Gold Metal Loan as a Working Capital Finance

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Context :-
Gold market has been on an uptrend over the last few years which therefore made sense for gold jewellers to hold on to their existing stocks.

When the gold market enters a downtrend, the jewellers are exposed to a huge price risk on unsold stocks. The loss may be notional as original stock normally was acquired at low prices but still loss is a loss. When the gold prices are on downtrend Gold Metal Loan works both as a natural hedge as well as a source of working capital finance.

In the normal consignment business model, a gold manufacturer would approach the Bank and price out a quantity of Gold and pays full value amount and take delivery of the Gold, then Convert it into Jewellery and sell the same.

Thus, the Gold Manufacturer runs a price risk. By the time gold is converted into jewellery and sold, rates could have gone down resulting in a loss to the gold manufacturer. To avoid this price risk RBI has allowed the nominated Banks to lend the gold to these manufactures.

A manufacturer instead of locking into a gold rate at first instance would take gold on loan for a maximum tenor as allowed by RBI. This is then converted into Jewellery for sale. Thus the pricing of gold happens at the time of sale for the jeweller which reduces the price risk considerably.

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What is Gold Metal Loan: Disbursed as loan with a gold interest rate (Linked to International Lease Rate). Domestic jewellery manufacturers/exporters are entitled to avail of gold metal loan, which is provided by Nominated Banks. GML provides credit line to manufacturers/exporters at close to International interest rates.

Gold Metal Loan was introduced by RBI in 1998 for exporters. In 2005 GML scheme was liberalized and was further allowed to be offered to domestic jewellery manufacturers, thus affecting the consumption value chain positively. On 3rd April 2007, the RBI issued a circular that increased the tenor of domestic gold loans from 90 days to 180 days. This accommodation provided more time for borrowers to manage their finances and repay the loans. In May 2013 RBI suspended GML facility (Below image shows without GML import situation)

GOLD JEWELLERY IMPORTS In ₹cr

Month	2012	2013	Variations (%)
Apr	1,875.03	381.78	-79.64
May	188.91	149.16	-21.04
Jun	8,170.24	102.41	-98.75
Jul	4,948.28	143.99	-97.09
Aug	2,963.12	353.47	-88.07
Sep	3,594.07	166.16	-95.38
Oct	502.19	137.86	-72.55
Nov	747.47	94.24	-87.39
Total	**22,989.31**	**1,521.11**	**-93.38**

Source: Gems & Jewellery Export Promotion Council

In May 2014 Regulator reviewed policy and re-allowed Banks to offer domestic Gold Metal Loan.

Types of Gold Metal Loan

Fixed :

- Tenor fixed at the time of draw down of the loan.
- Interest rate fixed for the entire period.
- No foreclosure allowed.

Flexi :

- Tenor not fixed, capped to maximum 180 days for domestic and 270 days for export.
- Interest rate can change during the tenor of the loan.
- Interest levied for the number of days the loan is outstanding.
- Pre-closure is allowed, Part pre-closure is also allowed.

Benefits of Gold Metal Loan to Borrower

- Lower Financial expenses : Lease interest rates are normally in the range of 2 % to 4 % depending upon collateral security provided by borrower. This is much lower than the 9 to 11 % that banks charge for OD/CC/corporate loans.
- Hedging mechanisms : The GML acts as a hedging mechanism against fluctuating gold foreign exchange rates. Since rates are determined daily as the gold is used, jewellers do not have the risk of buying larger amounts of gold and price varying till it is sold. Here the gold is paid for each day as it is used.
- No inventory Risks : If gold is bought, the jewellers inventory is valued on the constantly changing purchase prices. However, in case of gold metal loan, there is no inventory. Holding no inventory also protects against falling customer demand. Gold Metal loan serve as a "Just in time" inventory mechanism.
- Improved efficiency : With the gold on lease approach of holding no inventory, return on capital will be higher making the company more efficient.
- Expansions : Players who usually would buy inventory for their new showrooms now benefit as they take the gold they need on loan.

Prerequisite condition:-

Qualifying for the GML Facility is based on financial documents and a thorough evaluation by the Nominated Banks credit team.

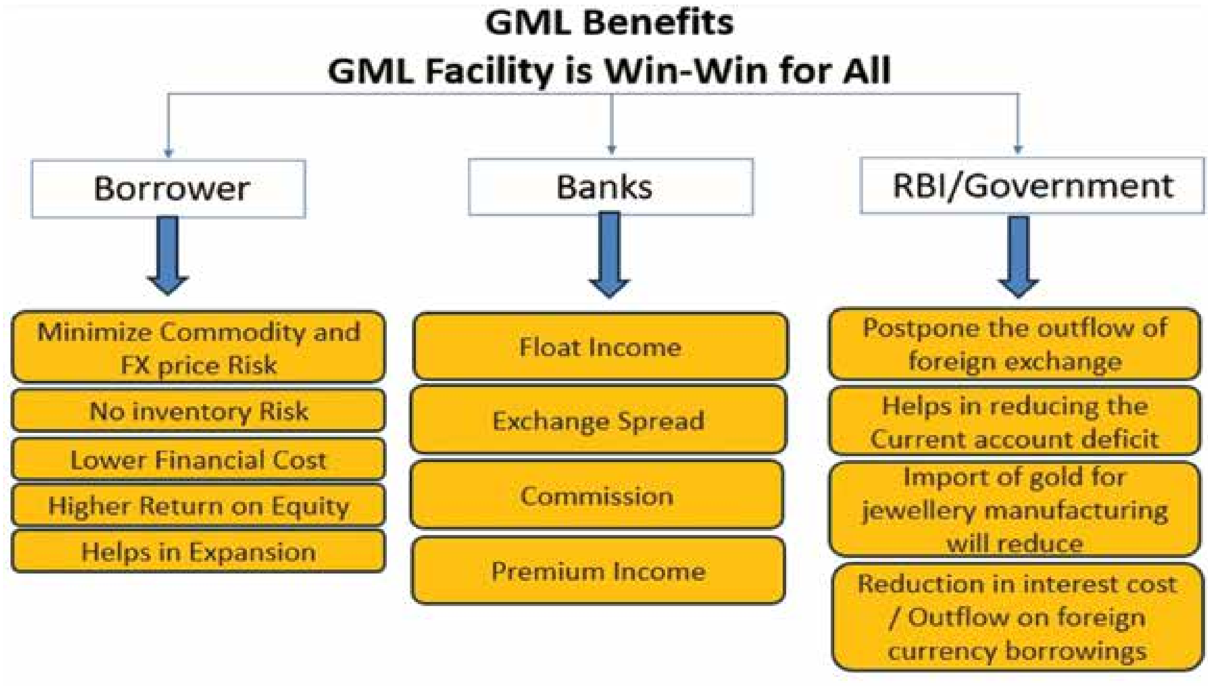
- Gold is disbursed on loan basis for a maximum tenor of 180 days in case of Domestic (Depending upon Trade cycle) and maximum tenor of 270 days in case of Export or lower as required by the borrower based on sanctioned gold loan limits for the borrower.
- Borrower provides required collateral acceptable to the Bank as a security for the gold loan availed.
- The Custom duty is collected on actuals paid for the consignment from which gold is delivered. GST is collected upfront on notional value which is calculated on the previous days London AM Fix / FBIL reference rate.
- The stipulated authorised margin band applicable for the GML borrower could range between 115% (Upper band) to 110% (Lower band) , as the case may be.
- Borrower has to price both the legs i.e XAU/USD and USD/INR on or before the maturity date and

repay the gold loan in Indian Rupees. The final price would include the applicable premiums, customs duty, GST.

- On the repayment of Gold metal loan, the borrower can utilise the available gold loan limits for further drawdowns against the existing collateral (In case of SBLC/BG Restoration letter required from issuing bank).
- Interest on gold loans is recovered on a monthly basis and is calculated till the last day of the month, from the borrower's bullion account. The interest is accrued In gold ounces and later debited on the first working day of the following month in INR using the month end London AM Fix and FIBIL rate.

Repayment of GML : –

- Repayment of the loan can be done by borrower by paying the outstanding Gold Metal Loan on Cash, Tom or Spot basis.
- Borrower can also avail Gold Forward and currency forward to fix the price of Gold Metal Loan. The gold forward/ currency forward would have the same due date as the GML. The forwards would be utilised to liquidate Gold Loan contract.
- Borrower shall fund the current/ cash credit account maintained with the bank sufficiently for repayment on or before the date of maturity



What Next ? For the Betterment of achieving success of Gold Metal Loan Facility

- On June 23, 2021 Reserve Bank of India issued a circular (RBI/2021-22/58 DOR.CRE(DIR). REC.24/23.67.001/2021-22) for GML repayments Banks shall provide an option to the borrower to repay a part of the GML in physical Gold But till now no Banks has enabled this option.
- Sanction GML limits in terms of the weight of Gold.

Federal Bank has been nominated by the RBI for importing Gold/Silver. Currently Federal Bank offer Gold Metal Loan to domestic gold jewellery manufacturers under which a jewellery manufacturer borrows gold metal instead of rupees and settles the GML with the sale proceeds.

Federal bank is providing GML facility to the many renowned jewellers of Pan India based, and one of the most preferred Bank among jewellers fraternity for Availing Gold Metal Loan Facility.

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