

India for Responsible Gold

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In July 2015 report published by Financial Action Task Force¹ highlighted the displacement in medium of transaction for money laundering and terror financing from official and cash route to gold. The key reason was most regions there was very little governance or oversight on this trade. Some of the examples in the typology report were just the tip of the iceberg. India for instance has seen this displacement for quite some time.

In India extremely high demand juxtaposed with significantly high tax rates has provided a ripe scenario for gold to be catapulted to the epicentre of smuggling, round tripping and sourcing unrefined gold (dore') with less than robust due diligence.

It is in this context, that we intend to explore the many dimensions of what is generally known as 'conflict gold', 'dirty gold', or 'blood gold'- the transaction of which gold, directly or indirectly has aided, enabled or propelled - money laundering, terror financing, smuggling, slavery, child labour, human rights violations, illegal mining, operation of armed militia. Gold from such sources not only leads to severe financial loss for the mining country, due to misrepresentation of origin of metal and non-payment of taxes and royalty to the mining country government, but also had ripple effects that adversely disrupts the economic, and more importantly, security concerns in countries across the globe.

1. The advent of gold dore' refining in India

In March 2012, MMTC-PAMP India Ltd (MPIL) commenced full-scale commercial refining, 4-years after incorporating in 2008. Three months before this new beginning, in January 2012, the levy of customs duty on dore' (unrefined gold of less than 95% gold content) and refined bullion was introduced at 1% and 2% respectively. Two years later MPIL went on to become India's first LBMA accredited refiner for gold. Rajesh Exports Ltd was importing gold dore' in large

¹ <https://www.fatf-gafi.org/documents/documents/ml-tf-risks-and-vulnerabilities-gold.html>

quantities even before the differential. Other refiners who were active before this was Gujarat Gold Centre and Shirpur Gold Refinery.

The additional 1% tariff incentive was available for refiners located in excise free zones leading to a rush that was unprecedented and understandable, in equal measure. This excise benefit was terminated with the introduction of GST in 2017. Post-GST the customs duty on imported dore' has been 0.65% lower than refined bullion, a significant differential which exists nowhere else in the world. In this period beginning January 2012 India had more than twenty BIS accredited refineries and these refineries together controlled 50 to 55% and MPIL around 15 to 20% share of domestic supplies respectively.

2. The refining business globally

India, in spite of being one of the largest markets for gold, has been peculiarly complex and particularly complicated in more ways than one. It has always been a one-way market as the minimum value addition norms as per the Foreign Trade Policy made it extremely difficult to export refined bullion from India. Indian refiners, therefore, created a recourse, a safe land that was Dubai. Such that during times market at discount of over 0.5% from LBMA price, dore' gets routed to UAE instead of getting to India. This exercise was akin to how an international refiner with an operation in India could route the gold to their parent company in Switzerland in order to ensure the continuing nature of their relationship with suppliers. The difference, however, is that being refined in Switzerland, the gold is moved to any of the vaults of the bullion bank whereas when it gets refined in UAE, it partly gets shipped to Switzerland and from there to a bullion bank's vault. Also, gold from UAE gets traded with fabricators from various consumption markets and allegedly sold to smugglers who ship it to India due to 12.5% duty benefit.

The development of refining centres in UAE and India eventually reduced the dore' refining business in Switzerland. This stands reflected in their trade with Switzerland's imports falling from the decade peak of 3,080 tonnes in 2013 to 2,081 tonnes in 2019.

However, owing to the discounts and premium in the market, the pricing varies to a point that the imported price of gold dore' is either close to parity to international benchmarks or at marginal premium. This is because of the fact that the suppliers are adequately aware of the 0.65% differential that is unique

to India and recognise that the absolute value increases with increasing prices. During the period between 2012 to 2017 this led to a scenario wherein the miners were witness to offers that they could never refuse. And that eventually sliced away the share of refining business from Switzerland and UAE to India and when Indian markets are at discount dore' is routed to refiners in UAE.

3. Importance of OECD's Due Diligence Guidance

The year 2010 witnessed the emergence of the OECD Due Diligence Guidance (DDG) for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. The London Bullion Market Association (LBMA) subsequently adopted it by launching a Responsible Gold Guidance in January 2012 aligned to OECD's DDG and mandated all the refiners in London Good Delivery List (GDL) to comply with same for retaining the accreditation. In April 2012 Dubai Multi Commodities Centre (DMCC) Guidance was launched and mandated all DGD refiners to comply with it (now known as Risk Based Due Diligence in the Gold and Precious Metals Supply Chain (RBD-GPM)). Thereby, the world had woken up to two good delivery standards that complied with OECD's DDG. To obtain a LBMA or DGD's accreditation, a refiner had to declare and be subject to audit as per the established technical, financial and production protocols. The programmes by Responsible Minerals Initiative and Responsible Jewellery Council which are also aligned with the OECD's DDG are focussed only on supply chain risks, and does not consider volumes and financial strength as criteria for certification. The UAE government is now working on UAE Good Delivery Standard to bring greater level of transparency across the bullion trade.

4. Routing of gold from sources that can't be confirmed

The governments of major mining countries have been looking inwards with mounting national debt, they have started tightening the process to export by channelizing through licensed agencies. However, the system always has people letting pilferage happen.

4.1 How big is the trade of illegally mined gold

The report by IMPACT² in November 2019 and The Sentry³ in November 2020 has documented the flow of illicit mined gold to UAE and India, and the losses created for mining countries. In addition, a December 2019 report by the Basel Institute of Governance⁴ clearly highlighted the routing of illicitly mined gold to Switzerland and getting into the formal channel. A December 2020 report by The Sentry⁵ discusses the illicit financial flows from Kleptocracies, largely from Africa to the United Kingdom.

If one is to arrive at a value that is being talked about related to illicitly transacted gold being traded globally, a minimum estimate would be in range of USD 5 to 7 billion annually basis the various reports on this subject. To give a perspective of the risks involved here, \$5 billion is higher than the combined revenues⁶ of top 10 richest terror organisation in the world.

4.2 Mined gold presented as jewellery scrap: An example from UAE

The illegally mined gold easily finds way to a source of high reward and India is the consumer market where it can be absorbed easily because of the elevated customs duty. The gold first gets smuggled to souks in Dubai from neighbouring countries⁷, gets documented as scrap before entering a refinery and then gets redistributed to various processing and consumption centres which includes India.

Prior to VAT (that came into effect in January 2018), dore' was easily hand carried to Dubai as the declaration by the buyer or refiner were not documented, thus there was no need to bypass the Dubai Customs. In the VAT regime the importer will have to drop the material at customs and can clear it either by a VAT registered entity or by the instruction from them. The VAT is reversed after the dore' is converted to refine gold of purity more than 99%,

² How India became one of the world's largest gold smuggling hubs- A Golden Web

https://impacttransform.org/wp-content/uploads/2019/11/IMPACT_A-Golden-Web_EN-Nov-2019_web.pdf

³ Understanding Money Laundering Risks in the Conflict Gold Trade From East and Central Africa to Dubai and Onward By Sasha Lezhnev and Megha Swamy <https://cdn.thesentry.org/wp-content/uploads/2020/11/ConflictGoldAdvisory-TheSentry-Nov2020.pdf>

⁴ https://baselgovernance.org/sites/default/files/2019-12/working_paper_31_gold_en.pdf

⁵ <https://thesentry.org/reports/safe-harbor-no-more/>

⁶ <https://www.forbes.com/sites/forbesinternational/2018/01/24/the-richest-terror-organizations-in-the-world/?sh=4b9a1c287fd1>

⁷ The Sentry report- <https://cdn.thesentry.org/wp-content/uploads/2020/11/ConflictGoldAdvisory-TheSentry-Nov2020.pdf>

because there is no VAT on gold above 99% purity. Refiners will not show direct affiliation to a source that is doubtful.

4.3 Risks are elsewhere too

UAE is just one of the many countries that faces this challenge but its name appears in every report because of its connectivity between mining countries and the refining and consumption hubs. The situations are, perhaps, riskier elsewhere, for instance with illicitly mined gold being smuggled from Myanmar to Laos and from there, it makes its way to India and China through formal routes. Another alternate route for gold from the same source is through Thailand's jewellery manufacturing units. It could also be directly smuggled from Myanmar to India. Transactions are similar in other Asian countries too; illegally mined gold in Philippines and Indonesia makes its way to Singapore through Malaysia and enters the formal channel through accredited refiners. Keeping a check on each transaction gets lot more difficult and there is always the incentive to circumvent when it comes to gold trade because of its characteristics, thus it is never easy to plug the loopholes and difficult to keep a check on each transaction.

4.4 It is not just Artisanal and Small Scale Mines

That ASM are the only source for dirty gold is a myth; dirty gold also comes from large and medium scale mines. The report by IMPACT highlights the case of supplies from large scale mines in Dominican Republic and Tanzania to India; it is a good example of possibilities of routing illegally mined gold that can go undetected.

5. What are the broader risks of sourcing gold from unconfirmed sources?

These can be summarized as under

1. Serious abuses associated with the extraction, for instance, slavery, child labour, gross human rights violations to name a few.
2. Transport or trading, directly or indirectly supporting non-state armed groups.
3. Unauthorised military groups controlled mining sites.
4. Bribery and fraudulent misrepresentation of origin.

5. Laundering money, non- payment of taxes, fees and royalties due to governments.

The experience since launch of these initiatives is that most of these risks have surfaced only a year after the incidence and more often through a report by non-government entities and UN Experts. This outcome has been witnessed irrespective of whichever of the four programmes a refiner had adopted and subsequently followed; sampling criteria is the key. One could observe that most of these risks pertain to sourcing from an Artisanal and small scale mines or tailings of a medium and large scale mines but the concerns pertaining to Money Laundering exist in a wider spectrum of eventualities and in case of related party transactions that are difficult to challenge. In essence these audit programmes are not foolproof but at this time do not appear to have acted as a strong enough deterrent, undoubtedly.

6. What are the lessons for India and what is the way forward?

In the light of our commitments to the Financial Action Task Force (FATF), how should India deal with this critical issue with the nefarious designs of money laundering and terror financing related to gold from sources that cannot be traced back to its origin.

The concerns aggravate when one realises that no action in this direction appears to be a complete solution particularly when it appears that gold either is already or is increasingly becoming a financial instrument for terror funding. Curtailing cash transactions seems to be a reasonably plausible solution, a first step forward in the right direction.

The updated RBI regulations for assessing Money Laundering and Terror Financing risks is a welcome step. However, it is widely observed that the Money Laundering risks continue to exist, with most of these being related party transactions, particularly in the context of dore' sourcing. It exists because the regulations are structured to circumvent it. Nominated banks, agencies and all the jewellery re-exporting companies need to employ adequate due diligence verifications about the source, which is not the case at present. Additionally, India is yet to comply with the FATF recommendation on notifying reporting entities for the jewellery sector.

6.1 Some of the suggested measures are:

(a) DGFT may change the packing list criteria and instead mandate a Certificate of Origin that has the name of government registered aggregator or miner or exporter, along with stamp of approved exporting company with assay certificate.

To break this down further, wherever the supplies are sourced from artisanal and small scale mines, the exporter from the mining country (usually) being an aggregator, collects dore' from multiple mines, converts it to a single dore' bar and exports it. The existing mandate regarding submitting a mining certificate, by default, ends up being some random mine and not representative of all the mines. Instead if the ask is for a certificate of origin (COO) as explained above, it would not create any need to circumvent the law but facilitate the importer to provide the name of the aggregator, making it easy to verify the credentials of the supplier. This should be followed by making a direct payment to the miner or registered aggregator or exporter from the origin country instead of routing it through a third party or an aggregator who is not registered. The resulting impact will be greater transparency in the supply chain that shall benefit all stakeholders long term. The country of origin would also have a mechanism to assess the royalties paid by their local exporter.

(b) Allow refiners to hedge on international market, either directly or through a bullion bank in India or overseas, only to equivalent quantity of import and allow advance remittance against a liquid collateral. This would remove the need for and the incentive to operate an account from Dubai.

(c) The differential duty benefit should be subject to refiner passing the third party audit which shall ensure the compliance with OECD guidelines. The DGFT issued license should ideally be linked to this requirement. This will also help India comply with the FATF recommendations.

(d) All the nominated agencies should respect the OECD guidance and commit to import gold only from refiners that are successful with the third party audit on responsible sourcing. The supplier's due diligence should be made mandatory for all the importers.

(e) E-way bill for transportation of bullion should be made mandatory for inter-district and inter-state movement, with stipulations that shall ensure that there

is a balance between compliance and facilitation. While this shall be a measure that will definitely enhance the enforcement in case of handling smuggled gold, a permanent solution is possible only when the policy corrections in this regard, particularly pertaining to the customs tariff, is comprehensively addressed.

(f) Extend the Bureau of Indian Standards (BIS) certification of refiners not only for dore' importers but also to cover scrap refining, similar to the rule that is being applicable on jewellers from June 2021.

In this context we would like to draw the reader's attention to Directorate of Revenue Intelligence's annual report on smuggling.

6.2 The following recent measures might help keep a check on unofficial trade:

(a) The TCS of 0.075% on sale of goods introduced recently is definitely a first good step.

(b) From 1st of Oct 2020 for turnover value of 500 crores, e-invoicing was made mandatory.

However, these are never fool proof and people always will find a way to circumvent it as the number of participants in unorganised sector outnumber the one in organised.

6.3 Enforcement cannot be a policy solution

It is reasonable to appreciate that the government may not be in a position to unilaterally push for these reforms and undeniably the industry and trade bodies, amongst other stakeholders, have an equal and important responsibility to protect the credibility of the sovereign.

The industry has made the beginning on this front but the road ahead is filled with daunting challenges. National Stock Exchange (NSE), through their commendable initiative, was the first to make it mandatory for their empanelled refiners to take up third party audit following OECD's DDG and pass it within 15 months from date of being empanelled. From what we learn, two refiners are already through the process; these are being done by Responsible Minerals Initiative (RMI). Bangalore Refinery which is focussed on industrial products has already passed the RMI audit. On a similar note, Multi Commodity Exchange of India has recently signed MoU with Responsible Jewellery Council for conducting responsible sourcing audit of refiners that are empanelled to deliver at their

exchange. In all we are seeing approximately 300 tonnes to 400 tonnes of capacity to come under the audit in over next 12 to 18 months. Although these refiners together constitute only 25% of the installed capacity, but they together contribute to 90 to 95% of the total refined output among non-LBMA list.

If LBMA and DMCC could lead the way from eight years ago, any reasons to not comply by Indian refiners will only lead to falling short on the requirements of responsible sourcing; there is no argument for non-compliance now.

The biggest push needs to come from the jewellers who should take a convincingly strong stand on responsible sourcing by conducting due diligence on every source of gold, even if the immediate and short term benefits of non-compliance may appear alluring. Jewellery and other trade associations need to reach out to all the stakeholders in order to educate and communicate the benefits of responsible sourcing and the ensuing independent audit. The banks have a very important role to play with respect to third party audit on the sourcing carried out by jewellers on an annual basis. This may not be an entirely new practice as some jewellers already maintain complete trail of all their transactions even as of today. In that context it is gratifying to see at least one jeweller in India running promotions that they source only Responsibly Sourced Gold. We need more doing this.

End consumers need to rise up to the issue and demand the same at the store, which may be a tall ask as of now. The least they could do is demand a bill for every transaction they do, whether selling old jewellery or purchasing.

Considering that the FATF India review is expected shortly, and with risks being very evident within India's gold trade, it could become a point of concern and contention for our negotiators. It is therefore – no exaggeration – to presume that the time for regulators, and the industry to act on responsible sourcing, is unarguably now.

We would like to convey our gratitude to our colleagues at IGPC for valuable inputs.

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