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Gold loans: Test by fire

Governance, compliance in focus as RBI cautions lenders against lapses

BY INVITATION

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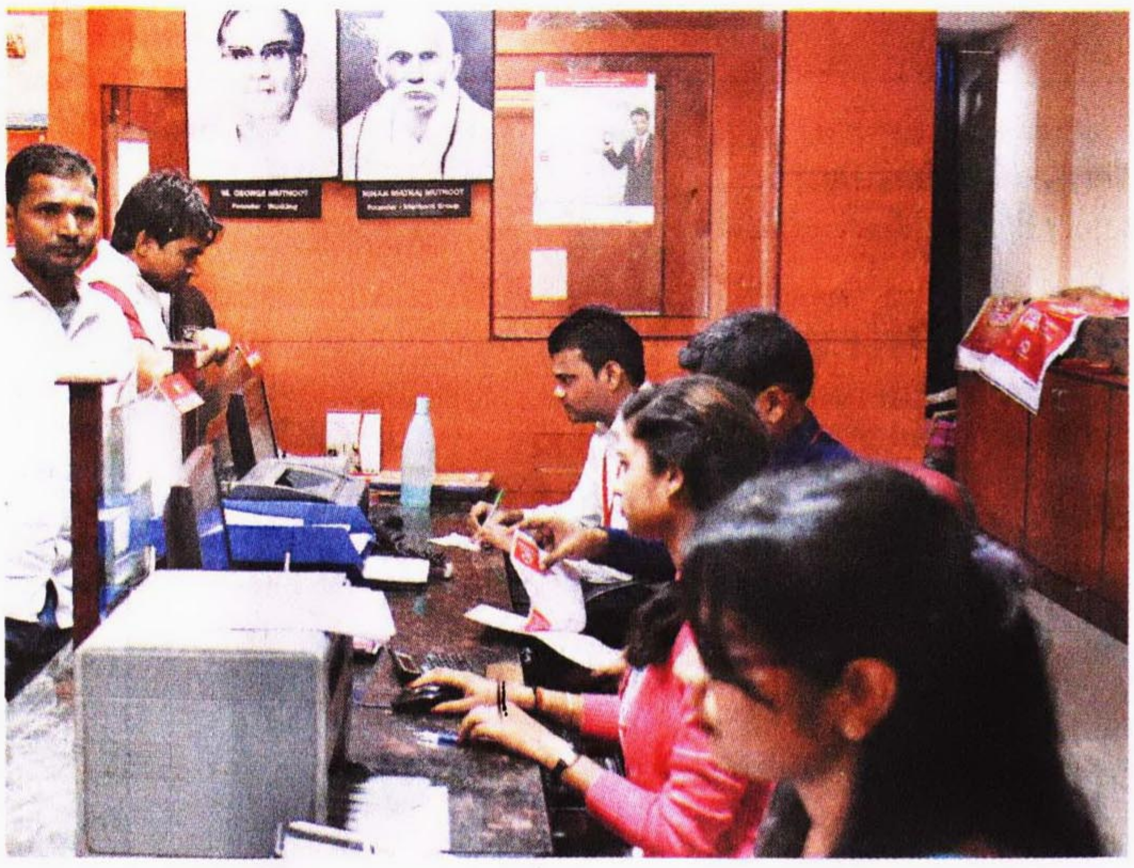
Gold loans are used by many Indian households to meet financial exigencies — the organised gold loan market is valued at ₹7.1 lakh crore and expected to cross the ₹14-lakh-crore mark within four years, according to a recent PWC report.

Nevertheless, the segment has its share of problems. Governance and compliance lapses are rising in tandem with the growth in gold-loan assets. This issue came to the fore again recently, after the Reserve Bank of India issued a directive highlighting the irregularities in loan sourcing, appraisal, valuation, auction, end-use monitoring, loan-to-value (LTV) ratio monitoring, and application of risk weights.

Specifically, the banking regulator cautioned banks and non-banking financial companies (NBFCs) against the practice of rolling over loans at the end of the term, evergreening, non-categorisation of gold loans as non-performing assets (NPAs), multiple gold loans under the same PAN, lower realisation from gold auctions, and closure of loan accounts soon after sanction.

The RBI also highlighted serious lapses such as gold valuation in the absence of customers, credit appraisal and valuation by fintech firms or business correspondents (BC), gold-keeping in the BC's custody, delayed transportation of gold to bank branches, outsourcing 'know your customer' (KYC) compliance service to fintech partners, and poor verification of end-use of funds.



YELLOW LIFELINE. Organised sector gold loans have registered a compound annual growth rate of 25 per cent during FY20-24 BLOOMBERG

UNORGANISED PLAYERS

Considering the popularity of gold loans and its deep impact at the grassroots level, regulating the segment is top priority for the RBI. However, this proves challenging, given the dominance of unorganised players at nearly 63 per cent, according to the PwC report.

They provide quick loans with little or nil documentation but at exorbitant interest rate. Customers also risk losing valuable collateral. The silver lining is that specialised gold-loan companies and banks are gaining ground.

Notably, the bigger presence of commercial banks promises to make the gold loan market more transparent, regulated and accountable. Public sector banks offer gold jewellery-backed farm loans at lower interest rates. A recent RBI report shows that gold loans from banks are increasing at 41 per cent year-on-year, as of August this year.

Overall, organised sector gold loans have registered a compound annual growth rate (CAGR) of 25 per cent between FY20 and FY24, says an ICRA report. Banks dominated this segment with a higher CAGR of 26 per cent since agri loans were included. Banks also have the advantage of low-cost funds. Gold loans offer a means for diversification and risk mitigation through a secured portfolio. This would help strengthen customer base too, says the PwC report.

NBFCs grew their gold loan business at 18 per cent during the period. They have an edge over banks as they employ innovative ways, including digital and AI tools, to boost business. Moreover, banks appear unable to explore the gold-loan market to the full extent as it doesn't fall in their core business area.

FINTECH CHALLENGE

With the emergence of new technology partners such as fintechs, systemic risks are on the rise. The RBI's observations are aimed at making intermediaries — third-party service providers and technology partners — more reliable. It is a stern message for lenders to ensure compliance when partnering with fintech companies and outsourcing core business operations, or risk disastrous outcomes.

The RBI appears a bit wary about the role of fintechs. Though fintechs are contributing significantly to financial inclusion, digitalisation, 'ease of doing business', and streamlining of loan processing, some do stray from their prescribed roles. The onus is on the lenders and NBFCs to ensure their tech partners follow regulatory guidelines, corporate governance practices, and ethical standards. In fact, regulating fintechs is priority for RBI, as was apparent from the alacrity with which it appointed the Fintech Association for Consumer Empowerment (FACE) as the first Self-Regulatory Organisation for Fintech (SRO-FT) in August this year. More SROs may be in the offing as fintech regulation requires cutting-edge technologies and close coordination with other regulators.

The RBI's scrutiny and three-month window to address procedural lapses and accounting follies offer gold-loan entities an opportunity to create robust internal mechanisms to avert a systemic collapse.

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