COMPETITION COMMISSION OF INDIA

Dated: **07.06.2011**

Case Ref. Case No. 15/28, 06/28, 13/28, 11/28, 12/28, 2/28

(i) Shri Gulshan Kumar Gupta (15/28)
(ii) Shri Norbert Lobo (6/28)
(iii) Shri Madan Lal Ghai (13/28)
(iv) Shri C. M. Gupta (11/28)
(v) Shri Prakash Bajpai (12/28)
(vi) Shri Govind Aggarwal (2/28) Informants

Vs.

(i) M/s ICICI Bank Ltd.
(ii) Citi Bank
(iii) BHW Home Finance Ltd. Opposite Parties

Per R. Prasad, Member (dissenting):

This case was received on transfer from the MRTP Commission. There are six informants in this case namely (a) Shri Gulshan Kumar Gupta vs. BHW Home Finance Ltd. (b) Shri Norbert Lobo vs. Citi bank (c) Shri Madan Lal Ghai vs. ICICI Bank Ltd. (d) Shri C. M. Gupta vs. ICICI Bank Ltd. (e) Shri Prakash Bajpai vs. ICICI Bank Ltd. (f) Shri Govind Aggarwal vs. ICICI Bank Ltd.

2. All the six cases relate to the charging of differential rate of interest from different set of borrowers and the prepayment penalty being charged by banks and finance companies. As a common issue was involved in all the six cases, these cases were clubbed together. It was observed that if a person wanted to switch from one bank to another he had to pay prepayment penalty which acted as a barrier. The commission considered all the six cases together and came to the conclusion that a prima facie contravention of the Competition Act existed in the case and therefore a reference under section 26(1) of the Competition Act was made to the Director General. The main issue for investigation was the differential rate of interest charged by the banks/HFCs from new customers qua the existing customers and the levy of prepayment penalty foreclosure charges on the customers / borrowers for switching over to another bank / HFCs.

3. The Director General in order to verify the information issued letters to the banks and obtained details from the RBI and considered various decisions of the Supreme Court, National Consumer Dispute Redressal Commission and other consumer forums. The DG observed that while the banks were subject to the regulation by the RBI, the HFCs were regulated by the National Housing Bank. Shri Gulshan Kumar Gupta had taken a home loan from BHW Home Finance Ltd. on 17.05.2007 at a floating rate of interest @ 11.75% per annum for a period of twenty years. Shri Gupta came to know that the aforesaid bank had reduced the rate of interest as low as 10.25% per annum, and in some cases as low as 9.99% per annum and therefore he wanted to know from the bank as to why he was being charged the same rate of interest i.e. 11.75% per annum. The bank informed Shri Gupta that for the new customers the rate of interest was low though for the old borrowers the rate of interest would be same as was prevailing at that time when the borrower took the loan. The bank also informed to Shri Gupta that in order to avail lower rate of interest he can switch to another bank or from itself provided penalty of 2% of the entire loan amount was paid by Shri Gupta. The home loan was taken at a floating rate of interest and according to the understanding of Shri Gupta the interest rate was to be lowered as and when the market went down or was to be raised if the market rate went up. In its reply to the DGI&R MRTP Commission, the bank stated that the interest rate was fixed on the basis of the amount of loan, terms of repayment, duration of repayment and many other factors which were negotiated at the time of signing of the loan agreement and it became binding upon the parties on execution of the same. The bank also stated that for taking a decision to enhance the rate of interest, various factors like cost of borrowing, state of economy etc. are taken into consideration and the same is informed to public and existing borrowers. The bank also stated that it had given an option to Shri Gupta to lower his rate of interest if he paid 1% plus service tax as conversion fee on balance outstandings. The bank also informed the DGI&R that a borrower could be pay 30% of the loan in a particular year without any prepayment penalty. A customer was required to pay the prepayment penalty only when he prepaid the entire loan. Before the DG, Competition Commission the bank stated that this case should be clubbed with case no. 5/2009.

4. Out of the 5 complaints in this case 4 were against ICICI bank Ltd. As all these complaints were similar they were clubbed together and were required to be dealt with by the DG. The bank informed the DG that Shri Madan Lal Ghai had taken loan of Rs. 20 lakhs from ICICI bank on a floating rate of interest of 7.25% on 01.06.2005. The rate of interest was increased in this case 7 times during the period 16.06.2005 to 31.03.2007. Thus the EMI increased from 17,545/- to Rs. 21,749/- per month from July 2007 at an interest rate of 11.75%. On the other hand Shri Ghai informed the bank that the bank had given a loan to its new customer namely Ms. Geeta Tyagi at a floating interest rate of 10.5% in the year 2007. Shri Ghai also informed to bank that Indian Bank and Punjab National Bank were giving home loans at a floating interest rate of 9.5% in the year 2007. The informant told the ICICI bank that it was charging 2% more from him. The informant therefore wanted to switch the loans but then he would had to pay 2.25% as foreclosure charges to the bank.

5. The second informant Shri C. M. Gupta had taken a loan of Rs.15 lakhs on floating rate of interest of 9.5% per annum in September 2006 from the ICICI Bank Ltd. In this case also the bank had increased the interest rate of Shri Gupta, though it was charging a lower rate of interest to the new borrowers. In fact the interest rate had gone up from 9.5% to 12%. Shri Gupta contacted the bank and stated that he was getting loan from other banks at 9.99% and for this reason he wanted to foreclose his loan with the bank. The bank requested an extra 2.5% for foreclosing the loan.

6. The third case is that of Shri Govind Aggarwal. He had taken a loan of Rs. 7 lakhs from the ICICI bank in March 2003 on a floating rate of interest. In October 2008 floating rate of interest in the case of Shri Aggarwal went to 14% whereas new customers were being offered loans at 12%. Shri Govind Aggarwal therefore came to the conclusion that the whole concept of floating rate is incorrect.

7. In the case of Shri Prakash Bajpai, he had taken a housing loan of Rs.13,25,000 on floating rate of interest of 7.75% on 09.10.2004. Shri Bajpai was of the view that the bank would offer market rates to him. The bank i.e. the ICICI bank started charging higher rate of interest than most other banks citing rising cost of funds. Later when the interest rate fell in the public sector banks were charging 9% interest though ICICI bank was charging 13% interest. Shri Bajpai observed that

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though old customers were being charged higher rate of interest the new customers were being charged lower rate of interest. DGI&R asked the explanation of the ICICI bank. The bank replied that the loan was given on the prime lending rate or floating reference rate. It is also explained to the DG that the rate charged is a function of FRR and the margin associated with the loan. It was stated that all FRR movements are decided by the Asset Liability Committee of ICICI bank. It was stated that various factors were taken into account while fixing a rate given to a customer. It was stated that the rates offered to certain customers at a point of time may not remain the same with another set of similar customers availing the loan at a different time. It was further argued that the rates were revised after taking into consideration various factors such as banks current cost of funds, likely change in Bank's cost of funds, estimated cost of operations, credit charge, market rates, interest rate outlook, systematic liquidity etc. Regarding the prepayment penalty levied at the time of prepayment, it was argued that a customer is informed about the fact as and when the loan is taken. It was further stated that the prepayment penalty is levied only when the entire loan is repaid before the tenure of the loan was over. It was also argued before the DG that the case is one of restrictive or unfair trade practices that the MRTP Act was not applicable to banks. To support this view a copy of the order of the Competition Appellate Tribunal dated 16.04.2010 was submitted to the DG.

8. Shri Norbert Lobo filed a complaint against Citibank before the MRTP Commission. According to this complaint Shri Lobo and his wife took home loan from Citibank on a floating rate of interest in February 2006. The bank increased the interest rate to 11.75% in April 2007 and brought it at par with existing rates for the old customers. Enquiry was made from Citibank and the bank replied that it incurs costs and expenses with regard to funding and therefore when some borrowers repay the loan the bank is put to a loss. Citibank therefore used to charge 4% prepayment penalty on the principal component whenever the borrower wanted to prepay. It explained that at the time of taking the loan this condition was shown to the borrower. Regarding prepayment penalty it was argued that cases are pending before the Supreme Court.

9. During the course of investigation the DG found that Axis Bank was not charging any prepayment penalty if somebody wants to foreclose his loan. The DG found that Axis bank followed a different method and that the main aim was reduced

overall payment fulfilment instead of focusing more on penalty. The DG also found that the case has two main elements (i) levy of differential rate of interest by banks and financial institutions. (ii) prepayment penalty charged by banks and financial institutions.

10. Regarding the disparity in interest rates charged to old customers and new customers, the DG was of the view that with the introduction of the base rate by the RBI, this problem would be sorted out. Regarding prepayment penalty the DG has reported that this issue was considered by him in his report in case no.05/2009 and that a case is made out under section 3(3)(b) of the Competition Act of the Competition Act. The DG also examined the provisions of section 19(3) and he came to the conclusion that many of the factors mentioned in section 19(3) are attracted such as clauses (a) (c) and (d) of section 19(3). Therefore the DG has held that the contravention of the Act has been made out in this case.

11. The Commission considered the report of the DG and found that all the factors necessary have not been considered by the DG such as whether there was a continuing affect of the practices followed by the bank after 20.05.2009 and as to whether there were any other anti-competitive elements in the transactions such as practices carried out and abuse of dominance. On this reference from the Commission the DG submitted another report.

12. The DG reported that the charging of differential rate of interest was continued even after 20.05.2009. The date 20.05.2009 is important because that is the date on which sections 3 and 4 of the Competition Act was notified by the Government. Regarding infringement of the Competition Act in respect of differential rate of interest DG stated that there is a violation of section 3(3)(b) of the Competition Act. Regarding prepayment penalty for the foreclosure of loans the DG had stated that his findings in case no. 5/2009 would be applicable in this case also. Regarding the fact as to whether the case is covered under section 3(4) of the Act, the DG was of the view that the issue cannot be covered within the ambit of section 3(4) of the Act. As far as the abuse of dominant position is concerned the DG was of the view that as none of these banks had a very large market share there is no case of abuse of dominance in this case.

13. After the receipt of this report the commission sent copy of the report to all the informants and the three banks involved. One of the borrowers i.e. Shri Norbert Lobo replied. Shri Norbert Lobo had taken loans from Citibank and according to his letter different customers were charged differential interest rates while taking loans. It was also stated that increasing interest rate in the scheme of home loans amounts to cheating, is anticompetitive and is a restriction on trade practices. It was argued that the banks allure the customers at lower interest rates and once the loan disbursed the borrower has no option but to low down to the cheating clutches of the bank because of the prepayment penalty.

14. Another informant Shri C. M. Gupta has stated that his bank which is the ICICI bank had cheated him. It was stated that the interest rates were increased without any intimation to him and that there was no transparency on the part of the ICICI bank. It was argued that the bankers on their own cannot increase the interest rate. Regarding prepayment penalty for the foreclosure of the loans it was stated that this factors was suppressed when the loan was sanctioned to him. It was also stated that the banks be directed to charge interest at 9% and adjust the balance amount recovered against the outstanding loan. Shri C.M. Gupta also submitted another reply and he stated that though the bank was charging higher rate of interest it was charging other persons who are new customers of the bank must lower rate of interest. Even when he wanted to repay the loan from its own sources the banks asked for 2.5% as prepayment penalty. If somebody wants to prepay the loan it was not clear to Gupta as to how he should be penalised. In his view if this is not a malpractice than what was a malpractice. It was therefore stated that he has been cheated by the ICICI bank.

15. In response to the notice issued by the commission Citibank submitted the reply and in this in the said reply Citibank submitted that it was not engaged in any anti-competitive activity. It was argued that in the case of Neeraj Malhotra vs. Deutsche case no. 5/2009, the Commission has already closed the case and therefore this case should also be closed. It was also argued that as there was no agreement to provisions of section 3(3)(b) are not attracted. It was therefore argued that the proceeding should be dropped.

16. The Deutsche Bank also relied on the decision of the commission in the case of Neeraj Malhotra and stated that no case under Sections 3 and 4 is made out and the case should be closed.

17. ICICI Bank submitted a number of written arguments. It was argued that the floating rate of loans are linked to the benchmark FFR. Reliance was placed in Section 21A of Banking Regulation Act which states that transactions between a banking company and its debtor shall not be reopened by any court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive. This was also argued that the rate of interest is monitored by the RBI. Regarding prepayment penalty it was argued that if somebody prepays then there may be a mismatch regarding deployment of funds by the bank. It was also argued that the banks have funds and it had to be deployed. That takes time which would be a cost to the bank. The question of asset liability mismatch was also argued. It was stated that as no agreement existed between the parties i.e. banks the provisions of section 3(3)(b) of the Act are not attracted. It was therefore argued that the case should be dropped.

18. Shri Madan Lal Ghai has also responded to the notice of the Commission and stated that the bank had already charged prepayment penalty and that he has paid on 06.02.2008. He switched the loan from ICICI bank to Indian bank and this happened prior to coming in force of the Competition Act.

19. Similar issues came up in the case of **28/2010 (five informants vs. HDFC Bank & ICICI Bank)**, as issues remain the same an extract of my order in the said **case is reproduced as under**:-

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> 18. The main grouse of the five information providers is that though the market rate of interest had dropped, ICICI Bank and HDFC were not willing to reduce the interest. In fact in two of the cases i.e. in the case of Shri Reddy and Shri Shiv Kumar Gupta the banks agreed to reduce the interest as and when they wanted to shift the loan to another bank. Therefore in these two cases, the banks admitted in a implied manner that they were overcharging their customers. But no benefit was given to the borrowers with retrospective date and in this manner, the two banks profited. The case of Shri Charanjit

Singh shows that the proper information was not provided by the banks the borrowers at the time of taking the loans. In the case of Ms. Muthukrishnan, HDFC was charging interest from the new borrowers at 8.75% but the old borrowers were charged interest at 11%. This is certainly discriminatory.

19. Inspite of these discriminatory and abusive practices the borrowers had to silently bear them as they could shift to another bank only the paying switching costs. The issue switching costs i.e. penalty for the prepayment of loans was considered by me in the case of Neeraj Malhotra vs. Deutsch Bank & ors. **Case No. 5 of 2005. Extracts of my orders in the said case are reproduced as under:-**

> 20. *We also have to examine the economic considerations for the levy of penalty charged by the banks for the foreclosure of loans. We have to examine the economies of treatment of this phenomena of penalty for the foreclosure of loans in other countries. We also have to examine the home loan market in India and its contribution to the Indian economy and vice versa. We also have to examine whether the banks/financial companies are losers or gainers if their customers prepay their loans.*
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> 21. *In India, the shortage of homes for living is approximately 70 million. The economy in India was liberalized in 1991. Home loan concept was introduced in India and tax breaks were introduced for home loan takers. After the opening of the economy, the G.D.P. in India increased substantially and from 2003 to 2008, the G.D.P. growth was approx. 8.9%. Due to liberalization of the home loan market, increase in disposable income, the requirement for home loans increased and the home loan market grew by 43% between 2000 and 2005. Many new banks and finance companies entered the home loan market. The market is very big and demand is so high that many more enterprises want to enter the market.*
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> 25. *An economy would grow in the short run if consumer spending increases. If consumer spending increases the savings rate would go down. Savings rate increase in the long run may be beneficial but consumption spending in the short run is beneficial for the economy. Thus it is necessary to put surplus cash in the hands of the consumers. But the banks by having a prepayment fine on the consumers is decreasing the cash availability. Further, a cap has been put on the banks and other companies as far as housing loan is*

concerned. If a filip is given to housing by having cheap property prices and cheap loans, the housing industry would receive a boost. This in turn would lead to higher employment, higher industrial growth, higher growth of person income and increase of G.D.P.

26. It is therefore necessary that as India faces shortage of houses, the home loan market should be expanded. Mobility in the market for the customer should be encouraged. Competition in home loan banking is important in order to ensure an efficient banking industry and should not be viewed as dangerous to the banking sector. In fact in Norway mortgages are the main source of income for customers constituting 75% of the total income. In India as well as in various countries, the banks charge customers for terminating services. This reduces the mobility of customers. The ability of the customers to switch banks helps the competitors the benefits of a competitive banking market. Any obstacle which reduces customers' ability to switch banks will correspondingly reduce the competitive pressure on banks. High switching cost may result in increased bank market power and enable the banks to extract extra rent from the customers. High switching costs may also constitute barriers to entry as they make it harder for new entrants to attract customers and hence discourage new market entry. Further high switching cost may discourage product innovation, as customers would be reluctant to switch to new products and services.

27. The European Commission carried out a study of retail banking. Even the EFTA Authority had carried out a study of retail banking in the EFTA countries. The European Commission found potential competition concerns and consumer harm in some of the areas such as list of coordinated behaviour in the banks to the detriment of customer mobility through a non-transparent treatment of certain products such as mortgages. There are some economists who consider that banks form a big cartel but most of the economists are not of this view. The European Commission observed that the mortgages generated largest share of income in retail banking in European banks. It has also been stated in the said report that before customers change banks he considers all the factors which help him in switching banks. This would include switching costs also. It was also observed by the Commission that switching costs in the retail bank industry has three significant effects (i) it increases the bank market power and this leads the bank to discriminate between new customers and old customers. The bank would charge low charges to attract new customers and

once the customers are locked, the banks would charge higher prices which may be in the form of switching costs. (ii) Switching costs served as an entry barrier because it does not allow switching to consumer to bank with cheaper and better product. If the switching costs are high it was uneconomic for new entrants in the market to induce customer to switching. (iii) The third aspect was it discourages product innovation. When a new product is introduced in the market due to innovation and the switching costs are low the customer would like to switch to the new product. But if the switching costs are high there would be no reward and no customer would like to switch. In the EFTA report it has been stated that in order to have the benefits of the competition in the banking sector the customers should be able to choose their banks. Any obstacle that reduces consumers' ability to switch banks would reduce the competitive pressure on the banks. If closing charges are charged by bank this would reduce the mobility of the customers. High level of switching cost in the banking industry results in increasing the bank market power and enables banks to extract extra rent form the customers. High switching costs also constitute barriers to entry as it makes harder for new entrants to attract new customers and hence it discourage new market entry. High switching costs also discourage product innovation as customers would be reluctant to switch to new products and services. The finding of the both European Commission and EFTA authority are similar.

28. A study was also carried out by Amsterdam Centre for Law and Economics. In this paper it has been mentioned that switching costs may be a reason for consumers' immobility as they remain locked-in one supplier. Switching costs also influence on behaviour as the firms should attract new customers by charge low prices and in order to exploit captured customers. The firms cannot discriminate between old and new customers due to high switching costs they have been giving incentives to keep their prices high and exploit their old customers instead of attracting new customers through lower prices. Therefore, it has been stated in the report that switching costs played an important role in consumers' decision. In another report the European Commission had analyzed the switching costs in the electricity market. In this report the Commission held that in the market of retail banking a policy of the mobility of the competitors has got to be followed.

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35. It is thus clear that the main aim of the banks or housing finance companies is to find the customers and not allow them to switch to other institutions. It also allows the banks to overcharge the customers as they are giving loans to new customers at lower rate of interest. Because of these facts, competition between the banks is killed and no new products would come and no innovation would be introduced. This practice also does not allow new banks/institutions with lower rate of interest to garner new business. Therefore, by charging pre-payment penalty, the banks/institutions are following anti-competitive practices which is having an appreciable adverse effect on competition in India.

36. Another argument which has been advanced is that if the customers prepay their loans what would the banks/HFCs do with the case which would be available with them. The market of home loan in India is very large and there is a very big shortage of houses in India. Further there is a cap placed on the banks as far as housing loans are concerned. The banks/HFCs would be in a position to loan the amount receivpd as pre-payment to new loan creditors. This in turn would lead to construction of new houses or the purchase of new flats and would help in the economic development of India.

62. But before examining competition in the home loan market it is necessary to examine the behaviour pattern of consumers i.e. behaviour economics. Before a theory or hypothesis is formed, it is necessary to have certain axioms. In economics, the axiom is that in a perfect market, a consumer would make a rational choice which would increase his economic well being. The question is as to how this rational choice can be made. This choice depends on whether a person wants to improve his economic well being. It also depends on the information which is available to person in the market. This choice is dependent on the advertisements which flood any market, it depends on brand value, it depends on the services which are given in the market or it could depend on the perceived advantage to the consumer. The consumer can suffer from processing overload. Consumer biases can set in the processing of information. For a market to function properly a consumer should be able to assess access and process information. Because of the bulky information which the consumer has to go through before he enters in the agreement he can enter into an agreement which is anticompetitive. This can happen due to processing overload. The agreement may lead him to high switching costs. It there are high switching costs, mobility of the consumers

would be affected. Thus, a new entrants would not get customers and innovation would suffer. Even the allocative efficiency of the markets would suffer. Competition Authorities such as the OFT and others thus realize that behaviour economies plays a major role in the competition in the market. It is recognized that agreements are not sacrosant as God's Ten Commandments. Even if a consumer has signed the agreement, it could be due to misinformation fed by the sellers of the products. Further, as discussed above, switching cost are being recovered even if there was no such factor in the agreement.

63. In the background of these facts, this case has to be decided. The facts are that the Indian home loan market is very large and is expanding at a very fast pace because of the growth of G.D.P. at a rate nearly 9%. There is a shortage of houses in the country and if the credit in the home loan market increases, due to high pent up demand for loan, the gross domestic product of the country would increase substantially. This in turn would give a boost to the cement and steel industry mainly because housing contributes nearly 6% to 7% to the G.D.P. of India.

64. But the banking industry and the home finance companies have introduced the concept of fines on the foreclosure of loans before the loans come to an end. When HDFC entered this segment of home loans in 1978, there was no penalty on the prepayment of loans. When competition came in the market in the form of L.I.C. Housing Finance in 1993, HDFC introduced the concept of penalty on the foreclosure of loans. L.I.C Housing finance introduced the system of penalty in 1995. National Housing Bank which is the regulator in the area of home finance and which lends to banks/HFCs introduced the concept of penalties in 1997. ICICI Bank which entered this field later introduced the concept of penalties on prepayment in 2001. The PSU banks entered the field of home loan at a later date and initially they did not charge any penalty. But after the meeting of the banks in September, 2003 the P.S.U. banks started charging penalties varying from 0.5% to 2%. Subsequently, many of the banks did not levy penalties from customers who prepaid the loans from their own funds. But if the loans were prepaid after taking loans from another bank, the banks levied penalty. Incidentally, according to a report of ICRA, HDFC and SBI have a market share of nearly 17% in the home loan market. ICICI Bank has a share of 13%. Even LIC Housing is a significant player in the market.

67. During the course of hearing of the banks, it was conceded by some of the banks that the concept of penalties for the foreclosure of home loans was introduced because the banks did not want to lose customers who could have migrated to banks giving loans at a lower rate. They thus wanted to reduce the mobility of consumers and reduce their choice. The banks also wanted to discipline the consumers. The banks wanted to extract rent out of the consumers by charging the penalty as they perceived losses. But what losses they had incurred to would have incurred was not worked out. The banks were also not aware of how much they had earned out of the prepayment penalties. The data was not available because home loans constituted a very small percentage of their total loan portfolio. In fact even today S.B.I. which is the largest bank in the country, has a total home loan portfolio of 13%. Most of the banks talked of asset liability mismatch when the consumers prepaid their loans. But no material to support this claim was furnished. On the contrary, as worked out above no loss is suffered by a bank if a consumer prepays his loan. In fact the prepayment enlarges and deepens the home loan market because there is an insatiable demand for home loans in India. I have already dealt with the arguments raised by the banks.

68. In view of the above noted factual position, the issues are to be examined with reference to the Competition Act, 2002. The question here is of switching charges which a consumer has to pay in the form of prepayment penalties. There is no doubt that by charging pre-payment penalty the banks reduced the choice of the customers. As a consequence of the prepayment penalty, a customer cannot shift from one bank to another. Further when a new bank enters the market it would not be able to get customers from the other banks because the customer would not like to shift in view of the penalties which he would have to pay if he shifts to a new bank. Thus by levying the pre-payment penalties banks are killing competition in the home loan market. This also leads to decrease in the allocative efficiency of the market and a reduction of innovation. Under the provisions of Section 3(1) of the Act, no supplier of goods and services can enter into an agreement which causes or is likely to cause an appreciable adverse effect on competition. In all the cases where the banks enter into an agreement with a consumer for home loans, the banks have envisaged penalties provided the consumer pre-pays his loans. As already discussed the levy of switching charges in the form of pre-payment penalties causes an appreciable adverse effect on competition. Therefore, under Section

3(2) of the Act of these agreements entered into by the banks are anti-competitive agreements and therefore void.

69. Before declaring an agreement to be void the provisions mentioned in Section 19(3) of the Act have to be looked into. An appreciable adverse effect on competition under Section 3 cannot be determined without regard to the facts enumerated in Section 19(3) of the Act which are:

(i) Creation of barriers to new entrant in the market.

(ii) Driving existing competitors out of the market.

(iii) Foreclosure of competition by hindering entry into the market.

(iv) Accrual of benefits to consumers,.

(v) Improvements in production or distribution of goods or provision of services.

(vi) Promotion of technical, scientific and economic development by means of production or distribution of goods or provision of service.

In this particular case for the foreclosure of the loans, a barrier has been created for new entrant in the market as no consumer would shift to the new entrant as he would suffer a loss as prepayment penalties would have to be paid. Competition has also effected as hindrance is caused to the consumers by the levy of the penalties when a person shifts to another bank. The next issue is the accrual of benefits to the customers. When pre-payment penalty is levied there is no benefit to the consumer. In fact there is a decrease of benefits to the consumer as he has to pay penalty. Further the choice of the customer decreases. Therefore, the provisions of clauses (a), (c) and (d) are applicable to the facts of this case. Therefore, by the levy of the switching charges by the banks an appreciable adverse effect on competition within India is created. Therefore the agreement by the banks with the consumers for the levy of penalty for the foreclosure of loans is an anti-competitive act and therefore void in accordance with the provisions of Section 3(1) and 3(2) of the Act.

70. The provisions of Section 3(4) may also be applicable to this case because home loans enterprises operate in the home loan markets whereas consumers who take a loan from the home loan enterprises operate in the market of construction or purchase of premises from realtors. Thus, the banks and customers operate in different markets. By entering into an agreement

where there clauses for the levy of penalty for the foreclosure of loans an exclusive supply agreement is entered into by the banks which its customers. This restriction placed on the customers by the banks also creates an adverse effect on competition in India as the customer is unable to switch to a bank with better and innovative products. It also debars new banks to enter the home loan market even though they may be having better products.

71. The D.G. has carried out investigation in this case and he has found a contravention by the banks/HFCs under Section 3(3) (b) of the Act.

The findings of the DG are based on following facts/evidences:-

- *(i) The Circular dated 10th September, 2003 issued by IBA suggests that there is a concerted action on the part of the banks.*
- *(ii) The internal circulars issued by the banks justifying their actions of charging pre-payment penalty are anti-competitive in nature.*
- *(iii) The origin and history of this practice.*
- *(iv) Regulatory position.*
- *(v) Judicial decisions, and;*
- *(vi) International practice.*

In order to find out whether the DG has applied the right provisions of law in the given situation, it is important to re-look into the provisions of the Act and find out whether this case fits into the entire scheme of things as provided therein.

Section 3(3) of the Act deals with the following situations:-

- *(i) the agreements entered into between the entities of the class described therein, or*
- *(ii) any practice carried on by them, or*
- *(iii) any decision taken by them and*
- *(iv) Containing the terms set out in clauses (a) to (d) which in substance are fixing prices, limiting or controlling supply of goods or services or technical development, sharing the market, ~~and~~ bid-rigging or collusive bidding.*

If the above conditions are satisfied, it shall be presumed to have an appreciable adverse effect on competition. They are deemed to be in per se violation of Section 3 and the onus is on the party to disapprove this claim.

Commission

The classes of parties to an agreement dealt with by section 3(3) are; enterprises, associations of enterprises; persons or associations of persons and they could act in any combination. It is that they are to be an association of persons or enterprises of services. Where the association of persons or enterprises is publicly identified as a group with a unity of purpose they are named as Cartel.

However, before applying this section, it is important to understand the definition of following "terms" of the provision.

"Practice carried on" – "Practice" has been defined in Section 2(m) of the Act and includes any practice relating to the carrying on of any trade by a person or an enterprise.

"Service"- "Service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial matters such as banking......financing.........and advertising.

In view of the above definition, following questions need be answered in the present case:-

a. Is 'Retail Home Loan Financing' is a service being provided by the banks?
b. Is there any practice of pre-payment penalty being carried by the banks?
c. Is there any association of banks?
d. Is there any concerted action on the part of the banks?
e. Are they engaged in identical or similar trade?
f. Are these association of banks is in any way limiting or controlling this provision of services?

If the answer is "yes" then Section 3(3) (b) is clearly attracted in this case because as per definition, the "practice carried on ...... by any association of enterprises or association of persons........, engaged in identical or similar trade of goods or provisions of services, which- limits or controls......provision of services;" is covered under Section 3(3) (b) of the Act and once the conditions mentioned in Section 3(3) of the Act are fulfilled, it is deemed to have "appreciable adverse effect on competition".

But before reaching a conclusion that the provisions of section 3(3) of the Act are attracted in this case the most important thing to find out is:-

(i) Whether there is any agreement, arrangement or understanding or action in concert in writing or informal?

(ii) Does this agreement or arrangement or understanding or action in concert cause or likely to cause an appreciable adverse effect on Competition within India?

As per Section 2(b) of the Competition Act, 2002, "Agreement includes any arrangement or understanding or action in concert–

(i) Whether or not, such arrangement, understanding or action is formal or in writing or,

(ii) Whether or not, such arrangement, understanding or action is intended to be enforceable by legal proceedings.

This means that in order to fall under this definition, a concerted action on the part of enterprises or persons is a pre-requisite. Even when party to such an arrangements do not intend to create any legally enforceable mutual duties and liabilities, it shall be considered as an agreement under this act.

In Technip S.A Vs S.M.S holding private Ltd. (2005) 5 SCC 465, the Court observed that the term "agreement" covers an arrangement or understanding which may be informal as well as formal. No written proofs of agreements are required, as writing has been done away with.

The definition is designed in such a way as to produce a vast and sweeping coverage for joint and concerted anti-competitive actions. There is no need for an explicit agreement in cases of conspiracy where joint and collaborative action is pervasive in the initiation, execution and fulfillment of the plan- United States Vs General Motors 384 US 127.

It has been a contentious issue as to what constitutes an agreement to come within the ambit of competition enquiry. In CFI Judgment in Volksawagen AG Vs Commission (2003), it has been held that there is no need for an explicit agreement in writing but there should be consensus between the parties concerned also referred to as meeting of minds or concurrence of wills.

It has further been held in Commission vs. Bayer AG (2004) 4 CMLR 13, that it is sufficient that the parties to the agreement have expressed there joint

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intention to conduct themselves in the market in a specific manner. As regards the form in which the common intention is expressed, it is sufficient for a stipulation to be the expression of the parties' intention to behave on the market in accordance with its terms.

However, there have been practical difficulties to establish the existence of an anti-competitive agreement between the firms. The fact is the firms engaging in anti-competitive behaviour have developed sophisticated mechanics of hiding their behaviour so that they escape the liability under the anti trust laws. Lord Denning in RRTA Vs W. H. Smith & Sons Ltd. have observed "People who combine together to keep up prices do not shout it from the house tops. They keep it quite. They make their own arrangements in the cellar where no one can see. They will not put anything into writing nor even into words. A nod or wink will do."

From the above definition of "agreement", it can be concluded that if following conditions are there, then it can be said that there is an agreement:–

- Any formal or informal arrangement or understanding
- No need to have an explicit agreement in cases of conspiracy where joint and collaborative action is pervasive in the initiation, execution and fulfillment of the plan
- No need for an explicit agreement in writing but a consensus, between the parties concerned which referred to as meeting of minds or concurrence of wills, is sufficient.
- It is sufficient that the parties to the agreement have expressed there joint intention to conduct themselves in the market in a specific manner.
- As regards the form in which the common intention is expressed, it is sufficient for a stipulation to be the expression of the parties' intention to behave on the market in accordance with its terms.
- No need to have anything into writing or even into words. A nod or wink will do.

However, there is a feeling of some different inference on the term "agreement". There is a view that Section 3(3) is wider in scope than Section 3(1) as Section 3(1) deals only with any agreement whereas Section 3(3), in addition to any agreement, also covers practices carried on or decision taken by which results in AAEC. The fact that the Act uses, these three terms also indicates that "agreement", "practices carried on" and "decision taken" are envisaged as distinct and distinguishable. A "follow the leader" syndrome may lead to anti-competitive "practices carried on" and "decision taken" without being an "agreement". But these would still be actionable under Section 3(3) if they result in acts covered under sub-clauses (a) to (d).

The inference drawn can not be subscribed to. Section 3(1) is the covering section of the entire Chapter on "Prohibition of agreements" and it is the broader provisions which covers both Section 3(3) and Section 3(4). In fact, in Section 3(1) two situations i.e. 3(3) and 3(4) have been envisaged. It means that any contravention of Sections 3(3) and 3(4), the contravention of Section 3(1) has to be there. Section 3(1) is inherent and implicit in Section 3(3) and 3(4). It also can not be concluded that "practices carried on" or "decision taken by" as provided in section 3(3) can be without any "agreement". Agreement is a necessary element in all the sections provided under section 3. It is the crux of the Chapter "Prohibition of agreements". Unless there is an agreement, there can't be prohibition of agreements. Thus, a contravention of section 3(3) without having an agreement can not be visualized. This presumption is further strengthened by the fact that in Section 19(3) also it is clearly mentioned that 'while determining whether an agreement has an AAEC under section 3, have due regard to all or any of the following factors, namely (a) to (f).

There is a feeling that to establish an "agreement" between persons, there has to be conclusive evidence. This is not a correct presumption. Even under Evidence Act two types of evidence have been prescribed to establish an offence – i.e. direct and circumstantial. As has been stated above and is a settled position also that in the case of cartels or anti-competitive agreements to establish an "agreement" of being anti-competitive in nature direct evidence can not be found unless through dawn raids, so, one has to depend on circumstantial evidence or the preponderance of probabilities. In the present case there is both circumstantial evidence as well as preponderance of probabilities which establishes that there was an "agreement" among the banks to carryout the practice of charging pre-payment penalty. Further, Evidence Act is strictly not applicable to these proceedings.

73. Now, coming to the "Practice carried on" by these Banks" which is limiting or controlling the provision of services", it is a fact that the banks have adopted the practice of imposing prepayment penalty to Borrowers who wish to either repay their loan in advance or to the Borrowers who wish to migrate the

said loan to another lender. The Banks are charging a rate of prepayment penalty varying from 1% to 4% on the outstanding loan amount. The banks have formed an association of banks known as Indian Banks Association (IBA). Though the Circular dated 10th September, 2003 issued by the IBA was not binding on any banks and it was optional for any bank to impose pre-penalty charge, it can not be denied that the practice adopted by most of the banks is a concerted action on the part of the banks in view of the settled legal position discussed as above. These banks are indulged in the restrictive practice as the consumers are not allowed to switch over from one bank to another because of this prepayment penalty clause. Switching costs are costs that existing customers have to incur when changing suppliers. Customer mobility and choice is essential to stimulate retail-banking competition but, here, consumers are tied to their bankers due to the existence of switching costs i.e., pre-payment penalty charge.

Secondly, the loans were provided to those customers by the banks on floating rate of interest were made to understand that the rates will fluctuate as per the prevailing conditions of the market, however, in practice, it is observed that interest rates were revised upward and not downward. Whenever there was condition in the market to lower the interest rate, lower rate of interest were being offered to the new customers and the existing customers were not being benefited.

Differential treatment were being given to the new loan customers by the banks by providing very lower interest rate on loan amount in comparison to the existing loan consumers. If the existing customer asked banks to lower the interest rate at par with the new customers, it was conditioned by the banks to pay pre-payment penalty/ foreclosure amount on the outstanding loan, and then to apply for fresh loan.

If any customer decides to pre-pay/foreclose the loans, they had to pay a certain percentage as penalty amount i.e. normally 2%-5% on the outstanding loan amount to clear their account. Is not this practice anti-competitive, and the practice is limiting the provision of services?

74. Now, what is to be seen by the Commission? Under Section 19(3) of Competition Act, 2002, the Commission, while determining whether an agreement has an appreciable effect on competition under section 3, is required to consider the all or any of the following factors:-

(a) creation of barriers to new entrants in the market;

(b) driving existing com[editors out of the market;

(c) foreclosure of competition by hindering entry into the market;

(d) accrual of benefits to consumers;

(e) improvements in production or distribution of goods provision of services;

(f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services,

However, it is a wrong presumption that the parameters prescribed under Section 19(3) are not required to be applied while assessing an "agreement" under Section 3(3) as it is a deeming provision. Merely because it is a deeming provision, it does not mean that the Commission is deprived of its powers to apply these factors while determining AAEC. Section 19(3) is a mandatory provision and the Commission is bound to apply these factors for arriving at AAEC. In my opinion the deemed provisions of Section 3(3) is for forming a prima facie opinion and not the final one. The parameters given in Section 19(3) are not the 'cause' of AAEC but a result thereof. For example, if an "agreement" results into the creation of barriers or driving existing competitors or forecloses the competition and so on, there has to be AAEC.

So, what Commission is to determine is that due to the practices followed by the banks are there any entry barrier is being created? Is the competition is being foreclosed by hindering entry into the market or due to such practice any benefit is being accrued to the consumers? Because, the principle objective of competition law is to maintain and encourage competition as a vehicle to promote economic efficiency and maximize consumer welfare. The focal point of competition should be the actual and / or potential business conduct of firms in a given market and not on the absolute or relative size of firms. What needs to be seen by the commission is that whether a firm can exercise "market power", i.e. engage in business practices which substantially lessen or prevent competition. The relevant product market in this case is "retail market of home loan financing" and the relevant geographic market is whole of India.

75. The case was, therefore, examined from the point of view of Section 19(3) and it is found that:-

(i) The practice of imposing prepayment penalty to borrowers who wish to either repay their loan in advance or to borrowers who wish to migrate the said loan to another lender, is rampant in the market and there is only one exception to that. The rates of prepayment penalty vary from 1% to 4% on outstanding loan. The said prepayment penalty charged from borrowers appears to be arbitrary, anti competitive and without any basis.

(ii) The asset liability mismatch argument does not support a charge of 1-4% penalty. Moreover, at least in an increasing interest rate scenario, the lender is actually benefited by the prepayment because it should have raised the money at cheaper rate and now it can lend it at much higher rate, so there is no reason to levy a charge on the prepayment. Secondly, ALM is not account specific and it matches the tenors of all deposits with all loans. This aggregation effect should render the impact, if any, to an insignificant amount.

(iii) Large corporate prepay hundreds of crores of loans (which should cause bigger ALM issue for banks) whenever they get cheaper funds, but it is a common knowledge that the banks do not charge any prepayment penalty. Moreover, the same corporate are given funds below PLR rates. It goes to prove that loss due to ALM is not the reason to charge prepayment penalty. It is mainly to restrict small borrowers from choosing a cheaper loan.

(iv) The prepayment penalty is clearly to stop a borrower from going to a competitor for a cheaper interest rate or for better service. Through the pre-payment of loan, the principal money is repaid well in advance to the banks through foreclosure. Even if it is paid through switching over from one bank to another, the banks get their principal money returned well before the tenure and this provides opportunity to the banks to further pump money in the market.

(v) Prepayment penalty is in effect an enhancement of interest rate from back door. The lenders advertise a lower interest rate but in effect it is higher due to such penal charges.

(vi) At the time of sanction of loans the lenders recover processing and other charges over and above the interest charge which is sufficient to cover all their risks plus a reasonable profit. There is no reason to impose prepayment penalty to the tune of 1-4% of outstanding amount.

(vii) Most borrowers fail to reckon and compare the exit loads mentioned by the lender because they are not clear when they will need to repay the *loan and what will the outstanding at that time. This situation is exploited by the lender.*

(viii) *There appears to be no financial calculation to establish that prepayment charge of 1-4% is reasonable and justified as the concept of 'time value for money' is not recognized by these Banks. As the money received today has better value than the same amount of money received in future. If we calculate the EMI and the 'time value for money' it will be evident that banks are unreasonably charging foreclosure amount as the consumer is bound to pay more first in terms of interest portion in the initial months of the payments and later he is made to pay in terms of pre-payment charges, if he decides to foreclose for better options. This practice is fleecing the consumers and also it is not generating any economic value and restricting the consumer to exercise the right of freedom to choose better financial options for the loan.*

(ix) *Moreover, the practice of pre-payment penalty on loans is not helping the banks to be more service efficient and competitive on the interest rate being charged on loans to the existing customers as banks are sure of their secured customers due to the anti competitive agreement of pre-payment penalty.*

(x) *There has been a tacit agreement among banks to follow the practice of pre-payment penalty and foreclosure fees on loans as to hold back their customers from switching over to other banks. Since all lenders have imposed prepayment penalty, it indicates of a concerted action leading to suspicion of cartelization. In fact, many lenders have already admitted that this practice is being adopted by them to stop their customers to switch over from one bank to another.*

(xi) *Even if it has not all the elements of cartel, which is prohibited under section 3(3) of the competition Act, 2002, customers were prevented from significantly reducing their property debts as it represented the most substantial household and repayment accounted for 50% of their disposable income. This restricts competition, as it restricts a consumer to avail banking services of another bank which is ready to offer the loan at lower interest rates.*

20. The issue is here again of a practice carried out by the banks. The issue of practice has already been discussed in the case of Neeraj Malhotra vs. Deutsche Bank and the extracts of the said judgement is reproduced above. In the section 3(3) there is a reference practice carried on which limits are control

provisions of services i.e. according to the section 3(3)(b) of the Act. In this particular case proper information at the time of taking loan is not provided to the borrowers and this leads to any information asymmetry. Further, as the old borrowers are charged at a higher rate of interest as compared to the new borrowers. The main aim is to get more borrowers and then capture them. Subsequently, the interest rates of the new borrowers are also increased. Thus there is not only an information asymmetry but the banks tried to control the provision of services. As and when a customer wants to switch the banks then the banks agree to give a discount or charge lower rate of interest. Further, even though the market interests goes down and as the loans were on floating rate of interest, the banks are obliged to reduce the interest but it is not done. Even if somebody wants to shift to another bank he can only do so after paying penalty for foreclosure of loans. Thus the penalty acts as a disincentive for switching of banks for switching of loans from one bank to another. There is also lack of transparency when the loan is sanctioned to a borrower. A number of factors considered when the interest rate offered to a borrower at the time of taking of a loan is offered. The factors have already been discussed above and there is no need to mention them again. Each of the factors should have explained by the banks to the borrower at the time of getting the loan and this is never done. In fact two borrowers on the same date can be offered different rates depending on a perception of the banks of borrowers. As no transparency is there in these transactions and a customer has no choice, it has an appreciable adverse effects on Competition in India. A borrower again switch banks and this act has a disincentive against the growth of the loan market and stop other competitors from getting customers in the long run as many of the borrowers are captured. Thus there is a violation of section 3(3) of the Act.

21. The above discussions shows that some other factors in section 19(3) of the Competition Act are attracted such as the practice followed by the banks:

(a) Acts as a creation of barriers to new entrants in the market;

(b) There is a new growth benefits to the consumers when the consumers suffered in the long run.

(c) It hampers economic development as the consumers' surplus discreet and an entrant caused in the market following practices.

22. The DDG has stated that there is no case under section 4 of the Competition Act. Section 4 of the Competition Act is about abuse of dominant

position. The finding of the DG that there was no case for dominance for either of the case is not correct. In the explanation to section 4 dominant position has been defined as a position of strength, enjoyed by an enterprise, in the relevant market in India which enables it to affect its consumers in its favour. In this case, before these five persons took the loan from the two banks, they were in a competitive market where lot of banks and other home finance companies were in a position to offer them loans. But after they signed the agreements with one of the banks then they were out of the competitive market and entered in a different market. This market may be called as a loan recovery market or an aftermarket. If one looks clause (g) of section 19(4) of the Competition Act, this dominant position can be acquired either through the statute or being a Government company or being a public sector company or "otherwise". In this particular case the banks got the dominant position by virtue of the agreement with the consumers signed with the bank at the time of taking the home loan. Thereafter the banks were in a position to affect their consumers in their favour. Thus the banks were in a position of dominance as far as their consumers are concerned as they were tied to them for a period of time. In the consequence the banks who are obliged to decrease the interest rate when in the market fell did not reduce the interest and charged the consumers at the old rates. On the other hand, in order to get more customers the banks were giving them home loans at a lower rate of interest. There is no material to hold that the banks were giving new loans at a low rate of interest and were incurring a loss. The action of the banks is therefore unfair and discriminatory and therefore hit by the provisions of section 4(2)(a)(ii).

23. A case came up the U.S. Supreme Court known as the Kodak case. In this particular case the Supreme Court of the USA came up with the concept of aftermarket where a consumer can be abused. This ratio of Supreme Court is incorporated in our Act by legislation with defines dominance.

24. I have already indicated that the banks have abused dominance in terms of clause (g) of section 19(4) of the Competition Act. The other factors under section 19(4) have to be got examined with reference to the facts of this case. There is no doubt that the size and resources of the enterprises i.e. the banks in this case is very large compared to the resources of the consumers and therefore they are in a position of influence consumers in their favour. Consumers are totally dependent on these banks as and when they take loans

from these banks. Even the social obligations i.e. equity and lower cost of credit to the borrowers has not been followed by the banks. This reduced the economic surplus of the consumers and as a consequence it leads to lower economic development. Therefore the other factors in the section 19(4) are applicable to the facts of this case.

25. In this particular case the banks were willing to lower the rate of interest as and when the consumers wanted to switch loans to a different bank. As already discussed above the behaviour of the banks are hit by the provisions of section 3(3) and section 4 of the Competition Act. Therefore the agreement between the banks and the consumers are hit by section 3(1) of the Competition Act as the said agreements led to an appreciable adverse affect on competition within India. Therefore such agreements are void in accordance with section 3(2) of the Competition Act.

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20. The case is similar and the behaviour of the banks are hit by the provisions of section 3(3) and section 4 of the Competition Act. The opposite parties are therefore directed:-

(i) To stop the practice of charging differential rate of interest. The rates of interest charged from the new customers should be the same as charged to the old customers and there should be no difference between the two. The banks cannot charge old consumers a higher rate of interest than that charged to the new consumers.

(ii) The banks should decrease the interest whenever the market rate of interest goes down and the banks cannot take the plea that the public lending rate has not come down and therefore the interest rate is not been reduced.

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Competition Commission of India

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13/6/2011

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