Indian Economy · GS - III

Analyse the vulnerabilities associated with gold-backed lending during periods of volatile commodity prices. How can regulatory supervision improve risk management in this segment?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 28/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Collateral valuation, loan-to-value ratio, credit risk, evergreening, NPAs, due diligence, RBI supervision

Model Answer

Gold-backed lending provides quick access to credit, particularly for households and small businesses. However, its dependence on fluctuating gold prices exposes lenders to collateral and credit risks.

Key vulnerabilities

1. **Collateral depreciation:** Falling gold prices reduce the security available against outstanding loans, increasing the possibility of recovery shortfalls.
2. **LTV breaches:** A decline in collateral value can push the loan-to-value ratio beyond the prescribed regulatory limit.
3. **Inadequate due diligence:** Improper assessment of gold purity, ownership and valuation can weaken loan security.
4. **Evergreening:** Extending fresh loans to facilitate repayment of existing stressed loans can conceal actual asset quality.

5. **Concentration risk:** Excessive dependence on gold-backed lending can expose lenders to common market shocks.

Regulatory and institutional safeguards

The RBI can strengthen risk-based supervision, examine collateral valuation practices and monitor compliance with applicable LTV norms. Banks and NBFCs should conduct periodic risk assessments, maintain adequate provisions and strengthen borrower verification.

Transparent loan agreements, effective internal audits and early identification of stressed accounts are equally important.

Gold loans can support financial inclusion, but their sustainability depends on prudent lending and reliable collateral management. Strong supervision must ensure that short-term credit expansion does not compromise financial stability.