ICRA

Non-banking Financial Companies – Gold Loans

Draft proposals expected to bring much-needed clarity; however, near-term growth would come under pressure

APRIL 2025

Highlights

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Banks permitted to offer income generating loans, including agri gold loans, with LTVs determined by internal policy

All gold loans offered by NBFCs and consumption loans by banks shall maintain the LTV ceiling of 75% throughout the tenure of loan

Bullet loan structure impacted as permissible sanction amounts could reduce by up to one-fourth from the current levels

- To move towards a principle-based and harmonised regulatory framework, on April 9, 2025, the RBI[1] issued draft Directions on Lending Against Gold Collateral (Gold loans), applicable to all REs[2], viz. banks and NBFCs[3]. The impact of these draft Directions, if implemented, have been presented in this note.

- The Directions propose classification of loans into income generating loans (IGL) and consumption loans (CL). At present, banks can offer 'agri gold loans'[4] at higher loan-to-value (LTV) ratio, as determined by their internal policy, vis-à-vis other forms of gold loans. With these proposed Directions, banks can offer all income generating loan including agri gold loans with LTV ratio determined by their internal policy and not restricted to 75%. However, they would have to implement adequate credit appraisal mechanisms on these loans, especially pertaining to assessment of repayment capacity and business cash flow generation. Given this, ICRA expects banks to retain their competitiveness in the higher ticket loans vis-à-vis NBFCs.

- NBFCs would have to maintain an LTV ceiling of 75% for all gold loans, irrespective of the purpose of the sanction. The prescribed LTV ratio shall be maintained on an ongoing basis throughout the tenor of the loan. Continued breach of the permissible LTV shall attract additional standard asset provisioning of 1%. ICRA does not expect any significant impact on NBFCs on account of these incremental provisioning requirements. However, growth would be impacted as entities offer loans based on the collateral value at the time of origination. Nevertheless, the tightened LTV requirements would safeguard the lender from sharp movements in gold prices.

- In the case of bullet repayment loans, LTV ratio is proposed to be computed by treating the total amount repayable by the borrower at maturity rather than the amount sanctioned at origination. Consequently, NBFCs would have to sanction lower amounts (by up to ~25% vis-à-vis the current practice) per weight of gold. Further, renewals of such loans can only happen on complete servicing of interest, which could impact disbursements till borrowers adapt to the new requirements.

1 – Reserve Bank of India; 2– Regulated Entities; 3 – Non-banking Financial Companies; 4 - Agricultural loans backed by collateral gold

Highlights

Doorstep gold loans and co-lending arrangements likely to be impacted by stringent requirements for handling and storage of gold collateral

- Innovative products such as 'Doorstep' gold loans and co-lending arrangements could be impacted as the gold collateral is proposed to be stored and handled only at the lender's branches and only by their employees.
- The draft Directions do not cover any requirement for NBFCs to obtain prior approval for opening branches exceeding 1,000. If implemented, this is expected to increase the ease of operations for larger players in the segment, paving the way for speedy branch expansions, if required.
- The proposed increase in reserve price on auctions of gold collateral to 90% of the gold value, from the existing 85%, is expected to support better recovery rates, thereby enhancing customer protection. Nevertheless, ICRA notes that the auction experience of entities historically suggest healthy recovery trends, limiting possibility of significant auction failures.
- Overall, the proposed Directions bring in much-needed clarity to lenders operating in the gold loan segment. While disbursements and operational efficiencies could be impacted in the near term, risk profiles of entities operating in the segment would be strengthened over the medium term as these practices get streamlined and consistent across lenders.

Pillars of the proposed regulatory framework

Customer Protection

Credit Appraisal, Asset Classification and Provisioning

Risk Management and Internal Controls

Documentation and Data Disclosures

Loan classification based on end-use

Distinction between income generating loans and consumption loans has been brought out under the proposed regulations

Lending against gold

INCOME GENERATING LOANS

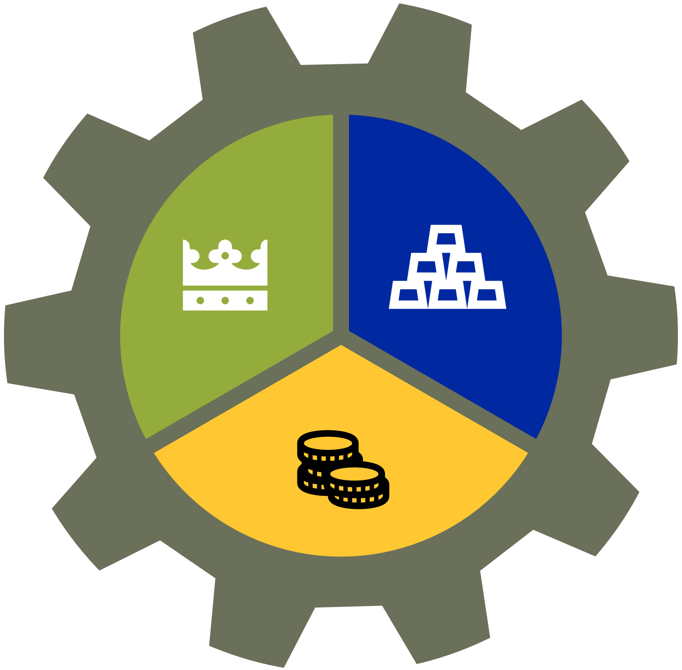
Loans extended for productive economic activities, such as farm credit, loans for business/ commercial purposes, loans for creation/ acquisition of productive assets, etc.

CONSUMPTION LOANS

Loans extended to individuals for meeting emergency requirements, medical needs, purchase of consumer durables, personal consumption needs and other similar requirements, which do not directly help in generating any income for the individual.

Source: ICRA Research

Eligibility criteria for usage as collateral



Gold Jewellery

- Gold that is designed to be worn as personal adornments

Gold Ornaments

- Items meant for use as adornment of any object, decorative items, or utensils, made of, or manufactured from gold, excluding gold jewellery

Specified Gold Coins

- Specially minted gold coins, with a purity of 22 carats or higher, sold by banks
- Coins sold by entities other than banks shall not be considered as specified coins

Source: ICRA Research; Note: loans against specified gold coins is disallowed for NBFCs and allowed only for banks

Credit appraisal and monitoring – LTV norms

Existing Regulation/ Practices

Maintain an LTV ratio not exceeding 75% for loans granted against the collateral of gold jewellery: *However, different practices are currently prevalent among NBFCs due to varied interpretations. Some NBFCs have been adhering to the practice of calculating LTVs at the time of origination.*

Proposed Regulation

- LTV ceiling of 75% shall apply to all gold loans sanctioned by NBFCs, irrespective of the purpose for sanctioning the loan. The prescribed LTV ratio shall be maintained on an ongoing basis throughout the tenor of the loan.
- In the case of bullet repayment loans, LTV ratio shall be computed by treating the total amount repayable by the borrower at maturity rather than the loan sanctioned at origination.

Impact

- NBFCs would incrementally need to sanction lower amounts vis-à-vis the current practice, especially for bullet loans.
- For example, for a 12-month bullet repayment taken at 20% yield per annum, NBFCs would be able to lend only up to 62% of the gold value vis-à-vis up to 75% being offered as per the current practice.

LTV at the time of origination for Bullet Repayment Loans

Loan Tenor (Months)

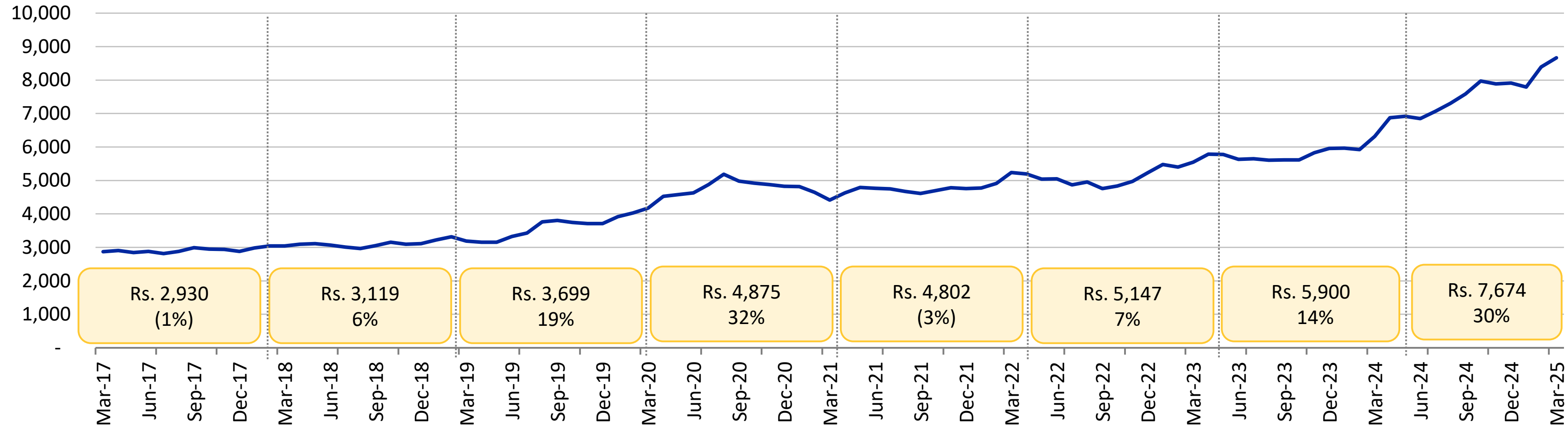
Loan Yield* (% p.a.)	3	6	9	12
12%	73%	71%	69%	67%
15%	72%	70%	67%	65%
18%	72%	69%	66%	63%
20%	71%	68%	65%	62%
22%	71%	67%	64%	60%
24%	71%	67%	63%	59%

Significant reduction in LTVs at the time of origination vis-à-vis the current practice

**LTVs have been calculated assuming compounding at monthly rests and constant gold prices over the tenor*

Gold price rally continues amid uncertainty in global economy; the proposed LTV norms would further protect lenders from price volatility

Exhibit: Gold price trend[1] – Monthly average (Rs. per gram)



- Gold prices in international markets have been buoyed by the evolving global economic and geopolitical environment, rising investment demand for gold amid expectations of interest rate cuts, and the purchase of gold by the central banks of various nations. The average gold price in India surged by 30% YoY in FY2025.
- ICRA notes that the proposed LTV restrictions would safeguard the lenders further against sharp volatility in gold prices.

Source: CMIE, ICRA Research; 1- 995 purity; Rs. per gram; Amount in the boxes indicates period average price and YoY growth trend

Credit appraisal and monitoring – LTV norms

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Existing Regulation/ Practices	Proposed Regulation	Impact
LTV norms for income generating loans by banks: At present, banks sanction agricultural loans backed by gold jewellery/ ornaments as collateral. LTVs for such loans are driven by banks internal policy. No other specified regulations at present	▪ The proposed regulation specifically distinguishes the applicable LTV norms for income generating loans sanctioned by banks. For such loans, banks would have to adhere to LTVs based on their internal risk assessment, thereby not being limited by the 75% cap applicable for gold loans extended for consumption purposes by them. ▪ However, bank would not rely on the value of the gold collateral but would have to carry out a proper credit appraisal and due diligence, with the sanctioned amounts, loan tenor linked to the business cash flows and repayment capacity of the borrower and charge creation on the primary security in addition to the gold collateral.	▪ Banks may have to incrementally strengthen their credit appraisal mechanisms on these loans, especially pertaining to assessment of repayment capacity and business cash flow generation. However, despite the same, they are likely to retain their competitiveness in the higher ticket loans vis-à-vis NBFCs, given that they would be able to offer comparatively higher LTVs to borrowers.
Breach of LTV by banks or NBFCs: No specified regulations currently. At present lenders seek top up of collateral or initiate recovery/auction processes.	▪ In case of a breach of the permissible LTV ratio (i.e. 75%) for more than 30 consecutive days, the entire outstanding amount shall attract an additional standard asset provisioning of 1%. The provisioning shall revert to normal levels only after the LTV ratio is brought within limits and remains so for at least 30 days.	▪ NBFCs in the gold loan segment enjoy healthy profitability metrics; accordingly, the suggested provisioning requirement would not have a significant impact on the performance of these entities. As banks are already adhering to the LTV norms, the extent of breach, if any, shall be minimal. ▪ Ultimate loans losses in this segment are negligible, in case of defaults.

Credit appraisal and monitoring

Existing Regulation/ Practices	Proposed Regulation	Impact
Loan renewals and top-ups: Can happen at the request of the customer, as long the LTV is within 75%.	▪ Loan renewals and top-up loans, may be sanctioned by lenders if the existing loans are classified as standard, and subject to within the permissible LTV ratio based on a fresh credit appraisal. ▪ Renewals of bullet repayment loans may be extended only after the repayment of interest accrued.	▪ Mandatory requirement for servicing of the interest accrued, before top-ups and renewals can be considered. This, coupled with the tightened LTV requirements, shall impact loan top-ups and renewals in the near term, especially for bullet loans.
End-use verification: Not specified in the existing regulations	▪ Required for consumption loans above a threshold amount (as determined in the lender's credit policy) and for all income generating loans.	▪ Increased operational costs for lenders with focus on income generating loans
Valuation of gold: 30 days' average of the closing price of 22-carat gold as per the rate quoted by BBA[5] or the historical spot gold price data by a commodity exchange (X).	▪ Lower of (a) the average closing price of 22-carat gold for the preceding 30 days, or (b) the closing price of 22-carat gold on the preceding day (Y).	▪ The proposed change would consider the recent gold prices too apart from the past price trends; limited impact is expected for the lenders on account of the proposed change.
Loan tenor: Not restricted in the existing regulations	▪ Tenor of consumption loans in the nature of bullet repayment loans shall be capped at 12 months.	▪ Sanction of large-ticket consumption loans are likely to be constrained, given the restricted tenors.

5 - Bombay Bullion Association Ltd.

Customer protection and standardisation in documentation

Existing Regulation/ Practices	Proposed Regulation	Impact
Ownership verification: Lenders shall keep a record of verification of the ownership of the gold collateral more than 20 grams	▪ Lenders shall keep a record of verification of the ownership of the collateral for all accounts	▪ Increased operational rigour, given that an undertaking or suitable document has to be obtained to establish ownership
Issue of certificate at the time of accepting gold collateral: Mentioning the purity (in terms of carats) and the weight of the gold pledged	▪ Mentioning the gross weight, net weight of gold, content and deductions, if any; damage/ breakage/ defects, if any; image of the collateral; and the value of collateral arrived at the time of sanction	▪ The certificate can serve to provide assurance to the borrowers on the safety of their collateral and adds to transparency during pledge release/ auctions ▪ Although disbursement time and operational overheads could increase for loan sanctions
Lending against re-pledged gold: Not specified currently	▪ Loans shall not be extended against re-pledged gold collateral	▪ Loans to Pawnbrokers, moneylenders and other lenders shall been restricted. This step is aimed at improving the retail borrower protection.
Loan agreement and Key Facts Statement (KFS): Required documentation under KFS already implemented for all REs recently	▪ In addition to description of the collateral security and value, details of auction procedure, circumstances leading to auction, notice period, etc., need to be specified ▪ All applicable charges payable by the borrower including those related to auction shall be included in the loan agreement and Key Fact Statement	▪ Provides assurance on the rights of the borrower under the agreement. Shall improve clarity on the rates and charges which would be applicable for the borrower.

Customer protection and standardisation in documentation

Existing Regulation/ Practices	Proposed Regulation	Impact
Timeline for release of gold collateral: Not specified currently	▪ Release of gold collateral within a maximum of seven working days upon full repayment/settlement. Rs. 5,000 per day shall be paid to the borrower in case of delay attributable to the lender	▪ Provides assurance on timely availability of the collateral, increasing the borrower's confidence in the formal sector
Auction procedures: Reserve price for the auction shall not be less than 85% of gold valuation indicated above (X) First auction to be conducted in the same town/ taluka where lending branch is located. In case of failure of the first auction, the second auction can be conducted at the district level No timeline mentioned for refunding auction surplus	▪ Reserve price shall not be less than 90% of gold valuation indicated above (Y) ▪ First auction to be conducted in the same town/ taluka where lending branch is located. In case of failure of the first auction, the second auction can be conducted online or at the district level. ▪ Auction surplus shall be refunded within seven working days from receipt of auction proceeds	▪ Higher reserve price likely to support better recovery rates. Auction experience of entities historically suggest healthy recovery trends. While ICRA does not expected significant auction failures on account of the higher reserve prices, the same remains to be seen going forward. ▪ Timely payment of auction surplus to the borrower could support the near-term financial requirements
Compensation in case of loss of or damages to the collateral: Not specified currently	▪ Loss/damages during the tenor of loan shall be compensated to the borrower by the lender	▪ Higher operating expenses to ensure safety of the gold collateral and follow up on unclaimed gold collateral

Risk management, internal controls and other operational aspects

Existing Regulation/ Practices	Proposed Regulation	Impact
Concentration limits: No specified requirement; however, borrower concentration is not significant	▪ Credit/risk management policy to include appropriate ceiling on single borrower limit and aggregate weight of collateral pledged	▪ No material impact of the proposed regulations, as loans are largely granular
Assaying of the collateral: Lenders to follow proper assaying process and provide certificate to the borrower stating the purity and the weight of the gold pledged	▪ No deviations in process of assaying purity, calculating net weight of gold at the time of sanction, return or auction of collateral ▪ Certificate to state additional details such as (a) net weight of gold content, (b) deductions, if any, relating to weight of stones, alloy, etc., (c) damage/ defects, if any, noticed in the collateral, and (d) image of the collateral	▪ Expected to support reduction in errors in assaying purity of the collateral. Consequently, risk of inadequate auction price realisations is expected to be minimized.
Handling and storage of collateral: Lenders shall ensure that necessary infrastructure and facilities are put in place, including safe deposit vault and appropriate security measures for operating the vault, in each of the branches where gold jewellery is accepted as collateral	▪ In addition to the existing requirements, gold collateral is to be handled only in the lenders' branches and only by their employees ▪ Further, lenders shall store the collateral only in their branches, manned by their employees and with safe deposit vaults fit for storing gold. The gold collateral may be transported from one branch to another only in case of shifting/ closure of branches or pooling of the collateral for auctioning procedures	▪ Likely to impact products like 'doorstep' gold loans, which involve pickup and transportation of the collateral from the borrower's location ▪ Co-lending and other sourcing arrangements involving transfer of gold collateral to the funding partners are also likely to be adversely impacted
Opening of new branches: Pre-approval from the RBI required for opening branches > 1,000	▪ This requirement has been removed in the proposed Directions	• If implemented, it would increase ease of operations for larger players, paving way for speedy branch expansions

List of ICRA-assigned ratings for NBFCs in the gold loan segment

Name of the NBFC	Long-term rating	Outlook	Short-term rating
Agro Indus Credits Limited	[ICRA]B+	Stable	[ICRA]A4
Bajaj Finance Limited	[ICRA]AAA	Stable	[ICRA]A1+
Fedbank Financial Services Limited	-	-	[ICRA]A1+
IIFL Finance Limited	[ICRA]AA	Stable	[ICRA]A1+
Keertana Finserv Private Limited	[ICRA]BBB	Stable	[ICRA]A3+
Muthoot Finance Limited	[ICRA]AA+	Stable	[ICRA]A1+
Muthoottu Mini Financiers Limited	[ICRA]A	Stable	-
SBFC Finance Limited	[ICRA]AA-	Stable	-

Source: ICRA Research

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Thank You!