Gold Exchange-Traded Funds (ETFs) in India: A Comprehensive Overview

Gold Exchange-Traded Funds (ETFs) have emerged as a key investment vehicle in India offering investors a convenient and cost-effective way to gain exposure to gold without the complexities of physically owning the metal. The evolution of Gold ETFs in India has been marked by significant regulatory support, increasing investor awareness, and the growing shift from physical gold to financial gold.

1. The inception of Gold ETFs in India (2007)

- **Launch of the first Gold ETF:** The first Gold ETF in India was launched by Benchmark Mutual on the NSE platform.
- **Structure of Gold ETFs:** Gold ETFs in India are open-ended mutual fund schemes that invest primarily in gold and gold related instruments (including Exchange Traded Commodity Derivatives and Gold Deposit Scheme of banks) and are listed and traded on stock exchanges. Each unit of the ETF usually represents a specific weight of physical gold (usually one gram or a fraction thereof). Investors can buy and sell ETF units like shares on the exchanges.

2. Early Adoption (2007-2010)

- **Initial Growth:** After the launch of Gold Bees, other fund houses began launching their own gold ETFs. Some of the prominent ones and the year of launch in bracket are shown below:
- **HDFC Gold ETF** (2010)
- **ICICI Prudential Gold ETF** (2010)
- **SBI Gold ETF** (2009)
- **Reliance Gold ETF** (2009)
- **Popularity:** Gold ETFs started gaining traction as they provided a more convenient and cost-effective way to invest in gold compared to buying physical gold (which often involves high premiums and storage concerns) in a regulated market environment. As these units are traded on the stock exchanges, they offered liquidity and reduced transaction costs in comparison to physical market.

3. Rise in Popularity (2010-2015)

Increased Investor Awareness: As awareness of ETFs grew, more investors began to shift their focus away from physical gold (coins, bars, and jewellery) to financial gold in the form of ETFs, driven by the ease of trading and lower costs.

- **Asset Growth:** The gold ETF market witnessed significant growth in terms of assets under management (AUM), especially during periods of high gold prices (e.g., 2011-2012), when gold became a favoured asset class for investors seeking a hedge against inflation and global uncertainties.
- The concept of **Gold Fund of Funds (FoF)** was introduced in India in **2011**. This financial instrument was launched to offer investors an indirect way of investing in gold without the need to directly purchase or hold physical gold or even Gold Exchange-Traded Funds (ETFs). For the investor, the minimum threshold investment dropped with the introduction of FoF.
- In 2012, SEBI introduced **AIF Regulations** to govern Alternate Investment Funds (AIFs) in India, initially permitting investments in equity, debt, and real estate. In **2015**, SEBI clarified that **Category III AIFs** (including hedge funds, private equity, and other complex funds) could invest in **Gold ETFs,** enabling them to diversify their portfolios. This clarification provided AIFs with an opportunity to include gold in their asset portfolios.

4. Market Volatility and Growth Challenges (2015-2020)

- **Volatility in Gold Prices:** Between 2015 and 2020, gold prices went through cycles of volatility. The demand for gold ETFs fluctuated, with investors showing more interest during periods of rising gold prices (e.g., during the 2018-2020 gold rally).

- SGBs have been a direct competitor to Gold ETFs, especially given their appeal due to the interest paid over the bond's life. However, since February 2024, there has not been any fresh issuance of SGB.
- Another financial product that gained popularity was digital gold. The main advantages of digital gold over gold ETFs are small ticket purchase, extended market hours and exchange accumulated gold for jewellery at select stores. However, digital gold is not regulated.
- The India Gold ETF (Exchange-Traded Fund) market has seen significant growth in recent years, driven by a rising interest in gold as an asset class, along with the increasing popularity of ETFs as a convenient and efficient investment vehicle.

Key Features of India's Gold ETF Market:

1. **Growth in Popularity:** The Gold ETF market in India has grown steadily, with investors increasingly looking to diversify their portfolios and hedge against inflation. The growing acceptance of financial instruments like ETFs has contributed to this growth, with more investors seeing gold as a safe haven.
2. **Regulatory Support:** The Securities and Exchange Board of India (SEBI) regulates Gold ETFs in India. These ETFs are listed on the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). The government has also made regulatory efforts to boost gold investment through initiatives like the Sovereign Gold Bond (SGB) scheme, further encouraging the shift from physical to financial gold.
3. SEBI's guidelines for Gold ETFs focus on ensuring transparency and security, requiring **100% physical backing** by gold for every unit issued, linking the ETF's value directly to gold prices. A third-party custodian is mandated for safekeeping the gold, ensuring independence from the fund manager to avoid conflicts of interest. The gold must meet a purity **standard of at least 995%,** and its value is based on the **current market price. Trustees** ensure compliance with SEBI's regulations, including periodic disclosures of holdings and custodian details. These measures boost **investor confidence,** reduce risks of fraud, and promote **regulatory oversight,** contributing to the popularity of Gold ETFs in India.
4. **Expense ratio:** Gold ETF expense ratios in India have significantly decreased over time. Initially, from 2007-2010, expense ratios ranged from 1.0% to 1.5% due to the nascent ETF market. By 2010-2015, as the market matured and competition increased, these ratios declined to 0.5%-1%. Between 2015 and 2020, further reductions occurred, with some large ETFs lowering ratios to around 0.5%, aided by economies of scale and the launch of direct plans. Key factors include competition, scale economies, technological advancements, and regulatory changes like direct plans (2013) and SEBI's efficiency-driven regulations (2014). This trend is expected to continue as investors demand lower costs.

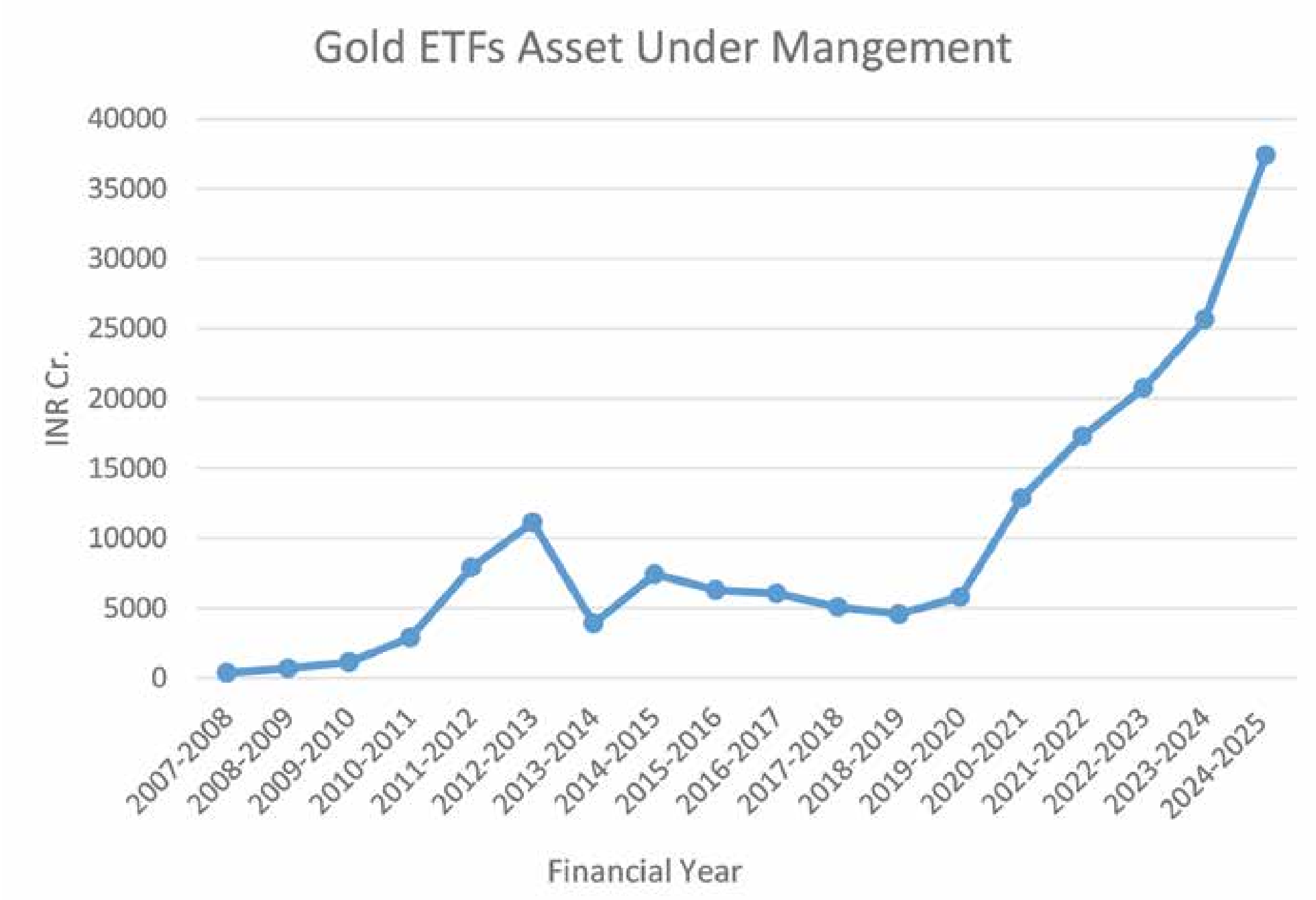
Taxation

A key factor driving the growth of gold ETFs is the favourable tax regime introduced in the 2024 budget. Accordingly, gold ETFs has been classified as debt funds with the holding period for Long-Term Capital Gains (LTCG) has been reduced from 3 years to 2 years. Additionally, the LTCG tax rate has been significantly lowered to 12.5%, with the removal of the indexation benefit, replacing the previous rate of 20% that included this

Challenges and Opportunities:

- **Price Volatility:** Gold ETFs are subject to the volatility of global gold prices, which can be influenced by factors like geopolitical tensions, inflation, and currency movements. This presents both risks and opportunities for investors.
- **Awareness and Education:** While Gold ETFs offer many benefits, there is still a need for greater awareness and education among Indian investors about how they work and their advantages over traditional physical gold investments.
- **Increased Competition:** As more AMCs enter the market, competition is increasing, which could lead to lower expense ratios and better services for investors.

Trends of Asset under Management of Gold ETFs in India- A Historical Perspective



Source: IGPC/ Note: For FY 2024-2025 data up to November 2024

Conclusion:
The Gold ETF market in India is poised for further growth, with increasing adoption from retail and institutional investors. With regulatory support, market liquidity, and the rising appeal of gold as a financial asset, Gold ETFs provide a convenient and efficient way for Indian investors to gain exposure to gold while diversifying their portfolios.

Key Enablers for Gold ETF Market Development in India

Enabler	Description
Regulatory Support	SEBI (Securities and Exchange Board of India) has established clear guidelines for Gold ETFs, ensuring transparency, security, and investor protection.
Tax Benefits	Gold ETFs are taxed as capital assets, benefiting from long-term capital gains (LTCG) tax rates after a 3-year holding period.
Liquidity and Accessibility	Gold ETFs are traded on stock exchanges (NSE, BSE), providing high liquidity and making them accessible to a broad investor base.
Diversification of Investment Options	Gold ETFs provide an easy diversification tool for portfolios, offering exposure to gold without the complexities of owning physical gold.
Convenience and Ease of Trading	Investors can buy and sell Gold ETFs like stocks, providing an easier alternative compared to the logistics and storage of physical gold.
Reduced Transaction Costs	Gold ETFs eliminate the need for storage, security, and insurance costs associated with physical gold, reducing overall transaction costs.
Government Initiatives	Government schemes such as Sovereign Gold Bonds (SGB) have encouraged investors to consider gold-backed financial products, indirectly boosting Gold ETF popularity.
Technological Advancements	Technological developments, including online trading platforms and demat accounts, have made Gold ETFs more accessible to retail investors.
Market Awareness & Financial Literacy	Increased awareness of Gold ETFs and financial literacy campaigns by mutual fund houses, banks, and other financial institutions have driven investor adoption.
Product Innovation and Variety	Introduction of new gold ETFs by various Asset Management Companies (AMCs) gives investors multiple choices based on their risk profiles and objectives.
Global Gold Price Movements	Gold price fluctuations, particularly during periods of global financial uncertainty, have led to an increased demand for Gold ETFs as a safe-haven investment.
Cost Efficiency of ETFs	Reduced expense ratios (as low as 0.15%-0.4%) due to economies of scale have made Gold ETFs increasingly attractive.
Flexibility in Hedging	SEBI's provision allowing Gold ETFs to hedge up to 100% of their holdings has enhanced their stability and reduced risk, appealing to institutional investors.
Investor Preference for Financial Gold	As investors shift towards financial gold for its convenience and ease of handling over physical gold (jewellery, bars, coins), ETFs have become a preferred choice.

References:
- SEBI/IMD/CIR No.4/58422/2006 dated January 24, 2006
- SEBI circular CIR/IMD/DF/04/2013 dated February 15, 2013
- SEBI circular CIR/IMD/DF/16/2013 dated October 18, 2013
- SEBI circular CIR/IMD/DF/11/2015 dated December 31, 2015
- SEBI/HO/IMD/DF2/CIR/P/2021/668 dated November 24, 2021