The New Era of Bullion Trading: Market Reforms through India International Bullion Exchange (IIBX) and Navigating Customs Duty Changes

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Abstract

The Government of India and the International Financial Services Centres Authority (IFSCA) have undertaken strategic initiatives to establish the India International Bullion Exchange (IIBX), a revolutionary platform set to transform bullion trading in India. With its prefunded model, IIBX provides a strong safeguard against unpredictable duty changes, ensuring enhanced liquidity, transparency, and price discovery. To support IIBX, the Government of India and IFSCA have enabled the participation of qualified jewellers, suppliers, and TRQ holders. As Indian banks begin to engage with IIBX, it may be opportune time for a reassessment of traditional consignment models and move towards more resilient, sustainable and secure bullion trading ecosystem. In a bold move, the Government of India in its Union Budget 2024 slashed the duties on gold and silver from 15% to 6%, sparking both excitement and uncertainty in the bullion market. We explore the sweeping implications of this change, particularly for nominated banks operating on consignment models, who may now face significant financial risks. Discover how the IIBX is set to become a game-changer in the gold and silver market, ensuring stability and fostering a vibrant, transparent marketplace in India's evolving financial landscape.

Background

The idea of a bullion exchange in GIFT IFSC was proposed by NITI Ayog Committee in its report on *"Transforming India's Gold Market"* in February 2018.

The Committee recommended that establishment of an International Bullion Exchange in International financial services centres (IFSCs) have two big advantages:

- A regulatory regime that provides global credibility
- Sufficient exemptions from capital controls to make the global contract feasible.

The Committee also recommended that the setting up of a Bullion Exchange in the GIFT-IFSC can provide the following:

- Allow import of gold in India through GIFT City.
- Create a set of vaults in GIFT-IFSC for gold that adhere to standards set by the regulator.
- Vaults to work with the proposed Bullion Exchange being setup in India for distribution of the same in the local markets.
- Allow trading with global markets, which can create a vibrant marketplace that helps in price discovery, with potential for India to be the price setter in the gold commodity.

Most of the recommendations in the NITI Ayog Report have been implemented, beginning with a regulatory regime that provides global credibility. The International Financial

Services Centres Authority (IFSCA) was established on April 27, 2020, under the International Financial Services Centres Authority Act, 2019, for formulating a regulatory framework that provides global credibility for all financial services activities, including, the regulations for establishment of an International Bullion Exchange. The International Financial Services Centres Authority (Bullion Exchange) Regulations, 2020 were notified on December 11, 2020.

The International Financial Services Centres Authority (IFSCA) spearheaded the creation of the India International Bullion Exchange (IIBX), supported by five major Market Infrastructure Institutions (MIIs) to create a sustainable exchange-based business model. The National Stock Exchange (NSE), India International Exchange (INX, a subsidiary of BSE), Multi Commodity Exchange (MCX), National Securities Depository Ltd (NSDL), and Central Depository Services Ltd (CDSL), which are institutions of immense credibility as exchanges and depositories have come together to establish a bullion trading and clearing platform at the International Financial Services Centre (IFSC) in GIFT City. The IIBX was officially recognized as a Bullion Exchange and Bullion Clearing Corporation on December 10, 2021.

The Hon'ble Prime Minister inaugurated the India International Bullion Exchange (IIBX) on July 29, 2022, at GIFT City's IFSC. During the launch, the Prime Minister stated:

"India is a very big market in the field of gold and silver today. But, should that be the only identity of India? The identity of India should also be that of a market maker. IIBX is an important step in this direction. IIBX will also provide opportunities to trade in gold directly through the exchange. As the gold trading market becomes organized, the demand for gold in India will also impact and determine the gold prices."

The IIBX aims to enhance liquidity, transparency, and price discovery in bullion trading through several mechanisms:

1. It serves as a centralized platform for market participants, facilitating efficient matching of buy and sell orders through price-time priority, thus improving market efficiency and liquidity.
2. It offers standardized contracts with defined sizes, quality specifications, and delivery terms, reducing transaction costs and ensuring uniformity in trading terms for all participants.
3. Through continuous trading activities in both spot and derivatives, IIBX contributes to price discovery, enabling informed decision-making for market participants.
4. Robust market surveillance mechanisms are in place to detect irregularities and market manipulations, maintaining market integrity and investor confidence. Under the regulatory oversight of IFSCA, IIBX operates transparently, ensuring fair and orderly trading and enhancing market credibility.
5. By granting access to a diverse range of participants, including traders, jewellers, brokers, banks, and financial institutions, IIBX fosters healthy competition, liquidity, and efficient price discovery.

Overall, IIBX plays a pivotal role in advancing liquidity, transparency, and price discovery in bullion trading through its centralized marketplace, standardized contracts, regulatory oversight, and inclusive market access.

Initiatives by the Government

To facilitate volumes on IIBX, various steps have been taken by the government which include the following:

- Enabling Qualified Jewellers (QJs) with a Net Worth Criteria of INR 25 Crore to import directly through IIBX.
- Enabling import of bullion (gold/silver) under India-UAE CEPA directly through IIBX for 'Qualified Jewellers and valid Tariff Rate Quota (TRQ) holders.
- Implementing ICEGATE at GIFT-IFSC customs for availing concessional rate of duty by QJs and TRQ holders under India-UAE CEPA.
- Exempting TRQ holders from IGCR Rules 2022 for import of gold through IIBX.
- Government of India had also initiated stakeholder consultations on January 2024, chaired by Hon'ble Finance Minister to facilitate the participation of Indian banks on IIBX.

IIBX- The new gateway integrating international and domestic markets

The IIBX has emerged as a significant platform facilitating the participation of both domestic and international market participants, effectively creating a unified marketplace for conducting bullion transactions.

Since the late 1990s, the physical supplies of gold and silver were predominantly controlled by a limited number of suppliers and importers under the conventional models of import. However, there is a paradigm shift with the introduction of new supply channels through IIBX, enabled by government initiatives and regulations from IFSCA.

IIBX has disrupted the prevalent structures of trading that largely support opaque bilateral bullion transactions, compelling a shift towards a transparent exchange-based ecosystem. Within this ecosystem, participation of clients, members, trading, risk management, clearing and settlement processes are objectively overseen by IIBX, rather than being contingent on institutional ties and bilateral agreements.

There is an expectation that large bullion-supplying banks, nominated banks and other entities will progressively adopt the transparent and credible exchange ecosystem offered by IIBX, surpassing traditional bilateral models of conducting bullion businesses.

Thanks to the initiatives led by the government and IFSCA, the IIBX has experienced an uptick in trading volumes and witnessed a rise in the participation of members and clients. Below are outlined some of the key developments across various aspects of the exchange:

a. Trading Volumes

Since the inception of IIBX in July 2022, the total volumes of gold traded had crossed 26 tonnes, while silver volumes stand at 1137 tonnes as on August 6, 2024. The disintermediation advantage facilitated by IIBX has attracted bullion dealers and jewellers with an alternative avenue for importing gold and silver, distinct from the conventional method of importing through nominated banks and agencies under the consignment model.

b. Participants

i. Qualified Jewellers and Suppliers: The exchange has successfully drawn in a significant number of participants, including 133 'Qualified Jewellers'and 25 active 'Qualified Suppliers'. Most of the suppliers are based in Dubai, as there is currently no mandatory requirement for nominated banks to import gold and silver through IIBX, and the consignment model for gold and silver imports remains operational. Suppliers and jewellers are participating in the IIBX due to government incentives, such as concessional duties and exemptions for TRQ holders to import gold through IIBX, which promote the use of this transparent platform. Qualified Jewellersand Qualified Suppliersare required to adhere to the guidelines issued by IFSCA and IIBX in order to participate in the exchange ecosystem and extensive and enhanced due diligence is conducted on their participation.

ii. TRQ holders under India-UAE CEPA: In order to facilitate participation on IIBX for the importation of gold under the India-UAE Comprehensive Economic Partnership Agreement (CEPA), the Directorate General of Foreign Trade (DGFT) under the Ministry of Commerce authorized the import of gold by valid TRQ holders on November 20, 2023. Subsequently, the IFSCA operationalized this directive through its circulars dated December 13, 2023. Apart from the 'Qualified Jewellers' who may also hold quotas under the India-UAE CEPA, a total of 296 TRQ holders have been granted permission to import gold through IIBX. The issuance of these TRQ quota licenses by DGFT occurred in May 2024 and is anticipated to enhance gold trading volumes on IIBX during the fiscal year 2024-25. The total quota allocated for the fiscal year 2024-25 was 160 tonnes, and a significant portion of import volumes is anticipated to be facilitated through trading on IIBX.

iii. Participation of India banks on IIBX: The Reserve Bank of India (RBI) in February 2024, has permitted Indian banks' branches located at GIFT-IFSC, designated as International Banking Units (IBUs), to function as Trading Clearing Members (TCMs) on IIBX. State Bank of India has achieved the distinction of being the first Indian bank to assume the role of a TCM on IIBX. Other prominent banking institutions with branches established at GIFT City, such as ICICI Bank, HDFC Bank, among others, are also poised to participate as TCMs on IIBX in the near future.

Furthermore, RBI has granted permission to nominated banks engaged in the importation of gold and silver to participate on IIBX as Special Category Clients (SCCs).

It is expected that large foreign banks and financial institutions are likely to participate on IIBX once the Indian banks commence operations on IIBX.

c. Products

The exchange has introduced new gold and silver products for hedging, such as futures trading, with the aim of increasing trading volumes and enable resident entities to hedge gold and silver prices. It may be noted that the RBI has already permitted the resident entities to hedge price risks on IFSC exchanges. Consequently, a significant amount of gold hedging may occur through IIBX which eventually may ensure India to become a price influencer.

d. Vaulting infrastructure

IFSCA has granted registration to three highly secured and state-of-the-art vaulting facilities located at GIFT-IFSC, boasting a combined capacity of approximately 420 tonnes for gold and 2200 tonnes for silver. Furthermore, an additional facility in Chennai is now activated which is having the capacity of approx. 20 tonnes and silver approximately 200 tonnes. This facility in Chennaiis the first vaulting infrastructure established outside

GIFT-IFSC, catering specifically to the delivery needs of gold and silver in the southern region of India.

Budget 2024: Unravelling the Impact of Drastic Customs Duty Cuts on Nominated Banks and the sustainability of Bullion Imports in the current model

In a dramatic policy shift, in the Budget 2024, the Indian government had slashed the customs duty and Agricultural and Infrastructure Development Cess on gold and silver from a hefty 15% to a mere 6%. This sweeping 9% reduction translates into a staggering drop in duties in absolute terms in today's price—INR 5,90,000 per kilogram for gold and INR 5,340 per kilogram for silver. While this may seem like a golden opportunity for importers, it's creating a whirlwind of uncertainty for nominated banks.

Picture this: February 2024, nominated banks, operating on consignment models with global bullion banks, potentially imported 700 tonnes of silver. These consignments, backed by customer margins in guarantees and cash, may now lie in domestic vaults. However, the sudden duty reduction has thrown a wrench into their carefully calculated risk management plans. Without full margin backing from their clientele, banks could face a jaw-dropping loss of around INR 370 Crores.

Gold, too, is not spared. If 8 tonnes of gold are sitting in domestic vaults, potentially imported under the previous duty regime, and client margins fall short, nominated banks might be staring at probable losses of INR 470 Crores. The stress levels within the banks' risk departments may be soaring as they grapple with these potential financial black holes.

This scenario begs a critical question: Is the consignment model, especially for non-manufacturing entities, worth the risk?

Nominated banks are caught in a speculative storm, unable to hedge on domestic exchanges, making them perilously dependent on traders for whom they ordered the consignments. With customs tariff changes known in advance, importers could exploit these fluctuations, turning the whole process into a high-stakes gamble.

IIBX: The Golden Shield Against Customs Duty Chaos

Amid the turbulence of customs duty funding, the India International Bullion Exchange (IIBX) may be the answer for the nominated banks with its prefunded model for gold and silver imports. In this system, nominated banks must ensure all funds, including customs duties, are secured in INR before transactions are executed. This approach shifts the entire risk to the clients, providing banks with a solid risk management shield against unpredictable duty changes. The Reserve Bank of India authorized Nominated Banks to participate in the IIBX on February 9, 2024. Following this, the IFSCA issued the necessary guidelines for their participation on April 19, 2024.

Regulators must seize this moment to reassess the consignment model. Despite its apparent simplicity, the inherent risks are enormous. Banks are not just intermediaries; they are pivotal players in the financial ecosystem. Moving to a prefunded exchange model could fortify their stability and promote a more resilient market structure.

In this fiscal storm, the stakes have never been higher. The future of gold and silver imports in India hinges on banks being trusted and well-regulated entities. It's now up to both the banks and regulators to reassess the risks and adapt to the evolving financial landscape.

Conclusion

The recent reduction in customs duty and cess on gold and silver presents significant risks for nominated banks operating under consignment models. These banks could face substantial losses if customs duties are not covered by cash margins from their clients. The India International Bullion Exchange (IIBX) provides a viable solution with its prefunded model, ensuring all funds are secured before transactions, thus mitigating financial risks.

Nominated banks, their internal risk teams, and regulators may need to reassess the consignment model and its associated risks, including the potential for speculative gold and silver imports. They should adopt the prefunded exchange model to better serve bullion dealers by ensuring full funding of the bullion through the exchange. The consignment model should be reserved for importing gold for jewellers and exporters who ensure value addition and require working capital finance in the form of gold metal loans.

Notably, the exchange ecosystem boasts 25 suppliers, whereas the consignment ecosystem has only 7 to 8 active global suppliers despite being in operation for over 15 years. Wouldn't an exchange model be an ideal solution to ensure more suppliers and reduce procurement costs?

This shift will enhance market stability and transparency, ensuring a sustainable and transparent trade of gold and silver imports in India. MA

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