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## **Plugging the Leaks: RBI Clamps Down on Irregular Practices in Grant of Gold Loans**

## 1. INTRODUCTION

- 1.1. The Reserve Bank of India (RBI) has issued a circular '*Gold loans - Irregular practices observed in grant of loans against pledge of gold ornaments and jewellery*' dated 30 September 2024 (Circular). The Circular is issued to all commercial banks (including small finance banks but excluding regional rural banks and payments banks), all primary (urban) co-operative banks and all non-banking financial companies (REs) undertaking lending against pledge of gold/jewellery.
- 1.2. It is to be noted that REs are required to carry out the business of lending against pledge of gold/jewellery in compliance with the prudential norms and guidelines prescribed for each of the entities under the following master circulars / master directions (Prudential Guidelines):
  - 1.2.1. *Master Circular - Basel III Capital Regulations* dated 12 May 2023.
  - 1.2.2. *Master Circular- Loans and Advances - Statutory and Other Restrictions* dated 1 July 2014.
  - 1.2.3. *Master Direction- Reserve Bank of India (Non-Banking Financial Company - Scale Based Regulation) Directions, 2023* dated 19 October 2023.
  - 1.2.4. *Master Circular - Management of Advances - UCBs* dated 25 July 2023.
  - 1.2.5. *Master Circular- Prudential Norms on Capital Adequacy - Primary (Urban) Co-operative Banks (UCBs)* dated 20 April 2023.
- 1.3. The RBI recently conducted a review of compliance with the

Prudential Guidelines among select REs concerning loans secured by gold ornaments and jewellery. This review, along with findings from onsite examinations, has identified several irregularities in this domain. The Circular has been issued to curb deviant and irregular practices noted by the RBI in relation to gold loans.

## 2. OVERVIEW OF THE CIRCULAR

- 2.1. The RBI has annexed a list of irregular and deficient practices in the Circular for reference. This annexure consists of an illustrative list of the several instances of irregular practices being adopted by REs in relation to grant of gold loans. Some of the specific deviant practices identified are enumerated below:
  - 2.1.1. *Third party reliance.* The RBI has noted shortcomings in use of third parties for sourcing and appraisal of loans, including credit appraisal and valuation being undertaken by business correspondents, KYC compliance being conducted through third parties such as FinTechs, inadequate security in transportation of gold, absence of monitoring the activities of third parties, etc. The RBI has also flagged the practice of valuation of gold without the presence of the end-customer / borrower (Customer).
  - 2.1.2. *Monitoring end use of funds and transaction monitoring.* The RBI has observed that adequate due diligence has not been undertaken and retained for the grant of agricultural gold loans. With respect to non-agricultural gold loans, instances of inadequate end-use

monitoring have been noted as a concerning practice. The RBI has expressed concern over inadequate transaction monitoring by REs, highlighting instances where an unusually high number of gold loans have been granted to the same individual using the same PAN within a single financial year. The RBI has also highlighted that senior management and boards of REs are not adequately monitoring gold loan practices.

2.1.3. *Evergreening of loans.* The RBI has recognized the concerning practice of granting top-up loans to cover delinquencies in existing loans, often with only partial payments made by Customer, without conducting a fresh appraisal of the Customer or classifying the primary loan as a non-performing asset.

2.1.4. *Valuation of gold.* A notable lack of transparency exists during the auction of gold ornaments and jewellery in cases of customer default. This situation includes instances where the value realized from the auction is lower than the estimated worth of the gold. Such discrepancies raise concerns about the fairness and effectiveness of the auction process, underscoring the need for improved process for valuation of gold to protect the interests of all parties involved.

2.1.5. *Evaluation of rapid loan closures.* The closure of numerous loan accounts shortly after sanction, often within a few days, raises concerns about the economic rationale behind such actions. The RBI has expressed

apprehension regarding this practice, indicating that it may suggest a lack of proper due diligence or intentional circumvention of regulatory guidelines.

2.1.6. *Non-compliance with statutory limits.* The RBI has mandated the REs to ensure compliance with Section 269SS of the Income Tax Act, 1961, which states that no individual shall accept any loan or deposit in cash where the amount involved exceeds INR 20,000. However, the RBI has noted instances where REs have failed to adhere to this requirement.

2.1.7. *LTV breach and monitoring.* The RBI has observed on review, deficiencies in monitoring of loan-to-value ratio (LTV) throughout the tenor of the loan and breach of regulatory LTV ceilings. The maintenance of LTV is a necessary prudential safeguard as the value of gold does not appreciate as much as the interest applicable on gold loans.

2.1.8. *Risk weight application.* The RBI has called out the practice of incorrect application of risk-weights and nonadherence to applicable Prudential Guidelines with respect to risk weights.

### 3. COMPLIANCE REQUIREMENTS

The following action items are prescribed under the Circular which have to be implemented by the REs:

3.1. REs are advised to review their policies, processes and practices on gold loans to identify the gaps in the same. They are also required to desist from resorting to

deficient practices as highlighted in the Circular and comply with the Prudential Guidelines prescribed (as applicable to such RE).

- 3.2. As some of the deviant practices relate to outsourced service providers, REs are advised to exercise adequate control over outsourced activities and third-party service providers.
- 3.3. The RBI has also directed REs to closely monitor gold loan portfolios in light of significant growth of the portfolios for REs.
- 3.4. The Circular is effective from the date of notification i.e., 30 September 2024 and REs are directed to inform the Senior Supervisory Manager (SSM) of Reserve Bank within three months i.e., by 30 December 2024, of all actions taken to ensure compliance with the Circular.

## COMMENT

The Circular requires REs to thoroughly review the processes set in place for disbursement of gold loans to ensure compliance with the applicable Prudential Guidelines. Further the practices undertaken by their outsourced service providers / business correspondents must also be

reviewed to ensure they are not undertaking any activity that should be performed by the RE. Such outsourced service providers / business correspondents must further be subject to monitoring and the REs must exercise adequate control over their activities. RBI has further highlighted that it views compliance with the requirements of the Circular seriously and may initiate supervisory action in case of failure to comply with the prescribed time period.

As the RBI has noted significant growth in gold loan portfolios as mentioned in the Circular, corrective action has been prescribed to protect the interest of Customers, as well as to maintain hygiene in practices followed by REs. Similar action has been taken by the RBI in case of the peer-to-peer lending ecosystem as well as in case of practices followed for charging interest in loans. This demonstrates an increased focus on the part of the RBI to clamp down on practices and processes which do not align with regulatory intent. REs to whom the Circular applies are advised to take requisite action to ensure compliance with Prudential Guidelines and to cease irregular practices in relation to gold loans.

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