Why is the RBI changing gold loan rules? | Explained

What are the draft proposals? What has the Ministry of Finance clarified? What will be the impact on borrowers?

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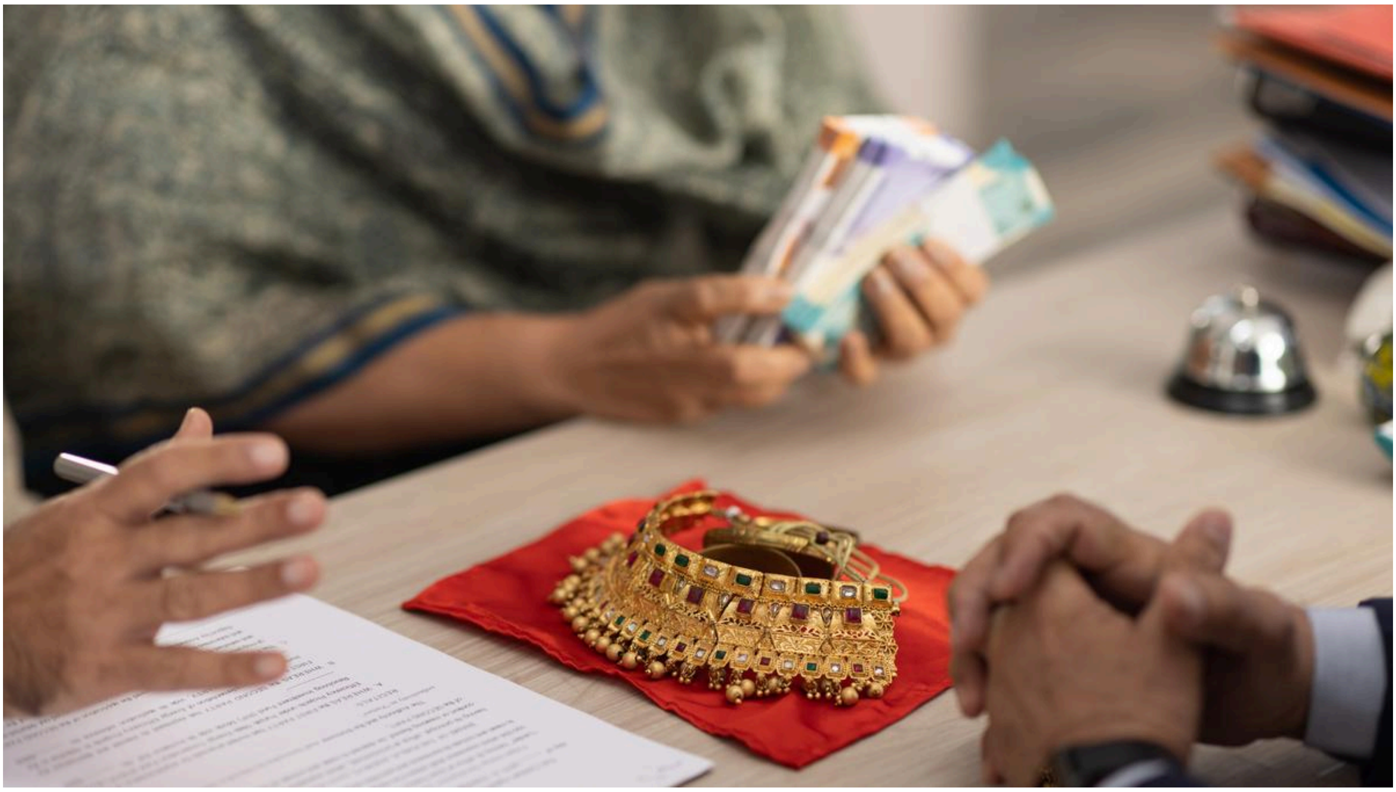

On April 9, the Reserve Bank of India (RBI) released draft directions on loans against gold collateral with the objective to harmonise the regulatory framework across regulated entities. | Photo Credit: Getty Images/iStock

The story so far: On April 9, the Reserve Bank of India (RBI) released draft directions on loans against gold collateral with the objective to harmonise the regulatory framework across regulated entities (banks and Non-Banking Financial Companies (NBFC)) and address differences in lending practices.

What was the response to the proposals?

Tamil Nadu Chief Minister M.K. Stalin wrote to Finance Minister Nirmala Sitharaman, seeking her intervention, pointing out that the proposal was likely to result in "serious disruptions to the rural credit delivery system in Tamil Nadu and across many parts of south India". The Ministry of Finance clarified that it has asked the RBI to ensure that the regulations on gold loans do not adversely impact small gold loan borrowers. It also noted that the new rules would be implemented only by January 1, 2026. Mr. Stalin had said that gold-backed loans serve as a primary source of short-term agricultural credit, especially for small farmers, and those engaged in allied sectors such as dairy and poultry.

Why did the RBI want to step in?

The draft directions come in the backdrop of the RBI highlighting irregular practices amid a significant increase in the loan-against-gold jewellery portfolio of some lenders in September 2024. In the last fiscal, the combined loans against gold jewellery portfolio of banks and NBFCs was estimated to have grown by over 50%; for banks alone, the business more than doubled, growing at 104%, which set alarm bells ringing.

The draft directions on loans against gold collateral aim to harmonise the regulatory framework across regulated entities and address the differences in lending practices. The directions aim at protecting the interest of borrowers; to provide clarity on certain credit and operational processes followed by lenders; and to enhance transparency and disclosure. C.V. Rajendran, Adviser, Arvog, said, "The draft circular comes at a critical juncture when rising gold prices and widening credit gaps are prompting more individuals, especially from the informal economy, to pledge household gold for short-term liquidity."

What are the key changes?

The maximum Loan-To-Value (LTV) ratio remains capped at 75%. For consumption-based bullet loans, accrued interest must also be included in the LTV calculation, which effectively reduces the disbursed loan amount. "With LTV at disbursement likely to reduce to ensure compliance, this could impact growth in this portfolio," said Subha Sri Narayanan, director, Crisil Ratings.

The draft proposes that borrowers furnish proof of ownership for the gold that will be used as collateral. Lenders are required to implement uniform procedures for assessing the purity and weight of gold. As per the RBI draft, gold accepted as collateral shall be valued based on the price of 22 carat gold. Concurrent loans for both consumption and income-generating purposes are to be prohibited. Loan renewals or top-ups are to be permitted only if the existing facility is classified as standard and complies with the prescribed LTV ratio. Borrowers must pay the entire outstanding amount, including both principal and interest, on the loan's maturity date to avail a fresh loan. If the lending institution delays returning the collateral to the borrower beyond seven working days after loan repayment, then the lender is liable to pay the borrower a compensation of ₹5,000 per day for each additional day of delay.

How will changes impact regulated entities?

The changes are expected to reduce the flexibility of borrowers and curtail the ability of NBFCs to renew/top-up loans seamlessly. It will lead to increased compliance burden due to documentation, DSCR (debt service coverage ratio) norms, and monitoring. Smaller NBFCs that rely on re-pledging for liquidity will face funding constraints, leading to potential market consolidation. The higher operational costs could be passed on to borrowers through increased interest rates or charges. "Banks and NBFCs may need to reduce their current gold loan LTVs at disbursement to comply with these revised norms, potentially slowing down growth," said Sankar Chakraborti, MD & CEO, Acuité Ratings & Research Limited.

Will a one-size-fits-all policy work?

Gold loans serve as a lifeline for many rural and semi-urban households, often being the only accessible source of formal credit. The RBI may consider creating differentiated regulatory norms for micro gold loans versus structured high-value gold loans.

What will be the impact on borrowers who pledge gold to avail a loan?

Gold loans, as a product, is positioned as a quick service loan with high flexibility in terms of repayment. Most borrowers mainly opt for gold loans to fund their short-term and immediate requirements. The draft directions from RBI are expected to enhance the disclosures and transparency which will help borrowers in their decision-making.

Nevertheless, the draft directions (if applied in their current form) will lead to revision in LTV computation which in turn could possibly reduce the quantum of loan offered to borrowers on same quantity of gold collateral, or alternately, may require the borrower to pledge higher quantity of gold for the same loan amount, ceteris paribus.

Borrowers may also need to better manage their cashflows to adhere to the requirement of repayment of the entire accrued interest for availing renewals or top-up loans.

The 75% LTV cap may limit the loan amounts disbursed, possibly impacting borrowers who need larger amounts.

The elimination of re-pledging of gold would pressure borrowers to repay the entire loan at once, possibly impacting borrowers' liquidity.

Prohibition on financial gold (such as gold mutual funds and ETFs) as collateral may limit options for some borrowers.

With gold prices appreciating, how beneficial will the new norms be?

The appreciation in gold commodity prices does contribute to the growth momentum in gold loans, in general. Therefore, in the current scenario when gold prices are on the upturn, gold loans are likely to witness healthy growth.

However, if the draft directions are implemented in their current form, it may lead to a slower growth pick-up for NBFCs focused on gold loans than may have otherwise been the case; this would largely stem from directions pertaining to LTV and renewal/top-up of bullet loans.

Also, it is pertinent to note that as a standard practice, lenders take the previous 30-day moving average while calculating gold commodity value for any loan disbursement. Hence, any sharp appreciation or fall in commodity prices may not have an immediate impact on gold loan growth.

Additionally, lenders do maintain sound risk management practices in order to counter the risk associated with the volatility in gold prices. The draft directions will also ensure a stricter and standardised practice for LTV breaches.

"All in all, these draft directions will further structurally strengthen the sector to manage the gold price volatility cycles and also create a level-playing field across REs in terms of practices followed," said Mr. Narayanan.

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