Higher loans for gold may put banks at risk

NBFCs too demand similar relaxation in LTV for them

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Increasing loan-to-value ratio to 90 per cent for gold loans will put the portfolio under risk for banks. NBFCs, which were left out from the LTV decision, have sought parity from the RBI.

RBI had on Thursday allowed banks to increase the LTV of gold loans for non-agricultural purposes from 75 per cent to 90 per cent till 31 March 2021.

Though this will help the borrower with additional liquidity and will increase retail lending avenues for banks sitting on excess liquidity, such lending is not devoid of credit risk for banks.

- **PRINCIPAL AND** interest components will not be fully covered by the collateral if the bank provides 90 per cent of the value of the gold as loan.
- **IF THE** gold prices fall from their record high levels, it will drag down the value of the collateral even lower. This will increase the chances of borrower defaulting or renouncing their asset.

Both principal and interest components will not be fully covered by the collateral if the bank provides 90 per cent of the value of the gold as loan.

Further, if the gold prices fall from their record high levels, it will drag down the value of the collateral even lower. This will increase the chances of borrower defaulting or renouncing their asset.

"Gold loans with an LTV of 90 per cent would result in a negative carry for banks as the total exposure will exceed the value of the pledged gold. It could adversely impact the recoverability and asset quality of banks in the case of a weakening in the borrower credit risk profile or sharp decline in gold prices," said Vydianathan Ramaswamy, director, Brickwork Ratings.

Earlier, when gold prices had started falling from their 2011 highs, RBI, anticipating a systemic risk, had brought in a series of regulations, which saw lowering of permissible LTV and diversification of businesses by gold loan companies. The latest LTV hike is not applicable for non-banking finance companies.

"Now RBI has gone back on what it has been teaching us," said a gold loan industry veteran. The NBFCs have made a representation to the RBI governor seeking parity in LTV.

A maximum 75 per cent LTV against 90 per cent by banks will dent the market share of NBFCs, finds Brickwork.

However, Thomas George Muthoot, director of Muthoot Fincorp begs to differ. "Our kind of customers do not go to banks to pledge gold. If not us, they will go to pawn brokers," he said.