A gold spot exchange for India: Delivering structural reforms

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

The membership of the World Gold Council includes the world's leading and most forward thinking gold mining companies.

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I: The case for change

With an annual demand of approximately 800-900 tonnes,[1] the size of the Indian gold market is second only to that of China. Despite its significant size and important global position, the Indian gold market is unable to realise its potential due to multiple challenges. These challenges include lack of quality assurance, weak price transparency and fragmented liquidity and regulatory issues. There is a pressing need to reform the gold trading market in India.

Challenges related to development of gold trading market in India

Challenges	Details
Lack of quality assurance	• Lack of good delivery standards for gold
	• Lack of quality assurance in bullion and jewellery
	• As a result of lack of trust in Indian gold, there is limited international demand for Indian jewellery
Weak price transparency and fragmented liquidity	• Lack of transparency in pricing and price distortions across the value chain
	• Wide variation in gold prices across the country
	• Large number of participants across the gold value chain with bilateral trades and weak central tracking
	• Limited recycling of household gold (estimated at ~22,500 tonnes)[2] restricting the growth of domestic gold market and resulting in ~90%[3] of demand being met through imports. As a result, as of FY17, gold is 2nd largest contributor to current account deficit after oil[4] *(Recent schemes such as gold monetisation scheme and sovereign gold bonds aim to address these issues, however, there is scope for further catalysing the domestic gold recycling industry in a systematic and sustainable manner)*
	• Limited influence in the global gold market; the market continues to be a price-taker despite being the second largest market
Regulatory challenges	• Distributed regulatory responsibilities across a number of agencies pertaining to gold
	• Import of gold doré from non-OECD compliant countries leading to non-compliance to responsible sourcing standards
	• Limited participation of banks in the gold market due to regulatory restrictions
	• Limited participation of international players due to regulatory restrictions

1 India Gold Policy Centre, *Viability of a gold exchange in India*, 2016.

2 World Gold Council, *India's gold market: Evolution and Innovation*, 2017.

3 Bloomberg.

4 Export and Import data bank, Ministry of Commerce and Industry.

India is on a drive towards transparency. Over the past three years, the Government of India has initiated multiple reforms. Initiatives such as Pradhan Mantri Jan Dhan Yojana, Digital India, launching of e-mandis for commodities, demonetisation, introduction of RERA,[5] Benami Act and Goods and Services Tax, all aim to bring greater transparency and tax accountability in the Indian economy. The government has also taken initiatives to address issues related to the gold market by launching schemes such as gold monetisation, sovereign gold bonds, introduction of Indian gold coin as well as initiatives such as setting up of a cross-regulatory committee on gold. Given the broad push for greater transparency and the appetite for reform, the time is opportune to introduce structural reforms in the gold trading market.

An exchange can play a key role in transforming the gold market as described below:

- Drive quality improvement: A spot exchange can strengthen the drive towards standardisation of bullion circulating in the Indian market by institutionalising Good Delivery Standards.[6] This will improve trust in the quality of Indian gold
- Ensure price convergence and transparency: A spot exchange is capable of creating a transparent price discovery mechanism for market participants and consumers. The traded price on the exchange can also be used to establish an 'India reference' price which will strengthen India's position in the global gold market
- Formalisation of the Indian gold market: A spot exchange can serve as a catalyst to organise the fragmented gold market in India as it would bring together a number of key players across the gold value chain on the same platform. This will bring transparency in operations and improve tax accountability
- Build foundation for success of gold related initiatives: The spot exchange will enable players across the value chain to source physical gold without going through several layers of intermediaries. The exchange will enable financial institutions to launch gold-backed products more effectively, thereby providing a strong impetus to government initiatives for monetisation of household gold. The exchange will also support development of the domestic refining and gold scrap market and stabilise the impact of gold on the Current Account Deficit (CAD).

This report outlines a vision for a gold spot exchange and its associated ecosystem, identifies key design elements, lists critical success factors (based on global examples), recognises potential benefits for entities across the value chain, the economy as a whole and sets forth a roadmap for multi-stakeholder collaboration to ensure successful design and launch of the exchange.

5 Real Estate (Regulation and Development) Act.

6 Good Delivery Standards are a set of accepted standards that benchmark and regulate the acceptable requirements for gold and silver bars. They ensure that market participants continue to maintain high standards.

II: Vision of a gold spot exchange

A gold spot exchange enables market participants to buy and sell physical gold with immediate (T+2) settlement of gold and cash. Though India currently has several commodity exchanges, they operate as futures exchanges[7] which are primarily used to hedge against gold price risk and take proprietary positions on gold price movement. A spot exchange,[8] on the other hand, focuses on price discovery and hence, provides the entire ecosystem around physical deliveries.

The vision of the gold spot exchange can be defined as:

"To provide an efficient and trusted ecosystem for trading gold with an aim to improve market transparency and protect the interests of market participants and end consumers"

In order to be able to deliver on the vision, the proposed exchange needs to meet international best practices and also be completely trusted by the market. In particular, it should adhere to following principles around transparency and fairness:

- A market that is accessible to the broadest range of participants
- Clearly defined and consistently applied standards to govern the market
- Transparent operations to demonstrate that the standards are being applied and enforced
- Confidence in the integrity and behaviour of participants (through oversight and controls)
- Accepted physical delivery standards that the market complies with.

A spot exchange, encompassing a broad ecosystem for efficient physical trading of gold, can play a significant role in reforming the gold market in India as illustrated in Figure 1 and Figure 2.

7 A futures exchange allows trading of Forward contracts. According to Forward Contract Regulation Act (FCRA), forward contracts are where delivery and payment is made after a period of 12 days or more (T+12 or more).

8 A spot exchange facilitates transactions in spot contracts where a spot contract involves delivery and payment on the spot date, which is typically two days after the date of the transaction (T+2) for securities and up to eleven days after the date of the transaction (T+11) for commodities.

Figure 1: Current state of the gold market in India

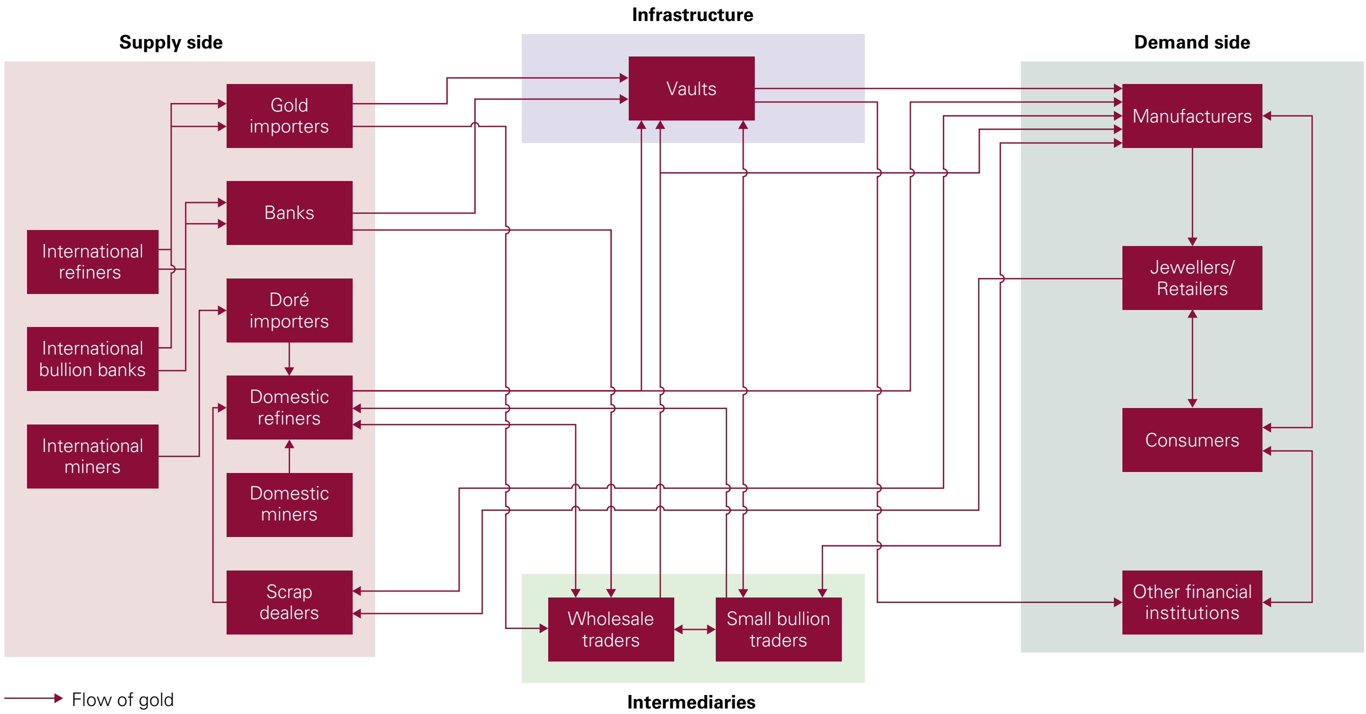


Figure 2: State of the gold market after introduction of gold spot exchange

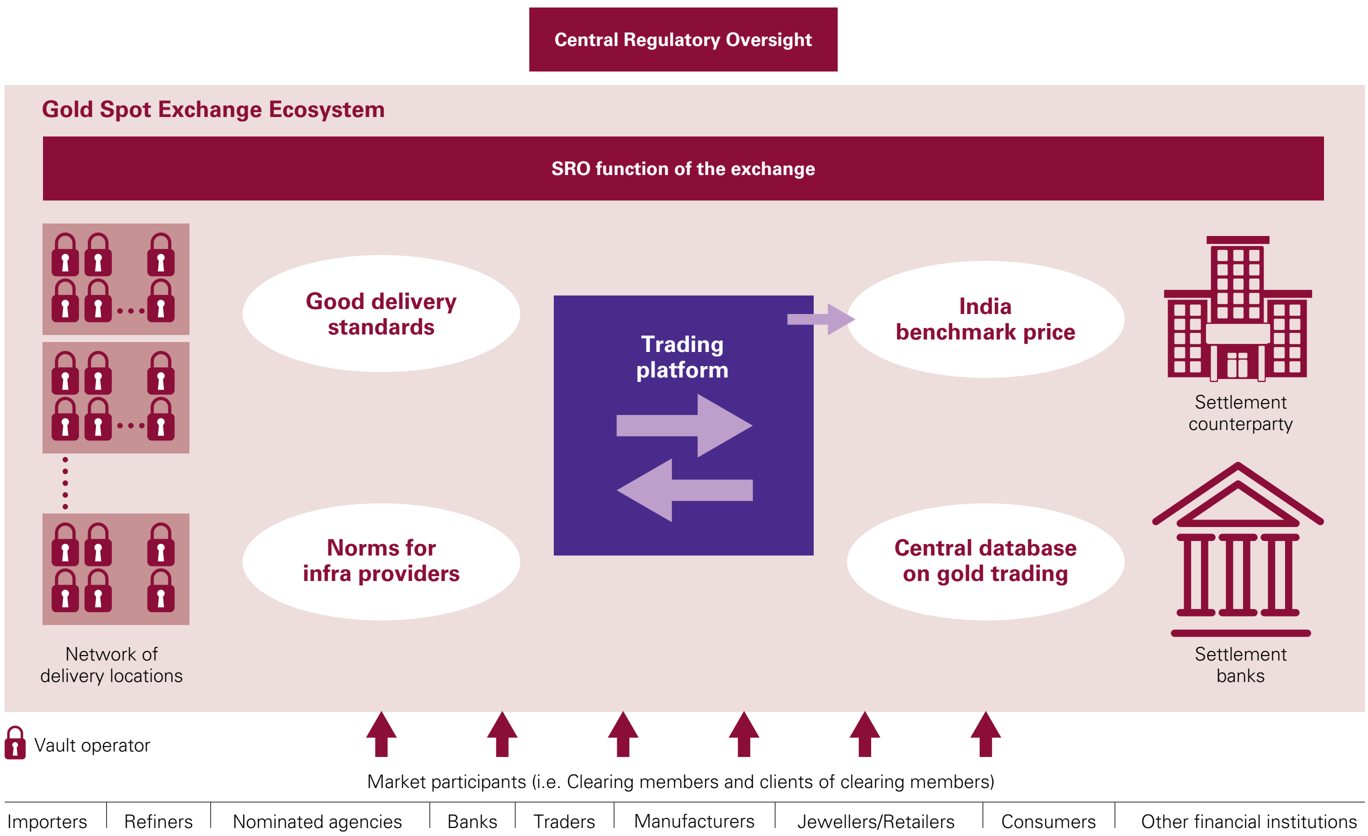
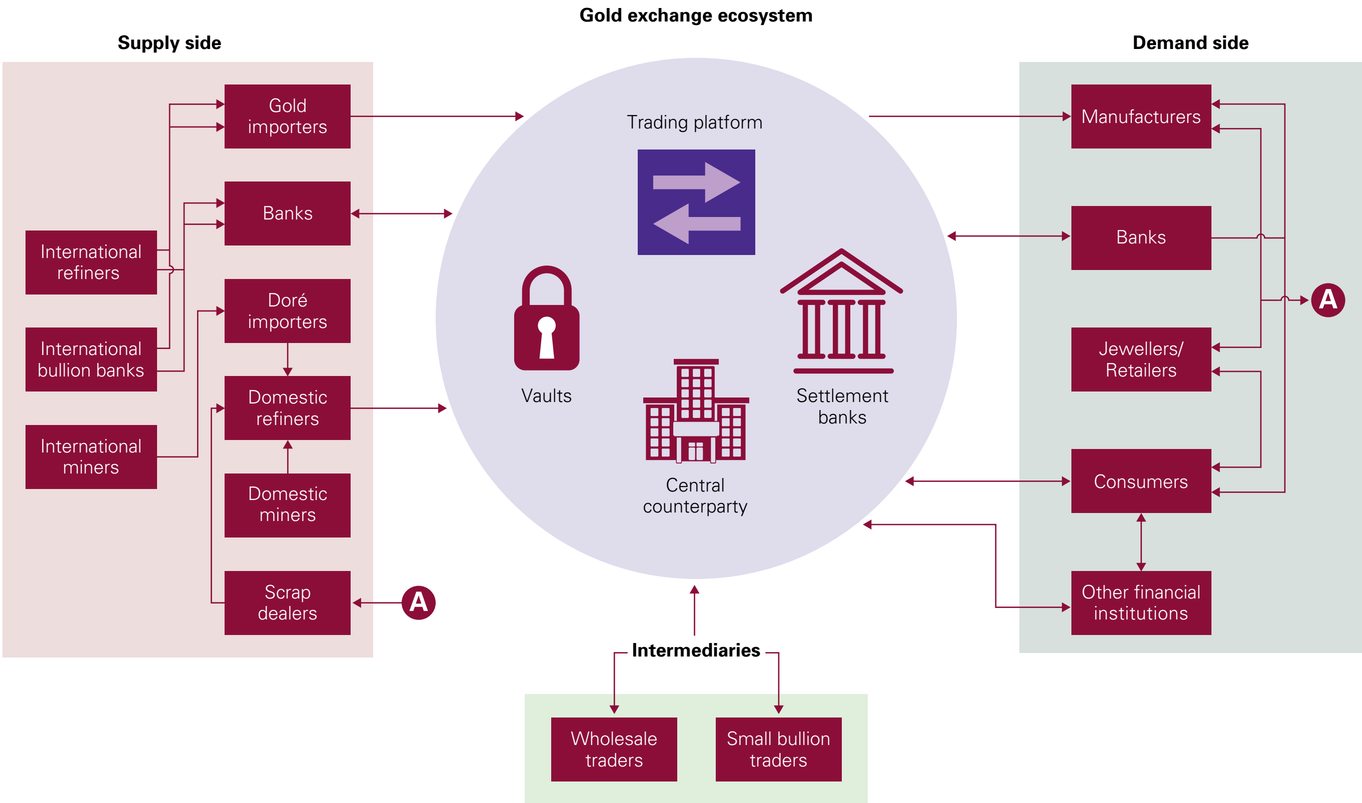


Figure 3: Components of the proposed spot exchange



The spot exchange is more than a venue where orders are placed and trades are executed. The spot exchange provides a robust ecosystem around trading and delivery. Specifically, the exchange would provide a central venue for trading, a well-connected network of delivery locations where each location would be serviced by one or more vault operators and a central counterparty to clear and settle trades. The exchange, functioning as a self-regulating organisation (SRO), would provide oversight on all these components and would also lay down norms for acceptable delivery standards and infrastructure providers. Furthermore, spot trades executed on the exchange can be used to define the India reference price which could serve as the reference price for OTC[9] gold market.

9 Over-The-Counter.

III: Key design elements of exchange operating model

The operating model of a spot exchange has a number of key elements: membership structure, products, order matching and execution, clearing, vaulting and physical delivery. In defining the design of each element, there are a number of trade-offs that need to be evaluated through consultation with the market. Most important is that each of the design choices is aligned with a coherent overall model that can be successful and contribute to the growth of the industry.

Trading platform

The exchange platform will be a venue for the buyers and sellers to trade gold at fair market price. The platform must maintain a central electronic order book and match best buy orders with best sell orders to minimise bid-ask spreads. In addition, the exchange must disseminate information on latest realised price (or bids and offers) in near-real time through the exchange's own website, data providers and news agencies to provide transparency in its operations and also maintain a repository of all trades for reporting purposes.

Product specifications

To ensure sufficient liquidity and standardisation in trade, most global gold exchanges only offer a small number of standardised contracts. There are many dimensions in contract design requiring consideration, the following two are particularly important:

Size: This defines size of the bar traded on the exchange. Going by global examples, gold bars of sizes 100g and 1kg are most common in the wholesale segment. In order to avoid fragmentation of liquidity, trading can be initially launched in wholesale size bars and smaller sized bars can be introduced over time (required to expand the reach of the exchange to retail segment).

Fineness: This defines the purity of gold being traded on the exchange. Typical fineness levels that are traded on an exchange are 999 or 995, and are generally adopted from the Good Delivery Standards established in the country. BIS[10] is in the process of defining Good Delivery Standards for India, and the proposed exchange can partner with BIS to adopt these standards.

Delivery locations

Delivery locations are a critical factor both for contract design, and for publishing the India reference price. India is a large market with 6–10 regional hubs which cater to demand across their respective regions. The exchange network should incorporate all the key regional hubs to facilitate access to a broad user base and allow a truly national approach.

There are multiple ways of defining product contracts that would ensure linkage of price with inventory levels in each delivery location across the country. For example, the exchange can have multiple contracts catering to multiple delivery locations – however, this is sub-optimal since it would fragment liquidity on the exchange. Another option may be to have contracts with 'India' as the delivery location (with a 'default delivery location' or 'a notional delivery location' as India) and introduce trade-able location premiums. The tradable location premiums are intended to reflect the dynamic price premium of each location vs. the default delivery location or a notional 'India reference.' In this option, there is one 'India reference price' that emerges based on transparency of demand supply dynamics across the country. The exchange can then seamlessly generate a range of all-in prices for locations across the country based on the India reference price and the tradable location premium.

The appropriate option and associated mechanics should be detailed in the blue-print stage based on consensus between market participants and infrastructure providers.

10 Bureau of Indian Standards.

Vaults

The vault operators will be responsible for safe storage and transportation of gold. In addition, vaults will also be responsible to ensure that the gold entering the exchange ecosystem is compliant with the good delivery standards. Sellers will be issued trade-able receipts (in dematerialised form) against the gold held in the vaults which they can use to trade on the exchange. Multiple vaulting centres across the country can be admitted, facilitating pan-India participation on the exchange.

India already has a well-established vaulting infrastructure which services all the major cities in the country. Given the established network, the proposed exchange can partner with one or more vault operators to provide vaulting and logistics services. Moreover, as the exchange gains scale, some banks may also be recognised as vault operators to leverage their wide reach, especially into the rural parts of the country.

Membership and access

The exchange can follow a standard tiered membership structure, where clearing members are direct participants on the exchange and their clients are indirect participants. This model is followed by established exchanges in India and will help extend the breadth of participants. Membership norms typically include eligibility criteria on qualitative and quantitative aspects and also require ongoing obligations to be met by the members.

Clearing and the Central Counterparty

Once an order is matched on the exchange, a Central Counterparty (CCP) becomes the counterparty to both seller and buyer. The CCP, therefore, underwrites any settlement risks on all trades executed on the exchange. This reduces settlement and clearing risks for participants which leads to lesser overall cost of operations, creating an incentive for more participants to trade on the exchange.

The CCP would need to comply with local regulatory requirements and adhere to global norms (such as IOSCO[11] Principles for Financial Market Infrastructures) on topics related to risk management (across financial and non-financial risks), default management, legal, governance, organisation, etc.

Settlement banks

Settlement banks provide the infrastructure for settlement of the cash leg of the trades. Since, trades executed by clients of clearing members are cleared through respective clearing members, all clearing members are required to have an account with one or more of the settlement banks. The norms for settlement banks can be defined by the exchange.

Settlement

All contracts on the spot exchange need to be physically settled and not cash settled. In Indian context, nomenclature of spot contract differs for securities and commodities. For securities, spot is defined as T+2 settlement (i.e. physical settlement two days after the trade is cleared). For commodities, spot is defined as T+11 or lesser and anything beyond T+11 (i.e. T+12 or more) is considered a forward contract. To facilitate physical deliveries, the standard settlement time for most global spot exchanges is T+2 and this should also apply to the gold spot exchange in India. This provides sufficient time for trade to be settled and also aligns the market with securities trading in India. Additional non-forward delivery options such as TOD (T+0, today), TOM (T+1, tomorrow), deferred spot (T+D) can be also considered depending upon industry requirements.

11 International Organisation of Securities Commissions.

IV: Potential for market transformation

A successful spot exchange and associated ecosystem can create a transformational benefit for India. Whilst it would involve significant changes for a number of market participants, there are benefits for all the stakeholders in the industry and the broader economy.

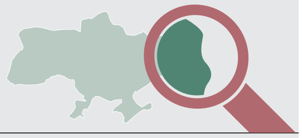
Lessons from global experience

Several countries such as the UK, China, Turkey, the UAE, Russia and Singapore have fully functional spot exchanges. However, Turkey and China, in particular, have a similar culture and consumption pattern to India. They also faced similar challenges around price, quality and monetisation. Early in their struggles, these markets introduced gold spot exchanges and have since witnessed significant growth and improvement. A number of lessons can be derived from these markets:

- A gold exchange can catalyse the process of reforming the gold market in the country
- The exchange may accrue indirect benefits for retail consumers (such as enhanced quality, transparent pricing, access to innovative gold backed products by banks)
- For the exchange to be successful, concerted efforts around policy making and market participation are needed by industry, banks and regulatory agencies
- Some exchange participants such as banks, importers, refiners can be mandated to participate on the exchange
- To truly transform the gold market, coordinated policy reforms are required along with setting up of the gold exchange
- The gold spot and futures exchanges offer products catering towards different objectives and therefore, independent existence of futures and spot exchanges may not lead to cannibalisation/ dilution of importance of either of the exchanges.

Figure 4: Gold spot exchanges – global case studies

Turkey



Market context

The Turkish market is similar to the Indian market in many ways. Turkey has historically had a similar affinity to gold and it is estimated Turkish households held approximately 3,500 tonnes of gold[12] in 2014. Like India, Turkey faced significant challenges managing gold import related current account deficit and mobilising gold held by households back into the financial system.

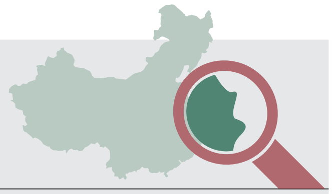
Reforms undertaken

The Istanbul Gold Exchange (IGE), established in 1995, was successful in solving most of the challenges in Turkey's gold market. The exchange was able to move trading of gold to the organised market thereby increasing market transparency. In addition to setting up the exchange, Turkey allowed Turkish banks to hold up to 30% of domestic currency reserves in the form of gold. This created incentives for Turkish banks to draw household gold into the financial system which led to several banks launching gold backed products such as gold current accounts and gold accumulations plans. This resulted in monetisation of more than 250 tonnes of gold allowing Turkey to achieve a current account surplus in 2012 from having a deficit of 10% of Gross Domestic Product, a year earlier.[13]

Impact

Setting up of IGE introduced transparency to the market which stimulated domestic demand and facilitated gold monetisation. This led to a number of tangible benefits for the market such as shifting of consumer preferences towards gold investment products, a significant reduction in the current account deficit, increased trust in Turkey's domestic market and greater pricing efficiency.

China



Market context

The Chinese market also bears significant resemblance to the Indian market. China is the world's largest importer and consumer of gold (India being the second largest) and gold is a preferred investment vehicle in both China and India.

Reforms undertaken

Until early 2000's, the Chinese market had restrictions on gold ownership and imports. The market also faced challenges around price transparency and quality issues. The Chinese government gradually liberalised policies to initiate gold market reforms. Additionally, while China already had an established gold futures exchange, a gold spot exchange (Shanghai Gold Exchange, SGE) was introduced to support market reform. The creation of SGE transformed physical gold trading in China, bringing transparency and market driven pricing mechanism to the market. SGE only allowed trading of standardised gold which was either imported into the country or recycled and refined by approved refineries which also ensured transparency around quality.

As in Turkey, commercial banks in China played an instrumental role in tapping the retail potential of the Chinese gold market. Chinese banks launched various gold related products and indirectly expanded the reach of the exchange to the whole country.

Impact

The SGE is a resounding success with approximately seven million individuals and 8,000 institutional clients trading on the exchange.[14] While gold consumption in China has increased at 6% over the last six years, value of gold traded on the SGE has increased by 27% over the same period. Partially as a result of these developments, China has emerged as a global gold hub and has gone from being a price taker to playing a significant role in influencing the global gold prices.

12 World Gold Council, *Turkey: gold in action,* 2015.

13 Similar to Cash Reserve Ratio (CRR) in India.

14 CEIC, exchange website.

Potential benefits to market participants and consumers

The spot exchange can accrue significant benefits to market participants. While bullion market participants will benefit directly, scrap dealers, gold doré importers and end consumers will receive indirect benefits. However, the exchange may also create some short-term challenges for those participants who currently do not adhere to delivery and compliance standards. The following table provides an assessment of the value proposition of the exchange for each participant segment.

Benefit-cost analysis for each participant segment from the exchange

Market segment	Value proposition of the exchange
Importers *(banks, nominated agencies, other importers)*	✓ Availability of a ready market to sell imported gold
	✓ Decrease in overheads due to reduction in counterparty and settlement risks and elimination of the need to conduct KYC[15] checks on clients
	✗ Possible increase in costs for imports from non-OECD compliant countries due to Good Delivery Standards requirements
Other domestic suppliers *(refineries, gold-scrap dealers, miners)*	✓ Large accredited refiners who adhere to international quality standards can access a broader range of market participants on-exchange
	✓ Decrease in overheads due to reduction in counterparty and settlement risks and elimination of the need to conduct KYC checks on clients
	✓ Growth opportunities for gold scrap dealers and unorganised refiners due to increased monetisation of household gold
	✗ Potential loss of margin for some players due to increased price transparency and competition
Intermediaries *(bullion traders)*	✓ Greater market access, reduced clearing and settlement risks
	✓ Can continue to play an active role in OTC market for non-standard contracts (e.g. contracts of different size)
	✓ Potential increase in business due to greater market making opportunities
Organised segment *(large manufacturers, retailers)*	✓ Transparency in price and quality of gold purchased from the market
	✓ Easy and reliable sourcing of gold through the exchange
Unorganised segment *(small manufacturers, retailers)*	✓ Addresses concerns such as non-availability of gold, low quality of gold and price distortions
	✗ Higher tax obligations for some players due to greater transparency in movement of gold
End consumers *(gold purchasing customers)*	✓ Provides a ready market for both purchase and sale of standardised gold at prevailing market prices
	✓ Enables consumers to deploy their gold holding through either banks or directly on the exchange
	✓ Price transparency and ease of recycling

In addition there are indirect benefits:

	✓ Enhanced quality
	✓ Transparent pricing
	✓ Innovative gold backed products

✓ Benefits ✗ Costs

15 Know Your Customer.

Benefits to the overall economy

While the exchange will bring some benefits immediately, the key benefits to the Indian economy will accrue over time as the exchange evolves from being a wholesale/institutional and domestically focused to enabling retail and offshore participation. For enabling offshore participation, the GIFT[16] initiative launched by the government, an offshore unit of the exchange can be set-up at the IFSC[17] to attract offshore investors.

Overall, there are four key benefits for the Indian economy:

India reference price: The Indian market has long aspired to introduce a credible India reference price. The spot exchange is the most appropriate mechanism for realising this objective. The price of executed spot trades during an agreed period (e.g. five minute window before the close) can be used to automatically generate a settlement price that can be used as a reference price. Most exchanges use a 'volume weighted average price' during the window with fall-back mechanisms in case of insufficient liquidity and should be implemented in a manner so as to be compliant with IOSCO Principles for benchmarks and best practices defined by international benchmark regulations.

Strong impetus to gold monetisation: Indian households hold ~22,500 tonnes of gold. While banks' widespread network and trust factor are essential to facilitate retail investors to bring their gold to formal financial channels, the spot exchange can be a key enabler for the success of these efforts. The exchange can provide strong impetus to gold monetisation schemes by facilitating price transparency at the time of both sale and purchase of gold. In addition, the exchange can also help enable banks to design and offer innovative gold linked products through the ecosystem provided by the exchange.

Stabilisation of gold imports: Monetisation of household gold will increase the circulation of gold in the Indian economy thereby stabilising the impact of gold imports on India's current account deficit.

Emergence of India as a global hub: An organised domestic gold market, along with establishment of India reference price, will increase India's influence in global gold market. Moreover, given the volume of gold imported into India, opening up India's gold market to offshore units can potentially create a strong case for India to emerge as a global hub for gold trading.

16 Gujarat International Finance Tec-City.

17 International Financial Services Centre.

V: Critical success factors

Establishing a new exchange and successfully building participation and liquidity is challenging. Many new exchanges struggle to become widely accepted and overcome the inertia of the status quo (such as shifting liquidity from existing OTC markets). Based on global experience, there are a number of success factors.

Clear regulatory architecture

A clearly defined regulatory architecture is a pre-requisite for confidence in the exchange. Currently, the regulatory framework in India defines trading in commodity spot markets under the State List.[18] Given the exchange will be national in nature, in order to be successful, central oversight and clear ownership of regulatory responsibilities will be critical. Amongst various choices, there are two options for oversight:

Oversight by financial sector regulators (SEBI and RBI): SEBI[19] is the regulator for all existing exchanges in India. SEBI can leverage its expertise to regulate the proposed spot exchange with appropriate adaptations of policies and supervision processes. Since banks will play a key role in the exchange as well as long term transformation of the gold market, certain policy actions may also need to be led by RBI.[20]

Allowing central financial regulators to govern the proposed exchange will require gold trading to be brought under the purview of Union List[21] or Concurrent List.[22] This can either be done by passing a constitutional amendment or by classifying gold trading as a subject of "investor protection." Additionally, gold traded on the spot exchange will need to be included in the definition of "security" as defined under the Securities Contract Regulation Act, 1956.

A new central body cum regulator for gold: A sector-specific body with constitutional powers to govern the gold trading and gold market can be established under the central government. This will require parliament to pass an Act to create and define the operations of the new body and also make associated amendments to allow this body to govern the gold market in India. Once done, this body will be the central body on gold market and thus will be able to focus on overall governance and development of the gold market.

Both the options above are feasible and the way ahead may be chosen based on the direction provided by policy making and regulatory bodies in India.

18 This list covers those matters upon which the state governments have exclusive powers to legislate, e.g., fisheries, public health, sanitation, commodities trading.

19 Securities Exchange Board of India.

20 Reserve Bank of India.

21 This list covers those matters upon which the central government has exclusive powers to legislate, e.g., foreign affairs, atomic energy, railways, banking.

22 This list covers those matters upon which both the central government and the state governments have powers to legislate. However, it is to be noted that the central government has the overriding power in all such matters, e.g., bankruptcy, adulteration, labour disputes, and oil seeds.

Collaborative approach across all market participants

No single organisation has the mandate or ability to single-handedly drive this agenda. Therefore, it is paramount that there is close consultation, collaboration and coordination across industry stakeholders, market participants and regulators on the key design elements of the exchange.

Additionally, once the exchange is set up, market participants such as wholesale bullion traders and large refiners will need to play an active role in creating liquidity for the initial operations of the exchange.

Pro-active measures to attract liquidity

Building liquidity on an exchange is the fundamental challenge and determines its eventual success. The product offering and operating model for the exchange needs to be designed in a way that it works for the market and offers tangible benefits for participants. In addition to the business benefits to use the exchange, it may be necessary to introduce a regulatory push (e.g. China model where numerous participants are mandated to trade only via the exchange). Buy-in and commitment to using the exchange can also be embedded through commercial incentives for market participants to trade on the exchange.

Active participation from banks

Participation from institutional players such as banks is crucial to the success of any exchange. For the gold exchange also, participation from banks will be important to gain scale and build liquidity. However, due to regulatory restrictions, banks cannot play an active role in the gold market. These regulations include restrictions on buying and selling gold in the domestic market, participating in the futures market and launching gold linked products. In addition, banks can only hold gold as part of SLR[23] requirements, which is not economical due to the lower yield from gold as compared to other liquid instruments, such as government securities. To truly incentivise banks to participate in the gold market and to make the economic case stronger, banks may also be allowed to hold gold as part of CRR[24] requirements.

Tax neutrality

The taxation structure on exchange trading should not deter participation on the exchange. As a result, the taxation norms may be adapted such that there is a level playing field with the OTC market:

- CTT[25] should not be levied on gold traded on the spot exchange to make the cost of transacting on the exchange comparable to the OTC market
- GST[26] should not be levied until the point where gold leaves the exchange (i.e. leaves the vaults under the exchange ecosystem by taking of physical delivery).[27]

The exchange must also enforce strict rules around membership and participation, including KYC and AML[28] checks to prevent money laundering.

Leveraging existing infrastructure

Given the above success factors, there are a range of synergies in partnering with existing market infrastructure providers to help create the proposed exchange. Existing players would not only provide appropriate governance but also offer proven operational and technology capabilities. This model is similar to that taken in other markets, where large gold exchanges, including Borsa Istanbul and LMEprecious, were set up in partnerships with existing infrastructure providers.

23 Statutory Liquidity Ratio.

24 Cash Reserve Ratio.

25 Commodity Transaction Tax.

26 Goods and Service Tax.

27 It is important to note, that there will not be any lost tax revenues if GST is applied at point of physical delivery (however, there may be a delay in tax revenue accretion). Overall, there will be an increase in tax revenues due to greater transparency in the gold market.

28 Anti-Money Laundering.

VI: Proposed next steps

A successful gold spot exchange will need to cater to the needs of all market participants.

This will require close coordination among market participants to define the vision, structure and implementation model. This will also require parallel development across the policy/regulatory framework, good delivery standards and design of the exchange's products and capabilities.

The implementation process may be carried out in three phases as shown below.

Given the magnitude of work that needs to be done in setting up the exchange, World Gold Council, as an industry body, is willing to play a key role in this entire process.

Phased implementation of the exchange

Phase 1

Mobilisation of market participants

- Secure participation and commitment from key market participants, industry bodies, infra providers towards the cause of setting up a gold exchange
- Establish an appropriate governance and project management office structure (e.g. cross-stakeholder steering committee) that balances breadth of participation with the need to work through detailed issues to setup the exchange
- Define a shared vision for the spot exchange with a clear articulation of objectives and target outcomes.

Phase 2

Blueprint of the design

- Design the detailed operating model including membership, products, trade execution, clearing and settlement and vaulting and physical delivery (refer appendix B for non-exhaustive list of topics that will need to be detailed)
- Create the business case for the exchange
- Perform a detailed regulatory and legal analysis to identify any additional risks and dependencies.

Phase 3

Partnering and implementation

- Agree on the implementation model i.e. partnership model vs greenfield project
- If the exchange is set-up under partnership model
  - Define and prioritise the selection criteria for potential partnerships to support the build out of the exchange
  - Conduct selection process for preferred partnerships
- Agree on the role of industry participants in the governance and ownership of the exchange
- Mobilise funds for setting up the exchange
- Finalise implementation plan
- Commence implementation.

Role of the World Gold Council

The World Gold Council is committed to supporting the development of the Indian market in line with global best practices. It has no affiliation to any market participants and is neutral. The World Gold Council has extensive experience in orchestrating and delivering similar market infrastructure initiatives across the world and would bring this expertise to bear.

The World Gold Council played an instrumental role in leading the reform of the London trading market. It identified the need for a suite of exchange-traded contracts to complement the OTC market and address a number of structural challenges in the market. The World Gold Council consulted a broad range of market participants and partnered with leading financial institutions to develop the target product and operating model. The World Gold Council led the selection process of a preferred infrastructure provider and negotiated governance and commercial arrangements with participating firms. The early success of this initiative demonstrates the World Gold Council's ability to partner effectively and drive positive structural change.

The World Gold Council has played similar roles in the launch of Shanghai Gold Exchange and a kilobar contract on the Singapore Exchange. Given the World Gold Council's international experience, it is well positioned to play a leading pivotal supporting role in establishing the spot exchange.

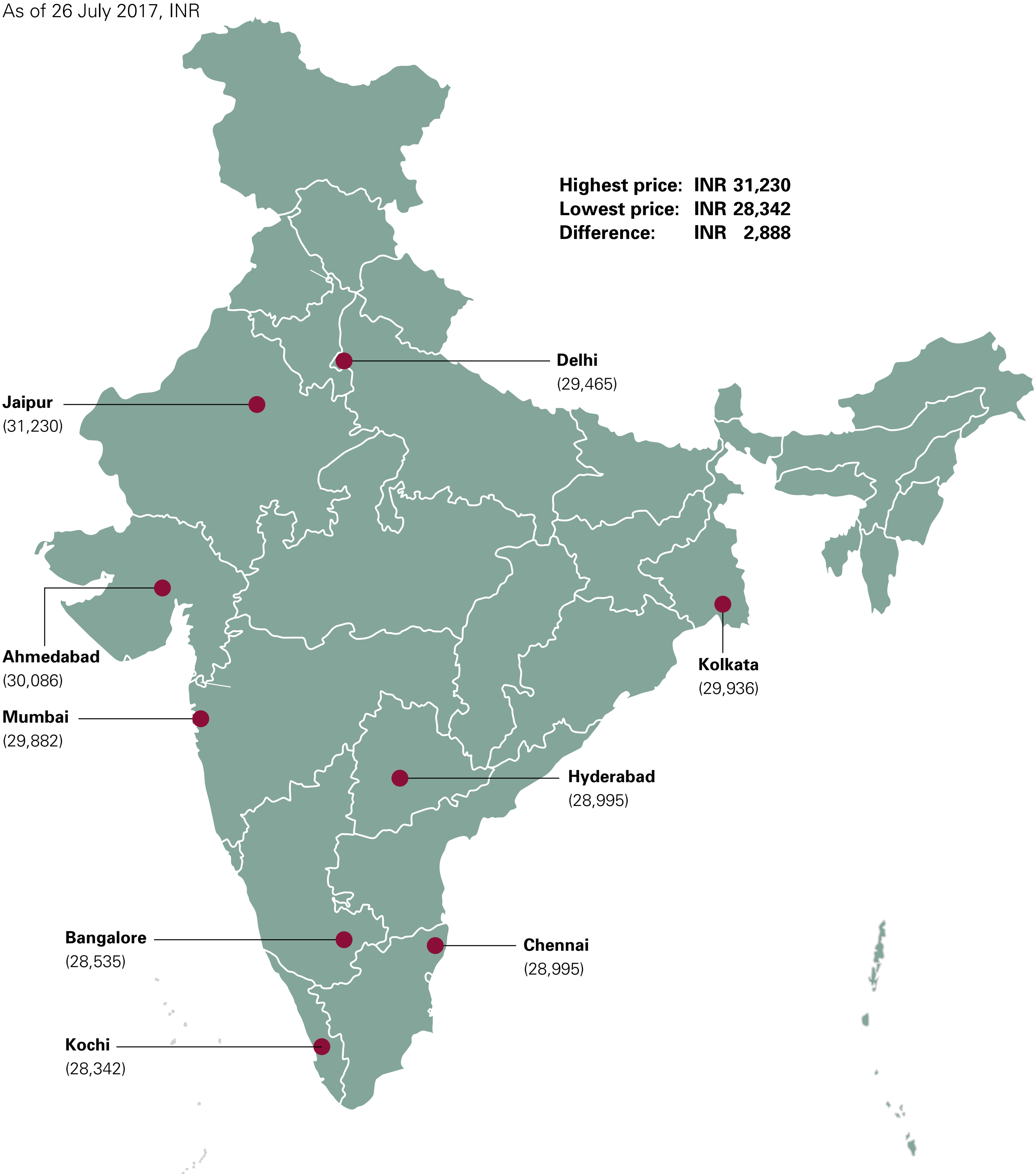
Immediate next steps

Phase 1 of the roadmap i.e. mobilisation, can be kick-started by creating an industry committee with broad representation from market participants to drive the agenda of setting up the proposed exchange. Key to this will be to have a lead champion to orchestrate the group. This body should start by validating and challenging the hypotheses put forward in this report so that a shared vision for the exchange can be defined. Subsequently, the committee will need to focus on designing key components of the proposed exchange. Only once the overall exchange architecture and product model is clear, does it become appropriate to discuss the approach for detailed design, partnering and implementation. It is also recommended that structured engagement with regulators and policy making bodies is initiated to facilitate the regulatory changes required that will enable the exchange to succeed.

Creation of an industry committee to drive the agenda

Appendix A. Wide discrepancies in gold prices across Indian cities

Price of 10 grams of gold (24 carat)
As of 26 July 2017, INR



Source: Sify Finance

Appendix B. List of factors to be detailed in exchange blueprint

Category	Topics to be detailed in subsequent steps
Regulatory oversight	• Who will regulate the proposed exchange?
	• Who will regulate the vaults?
	• What will be the mechanism for cross regulatory co-ordination?
Business case evaluation	• What will be the revenue model?
	– What should be the trading and clearing fees?
	– What should be the criteria for determining the fees?
	– Are there any revenue sources other than trading and clearing fees?
	– What will be the other sources of income?
	• What are the costs requirements for setting up the exchange?
	– What will be the upfront investment required (greenfield vs partnership)?
	– What will be the sources for capital?
	• What will be the annual costs of operating the exchange?
	• What will be the breakeven trading volume?
	• What will be level of initial participation required to kick off operations of the exchange? What will be the extent of incentives required to bring that participation?
Membership norms	• Who can be members of the exchange?
	• What will be the eligibility requirements for membership?
	• What will be the ongoing requirements of capital, risk management, net worth for members?
	• What will be the turnover limits for trading on the exchange?
	• What are rights of a member?
	• What will be the KYC norms for clients of the clearing members?
	• What will be the fees and deposit structure for members?
	• What is the limit on fees which clearing members can charge to their clients?
	• What are the rules for maintenance of margins?
	• What is the transaction limit for members (if any)?
Trading	• What is the list of contracts that will be traded on the exchange?
	– What will be the trading unit?
	– What will be the quality/ fineness specifications and what will be the tolerance limit, if any?
	– What will be the tick size for contracts listed on the exchange?
	• What will be the trading timings of the exchange?
	• What will be the order matching rules?
	• What types of orders can be placed on the exchange?
	• What will be the daily price variation limit for gold?
	• How will the India reference price be determined?

Category	Topics to be detailed in subsequent steps
Clearing and settlement	• What will be the different settlement periods offered by the exchange?
	• What will be the clearing and settlement mechanism?
	• What types of collaterals will be accepted by the exchange?
	• What should be the size of the default fund and what would be the overall design of lines of defence?
Vaulting and delivery	• What will be the physical delivery mechanism?
	– How many delivery centres should be set-up?
	– Whether the seller or the buyer has the delivery location option?
	– Who will pay the delivery charges?
	– What will be the delivery unit for each contract listed on the exchange?
	• What will be the norms for vault operators?
	– Which locations can have exchange recognised vaults?
	– What are the minimum requirements for vault operators?
	– What delivery standards should the operators adhere to?
	– What will be the prescriptive list for vaulting charges?
	– What will be the prescriptive list for delivery charges for delivery to the delivery centres?
	– What will be the prescriptive list for delivery charges for delivery to locations other than the delivery centres?
	– What are the minimum infrastructural requirements for vaults?
	– What directions are required to be followed by vault operators to participate with logistics service providers?
Ownership and governance	• (Assuming that the exchange is set-up through partnership) What will be the criteria for selecting which market infra providers the exchange should partner with?
	• What will be the ownership structure of the proposed exchange?
	• What will be the governance norms for the proposed exchange?
	• What should be the mode of industry participation in governance mechanism of the exchange?
Reporting	• What reporting requirements should the exchange, the CCP and the vault operators comply with?
	• What will be the delay in publishing gold prices in the market?

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