

## **Financing against Gold Backed Collateral-Instructions for MFBs**

The MFBs are offering personal and business loans with gold as a security. While this provides protection to MFBs against borrowers' default, it also makes them responsible to hold the borrowers' gold (ornaments) in a secured manner. Due to increased growth of gold-backed loan portfolio, the MFBs are now dealing with gold collateral on daily basis in some way - valuation, transfer, storage, redemption, and auction. This makes it critical for MFBs to develop and implement an appropriate framework of controls to manage security, procedures, and contingency planning for gold collateral bearing in mind a probable threat scenario at any time.

Risks relating to handling of the gold collateral can be many, including lending against fake gold, tempering of gold bags, theft of gold, valuations against low carat gold, and fake borrowers. Such risks often emanate as a result of negligence and/or collusion between bank's staff, shroff, and borrowers.

### **Policy/product for lending against Gold**

To address the above-mentioned risks, MFBs are instructed to develop an appropriate collateral handling policy duly approved by their board of directors. The policy should include criteria for authorizing branches for offering gold-backed loans, purpose of the loans, eligibility of borrowers, hiring of shroff, valuation criteria, loan processing procedures, release/auction of gold, and insurance & internal controls.

Senior management of the MFB shall review its gold-loan policy periodically based on the results and feedback received from branches. The policy shall include following:

#### **1. Authorized Branches**

MFB shall allow lending against gold ornaments at authorized branches only, by meeting minimum criteria including availability of physical infrastructure, existence of potential business, availability of trained staff, security arrangements etc.

MFB shall submit a list of authorized branches to SBP offering gold loan product on quarterly basis i.e. within two weeks after the end of each quarter.

#### **2. Purpose of Financing**

The MFB shall record purpose of loans against gold. Following may be the purpose of the loans:

- Agriculture
- Livestock
- Small business & enterprises
- Asset purchased for agriculture or enterprise
- Housing Finance
- Domestic needs/Emergency loan
- Any other

Note: MFBs shall maintain purpose/product wise tagging of all loans backed by gold in their MIS. To substantiate the purpose of loan, the MFBs may obtain relevant document (s) where necessary. Further, the MFB shall not lend to a borrower to purchase gold/gold ornaments.

### **3. Application Form for availing loan against gold**

MFB shall incorporate following in the application form:

- a. Details of borrowers as per requirements under MFB policy/SBP Regulations
- b. Product details
- c. Terms & Condition clearly mentioned in national language shall be the part of application form
- d. Application form must contain section of "Next to Kin" or a separate certificate especially for handing over gold in case of death of borrowers.

### **4. Eligible Clients**

Financing shall be made as per eligibility criteria under Prudential Regulation for Microfinance Banks and other conditions defined in MFBs' product/operational manual.

### **5. Eligibility of Gold Ornaments**

Financing against gold is allowed to the extent of net gold contents of the required fitness. MFBs shall develop criteria on eligibility of gold/ gold ornament and fitness. MFBs are encouraged to incorporate relevant section in leaflet/broachers developed for clients in national or regional language.

### **6. Authorized Valuers/Goldsmith**

To reduce/minimize the risk of extending finance against fake gold, the services of only well-reputed and trustworthy goldsmith/shroff shall be employed in all cases to obtain measurement, fitness and evaluation. MFB shall establish a panel of at least three Goldsmith/Shroffs under one branch to assign task of valuation randomly.

The valuation of gold ornaments shall be conducted preferably in the MFB's own branch in presence of borrower & designated bank officer. In case if valuation carried out at the place of goldsmith, MFB shall take into account security measures, proper transportation and insurance coverage.

MFB shall develop a criterion of hiring Goldsmith/ Shroff. The criteria must include:

- a. Adequate number of years in business
- b. Not defaulter of any bank/MFB as per e-CIB
- c. Not convicted by any civil or criminal offence
- d. Holder of valid license, member of Sarrafa Association (where applicable).

MFBs shall execute standard agreement with approved goldsmith/shroff, mentioning tenure, Terms & condition, fees etc.

### **7. Valuation of Gold**

Valuation of gold ornaments must be based on the weight and fitness of the gold only. Valuation certificate issued by the goldsmith/shroff shall clearly indicate the description of the gold ornaments, fitness, gross weight, net weight of gold exclusive of stones, lace, alloy, strings, fastenings and the value of gold at the prevailing market price.

MFBs may seek valuation of the gold ornament from two Shroff/goldsmiths on sample basis with an objective of imposing control on gold smith/shroff.

## **8. Custody of Gold Ornament**

To ensure safety of the gold, MFB shall maintain a minimum level of physical infrastructure including fire proof safe vault, strong room in each branch engaged in financing against gold ornaments.

The gold ornaments shall be kept in a tempered proof bags with description details, account title, account number. A tag indicating details should be tied to the bag and placed in a way to identify easily.

MFBs shall ensure dual control on keeping of gold ornament (collateral) in safe vaults by the officers duly authorized by the competent authority.

## **9. Loan Processing**

For developing a smooth lending process, MFBs shall device process flow of loan against gold- backed security and incorporate in operational manual. MFB shall clearly define roles & responsibility of MFB/Shroff/Borrower in their policy. Further, MFB shall ensure following while lending against gold loan;

- a. MFB will document Turn Around Time (TAT) from receipt of loan application to disbursement.
- b. MFB shall develop proper internal control mechanism to avoid any fraud/misappropriation.
- c. In case of rejection of loan, MFB shall inform the client within 3 working days.

## **10. Insurance**

Gold ornaments held against loans should be insured against theft, fire, riots and other possible risks. In addition, MFBs shall obtain appropriate insurance to protect borrowers' loan outstanding in case of his/her death.

## **11. Margins**

MFBs shall maintain reasonable margins to cover their amount of principal and mark-up. Further, MFBs shall keep monitoring the gold prices and market fluctuation to make necessary adjustment in the margin requirements, if deemed necessary.

## **12. Release of Securities upon adjustment**

On settlement / repayment of outstanding loan along with applicable markup against gold ornaments held as collateral, the gold should be returned to the borrower with acknowledgement receipt within 3 working days after the full repayment of loan. Receipt should contain details of Gold returned.

MFB shall layout procedures for release of securities in case of following situation:

- Repayment/settlement of loan
- Death of a borrower
- Absence of borrower

Further, MFB shall an updated list of such borrowers in its MIS who have settled their loans but not obtained their gold ornaments.

### **13. Default and Auctions**

MFBs should develop a detailed and transparent auction process which shall at least follows:

- a. In case borrower fails to repay the loan on the due date, MFB will serve **FIRST** notice with a specified timeline to settle the loan.
- b. If borrower does not respond to the first notice, MFB would serve **SECOND** notice within 15 days after due date of the first notice informing the borrower that the ornament would be auctioned and outstanding loan would be adjusted.
- c. On completion of 15 days after **SECOND** notice, MFB will serve **THIRD & FINAL** notice with Public Auction Notice mentioning the date of auction to the borrower through registered courier at least 10 days (inclusive of courier shipment time) before the auction.

In addition, MFB shall also communicate date and place of auction date through telephone/mobile phone call.

In case of prevailing gold value below Rs.100,000/-, the MFB shall call borrower, gold owner, Loan witness and panel of gold smith to participate in the auction. In case of prevailing gold value more than Rs.100,000/- MFB shall notify auction through public announcement in at least two local news paper (at least one should be in Urdu). Notice must contain details of net gold and particulars as obtained at the time of pledge.

All such pledges, which have been sold for more than the amount of loan, the surplus derived by offsetting loan amount, interest, and other charges from the sale price, the MFBs are obligated to timely inform the borrower to collect the surplus amount.

**Note:** MFBs should mention in bold letters in the loan application the procedure of auction process in case of nonpayment of the loan on stipulated time. Further, the MFB shall maintain detailed record of each auction.

### **14. Role of Internal Audit Department**

Internal Audit Department of MFB shall from time to time monitor the lending and collateral management activities including verification process, loan process, safekeeping, valuation process, auction process and identify the gaps (if any) to the senior management.

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