestic savings. EGR has the potential to funnel the country's gold demand into organised financial units, thereby enabling financialization and monetisation of gold.

Regulatory Framework supporting EGR

Government of India vide Gazette notification S.O. 5401 (E) dated December 24, 2021, has notified "electronic gold receipts" as 'securities 'under Section 2(h)(iia) of the Securities Contracts (Regulation) Act 1956, and vide Gazette notification dated December 31, 2021, SEBI (Vault Managers) Regulations, 2021, have been notified. The stock exchanges were permitted to either set up a new stock exchange for trading of EGR or can launch EGR in the existing exchange infrastructure but in a separate segment. SEBI has established a detailed regulated framework for entire EGR ecosystem. The stock exchange, along with intermediaries like the vault manager and the clearing corporation, would facilitate the creation of EGR, its trading and redemption.

Vault Manager is a new entity registered by SEBI for providing vaulting services for gold deposited for the purpose of creation of EGR. The services provided by the Vault Managers are threefold

- Storage and withdrawal of gold underlying EGR
- Creation and Extinguishment of EGR
- Safety and security of the underlying Gold

This infrastructure is robust and at par with any global environment that were created to support investment and trade in any asset class.

Expectations from EGR

Electronic Gold Receipt (EGR), is a move that will help in efficient and transparent price discovery of the metal. EGRs will cater to all market participants, as buyers and sellers on the exchange will include individual investors and commercial participants along the value chain like importers, refiners, bullion traders, jewellery manufacturers, retailers, mutual funds/ exchange traded funds.

The EGR platform will lead to greater assurance in the quality of gold supplied, efficient locking-in of prices based on exchange order book liquidity as well as ease of transactions. This can create a vibrant gold ecosystem in India by enabling the actual fungibility of gold. The country has remained a price- taker in the global markets, and at present, does not play any significant role in influencing the price- setting for the commodity. EGR infuses transparency in gold spot transactions, enabling India to emerge as the global price setter by channelising India's gold demand into efficient spot markets and financial instruments based on such tokenised and efficient units of EGR.

Functioning of EGR

EGR is an electronic receipt issued by the Vault Manager against the gold deposited with them.

Each of the EGRs is backed by the physical gold which is stored with the Vault Managers. It represents ownership of the underlying physical gold, which is securely stored in designated vaults.

Two routes through which gold can enter into EGR ecosystem for conversion into EGR are as mentioned below.

- First, the gold entering the country through Import and stored with the registered Vault Manager.
- Secondly, the gold refined by domestic refineries, which are registered with BIS and accredited with stock exchanges.

The gold coming into the system through the above mentioned two routes can remain traceable and be unitised and tokenised for the mass holding under Mutual Funds as well as by individuals in dematerialised form.

The purity and denomination of gold, which can be converted into EGR, will be decided, and specified by the stock exchanges in the contract specifications of EGR.

Currently, gold confirming to Good Delivery Standard notified by London Bullion Market Association (LBMA) and also gold refined by Bureau of Indian Standard (BIS) licensed Exchange empanelled refiners is allowed for delivery on Exchanges and hence would be common for conversion of gold into EGR.

The trading unit can be smaller than the deposit unit of EGR. The details of trading unit and deposit unit will be available in the contract specifications of EGR.

The daily margin comprising of the sum of Value at Risk margin (VaR), Extreme Loss Margin (ELM), Mark to Market losses (MTM) or any other margin as prescribed by the Clearing Corporation/ SEBI is to be collected by Trading Member (TM)/Clearing Member (CM) from their clients.

The settlement of EGR will be done on T+1 rolling basis. The trades on the stock exchange will be settled by way of transferring funds to the seller and EGR to the buyer. The EGR will be transferred in the demat account of the buyer.

It is the discretion of the buyer of EGR whether to take physical delivery of gold or not. The buyer can continue to hold the EGR in demat account for further trading or take the physical delivery of gold from the Vault Manager. The storage charges will be borne by the beneficial owner (BO) of the EGRs as at the end of each settlement cycle. The storage charges will be collected by the Depository through the Depository Participants, for onward payment to the Vault Managers.

As per the norms, Depositories i.e. NSDL and CDSL will hold the EGRs of the beneficial owners in the dematerialized form. Further, the Depository will regularly reconcile, with the Vault Manager, the data of EGR's created and the corresponding physical gold lying in the recognized vaults.

The Depository will also inspect the physical gold (underlying the EGR) deposited in the recognized vault/s at periodic intervals. The EGRs will be extinguished by the Vault Manager upon delivery of the gold to the investor. The advantage with an instrument like EGR would be that it can be pledged or hypothecated easily, subject to Government Regulations.

At the time of withdrawal of gold, the purity and weight of gold which will be delivered to the beneficial owner will be as per the EGR held by the beneficial owner and it is the responsibility of the Vault Manager to ensure that the purity and weight of gold is as specified in the concerned EGR.

EGR Relevance for Indian Economy

Electronic Gold Receipts (EGRs) offer several benefits specific to the Indian economy, contributing to financial inclusion, economic growth, and regulatory compliance. A thriving gold ecosystem could result in India, which includes the full ecosystem of creation, trading and physical delivery of gold via redemption of EGR. The EGRs would bring in more transparency to trade, better spot price discovery, quality assurance and integration with the financial markets, thereby helping monetize the gold investments and aide in actual financialization of the gold held by households. This may in turn help household gold stocks come back into circulation and recycling thereby reducing import dependence.

Issues that need addressal in EGR

EGR represents an asset that is first converted from physical to electronic form and then vice-versa. GST provisions currently do not cover such scenarios. As EGR is unique and the first such Security, the lack of clarity around GST framework is affecting the initial pick-up to meet Government and SEBI vision.

EGR and GST

EGRs represent a financial instrument where ownership of physical gold is transferred electronically. From a GST perspective, EGRs are to be considered akin to financial services rather than physical goods. EGR is a security and cannot be traded inclusive of GST, as when an EGR passes through the hands of non-GST registered holder, input credit cannot be availed by the buyer of EGR. Since EGR will be traded on exchange, ordinary investors or traders without GST number will purchase and sell EGR. Hence the GST council should exempt conversion of commodity to security from the definition of Supply under GST. Further, EGR being 'Securities 'need to be kept outside GST ambit. As there is no co-relation between the Depositor [converting the gold into EGR] and the ultimate buyer [converting EGR back into Gold], the GST paid by Depositor will be additional cost (current GST rate on Gold is 3%) and dissuade participation.

Additionally, since EGR transactions involve exempt supplies of financial services, entities issuing EGRs may have limited or no entitlement to claim input tax credit (ITC) on GST paid for inputs and services used to provide these exempt services.

Compliance Requirements around GST are also impacting participation in EGR as authorised entities engaged in providing services related to EGRs must obtain GST registration if their aggregate turnover exceeds the threshold limit prescribed by law. Regular GST filing requirements apply, including the filing of GST returns and payment of GST liabilities, if applicable on taxable services provided in relation to EGRs.

EGRs allow people to invest in gold in very small quantities and also provide the option of taking delivery. One can also convert their physical gold into EGRs through a registered vault member. Under this form of gold, the trading exchange holds the underlying value of the receipt in physical gold in a vault. Hence, the conversion of physical gold to Electronic Gold Receipt and vice versa shall not to be treated as a transfer and not to attract any capital gains. This would promote investments in electronic equivalent of gold.

No loss of revenue to the government

Revenue loss impact will not be there on the Government through GST exemption, as when the EGR is converted back to Gold, the GST will be received by the Government. The grant of refund of GST paid is only because once gold is converted to EGR, there is fungibility of the asset and no co-relation between the initial depositor and ultimate Buyer. This is only a temporary cash flow relief mechanism to the purchaser of Gold who has incurred GST [either on import or procurement from domestic market] and is converting such gold to EGR. The Government revenue [including the respective state revenue] is safeguarded since when EGR is converted back into physical Gold and withdrawn from the vaults in those states, respective GST will be levied on the price of final conversion of EGR into physical Gold.

Further, since EGR will indirectly help in monetizing of gold, this can easily bolster the vision behind Gold Monetisation Scheme of the Government of India. Any person can convert their physical gold to EGR through a refinery. EGR will also be an effective tool for lending and borrowing through regulator

which can be exchange. This will help in saving foreign exchange as fresh import will automatically reduce and will be replaced by recycled gold via EGR.

Experiences of Other Nations with EGRs

The closest illustration of successful exchange traded investment tool that is also held in units and is benchmarked to a price thereby enabling investment, return and in case the investor so desires, then redemption into physical bars, is the Exchange traded Funds(ETF). The global ETF Assets under Management(AuM) remain robust and even peaked during Covid pandemic to over 3750 MT in December 2020.

Post-Covid, the ETF holdings remained steady at 3570 MT and 3472 MT in 2021 and 2022 respectively. Current ETF holdings are stable at 3225 MT in December 2023. This has grown from 2440 MT in 2018. The top 10 ETFs including SPDR Gold Shares, iShares Gold Trust and Invesco Physical Gold ETC hold about 1500 MT put together as at the end of 2023.

This shows that investors drew comfort in this instrument and utilised its advantages for hedging their portfolios and choosing ETF route for investing in safe-haven gold.

In the United States, the concept of Gold Exchange Traded Funds (ETFs) is well established. These ETFs are backed by physical gold stored in secure vaults and offer a convenient way for investors to gain exposure to gold prices. The success of gold ETFs in the U.S. highlights the potential of EGRs in providing a secure and efficient investment vehicle.

Australia has also embraced the concept of digital gold through products like the Perth Mint Gold (PMG) token. This digital token is backed by physical gold stored at the Perth Mint, providing investors with a secure and cost-effective way to invest in gold. The PMG token can be traded on various exchanges, showcasing the versatility of digital gold products.

The United Kingdom has a well-established market for gold ETFs and other digital gold products. The London Bullion Market Association (LBMA) oversees the trading and settlement of gold, ensuring high standards of transparency and security. The UK's experience demonstrates the importance of regulatory oversight in ensuring the success of digital gold products.

India's affinity for gold presents a tremendous opportunity for the adoption of EGRs going by the international success of ETFs.

Market Size and Demand

India's gold market is one of the largest in the world, with annual consumption ranging from 700 to 900 tonnes. The cultural and economic significance of gold ensures a steady demand, providing a substantial market for EGRs. The introduction of EGRs can tap into this demand by offering a more efficient and secure way to invest in gold.

1. Gold Holdings: According to the World Gold Council, Indian households hold approximately 25,000 tonnes of gold, valued at over $1 trillion. Converting even a small fraction of this into EGRs can create a substantial market.

2. Potential Market Size: If EGRs capture even 10% of the annual gold consumption in India, it could result in trading volumes of 70 to 90 tonnes per year, valued at approximately ₹65,000 crore (about $ 8 billion).

Conclusion

Electronic Gold Receipts (EGRs) represent a modern approach to gold ownership and trading, leveraging technology to enhance convenience, transparency, and security. By bridging the gap between physical gold and digital transactions, EGRs play a crucial role in India's efforts towards financial inclusion and regulatory compliance in the precious metals market.

Electronic Gold Receipts (EGRs) represent a transformative tool for the Indian economy, offering benefits that range from formalizing the gold market and enhancing financial inclusion to promoting regulatory efficiency and technological advancement. By embracing EGRs, India can harness the potential of its vast gold reserves and market activity while aligning with global trends towards digital finance and economic formalization.

Implementing Electronic Gold Receipts (EGR) in India presents a promising opportunity to formalize the gold market, enhance transparency, and promote financial inclusion. However, addressing the challenges related to regulatory alignment, technological readiness, consumer awareness, operational efficiency, and market dynamics will be crucial for successful implementation and widespread adoption of EGRs in the Indian context. Collaborative efforts among regulators, financial institutions, technology providers, and stakeholders will be essential to overcome these challenges and realize the full potential of EGRs in India.

In conclusion, Electronic Gold Receipts (EGRs) play a pivotal role in modernizing India's gold market, promoting financial inclusion, enhancing transparency, and contributing to economic growth. By leveraging technology and regulatory oversight, EGRs provide a secure and efficient mechanism for investors to engage in gold transactions, thereby bolstering the overall economy.