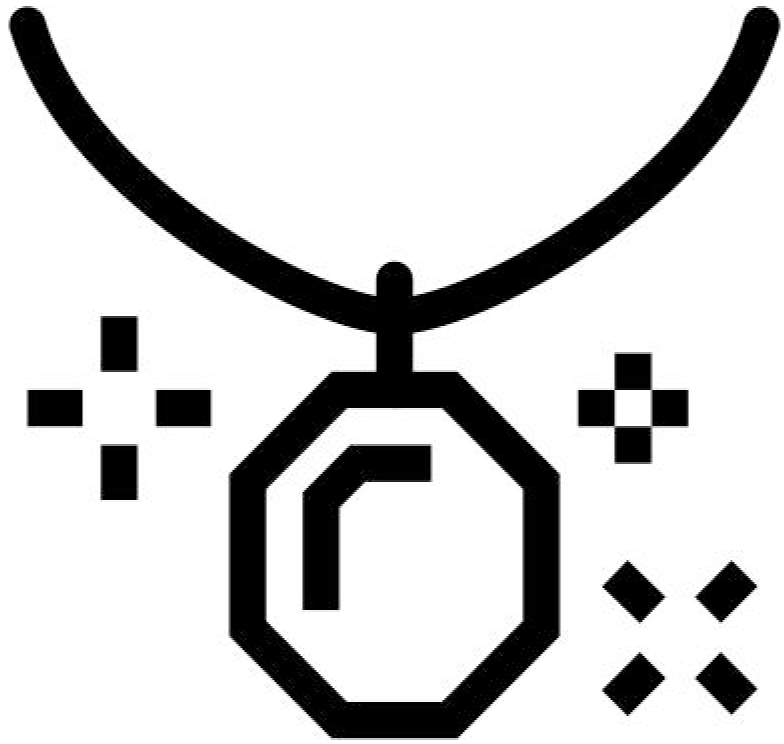
Excessive glitter

RBI diktat on lending practices in gold loans welcome



The RBI has been increasing its scrutiny of retail loan books of regulated lending entities over the past two years. This has resulted in a series of actions against Paytm Payments Bank, JM Financial, Kotak Mahindra Bank and IIFL, asking them to stop operating in certain segments. Retail loans turned into the primary driver of credit growth during the pandemic. Competition for advancing these loans increased, leading to adoption of unsavoury practices by lenders. This included inadequate due diligence while opening accounts, evergreening of loans and creating fake accounts to drive numbers.

The central bank's recent circular regarding irregular practices in advancing gold loans marks yet another step to improve lending processes. The warning to banks to put their gold loan portfolios in order is likely to be followed by more stringent action if lenders continue to be wayward. RBI's increased scrutiny on retail loan books over the last couple of years has had the desired impact of slowing credit growth in this segment. Year-on-year growth in total loans to individuals moderated to 14.4 per cent in July 2024 from 31.7 per cent in July 2023. Following an RBI crackdown on unsecured credit such as credit card and personal loans, lenders turned to secured loans such as gold loans to drive business. Gold loans of banks increased from₹27,102 crore in June 2019 to ₹1.32 lakh crore in July 2024. Large NBFC players have also grown their gold loan portfolios between 15 and 30 per cent over the past year.

The RBI has unearthed serious lapses in lenders' gold loan portfolios during its review. For instance, the fintechs and banking correspondents being used by the lenders to source gold loans are being given the responsibility of conducting KYC compliance, credit appraisal and the valuation of the gold as well. Processes for storing and transporting the gold have been found wanting. Lenders were also careless in tracking the loan-to-value limit; many loan accounts had collateral values below the regulatory limit. While some malpractices could be attributed to lenders trying to grow their business, others point towards possible money laundering through gold loans. Some lenders are using their internal accounts for disbursement as well as repayment of gold loans. Many loans were closed within a few days of sanction of the loan. A large number of gold loans have been issued to the same individual with the same PAN in a financial year.

It is just as well that the central bank is keeping a close watch on these errant lending practices. It has given lenders three months to review their internal processes, take remedial action and report back on action taken. If any lenders are found non-compliant after the deadline given by RBI, it should not hesitate to ban them from advancing gold loans. The RBI has been rightly focused on curbing sharp retail lending practices. It needs to strike a balance between allowing product innovation and securing financial stability.