Gold Saving Scheme: An unusual way of investing in Gold thrust on Sovereign Gold Bond Scheme (SGBs)

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***Abstract:** Sovereign gold bonds are papers or certificates issued by the Government of India indicating that investors bought the stated quantum (in grams) of gold. The value of the bond will be linked to gold prices. The objective of the scheme is to provide an alternative to buying physical gold.*

Since times immemorial, India has been a leading consumer of gold in the world with an ever-increasing demand for the metal. However, due to a shortage of domestic gold, the country has largely been dependent on gold imports to meet this demand, resulting in large current account deficits. Gold monetization can be one of the lucrative investment options. It is all about fixed deposit scheme for gold, earning interest.

The objective of launching the two schemes is to lure Indians away from buying physical gold which remains passive and serves no economic purpose. As estimated, about 22,000 tonnes of gold (which when converted to currency will be precisely around Rs. 60 lakh crores), are held by households and institutions. In a country like India, where liquidity is the key to drive economic growth, money worth of Rs. 60 lakh crores remaining idle, does not augur well. Besides, in spite of having such big gold holdings, our appetite for the yellow metal has been on rise. This not only makes India the biggest consumer but also the biggest importer of gold in the world affecting our Balance of Payments adversely. Gold and crude oil import comprises of 65% of the total import bills, which has been the main reason behind rising current account deficit. Gold monetization and Gold sovereign bond schemes will be of great help to the country's economy.

Through a literature survey, this study attempts to identify and analyse the challenges that inhibit the scheme from realizing its full potential. The study concludes with recommendations to enhance adoption of the scheme by households and individual investors.

***Key words-** Gold, Gold monetization schemes, Sovereign Gold Bond, Investment, Gold ETF.*

I. INTRODUCTION

While addressing the nation through Man Ki Baat on 25th Oct. 2015, the Prime Minister, Mr. Narendra Modi announced launching the gold monetization and sovereign **gold bond scheme** on the auspicious occasion of Dhanteras. Sovereign **Gold Bonds** will enable investors to buy gold certificates from the government which can later be converted to money or physical gold. As per proposal, gold bonds will be issued in denominations of 5, 10, 50 and 100 gms of gold and duration of such gold bonds will be for minimum 5 to 7 years.

Banks will also benefit from these two schemes in the following manner: Banks are required to maintain Cash Reserve Ratio and Statutory Liquidity Ratio which are currently at 4% and 21.5% of their deposit with RBI. This money can be used for creating further credit, as bank may use mobilized gold as part of CRR/SLR requirements.

Banks may also sell the **gold deposits** to generate foreign currency which can be used for lending to importers and exporters. The aforesaid scheme is expected to be a major success, as vibrant young Indians understand that it is in both their personal and the country's interest to go for paper gold instead of physical gold. However, with tax incentives and higher interest rate offering on sovereign gold bond, the schemes may become attractive for older generation as well, who have been investing in physical gold.

II. OBJECTIVES OF STUDY

The main objectives of the study are as follows:

1. To understand the Gold monetization Scheme in India.
2. To study the Sovereign Gold Bond scheme
3. To Compare the performance of of Physical gold, Gold ETF and Sovereign Gold Bond.

III. METHODOLOGY ADOPTED

The research methodology adopted for this study is Secondary research to collect information about the SGBs. Journals, Articles and web resources were reviewed to draw a conclusion. Based on this these facts conclusion is drawn and recommendations has been suggested in the paper.

IV. DATA COLLECTION

1. SOVEREIGN GOLD BOND BY RBI (SERIES-III)

Sovereign Gold Bonds are Government securities denominated in multiples of gram(s) of gold. They are substitute for investment in physical gold. To buy the bond, investor has to pay the issue price in cash to an authorized SEBI Broker. On redemption, cash is deposited into the investor's registered bank account. These Bonds are issued by the Reserve Bank of India on behalf of the Government of India and are traded on stock exchange.

Government of India, in consultation with the Reserve Bank of India, has decided to issue Sovereign Gold Bonds 2017-18, Series-III. Applications for the bond will be accepted from October 9, 2017 to December 27, 2017. The bonds will be issued on the succeeding Monday after each subscription period.

The bonds will be sold through banks, Stock Holding Corporation of India Limited (SHCIL), designated post offices and recognised stock exchanges viz., National Stock Exchange of India Limited and Bombay Stock Exchange.

Process/Where can you buy it?

Investors can apply for the bond through SEBI authorized trading members and financial advisors of National Stock Exchange of India Limited and other channels specified by RBI. Application forms will be provided by trading members, authorized agents and can also be downloaded from RBI's website.

The bonds will be restricted for sale to resident Indian entities including individuals, HUFs, Trusts, Universities and Charitable Institutions. The bonds will be denominated in multiples of grams of gold with a basic unit of 1 gram.

The maximum limit of subscribed shall be 4 kg for individual, 4 Kg for HUF and 20 Kg for trusts and similar entities per fiscal (April-March) notified by the Government from time to time. The price of the bond will be fixed in rupees terms on the basis of simple average of closing price of gold of 999 purity published by the India Bullion and Jewellers Association Limited for the last 3 business days of the week preceding the subscription period. The issue price of the Gold Bonds will be Rs 50 per gram less for those who subscribe online and pay through digital mode.

Commission for distribution of the bond shall be paid at the rate of 1% of the total subscription received by the receiving offices 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.

Basic Details/ Highlights of the Bonds:

- **Interest Rate**: The Sovereign Gold Bonds offer an interest rate of 2.50% per annum payable semi-annually. Interest will be credited semi-annually to the bank account of the investor. Investors will earn returns linked to gold prices.
- The Bonds will be restricted for sale to resident Indian entities including Individuals, HUFs, Trusts, Universities, Charitable Institutions and minors applying (through their guardian).
- **Minimum application criteria**: 1 unit (i.e. 1 gram of gold).
- **Maximum application limit**: Not be more than 500 grams per person per fiscal year (April-March).
- **Tenor**: The tenor of the Bond will be for a period of **8 years** with exit option permitted from 5th year of the date of issue on interest payment dates.
- **Redemption**: The Bonds are repayable on the expiration of eight years. Pre-mature redemption of the Bond is allowed from 5th year of the date of issue on interest payment dates. Bond carry sovereign guarantee both on redemption amount and on the interest.
- **Redemption price**: The sovereign gold bonds will be redeemed for cash at the end of the investment tenure. Redemption will take place at the prevailing gold price (based on previous week's (Monday-Friday) simple average of closing price of gold of 999 purity published by IBJA.), giving the investor the value of the bond plus capital appreciation/depreciation from increase/fall in gold price.
- **Premature redemption**: After 5 years, investors can approach the concerned bank/Post Office/agent thirty days before the coupon payment date. Request for premature redemption can only be entertained if the investor approaches the concerned bank/post office at least one month before the coupon payment date.
- **Liquidity**: Liquidity is available from secondary markets as these bonds are mandated to be listed on BSE and NSE.
- **Nomination facility**: Yes. Available in DEMAT and paper form
- **Loan against Bonds**: Available.
- **Taxation**: 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 (20% tax after indexation benefit if held for three years) (Explained below). TDS is not applicable on the bond interest/redemption proceeds. The redemption of these sovereign gold bonds by an individual will be exempt from capital gains tax. Long-term capital gains to any person on transfer of sovereign gold bonds shall be eligible for indexation benefits.

Advantages

- **Safest:** Zero risk of handling physical gold
- **Earn Interest:** 2.50% assured interest per annum on the issue price
- **Tax Benefits:** No TDS applicable on interest,Indexation benefit if bond is transferred before maturity.Capital gain tax exempt on redemption
- **Assurance of Purity:** Gold bond prices are linked to price of gold of 999 purity (24 carat) published by IBJA.
- **Sovereign Guarantee:** Both on redemption amount and on the interest
- **Easy Exit Option:** The tenor of the bond is for 8 years with an option to redeem from 5th year onwards on the date on which interest is payable
- **Traded on Exchange:** All earlier issuance of SGB are available for trading on NSE
- **Ease of Borrowing Loan:** Can be used as collateral for loans

Key benefits:

- The issue price that fixed at Rs. 50 less than the nominal value for per gram is beneficial for investors. This helps investors to get slightly higher returns than that of the gold price in the spot market.
- Sovereign Gold Bonds deliver two streams of returns. One in the form of regular interest of (2.50% p.a) on invested capital every six months and the other in the form of capital gains at the time of redemption in case the price at the time of redemption is higher.
- SGBs can be used as collateral for loans. This bond is as liquid as physical gold and could be exchanged for money, albeit on loan basis, at the time of financial need.

- The bonds will be available both in demat and paper form.
- In Union budget 2016, Finance Minister has proposed exempting such bonds from capital gains tax on redemption (under normal case, LTCG tax is levied 20% with indexation on gain). The indexation benefits will be provided to long term capital gains arising to any person on transfer of bond.
- High Liquidity: Investors can liquidate these bonds from the secondary market such as BSE and NSE.

Listing of SGB:
The below table shows the details of the previous issues of the sovereign gold bonds:

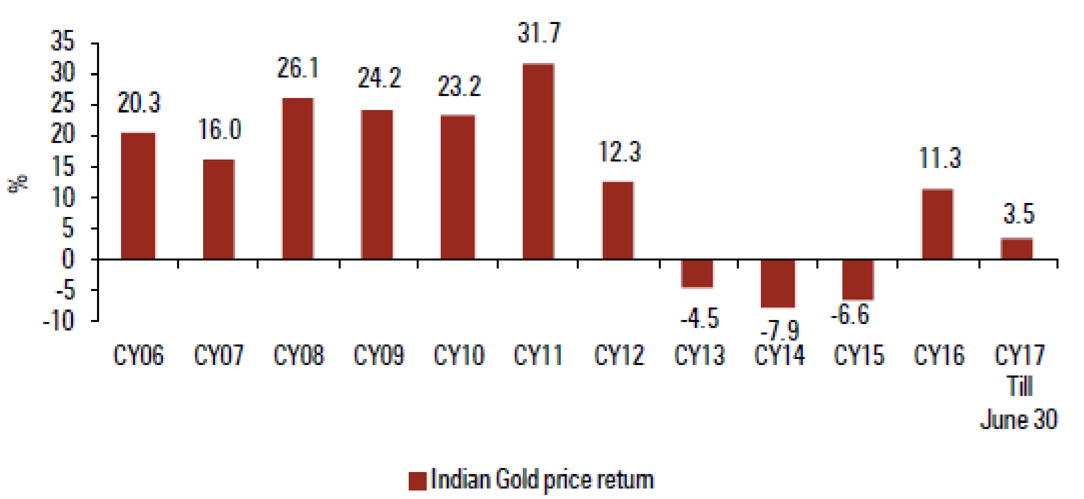
Issue-Tranche	2nd 16-17	3rd 16-17	4th 16-17	5th 16-17	6th 16-17	7th 16-17	1st 17-18
BSE Code	800252	800253	800254	800258	800259	800265	800268
NSE Code	SGB FEB24	SGB MAR24	SGB AUG24	SGB SEP24	SGB NOV24	SGB MAR25	SGB MAY25
Issued date	08-Feb-16	29-Mar-16	05-Aug-16	30-Sep-16	17-Nov-16	17-Mar-17	12-May-17
Issue price (Rs)	2,600	2,916	3,119	3,150	2,957	2,893	2,901
Total no of applications	3,30,000	64,000	1,95,000	2,00,000	-	-	-
Collected Amount (Rs Crs)	798	329	919	768	1067	1273	-
Worth of gold (in Kg)	3,071	1,128	2,950	2,435	3,550	-	-
Interest Payment Date	8 Feb & 8 Aug	29 Mar & 29 Sep	5 Feb & 5 Aug	30 Mar & 30 Sep	17 May & 17 Nov	17 Sep& 17Mar	12 Nov & 12 May
BSE Price as on 7 Jul 2017	2,750	2,711	2,765	2,800	2,740	2,681	2,700
NSE Price as on 7 Jul 2017	2,740	2,770	2,765	2,790	2,730	2,706	2,712
Returns % (BSE Price) since issued	5.77	-7.03	-11.35	-11.11	-7.34	-7.33	-6.93
Returns % (NSE Price) since issued	5.38	-5.01	-11.35	-11.43	-7.68	-6.46	-6.51

Source: NSE India, BSE India, RBI & News papers.

SGB are to be treated more as an asset diversification strategy rather than to earn superior returns. Although investors in 3rd tranche onwards are in the negative based on the current price, one needs to appreciate that gold prices are prone to fluctuations based on macro events globally and USDINR rates and doing a SIP in every tranche of gold can be considered by investors who are either underinvested in gold or have regular fresh monies for allocation among various asset classes.

2. Physical Gold-

Exhibit 1: Gold prices saw a good rally in 2016 on geopolitical events and revival in demand



Source-Bloomberg

GST puts the spotlight on Gold

GST would be levied on gold purchases and sales at 3%. Under the earlier laws, the tax incidence was lower, at around 2%. This higher incidence of tax on physical purchase of gold makes Sovereign Gold Bonds more attractive as they do not suffer GST or any other transaction tax. Purchase cost at the final consumer level is expected to increase since he cannot avail any tax credit. However in the medium to long term GST would have a positive impact on the gold sector by way of increased transparency, better supply chain efficiencies, etc.

After having delivered negative returns in 2013, 2014 and 2015, gold prices have bounced back sharply gaining 11% in 2016.

3. Gold ETF & its performance

If we compare SGBs or gold ETFs for price appreciation though, we are likely to get similar results. While gold ETFs have sparkled recently, their long term performance has been unimpressive. Their 5-year returns are in 6.3-6.5% p.a. range as on June 30, 2017.

'Investors should choose based on their liquidity requirements. If liquidity isn't important and investors can hold to maturity, gold bonds are superior. If investors feel they may need liquidity, ETFs are superior,' said Rajiv Shastri, CEO, Peerless MF.

As per Government of India Notification and RBI's circular on Sovereign Gold Bond (SGB) dated October 06, 2017, the Sovereign Gold Bond Scheme will be open for subscription from Monday to Wednesday of every week starting from October 09, 2017 until December 27, 2017. The settlement will be made on the first business day of the next week for the applications received during a given week.

The nominal value of the bond will be based on the simple average closing price [published by the India Bullion and Jewellers Association Ltd (IBJA)] for gold of 999 purity for the last three business days of the week preceding the subscription period. Government of India, in consultation with the Reserve Bank of India, has decided to offer a discount of Rs.50 per gram on the nominal value of the Sovereign Gold Bond to those investors applying online and the payment against the application is made through digital mode

V. DATA ANALYSIS AND INTERPRETATION

Comparison of Physical gold, Gold ETF and Sovereign Gold Bond

With a fresh tranche of sovereign gold bonds on sale, it's a good time to review how these instruments stack up against the earlier favourite, gold exchange traded funds or ETFs. Just based on returns and taxation, the bonds seem better.

Sovereign gold bonds (SGBs) are issued by the Government of India. One can buy a minimum of 1 gram and a maximum of 500 grams. In comparison, gold ETFs are sold based on net asset value (NAV) through the exchanges. These NAVs currently start below R500 (per unit). Both SGBs and Gold ETFs, which help you to hold gold in paper form have big advantages over physical gold. They don't have purity issues, they don't force you to shell out hefty locker rents and they offer liquidity at prevailing gold prices without ad hoc deductions for wastage or losses.

DATA TABULATION

Exhibit 2-Comparison of Physical gold, Gold ETF and Sovereign Gold Bond

Particular	Sovereign Gold Bonds	Physical Gold	Gold ETF
Sovereign guarantee	Yes	NA	No
Interest on the investment	Yes	No	No (No dividend option provided on Gold ETF)
Capital Appreciation/depreciation	Yes	Yes	Yes
Annual fund management fees (AMC)	No	No	Yes
Brokers charge on buying	No	No	Yes
Exit / redemption option	Only from 5th year	Any time exit	Any time exit
Tradability	Yes	Yes	Yes
Liquidity	Limited	Highly liquid	Highly liquid
Storage/Insurance charges	No	Yes	No
Quality check required	No	Yes	No
Returns	Higher than actual return on gold	Lower than actual return on gold	Lower than actual return on gold
Safety	High	Risk of handling physical gold	High
Purity of Gold	High as it is in Electronic Form	Purity of Gold always remains a question	High as it is in Electronic Form
Capital Gain	Long term capital gain applicable after 3 years. (No Capital gain tax if held till maturity)	Long term capital gain applicable after 3 years	Long term capital gain applicable after 3 years
Collateral against Loan	Yes	Yes	No
Tradability/ Exit Route	Tradable on Exchange. Redemption- 5th year onwards with GOI	Conditional	Tradable on Exchange
Storage Cost	Very Low	High	Very Low

Comparison between Sovereign Gold Bonds to Physical gold

- Here, investors buy gold in paper; hence there is no need of checking the quality of gold as that is a major hurdle when purchasing gold from jewelers.
- Further no storage/locker/insurance charges are payable in case of SGB.
- Apart from this, the investor has to face counterparty risk while selling their physical holding of the yellow metal which is not the case here.

Comparison between Sovereign Gold Bonds and Gold ETF:

Sovereign Gold Bonds score over Gold ETF on many grounds.

- The Sovereign Gold Bonds pay an interest of 2.50% per annum (though taxable), an added benefit to the investors which is not available with Gold ETF. However, both options are providing capital appreciation/depreciation.
- Sovereign Gold Bonds hold Sovereign guarantee hence there is no default risk is involved. The credit risk in Gold ETF is also very minimal.
- Investors have to bear the transaction charges if they want to trade in Gold ETF while there is no such charge involved with Sovereign Gold Bonds if they don't exit through the exchanges.
- Further, Gold ETF deduct some charges in the name of TER (Total Expenses Ratio) from the total assets. This expense ratio ranges from 0.57% - 1.08% per annum of the total assets.
- On the liquidity front, the Gold ETF score over Sovereign Gold Bonds. Investors can enter/exit from Gold ETF during any working day of the stock exchanges. Liquidity will not be the constraint (though impact cost may be a hurdle) for the Gold ETF. On the other hand, the
- Encashment/redemption of the Sovereign Gold bond is allowed after fifth year from the date of issue on coupon payment dates. However, these bonds will be tradable on Exchanges, if held in demat form (but, liquidity may be limited).
- No capital gains tax is payable if the sovereign gold bonds are held till maturity, while ETFs held for more than three years attract capital gains tax (with indexation benefits).

Advantage of SGB over Gold ETF

One area where the SGBs score over gold ETFs is the sovereign guarantee. The government guarantee, a good marketing ploy, is applicable both on the redemption amount and on the interest. Gold ETFs are offered by private sector AMCs and do not have that kind of advantage. But do note that the sovereign guarantee here does not shield investors' capital from volatile gold prices. Both the value of your SGB and the value of your ETF swing up and down with market prices of gold during your holding period.

Secondly, SGBs pay you an assured interest over and above the price returns on gold. Gold ETFs do not give you that comfort and rely only on price returns. Gold bonds offer 2.75% per annum (paid half-yearly) on the initial investment. Thus, investors earn returns linked to the gold price (just like in gold ETFs) plus a fixed annual interest income. The tenure of gold bonds is 8 years but exit options are available in the 5th, 6th and 7 year.SGBs are cheaper to own than gold ETFs too. This is because gold ETFs charge management charges of up to 1% of their net assets every year. But gold bonds do not have any such recurring charges.

Tax sops/structure for gold bonds

Gold bonds get indexation benefit if they are transferred before maturity.Given that SGBs score over ETFs on these three counts, will the gold ETF assets in the MF industry see a shift to these bonds? Chirag Mehta, senior fund manager - alternative investments, Quantum AMC, says: 'That kind of shift is not happening right now. Gold bonds and gold ETFs are listed on exchanges,which means you could exit them in the secondary market if you require the money before maturity. The redemption will be done at the prevailing price at the market. 'However, gold ETFs have better liquidity (than SGBs). They register far higher volumes than gold bonds at present,' says Anil Rego, Founder and CEO of financial consulting firm Right Horizons. The liquidity issue is a major one. The exchange bid-ask spread for SGBs, a relatively new instrument with a short trading history, is pretty high compared to gold ETFs.

VI. CONCLUSION

The study revealed that gold loans were primarily being used for smoothening household consumption and for repaying debts.

Monetisation of gold involves mobilising gold accumulated by Indian households to ensure that it plays a growth oriented role in providing financial resources for development of Indian economy. This concept is not new in India, but was implemented earlier without much success.

The gold monetisation scheme as launched by the Government of India in November 2015 is an improvised version of the erstwhile gold schemes, making it much simpler for prospective depositors to participate in the scheme, making it a win-win situation for both the government, and the end consumers.

Gold bonds are a new product and investors are still learning about them. An issue about gold bonds is that they are not on-tap. Investors have to wait for the government to sell a new tranche. You cannot go and buy them whenever you want. Also, some investors prefer to buy smaller denominations than a gram which can be done via gold ETFs, but not gold bonds.'

Having launched the scheme in November 2015, and not been able to successfully mobilize enough gold since then, it is imperative for the government to identify gaps in policy formulation and implementation on gold, and ensure that such identified gaps are addressed, to encourage confidence and participation from households without which the policy will not be able to achieve its intended objective of reducing dependence on imports of gold.

"It has been found that people had little or no awareness about these three gold schemes, which were introduced two years back by the Centre. Various gold investment and savings schemes such as the Gold Monetisation Scheme floated by Central government has met with little success due to lack of awareness among the masses, according to a recent study.

"Around 15,000 tonnes of gold, in the form of jewellery is lying idle with citizens across the country. The study had revealed that people are willing to invest in these schemes if they got adequate information about them. It shows that there is indeed a potential," said Sahay.
Nearly 50% people took gold loan for productive purposes, such as for business, education and house repairs.

VII. SUGESSIONS AND RECOMMENDATIONS

Formulation and successful implementation of a policy around gold can never be easy task because of sentimental value of gold for an Indian. Thus, sustained efforts from all key stakeholders (governments, jewellers, central banks etc.) are a must if the Government has to be successful in mobilising gold under the schemes.

Commenting on the findings of the study, which was aimed at finding out the importance of gold as a tool for financial inclusion, So, it is suggested that government should beef up its marketing efforts to popularise these schemes

"Apart from beefing up marketing efforts, banks should also be motivated to promote gold loan, so that they go out and convince people to opt for such loans. We don't see such motivation by banks at present," he added.

Sovereign gold bonds offer a good option to take exposure to gold as it offers a discount of 50 per gram along with additional interest of 2.50% per annum. The allocation to gold bonds however should be in accordance with the overall asset allocation.

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