Joyce Teo

Gold buy-back schemes: Before you rush in...

Seen traditionally as a "safe haven" in times of economic uncertainty and as a hedge against inflation, gold is the type of precious metal that few can resist.

Typically bought in its physical form through goldsmiths, jewellers or banks, it denotes wealth and status, and is a store of value and a way of passing wealth on to the next generation.

Today, you can buy not only gold bars and coins, but also gold certificates and gold-related funds.

Investment vehicles such as gold buy-back schemes have also emerged of late. These purportedly pay regular returns to consumers and/or offer to buy back gold at a premium to the original sales price.

But you must first know what you are putting your money into. On the Web, you may find entities offering gold buy-back schemes telling you that gold is a scarce resource that will continue to rise in price as global demand increases.

The gold price reached US$1,595.50 (S$2,000) an ounce in the middle of this month, up from US$1,587 a week earlier. But this is down from a peak of US$1,900 in late August last year, after having more than doubled in price from just over US$700 an ounce in November 2008.

Contrary to what many may believe, gold may not continue to rise in price and act as a good hedge against inflation.

History has also shown that gold prices exhibit fairly high volatility.

Low risk, high returns?

Gold buy-back schemes sound extremely attractive as they appear to be low-risk ventures that offer high returns.

Here's how a typical scheme works: You buy physical gold from an entity at a purported discount of say 1.5 per cent to 2 per cent and you may choose to take the actual gold coins or bars home.

The entity then offers to buy the gold back at the original sale price after a fixed period of time, regardless of gold price fluctuations.

It would appear that you get to earn a 1.5 per cent to 2 per cent return when you sell the gold back.

In reality, the consumer's purchase price is actually a premium to the prices offered by goldsmiths or banks for the similar grade of gold. So, the consumer is in fact paying more for the gold by participating in the buy-back scheme.

At one entity, the purported discount is actually a substantial premium of 20 per cent to 30 per cent to the market price.

Beware of the risks

What you have to note about companies offering gold buy-back schemes is that they typically do not tell you how they generate those returns.

This should raise red flags.

If you don't know how the returns are generated, how can you assess what the risks are, how sustainable the returns are and what can go wrong?

Remember that there are no free lunches when it comes to investments.

Some of the entities offering gold buy-back schemes have been liquidated as they were unable to sustain their unrealistic business model. The result is losses for the consumers.

So, be cautious. Don't feel pressured to rush into such schemes without first thinking it through and doing your homework and reading up on the viability of the schemes.

Remember that many of these entities that offer gold "buy-back schemes" are not regulated by the Monetary Authority of Singapore (MAS).

Some of these entities – for instance, Genneva and The Gold Label – are included in the MAS Investor Alert List of unregulated persons who, based on information received by the MAS, may have been wrongly perceived as being licensed by the authority.

The listing includes those operating in Singapore as well as those based overseas.

You can access the list from the MAS website (www.mas.gov.sg) or the MoneySENSE website (www.moneysense.gov.sg).

While it is useful to check if the entity you want to deal with is on the Investor Alert List, do note that the list is not exhaustive and that it is updated only from time to time.

So, even if an entity is not on the list, it does not mean that it is regulated by the MAS.

Difference between buy-back schemes and funds

	Gold buy-back schemes	Funds investing in gold-related securities and futures
How are such schemes/ products sold or distributed?	Typically by entities not authorised or licensed by the Monetary Authority of Singapore (MAS).	By financial institutions licensed by MAS. Exchange-traded funds (ETFs) are listed on SGX and traded through stockbrokers. Funds are distributed by banks and financial advisers.
Is there pricing transparency?	Typically no. Consumers may have to obtain market prices of gold from elsewhere (for example, goldsmith shops) to decide if sale prices provided by the entity offering the buy-back scheme are reasonable.	Yes, ETF prices are quoted on SGX and fund prices are available from fund managers' websites, distributing banks or financial advisers.
Are there disclosure requirements?	Typically no. The entity offering the scheme decides on the level of details of the buy-back scheme to disclose to consumers.	Yes. Apart from the prospectus, issuers of ETFs and funds must provide consumers with a Product Highlights Sheet that contains key information of the ETF or fund in a clear, concise and effective manner.
Is there liquidity risk?	Yes. The level of liquidity risks would depend on the nature of the scheme. For a scheme that entails consumers holding on to the gold bought from the entity, consumers who need to liquidate their gold holdings can sell the gold in the open market or to the entity if it is able and willing to buy back the gold. In a scheme where consumers' gold holdings are held in custody with the entity, those who need to liquidate their gold holdings will need to request for the gold from the entity. Consumers will be subject to risks if the entity is unable and/or unwilling to deliver the gold to them.	Yes. Consumers who wish to liquidate an ETF may be subject to liquidity risks when trading volume of the ETF is thin and the bid/ask spread on the ETF is fairly wide. For funds, consumers can redeem their holdings in the funds any time from the distributor.

Source: MAS

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Ask before you dive in

- How is the entity going to pay you?
- How are the returns generated? If the entity tells you that this is a trade secret or that it is confidential information, how can you assess the risks? And how will you know if the returns are sustainable?
- What are the terms and conditions?
- If you have a complaint, is there anyone you can approach with it?
- If you are told that you are buying gold at a discount, do you know that for sure?

You can check how the price compares with the price of gold bars at, say, goldsmith shops.

- If you are told that you can sell your gold bar in the open market and potentially earn a return, have you checked where you can do that and at what price?

You can simply visit some goldsmith shops to find out.

- What happens if the entity folds?

Some schemes may hand over the physical gold bar to the consumers while others may hold the gold bar in custody for consumers. If it is the latter, you may be left empty-handed in the event that the entity folds.

Your entire capital may be lost, particularly if the entity has not earmarked the gold for the consumer, but has instead recycled it for multiple consumers.

Even in the case where you have custody of the gold bar, there is still a lot to lose if you paid an inflated price for the gold. You would incur a loss if you were to sell it in the open market.

Other ways to buy gold

If you are keen to invest in gold, there are alternatives to gold buy-back schemes. There are funds investing in gold-related securities and futures.

You should always do your homework before investing in these products.

First, read the product documents to understand the product's features and risks. For instance, if you are looking at a fund, ask for the prospectus and the Product Highlights Sheet (PHS). The PHS should provide you with a good snapshot of the product.

You can also ask the person offering the product to you to highlight or explain the key features or risks.

Find out what the product invests in, what factors can cause you to incur a loss and also, what can happen in the worst-case scenario.

If you have queries, it is prudent to ask for the clarifications in writing. This way, you can review the information carefully and consider if the product is suitable for you. Remember to keep a copy for your reference.

If you find that you do not have a good understanding of a product or are not comfortable with the risks, look for something else that you are more comfortable with.

If you have invested in a fund and feel like it is a bad decision, you can change your mind within seven days.

This cooling-off period means that you will not incur any administrative penalty for cancelling your purchase but you may suffer a loss if the fund has fallen in market value after you bought it.

If the market value of the fund has risen, you will get a full refund of what you paid for the fund, but you will not be entitled to the gain. In either case, the sales charge will be refunded to you.

Do note that this cooling period may not be available for certain funds such as exchange-traded funds which are bought and sold on an exchange.

This column is sponsored by MoneySENSE, a national financial education programme for Singapore.