Note

Restrictions on NBFCs with respect to Gold Loan

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NOTE

Gold loan NBFCs has recorded significant growth in recent years in terms of both their balance sheet and physical presence. To meet their growth objectives, the NBFCs have increased their dependence on public funds, including bank finance and non-convertible debentures issued to retail investors.

With these NBFCs are growing beyond the normal rate, the impact on them of any future crash in price by the same margin or more could be severe. The financial sector may also be affected, since NBFCs are often big borrowers. To rein in the uncontrolled growth of gold loans and reduce the risks involved such as concentration risk and market risk because of adverse movements in gold prices), the Reserve Bank of India (RBI) has brought some measures to tighten regulatory supervision in the sector.

Restrictions with regard to gold as collateral security to seek loans

Earlier, in February 2011, the RBI removed priority sector status from gold loan companies, which led to a higher cost of borrowings for these companies. In another step to protect the financial system against any possible adverse movement in gold prices, RBI introduced the following guidelines[1] for gold loan NBFCs in March 2012:

- Loan to value (LTV) ratio not to exceed 60 percent for loans granted against the collateral of gold jewellery
- Percentage of gold loans to total assets to be disclosed in balance sheets
- Loans not to be granted against bullion, primary gold, gold coins
- Tier I capital requirement (currently 10 percent) raised to 12 percent by April 1, 2014 for gold loan NBFCs (where such loans comprise 50 percent or more of their financial assets).

The new LTV cap of 60 percent could result in significantly lower growth rates, as borrowers will have to bring in additional gold jewellery to obtain a loan of the same amount. In the long term these guidelines should have an overall positive impact on the sector, by bringing regulatory clarity.
The Reserve Bank of India (RBI) has imposed restrictions on banks and NBFCs for providing loans against gold coins as well as units of gold Exchange Traded Funds (ETFs) and Mutual Funds (MFs) through notification dated May 27, 2013 [2]on Lending against gold.

The central bank in its notification said, "*while granting advance against the security of specially minted gold coins sold by them, banks should ensure that the weight of the coin does not exceed 50 grams per customer*".

[1] http://rbi.org.in/scripts/NotificationUser.aspx?Id=7086&Mode=0

[2] http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7997&Mode=0

The RBI has also asked the banks to ensure that the amount of loan to any customer against gold ornaments, gold jewellery and gold coins (weighing up to 50 grams) should be within the board approved limit. The central bank further said that banks cannot give advances against gold ETFs and units of gold MFs. As specially minted gold coins sold by banks may not be in the nature of bullion or primary gold, there would be no objection to the bank granting loans against these coins.

Restrictions against advances for purchase of gold

In order to curb demand for gold, the Reserve Bank has further imposed restrictions on NBFCs though a notification dated May 27, 2013 [3]stating that no advances should be granted by NBFCs for purchase of gold in any form, including primary gold, gold bullion, gold jewellery, gold coins, units of gold ETF and units of Gold Mutual Funds.

Our Analysis

The RBI move would create a gap between bank and NBFC gold loan operations. The banks are expected to make an aggressive take over on the gold loan segment in the absence of a strong NBFC presence. In the current scenario, RBI's recent regulations have hit the top as well as bottom-line of the NBFCs. In India, gold buying is a regular process, and people are expected to continue its inclination towards gold in the future. The regulations may negatively affect the gold loan business in the short term for NBFCs but in the long term, the overall gold loan market is set to grow as long as the demand for gold is growing in the country, and NBFCs just need lay the foundation to pick up the pace again and devise ways to cater to their customer base in an innovative manner.

[3] http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7998&Mode=0