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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

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# RBI releases Final Report of the Working Group on Issues Related to Gold Imports and Gold Loan NBFCs in India

The Reserve Bank of India has today placed on its website the final Report of the Working Group to Study the Issues Related to Gold Imports and Gold Loan NBFCs (non-banking finance companies) in India.

## Key Recommendations *of the Working Group:*

### *a. Macro Issues*

- There is a need to moderate the demand for gold imports considering its impact on the current account deficit. A combination of demand reduction measures, supply management measures and measures to increase monetisation of idle stocks of gold need to be put in place.

**i. Demand Reduction Measures:**

- Fiscal measures to reduce the gold imports may be revisited;
- Better documentation of gold deals and ensuring a better tax treatment of gold is important;
- There is a need to design innovative financial instruments that can provide real returns to investors, i.e., inflation indexed bonds;
- Need to convert both rural and urban demand for gold into investment in gold-backed financial instruments through dematerialisation of gold;
- There is a need to consider introducing new gold-backed financial products to unlock the hidden economic value in the idle gold in the economy;
- Introduction of products like Gold Accumulation Plan, Gold Linked Account, Modified Gold Deposit and Gold Pension Product may be considered;
- Careful evaluation of regulatory issues in introducing the proposed gold-backed products is critical;
- Differential pricing of banking services and finance for gold imports may be considered;
- Bank finance to purchases of gold bullion may be prohibited;
- Preferential treatment accorded to gold imports in the procedures, etc., may be reviewed;

- There is no strong case to exempt Metal Gold Loans from the Base Rate stipulations;

**ii. Supply Management Measures:**

- There is a need to recycle considerable domestic scrap gold;
- Banks may continue their role as nominated agencies in gold imports;
- But, limits on the volume and value of gold to be imported by banks may be considered, if required under extreme situation;
- Consider imposing export obligation on bulk gold importers;
- Idle gold reserves of gold exchange traded funds (ETFs) may be put to productive use;
- Introduction of tax incentives on instruments that can impound idle gold may be considered like introduction of gold bonds;
- Authorities may consider setting up of a Gold Bank. This institution can pool the idle stocks of gold besides undertaking several other functions including providing refinance. In this regard, a Concept Paper on Bullion Corporation of India is also enclosed;

**iii. Measures to expand monetisation of gold:**

- Banks may expand their gold jewellery loan portfolio to monetise the stocks of idle gold;
- There should not be any curb or limits on advances against gold jewellery and gold coins by individuals;

**b. Institutional and Micro Issues**

- The rapid growth of the assets, borrowings and branch network of gold loan NBFCs need to be monitored continuously;
- Need to reduce the gold loan NBFCs' heavy borrowings from the banking system so as to reduce their interconnectedness with the formal financial system gradually;
- Declining capital adequacy ratio – Need to improve the capital of gold loan NBFCs;
- Need to review the current stipulations pertaining to raising of resources through non-convertible debentures (NCDs) by gold loan NBFCs;
- The exemption available to secured debentures from the definition of "deposit" may be reviewed;
- There is a need for monitoring transactions between gold loan NBFCs and unincorporated bodies;
- Though leverage of the gold loan NBFCs is not a cause for concern at the present juncture, going forward, there is a need for improving owned funds of the NBFCs;

- There is a need to thoroughly review the operational practices followed by gold loans NBFCs;
- There is a need to ensure transparent communication of loan terms by gold loans NBFCs;
- Institution of a customer complaints and grievances redressal system by gold loans NBFCs is important;
- Need to review the auction procedures followed by gold loans NBFCs;
- Location of auctions should be the same Taluka where the borrower is located;
- Post-auction safeguards should be followed by gold loans NBFCs;
- Better disclosure standards need to be followed by gold loans NBFCs;
- Monitoring the implementation of the Fair Practices Code is necessary;
- Standard documentation to be followed by gold loans NBFCs needs to be ensured;
- Use of PAN Card for large gold loan transactions is advised;
- Payment through cheque for large gold loan transactions may be tried;
- As of now, there is no case for conceding level playing field for the gold loan NBFCs with the banks;
- There is a case for reviewing the extant 'loan to value ratio'; however, a well-defined and standardised concept of the term 'value' is necessary;
- Unbridled growth of branches by large gold loan NBFCs needs to be moderated;
- There is a need for an ombudsman to address the grievances of gold loan borrowers;
- Rationalisation of interest rate structure by gold loans NBFCs is advised;
- Some gold loan NBFCs have been raising public deposits surreptitiously through unincorporated bodies raising concerns;

**III. Major Findings from Technical Work**

- Gold loans have a causal impact on gold imports substantiating the emergence of a liquidity motive for holding gold;
- International gold prices and exchange rates significantly and positively affect the gold price in India;
- Increase in gold price appears to be a main factor in increasing the gold loans outstanding;
- Increase in gold loans extended by NBFCs and banks does not impact significantly the gold price in India;

- Going by the past trends, a sharp and sudden drop in gold price by 30 to 40 per cent is a remote possibility causing financial distress to the gold loan NBFCs;

- The extant loan to value ratio (LTV) ratio should provide a reasonable risk cover in case the gold prices fall by 10 per cent;

- NPAs as per cent of total credit exposure and Capital adequacy of gold loan NBFCs are not a cause for concern at present;

- Banking sector's existing exposure in the form of their individual gold loans appears small and may not have any significant repercussions for the stability of the banking sector at present;

- Gold loan NBFCs are doing a socially useful function and that provides a strong rationale for careful regulation of the activities of these NBFCs;

- The recent slew of regulatory measures taken by the Reserve Bank on the functioning of the gold loan NBFCs may be continued to ensure a healthy growth of the sector in the medium and long term;

The Reserve Bank would examine the recommendations of the Working Group and take a view.

**Background**

The motivation for the study of gold related issues stemmed from macroeconomic issues, namely, impact of large gold imports on external sector stability and also domestic financial stability due to strong interconnectedness between gold loan NBFCs and the banking system. Large rise in the gold loan business, rapid expansion of branch network of gold loan NBFCs in a short span of time, quantum jump in bank borrowings by NBFCs raised certain regulatory concerns. Accordingly, the Monetary Policy Statement 2012-13 announced on April 17, 2012, stated that a Working Group to Study the Issues Related to Gold Imports and Gold Loan NBFCs in India would be constituted. The Working Group was later constituted with Shri K.U.B. Rao, Adviser, Department of Economic and Policy Research, Reserve Bank of India as its Chairman. Members for the Working Group were drawn from various Reserve Bank departments, such as, Department of Economic and Policy Research, Department of Non-Banking Supervision, Department of Banking Operations and Development, Department of Statistics and Information Management, Department of External Investments and Operations and Financial Stability Unit. The draft report of the Working Group was placed on the RBI website for public comments on January 2, 2013. After incorporating comments and suggestions received from experts, stakeholders and general public, the Working Group submitted its final report to the Reserve Bank on January 31, 2013.

**Alpana Killawala**
Chief General Manager

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