DRAFT OUTLINE OF THE SOVEREIGN GOLD BOND SCHEME

(For discussion purposes only)

I. Introduction

- Sovereign Gold Bonds will be issued on payment of money and would be linked to the price of gold.

II. Objective

- Need for a Sovereign Gold Bond
  - The main idea is to reduce the demand for physical gold.
  - Shift part of the estimated 300 tons of physical bars and coins purchased every year for Investment into 'demat' gold bonds.

III. Agency

- Bonds will be issued on behalf of the Government of India by RBI.
- Issuing agency will need to pay distribution costs and a sales commission to the intermediate channels, to be reimbursed by Government.

IV. Sale to Indian entities

- The bond would be restricted for sale to resident Indian entities. The cap on bonds that may be bought by an entity would be at a suitable level, not more than 500 grams per person per year.

V. Features

- The Government will issue bonds with a nominal rate of interest (which will be linked to international rate for gold borrowing). An indicative lower limit of 2% may be given but the actual rate will have to be market determined. On maturity, the investor receives the equivalent of the face value of gold in Rupee terms. The rate of interest on the bonds will be payable in terms of grams of gold. The interest will be calculated on 10,000 at a certain per cent say 2 or 3%.
- The price of gold may be taken from NCDEX/ London Bullion Market Association/RBI and the Rupee equivalent amount may be converted at

the RBI Reference rate on issue and redemption. Banks/NBFCs/Post Offices may collect money / redeem bonds on behalf of government (for a fee, the amount would be as decided).

- The bonds will be issued in denominations of 2, 5, 10 grams of gold or other denominations.
- The tenor of the bond could be for a minimum of 5 to 7 years so that it would protect investors from medium term volatility in the gold prices. Since the bond will be a part of the sovereign borrowing, these would need to be within the fiscal deficit target for 2015-16 and onwards.
- Bonds to be used as collateral for loans. The Loan To Value ratio be set equal to ordinary gold loan mandated by RBI from time to time.
- Bonds to be easily sold, traded on commodity exchanges.
- KYC norms to be the same as that for gold.
- Bonds to have a sovereign guarantee.
- Capital gains tax treatment will be the same as for physical gold. This will ensure that an investor is indifferent in terms of investing in these bonds and in physical gold- as far as the tax treatment is concerned. This is still under examination.

VI. Hedging

- The agency issuing the Sovereign Gold Bonds will be running a price risk on the amount of bonds issued. The price risk will comprise the price of gold in USD and the USD/INR exchange rate risk. Hedging of this risk is expensive and since the agency is the sovereign, and the amounts expected may not exceed 50 tonnes in the first year, may not hedge it. However, it should be cognizant of the existence of this risk.
- Upside gains and downside risks will be with the investor and the investors will need to be aware of the volatility in gold prices.
- The government would bear the risk of gold price movement on issuances.

VII. Marketing

- In order to ensure wide availability the bond will need to be marketed through post offices and by various brokers/agents who may need to be paid a commission (like for Kisan Vikas Patra).

VIII. Operational Issues

- Based on the current market price, issuance of gold bonds equivalent of 50 tonnes would be around Rs. 13,500 crore. Since the amount is not very high, it can be accommodated within the market borrowing programme for 2015-16.

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