BEFORE THE

COMPETITION COMMISSION OF INDIA

Case No. 5/2009

DATE OF DECISION: 2.12.2010

Informant:

Sh. Neeraj Malhotra, Advocate

Opposite parties:

1. Deustche Post Bank Home Finance Limited (Deustche Bank); **2.** HDFC Limited (HDFC); **3.** HDFC Bank Limited (HDFC Bank); **4.** LIC Housing Finance Limited (LIC Housing); **5.** Allahabad Bank; **6.** Canara Bank; **7.** Corporation Bank; **8.** ICICI Bank Ltd. (ICICI); **9.** Indian Bank; **10.** Indian Overseas Bank (IOB); **11.** Oriental Bank of Commerce (OBC); **12.** Punjab & Sind Bank (P&S Bank); **13.**Punjab National Bank (PNB); **14.** State Bank of Hyderabad (SBH); **15.** State Bank of India (SBI); **16.** Vijaya Bank

ORDER

The present information has been filed under section 19(1) (a) of Competition Act, 2002(the Act) by informant Neeraj Malhotra, against banking and non banking financial companies for the levying of Prepayment Charges on the prepayment of amount of home loan taken. The opposite parties are private and public sector banking and non-banking financial institutions, engaged in the business of offering different types of loans including retail home loans, to the general public. Before examining the various elements of the alleged violation of the provisions of the Act , the findings of the Director General during investigation and the contentions of the Opposite Parties, it is necessary to look at the overall environment prevailing in the retail home loan market.

BACKGROUND

Retail home loan market in India

1.1 Housing market in India took off mainly since the year 2001, as evidenced by the growth in bank exposure to the sector. The rapid growth in housing loan market has been supported by the growth in the middle class population, favorable demographic structure, rising

job opportunities in the metropolitan centers, emergence of a number of second tier cities as upcoming business centers, IT and ITES related boom and rise in disposable incomes. Furthermore, attractive tax advantages for housing loans make them ideal vehicles for tax planning for salary earners.

1.2 The real estate market has also grown rapidly recording considerable annual price appreciation in recent past. The real estate market has also been boosted by the proposal to permit 100 per cent FDI in the sector. For banks and other housing finance institutions, the regulatory framework enabled expansion in house loan portfolios given the helpful prescriptions on risk weights for housing exposures and the benefits of compliance with the regulatory targets mandated for priority sector lending. Besides, housing loans growth by financial institutions has been assisted by the comfort of relative safety of such assets given the tangible nature of the primary security and the comfort obtained from The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (*SARFAESI*) Act, 2002.

1.3 One of the most significant factors that drove the growth of housing market in India in the recent years was the easy availability of bank finance at affordable interest rates owing to surplus liquidity with the banking sector coupled with the softening of interest rate environment on the back of lower inflationary expectations.

1.4 With the increase in the consumer demand and to fill the demand supply gap, many financial institutions emerged providing lending services at attractive interest rates. There are two different types of lending institutions viz., Banks and Non Banking Financial Companies (NBFC). The banks apart from lending can accept deposits of current and savings accounts and fixed deposits, whereas an NBFC can only accept fixed deposits and also lend.

1.5 There is no interest paid to the balances of current accounts and for savings accounts the rate of interest paid is 3.5% p.a on a daily balance basis. When there are sufficient balances in these accounts the bank would not require to approach any other financial institution for relending purposes. In addition to these current and savings account (CASA) balances, if needed bank can source the funds through fixed deposits for a short term of 15 days to as long

as 10 years. The banks also raise funds from National Housing Banking Finance and other financial institutions for relending purposes.

1.6 NBFC source their funds primarily through other financial institutions and fixed deposits. Since they don't undertake the business of CASA operations through which the cost of funds would have been cheaper, the NBFC generally offers higher rate of interest to the fixed deposit holders. Also the lending rates of the NBFC are generally higher.

Home loan market composition:

1.7 The Indian home loan market is catered by many public sector and private sector banks along with the Housing Finance Companies (HFC). HFCs are the Non Banking Financial Companies. According to the report of ICRA in their report dated June 17,2010 "Performance Review of Housing Finance Companies and Indian Mortgage Finance Market for 2009-10 and Industry Outlook", the major players in the home loan market are HDFC with 17% (along

with HDFC Bank), State Bank of India (SBI) 17%, ICICI Bank 13%(along with ICICI Home Finance), and LIC Housing Finance (LIC HFL) with 8%, account for 55% of the total housing credit in India (as of March 31, 2010). Apart from these big players, there are some HFCs with relatively smaller credit portfolios operating in their respective areas or serving niche customers. Small HFCs over the past few years are growing their portfolio considerably.

1.8 Credit portfolio of the HFCs as well as scheduled commercial banks year wise from 2004 is given below:

	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10
HFCs	3540	4680	5980	7340	9120	11050	13410
SCBs	8940	13470	18520	2310	25570	27240	29720
Total	12490	18150	24500	3044	34680	38290	43130
						Rs. In crores	

1.9 According to the ICRA report credit growth in the Indian mortgage finance market improved to 12.6% in 2009-10 from 10% in the previous fiscal drawing on several factors, including a healthier operating environment, expectations of appreciation in property

prices, and attractive interest rate schemes offered by banks and housing finance companies (HFCs). Although housing loans remain the main source of revenues for small HFCs, the proportion of other loans in their loan book increased to 8% as on March 31, 2010 from 7% the previous fiscal.

Factors affecting non-price competition in retail home loan market:

1.10 In this decade business of home loan market has grown rapidly with many players forayed into this business. In this regulatory environment where the interest rates are almost similar across the banks adhering to the prudential norms of the central bank, increasing the customer base by improving the service standards became a practice. These can be said as non-price competitive factors which are as under:

1) Providing the loan to the customer depending on the need of the customer by providing an option for loan on either fixed or floating rate of interest rates.

2) The technical support provided to the borrower in choosing the home w.r.t choosing the property in the desired market, making the customer aware about the prevalent market prices and also assisting in getting documents from the builder by checking its authenticity.
3) Depending on the risk appetite of the banks about its customers, some of the guidelines are liberal to some credit worthy customers, without asking for the guarantor or reducing the margin money for availing the loan. This was help to many customers who are credit worthy buyers but without any guarantor.
4) Helping the customer with door step service without asking him to visit the branches for their procedural works. The busy customers would be interested in this type of services.

Types of home loans:

1.11 There are two types of home loans. One is the fixed rate loan and the other is the floating rate loan. In the fixed rate loan, whatever interest is fixed on the start of loan is carried on for the complete period. However, for the other the interest rate is not fixed and is completely dependent upon the market forces. As the interest rate goes up or comes down the burden is transferred to the person and

the Equated Monthly Installment (EMI) fluctuate accordingly. Also there can be an increase or decrease in the tenor of the loan depending on the rise of the interest rates. In these fluctuating market conditions banks are more interested in offering floating rate than the fixed rate products.

Factors influencing interest rates:

1.12 Home loan interest rates are dependent largely on the monetary policy of the RBI. The rate of interest would be influenced by the increase/decrease in the repo rate, reverse repo, statutory liquidity ratio (SLR) and cash reserve ratio (CRR). These terms are explained below:

Cash Reserve Ratio(CRR):

1.13 Cash Reserve Ratio is the amount of mandatory funds that commercial banks have to keep with RBI. It is always fixed as a percentage of total deposits. These deposits are designed to satisfy cash withdrawal demands of customers. CRR is also called the Liquidity Ratio as it seeks to control money supply in the economy

1.14 The higher the cash reserve (CRR) required, the lower the money available for lending. The bank has to compulsorily keep a part of the deposits of the customers' accounts with the RBI. Hence this reduces credit expansion by controlling the amount of money that goes out by way of loans.

1.15 CRR can be used as a tool to bring down inflation which happens due to excessive spending power. Spending power is augmented by loans and if money that goes out as loans is controlled, inflation can be tamed to some extent.

Statutory Liquidity Ratio (SLR):

1.16 SLR is the portion that banks need to invest in the form of cash, gold or government approved securities (Bonds) before providing credit to its customers. The quantum is specified as some percentage of the total demand and time liabilities of the bank and is set by the Reserve Bank of India.

1.17 Time liabilities are the fixed deposits of the customers with a bank for a fixed tenor whereas demand liabilities are the fund balances available in the saving and current accounts of the customers.

Repo rate:

1.18 It is basically the rate at which RBI lends to commercials banks for meeting the short term deficits. Repo Rate is the interest rate for secured overnight or short term financing involving repurchase of securities. A reduction in the repo rate will help banks to get money at a cheaper rate.

Reverse Repo rate:

1.19 It is the rate at which Reserve Bank of India (RBI) borrows money from banks. Banks are comfortable to lend money to RBI as their funds are in safe hands with a good interest rate. An increase in Reverse repo rate can make the banks transfer more funds to RBI due to attractive interest rates. It can likely to cause the money to be drawn out of the banking system.

Prime Lending Rate (PLR):

1.20 Interest rate charged by banks to their largest most secure and creditworthy customers. This is fixed by each bank by taking into

account cost of funds administrative expenses allowances of maintaining reserve requirement and reasonable margin of profit.

Levy of Prepayment charges:

1.21 The levy of prepayment charges for the foreclosure of the home loans is prevalent in many banks. The prepayment decisions of a borrower is a function of movements of rates of interest, known as cyclical pre payments and rising income level, known as structural pre-payments. Cyclical prepayments are those prepayments in which because of the drop in interest rates the borrowers shift from one loan to another loan which is offered at a lesser interest rate. The structural prepayment is foreclosure of the loan with the personal funds available with the borrower. This can be due to the rising income level of the borrower and foreclosure is done with his personal savings. Hence in a rising interest rate scenario there would be more structural than the cyclical prepayments and vice versa when the interest rates are falling.

1.22 The facts of the instant case have to be viewed in the background of retail home loan sector outlined in the foregoing paras.

ESSENTIAL FACTS OF THE INFORMATION

2. The informant alleged that the Opposite Parties are following a practice and taking decisions in concert for levy of prepayment charges ranging between 1% to 4% of the outstanding principal amount of the loan/ interest, for the balance unexpired period of the loan.

3. The informant has alleged that the above prepayment charges are being levied if borrowers are prepaying the loans for refinancing its loan from another bank/NBFC at cheaper rate of interest. As per the informant the said practice of levying of prepayment charges discourage/ prevent the borrower from switching over to another enterprise which is offering loan at lower rate of interest. The informant also alleged that the said banking and non-banking financial institutions are charging penal interest towards prepayment charges on the entire loan amount and not only on the outstanding loan amount.

4. As per the informant the same also results in increasing the effective rate of interest on which the loan was earlier availed by the borrower. In certain cases, the terms of the agreements entered into and executed by the above banking and non-banking financial institutions did not even reflect the clause for prepayment charge yet the same is charged. The informant alleged that the said banking and non-banking financial

institutions are therefore not allowing the borrower to opt out without payment of prepayment charges/penalty.

5. The informant further alleged that agreement and understanding entered into between the above enterprise/persons or the practice carried on or the decision taken by the above enterprises/persons who are engaged in the supply of the similar kind of services, has the effect of determining prices of the services being supplied by them. The levy of prepayment charges/penalty has the effect of increasing the actual interest rate initially agreed upon by the client. According to the informant this has the effect of indirectly determining the prices of the services of home loans provided.

6. In addition to the above, the practice also limits the supply/provision of services, as the client is unable to opt for another source of loans. This results in an Appreciable Adverse Effect on Competition (AAEC) within India.

7. The informant also alleged that the above enterprises/persons are also abusing their dominant position within the public domain by imposing unfair and discriminatory conditions in purchase or provision of services (i.e. loans). The practice of charging prepayment charges/penalty prevents borrowers from switching over to competitors offering lower rate of interest. It also has the effect of driving existing competitors of the above enterprises/persons out of the market as also causing

foreclosure of competition by hindering their competitors' entry into the market.

8. The Informant had filed the instant information against the following 4 entities.

(i) Deustche Post Bank Home Finance Limited (Deustche Bank)

(ii) HDFC Limited (HDFC)

(iii) HDFC Bank Limited (HDFC Bank)and

(iv) LIC Housing Finance Limited (LIC Housing)

9. The information alleged that the acts/practices carried on and decision taken by opposite parties are violative of provisions of the Section 3(1), (2) & (3)(a) and (b) read with Section 4(1), (2) (a) (i) of the Competition Act,2002 (the Act).

10. The informant had prayed for the following reliefs:

(i) To inquire into above mentioned contravention of the provisions contained in Section 3(1), (2) & (3) (a) & (b) read with Section 4(1), (2(a)(i) of the Act.

(ii) To order the enterprises/persons as mentioned above to discontinue the practice of charging prepayment charges/penalty, not to reenter into the above agreements and also to discontinue the practice and the decision taken

by them leading to indirect determination of the sale prices of the services rendered by them.

(iii) To order the above said enterprises/persons to discontinue imposing unfair and discriminatory conditions in purchase of services by their consumers, which amounts to abuse of their dominant positions.

(iv) To further penalize the above enterprises/persons for the above violations to the extent of 10% of their average turnover for the last three preceding financial year;

(v) To pass such further orders as it deems fit and proper in the facts and circumstances of the present case.

INVESTIGATION BY THE DG

11. The Commission considered the matter and having formed an opinion under Section 26(1) of the Act that there exists a prima facie case, referred the matter to the Director General (DG) for investigation vide order dated 10.09.2009. In absence of any substantive evidence in support of the allegations, the Commission did not deem it fit to grant any interim relief.

11.1 The DG after receiving the direction from the Commission got the matter investigated by the Deputy Director General (DDG) and submitted the report dated 16.12.2009 to the Commission.

11.2 in the report of DG, it has been reported that the practice of charging prepayment charges/penalty, having been followed by almost all the banks engaged in providing retail home loan, the scope of the investigation was enlarged by the DG examing other banks in addition to the banks mentioned by the informant :

1. Allahabad Bank
2. Canara Bank
3. Corporation Bank
4. ICICI Bank Ltd. (ICICI)
5. Indian Bank
6. Indian Overseas Bank (IOB)
7. Oriental Bank of Commerce (OBC)
8. Punjab & Sind Bank (P&S Bank)
9. Punjab National Bank (PNB)
10. State Bank of Hyderabad (SBH)
11. State Bank of India (SBI)
12. Vijaya Bank

11.3 During the investigation certain information had also been sought from the Reserve Bank of India (RBI) and the Indian Bank Association (IBA). As per the report, following questions were found relevant for the investigation :

i. What is the practice which is allegedly anti-competitive and violative of Section 3 and 4 of the Act?
ii. What is the origin and history of this practice?
iii. What are the justification for this practice either at present and when it was started?
iv. What is regulatory status? Are any regulatory authorities such as RBI looking into it and has it been ever been examined?
v. Legal position-has such a matter ever been agitated in court of law earlier? If yes, what is the present status?
vi. International practices: What are the practices elsewhere? Is this practice prevalent in other jurisdictions?
vii. Violation of competitive law, if any.

11.4 As per the DG report, on perusal of the replies and circulars received from the banks/financial institutions (including RBI & IBA) issues for investigation were as under :

(i) Issues related to Asset Liability Management (ALM) of the banks/Financial institutions.

(ii) A regulatory framework on pre-payment penalty by RBI and National Housing Bank (NHB).

(iii) Legal status of the issue in the light of various judgments by Indian courts/commission related to pre-payment penalty.

(iv) Master circular on finance for housing schemes of RBI.

(v) International practice with regard to pre-payment penalty.

FINDINGS OF DG

12. In the Investigation Report of DG it has been reported that IBA conducted a meeting of its members on banking issues related to commitment and prepayment charges in 2003. The DG office requisitioned the background note circulated before the meeting, agenda of the meeting, issues deliberated in the meeting, minutes of the meeting and any circular/ notice issued to the members after the meeting. IBA vide letter dated 09.11.2009 submitted that

> "*Pursuant to regulatory prescription laid down by RBI in 1990, a system of levying 1% commitment charges on unutilized portion of Working Capital operating limit was introduced in the banking system. However, later on when the RBI had withdrawn the credit control guidelines issued to the banks and left the matter of*

levy of commitment charges to the discretion of financing banks and in view of the increased competition in the lending field, banks have framed their own guidelines on levy of commitment charges. The issue of commitment charges was discussed by the Managing Committee of IBA at its meeting held on 28 July, 2003. The Committee deliberated on the pros and cons of IBA making a suggestion to its members for reintroduction of the practice of levying commitment charges on the unutilized portion of working capital limits sanctioned to borrowers. In the next meeting of IBA held on 28 August, 2003, some of the members pointed out that the international practice was in favour of levying commitment charges. It was also pointed out that under the proposed Basel II norms on fixing economic capital, banks would be required to allocate capital in respect of committed lines of credit though not actually disbursed. At the meeting, the need for a common approach in fixing prepayment charges on loans was also suggested by some of the members. After detailed discussion, the Committee while fully appreciating the market dynamics decided that a suitable communication be sent to member banks bringing out the view points expressed by the members so that the member banks could take a

decision on levy of commitment charges and prepayment charges"

12.1 Based on investigation, DG's report stated that:

i. The contention that the prepayment charges are needed for Asset Liability Management is not sustainable.

ii. Imposition of prepayment levy by National Housing Bank was a business decision and could not be anti-competitive.

iii. The fair practice guidelines of RBI do not encourage usurious charges.

iv. Just mentioning of prepayment penalty on the website of banks does not help the borrower to get out of the trap.

12.2 Upon investigation of facts, the DG concluded that:

i. The allegations regarding **violation of Section 3(1), (2) read with Section 4(1), (2) (a) (i) are found to be untrue**. Also with regard to allegation that the entities are levying pre-payment charges on the entire loan amount and not on the outstanding loan amount is found to be untrue as all the entities mentioned by the information provider are charging pre-payment penalty on the outstanding principal at the time of pre-payment and not on the entire loan amount

ii. The allegation that the banks are imposing pre-payment penalty/charges are found to be true. Further, with regard to allegation for violation of Section 3(3)(a) & (b) made by the information provider, **violation of Section 3(3)(b) of the Act is found to be true.**

iii. In context to Section 19(3) of the Act, levying of pre-payment penalty creates a barrier to new entrant in the market in way that if the new entrant is providing competitive/lower interest rates, better services etc. the borrower of the existing banks can only avail the services of the new entrants by incurring additional cost in the form of pre-payment charges. Levying of pre-payment penalty by banks makes the exit expensive thus acts as a deterrent for a borrower in availing the best prevailing interest rate of other bank/financial institution.

iv. It is noted from the meeting of IBA that the group of banks have come together and taken a collective decision to limit market competition and to generate fee based income. The said collective decision of bank is beneficial to banks and on the contrary is anti-consumer and anti-competitive. In view of above, **levying pre-payment charges by banks violates provision of Section 19(3) (a) (c) and (d).**

13. **Replies filed by Opposite Parties**

After receipt of their DG report the Commission issued notices to all the above 16 parties vide the order dt. 05.01.2010 to file their reply/objections to the findings of the DG. The GIST OF replies/objections filed by the banks are as follows:–

13.1 **Opposite party No.1,DEUTSCHE POSTBANK HOME FINANCE LIMITED**:

It has been submitted in the reply/objections by Opposite party No.1 that:

i. Prepayment directly affects the asset liability management of the bank. In the rising interest rate situation the bank loses interest which the bank would have collected if the customer had not prepaid the loan and as the unexpected inflow of funds takes times for its utilization, the bank loses interest on such surplus fund also. In order to compensate such opportunity loss, the bank charges prepayment charges from its customers in the event of foreclosure of the loan.

ii. The refinancing bank National Housing Bank (NHB) also charges the prepayment levy.

iii. There has been an increase in numbers of instances where customers have prepaid the loan in the initial years of loan tenure or have decided to switch over to

some other lender, such a situation makes home loan market very volatile with customers moving from one HFC/bank to the other or vice-versa, this leads to high escalation of fixed and other associated costs. Such unprecedented increase in cost affects the overall wholesale business of the bank. Therefore, in order to prevent volatility and the capture increase in cost the bank imposes the prepayment charge which is not penal in nature but is aimed to regulate its cost of funds.

iv. Fair practice guidelines of RBI permits freedom to levy such charges and it is transparent in terms of the guidelines of the RBI as the customers knows before signing of the agreement that he has to pay prepayment charges the bank. It cannot be said that levy of prepayment charges is a non-service based usurious charge.

v. In Usha Vaid's case, the Consumers had raised a dispute on the ground that prepayment amount of Rs. 42,300/- was charged in spite of the fact that the State Bank of India had advertised that no prepayment charges would be levied in loan take over case. The learned State Commission, Delhi while deciding the above said dispute also observed that request for transfer of loan amount cannot come within the ambit

of “prepayment” as it has to be deemed a case of “take over”. It is for this reason that the appeal of the State Bank of India was dismissed. The State Bank of India challenged the said order till the Supreme Court of India but the Supreme Court also did not interfere with the said order, but the same does not imply that the issues of levy prepayment charges stands settled. This does not by itself render the levy of prepayment charge anti competitive in terms of Section 3 (3) of the Act. International practices on the levy of prepayment charges conclusively indicate that the levy of prepayment charges is a universally accepted norm but the charges thereof are determined by each individual state bases on its economy situation and the housing loan business.

13.2 Opposite party No.2, HDFC LIMITED : The Opposite party No.2, HDFC has submitted in it’s reply that:

i. The bank has not violated the Section 3(3) of the Act.

ii. The DG has alleged an agreement only by virtue of the meeting of IBA, which was held sometime in Aug-Sept 2003. HDFC is not a member of IBA at present nor has it been a member for at least the past two decades . HDFC did not attend the alleged meeting of IBA and had never received the alleged IBA circular

dated 10.09.2003, which DG seeks to rely on to substantiates its claim regarding agreement between HDFC and other bank/HFCs. HDFC's decision to levy prepayment charges was unilateral business decision taken in 1993 much before the imposition of prepayment charges by any other banks/HFCs named in the DG's report.

iii. The aforesaid facts make it clear that the allegation of violation of Section 3(3)(b) of the Act is baseless *qua* HDFC. The DG's Report does not have any other evidence which, even remotely, suggests that HDFC imposed prepayment charges based on an agreement with other HFCs or banks.

iv. It is submitted that, the DG has not produced any evidence to prove that

   a. HDFC was part of any agreement with other financial institutions to levy prepayment charges,

   b. or HDFC ever attended the meeting where the prepayment charges were allegedly discussed in 2003,

   c. the IBA circular dated September 10, 2003 was addressed to HDFC, and (4) that HDFC received

IBA circular dated September 10, 2003 and HDFC acted upon it. The DG has failed to appreciate that since HDFC is not and has not been a member of the IBA anything said and done in the IBA cannot be imputed to it. Thus the only basis on which the DG alleges an agreement between HDFC and the banks/HFCs is inapplicable to HDFC.

v. Prepayment can lead to number of different types of costs and losses for the lenders, and there are advantages to the borrowers who have prepayment charges in their contracts as opposed to the borrowers which choose not to have such clauses. Borrowers with prepayment charges clauses in their contracts are likely to pay lower rate of interest as opposed to the borrowers which do not have prepayment clauses. The DG's report states that the practice of levying prepayment limits/controls supply of funds in the loan market.

vi. It further alleges that levying of prepayment charges results in foreclosure of competition and causes consumer harm. It is submitted that the DG has not adduced any evidence or any economic analysis which suggests that the levy of prepayment charges has resulted in decrease or controlling the supply of

home loans in the Indian market. The levy of prepayment charges does not reduce consumer welfare but to the contrary is likely to be welfare enhancing.

vii. NHB imposes prepayment charges on the institutions that it lends to, including HDFC. If the prepayment charges imposed by the NHB are not anti competitive, equally prepayment charges imposed by HDFC cannot be anti competitive. RBI's various guidelines and practice codes do not question the justification of the imposition of the prepayment charges and neither do they ban levy of such charges. International practice is not in favour of restriction on prepayment charges.

13.3 Opposite party No.3, HDFC BANK LIMITED : The opposite party No.3,HDFC bank in it's reply submitted that:

i. HDFC Bank Limited does not grant any home loan. The question of inclusion any prepayment clause on home loans does not, therefore, arise.

ii. The action of levying charges and interest by bank is an occupied statutory and regulatory field of RBI.

iii. The bank has a practice of levying prepayment/foreclosure charges to its customers in the event of the customer voluntarily opting to

foreclose/prepay his loan before the contracted tenure of the loan.

iv. Prepayment/Foreclosure charges (as may be applicable) are levied on the loan outstanding amount at the time of the prepayment/foreclosure.

v. Levy of such prepayment/foreclosure charges is a prevailing market practice adopted by most banks/loan providers. Such charges are nominal and are levied to cover the expenses incurred on cost of sanction, booking, maintaining the loan account and to manage asset liability mismatch.

vi. Banks do not create money on their own. In order to lend money, it accepts deposits from public or further takes loan from other institutions at a fixed or floating interest as the case may be. Thus while advancing loan the bank has taken into account the cost of funds, thus obtained by the bank from the public and other financial institutions. In case of prepayment, the liability of the bank remains unaffected towards the depositors as well as financial institutions from which it borrowed money.

vii. Further, prepayment creates surplus funds, which remains unutilized for certain period of time and thus increase working cost of funds of the bank, hence, the

banks are entitled to recover prepayment charges, which is the fee towards services provided by the bank.

viii. There is no violation of the Act. When there is no contravention of sub section(1) of Section 3 and sub section (1) of Section 4 of the Act, nothing in inquiry under Section 19 survives . How the practice by banks can be anti competitive when with regard to an NHB, it has been held in the DG report that it is a business decision and cannot be anti competitive. Only 16 companies, banking and non-banking financial institutions are called upon to file responses. There are various other financial and non-banking financial institutions, which are operative in this country, there cannot be any adverse direction unless, all those banking and non-banking financial institutions are issued notice by Hon'ble Commission.

13.4 Opposite party No.4, LIC HOUSING FINANCE LIMITED : The Opposite party No.4, LIC housing finance limited in it's reply submitted that:

i. Prepayment charges levied within reasonable limits cannot be termed as usurious charges.

ii. The practice of levying prepayment charges has not been practically prevented a customer from shifting his

loan from one institutions to another as is observed by a number of takeover of loans happening in our country.

iii. The prepayment charges by LIC Housing Finance Limited is for the purpose of covering financial strain/cost of the company that is arising due to premature closure of loan and not to prevent customers from availing loans from a lender of their choice.

iv. Subsequent to the introduction of prepayment charges by LIC Housing Finance limited in 1995, many banks and financial institutions have entered into the housing finance industry and some of them are having top market share in the industry, which, in itself, is reasonable evidence to disprove the contention that prepayment charges prevents new entry into this industry or prevents their business development.

v. The compounded annual growth rate of the housing finance industry is over 30% over the last 10 years, one of the highest growth achieved by any industry in the country, which points to the fact that prepayment charges have not in any manner acted against growth of the industry, rather it has only brought in stable, robust development of the country.

vi. In general the need for such levying is acknowledged by RBI and the amount to be levied is left to the fair discretion of respective financial institution.

vii. NHB raises long term funds, LIC Housing Finance Limited which is promoted by a 100% Government owned Corporation, also raises funds for longer duration. As the NHB finances only a part of our funds requirement, the balance raised from other sources also entails condition of prepayment charges or additional charges in the event of pre-closure.

viii. Hence LIC Housing Finance Limited is susceptible to strain arising out of pre-closure of loans in a volatile interest rate scenario like NHB. Prepayment charges are to be paid not only to NHB but to other financial institutions/banks also wherever applicable. Hence on the whole LIC Housing Finance Ltd. has to bear financial strain whenever loans are pre-closed, whatever be the sources and the nature of its borrowing. In a volatile interest rate scenario, the effect of such a strain will be severe.

ix. The observation that NHB's rate of interest is more or less stable do not seem to be correct as is evident from the various rate of interests charges by the them

during the period from 1997 to 2009 ranging from 6.8% to 12.8%.

x. The decision LIC Housing Finance Ltd . to levy prepayment charges was done to mitigate the financial strain independently and before banks (IBA decision) and hence it is not of the nature of cartelization. It was a business requirement to safeguard the viability of the company. In respect of the international practices, the DG report pointed out the practice followed by USA and Taiwan. In view of the recent economic crisis faced by USA, it is not an example to follow. The economy of Taiwan, compared to Indian economy, is too small to be compared. Therefore, the reference of these two countries with respect to international practice may not be appropriate.

xi. it may be noted that the provision of prepayment charges by LIC Housing Finance Limited is not to restrict the competition, but to cover up the losses arising out of prepayment of the loans and for better management of the assets – liability gap. It is also not, as is evident from the industry history, to prevent new entrants of their growth, but purely on account of a business requirement to keep the company surviving, that too with the prior knowledge and consent of the customers.

13.5 Opposite party No.5, ALLAHABAD BANK : The Allahabad Bank in its reply submitted that

i. Section 62 of the Competition Act envisages that provisions of the Act shall be in addition, and not in derogation of provisions of law for the time being in force which means that any contractual obligation between the parties which is not hit by the provisions of contract act shall be legally valid unless the same is so unreasonable which is against the public policy.

ii. Section 73 and 74 of the contract act envisages that if there is a breach of contract in that event any loss suffered by the party because of such breach, the party is liable to penalty, damage as envisaged in the contract or otherwise. A particular loan having granted on particular terms as to be payment but the borrower decides to terminate such contract , the party who suffers loss caused by such breach is entitled to recover the loss from the party who is terminating the contract the distinction made by Ld. DG in its investigation report regarding charging of prepayment charges by NHB and lending bank is without any basis.

iii. if the explanation of NHB is accepted as being business decision and that it virtually was becoming cash manager for its refinance plan then the same

principle and explanation is equally applicable to the retail finance by banks. The Ld. DG in its investigation report has failed to appreciate that prepayment penalty being charged by bank is very nominal and is not so high as to discourage borrowers from shifting to any other institutions who is offering lower rate of interest.

iv. The practice of charging prepayment penalty does not have predictable and pernicious anti-competitive effect and ought not to be invalidated under 'per se rule' viz Section 3(3) of Competition Act, 2002. Under Section 3(3) law permits the Commission to presume violation without further enquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to relevant market falls foul of any of those parameters.

v. Therefore, evidence gathered and documents collected during the investigation shall be evaluated from the perspective of presence or otherwise of the parameters laid down clauses (a) to (d) of Section 3(3) in relation to relevant market. Neither the Director General nor the Deputy Director General had gathered any evidence or data in this regard.

vi. Further there is no discussion in the report as to how the practice of charging prepayment penalty *per se*

limits or controls provision of financial services, although it is concluded that the practice is violative of Section 3(3)(b)of Competition Act, 2002. According to CRISIL research report of March 2009, the Home Loan Market has registered a growth of 43% CAGR from 2000-01 to 2004-05, that is during and after the period of IBA circular.

vii. It is submitted the growth is mainly attributable to the entry of Scheduled Commercial banks in to the market and IBA circular and the practice of charging prepayment penalty has not in any way limited or controlled the availability of home loan products .

viii. Entry barriers are virtually absent for HFCs. NHB, the regulatory authority has been receiving applications from new HFCs. It had granted licenses for 3 HFCs during the year 2008. Applications of 3 more HFCs are pending with NHB as of date. If practice of charging prepayment penalty has any correlation to entry into market, then there would not be new applications for registrations before NHB. Similarly it is an observed fact that banking industry has seen entry of new private sector banks in considerable numbers in the last decade. There is no evidence to show that practice of charging prepayment penalty has in any way deterred the new entrants into

the market and foreclosed competition. The practice of charging prepayment penalty has no correlation at all to entry of new entrants and competition in the home loan market much less a strong correlation to hand down a finding that the practice has appreciable adverse effect on competition ***per se***.

ix. In order to support a finding to the effect that prepayment penalties influence market entry decisions of new entrants and forecloses competition, evidence should clearly show that prepayment penalty creates a demand side constraint forcing the new entrants to defer or decide against their entry into the market. Observed facts in the home loan market are otherwise. CRISIL report demonstrates that prepayment decisions are a function of movement of rates of interest and raising income level called cyclical prepayments and structural prepayments respectively. Prepayment decisions are not influenced by prepayment penalties. It is demonstrated that cyclical repayments were increasing till 2006-07 due to falling interest rates and were negative during the year 2006-07 due to increase in the interest rates. Structural prepayments had been increasing till 2007-08, but it had slowed down during 2008-09 due to global melt down and decreasing

income levels. It is expected to show an increasing trend as income levels improve.

x. Therefore the findings that prepayment penalties create a demand side constraint are not correct and are based on considerations other than considerations of relevant market. The finding of the DG that the practice of charging prepayment penalty does not result in any benefit to consumers and thus factor enumerated in Section 19(3) (d) is present in the practice is not tenable and is based on mere conjectures and surmises and not based on facts and conditions of the relevant market. In the Indian market, prepayment penalties are finite and not infinite or ballooning as in other markets world over. It can be seen from page 14 of the Deputy Director General report that the rates are heterogeneous and nominal ranging between 1% to 2% among the investigated banks and financial institutions. One of them, namely Axis Bank does not impose any prepayment penalty. Further, prepayment penalties are imposed by the banks and financial institutions only on cyclical repayments and not structural repayments.

xi. RBI while replying vide its letter dated 11.12.2009 to Deputy Director General has categorically acknowledged that prepayment adversely impacts

asset liability management. This aspect was completely ignored by the DG. DG misdirected himself in restricting his investigation to individual consumer interest and failed to considerer the totality of economic factor and interest of all classes of consumer required to be consider under Competition Act, 2002. The findings in the DG report that the overwhelming International Trend has been towards a situation where there is no exit loan on the borrowers in home loan market is not correct and the findings are based on irrelevant material and fallacious reasoning.

13.6 Opposite party No.6,Canara Bank : The opposite party No.6 contended in its reply that

i. DG in its investigation report relied upon *Financial Regulatory Reforms- A New Foundation*. The said report was prepared in the context of severe financial crises like unemployment, falling business, falling home prices and declining savings faced by United States. As such report prepared in the context of US cannot be relied upon for arriving at any conclusion in the Indian context.

ii. In US home loan market is regulated by both Federal Legislation as well as by legislation of respective States. In Indian context banks and HFCs are

regulated by the law of Parliament. In US the law combines both Competition regulation and consumer protection regulations whereas India has an overreaching Consumer Protection Act which, after amendment in 2002, included both Consumer laws and unfair and restrictive trade practices in it's ambit. The investigating officer in his report after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' and having found that the practice has reasonable economic justification has given a finding that practice is not violative of Section 3(1) of the Act. He has also rejected the allegation of market dominance and abuse thereof by the banks and financial institutions and found that banks and financial institutions and IBA have not violated Sections 4(1), (2)(a)(b) of the Act. Therefore, investigating officers having given a finding that practice of charging prepayment penalty is economically reasonable and the persons investigated are not in dominant positions in the market to determine prices and control services, ought not have come to a contrary and inconsistent conclusions on the basis of same evidence that banks and financial institutions have violated the Section 3(3) of Competition Act, 2002.

iii. The investigation officer in his report relies heavily on language of internal surplus of banks and financial institutions and IBA circular dtd. 10-09-2003 and contends that the stated intent is discipline the customers and increase the income. He concludes that the language being monopolistic, the practice of charging prepayment penalty is *per se* anti competitive under Section 3(3). It is settled law that language in form of agreement cannot be the criterion but the economic consequences are the criterion in any anti competition investigation. DG report concludes that the practice of charging prepayment penalty is not anti competitive under Section 3(1) and the material considered does not disclose market dominance and abuse thereof under Section 4 of the Act. The practice which is not anti competitive by application of rule of reason cannot by any stretch of imagination be inherently anti competitive calling for application of '*per se* rule' as concluded by the investigating officer.

iv. Under Section 3(3), law permits the commission the presume the violation without further inquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to the relevant market falls foul of any of those parameters. No evidence or data in this regard had

been gathered by the DG. Further, there is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provisions of financial services, although it is concluded that the practice is violative of Section 3(3)(b) of Competition Act, 2002.

v. Entry barriers are virtually absent for HFCs. NHB, the regulatory authority, has been receiving applications from new HFCs and it has granted licenses for three HFCs during the year 2008. Applications of 5 more HFCs are pending with NHB. If the practice of charging prepayment penalty has any correlation to entry into market, there would not be new applications for registrations before NHB. Similarly, banking industry has seen entry of new private sector banks in considerable numbers in last decade. There is no evidence to show that practice of charging prepayment penalty has in anyway deterred the new entrant into the new market and foreclosed the competitions.

vi. RBI while giving reply by its letter dtd. 11.12.2009 to the Deputy Director General, CCI has categorically acknowledged that prepayment adversely impacts assets liability management. This aspect was completely ignored by the investigating officer. It is settled law the rate would be called usurious only

when the rate is unconscionable and extortionate. All banks and Financial Institutions charge a nominal rate of 1% to 2% for prepayment. The rates are not usurious.

vii. In the investigation report, the investigator has quoted that the judgment rendered by National Commission in the matter of SBI vs. Usha Vaid and another. The said judgment was not rendered in the context of Section 3(3)(a), Section 3(3)(b) and Section 19(3) of Competition Act. As such the investigator should not have relied upon the said judgment in arriving at such a conclusion.

13.7 Opposite party No.7,Corporation Bank : The Opposite party No.7,Corporation Bank in its reply contended that

i. Investigation report of DG has not taken into consideration provisions of Section 73 and 74 of the contract Act which envisages that if there is a breach of contract in that event any loss suffered by party because of such breach, the party is liable to pay penalty/damages as envisage in the contract or otherwise. The main rationale behind charging prepayment penalty is not discourage borrower from shifting its loan to other lenders but to mitigate loss

caused by such prepayment and mitigate ALM position.

ii. The DG has based his conclusion merely on recommendation of financial regulatory reforms in USA and Taiwan. However, it has not been considered whether these recommendations were followed or not. Basing conclusions on recommendations without the same being adopted is not sustainable.

iii. The distinction made by the DG in the investigation report regarding prepayment penalty by NHB and lending bank without any basis. If the explanation of NHB is accepted as being the business decision then the same principle and explanation is equally applicable to the retail finance by banks.

iv. The DG in his investigation report has failed to appreciate that prepayment penalty being charged by bank is very nominal and is not so high as to discourage borrowers from shifting to any other institution who is offering lower rate of interest.

v. The DG having observed that the practice of charging prepayment penalty is not violative of Section 3(1), 3(2) and Section 4(1), 4(2)(a)(i) of the Competition Act, 2005, the conclusion that the practice is violative

of Section 3(3) is not correct. The practice of charging prepayment penalty does not have predictable and pernicious anti competitive effect and ought not be invalidated under '*per se rule*' viz Section 3(3) of the Act. In order to presume that any practice has predictable and pernicious anti-competitive effect and violates Section 3(3) of the Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly pricing in the relevant product market. There is no evidence in that regard. It is an observed fact that there is intense competition in the relevant product market, namely home loan market, as there are large numbers of service providers (sellers to use economics expression), namely Housing Finance Companies (HFCs) (43), Public Sector Banks(27), Urban Cooperative Banks (53) that are operating the market. DG investigation report while concluding that the practice of charging prepayment penalty has appreciable adverse effect on competition failed to have due regard to the provisions of Section 19(3) of the Act. Any practice before being declared as *per se* anti-competitive due to AAEC under Section 3, factors enumerated under Section 19 of the Competition Act shall be considered. The practice of charging

prepayment penalty to be anti-competitive *per se* , shall *ex-facie* disclose presence or absence, as the case may be, of any or all factors mentioned in Section 19(3). DG in his report did not have due regard to any of said factors in relation to relevant market and has straight away declare without any hindrance that the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a),(c), (d). Entry barrier are virtually absent for HFCs.

vi. NHB granted licenses to 3 HFCs in year 2008 and applications of the 3 more HFCs are pending with the NHB. If practice of charging prepayment penalty has any correlation to entry into market, then there would not be new application for registration before NHB. The practice of prepayment penalty is highly unlikely to operate as demand side constrains creating entry barriers to new entrants.

vii. The finding of the DG report that the practice of charging prepayment penalty does not result in any benefit to consumers and thus factors enumerated in Section 19(3)(d) is present in the practice is not tenable and is based on mere conjectures and surmises and not based on facts and conditions of the relevant market.

viii. In the Indian market, prepayment penalties are finite and not infinite or ballooning as in other markets world over. The process of managing the investment risk by the banks and the financial institutions is known as Asset Liability Management (ALM) and that was the justification offered by the bank, which unfortunately was brushed aside nonchalantly by the respected DG as not enough justification. Prepayment penalty as ALM tool is eminently reasonable as long as it is meant to cover the costs associated with the investment risk

13.8 Opposite party No.8, ICICI Bank Ltd :. The opposite party No.8 contended in its reply / objections that

i. Decision of customer/borrower to prepay the loan is a well informed and consciously well thought about decision and is based on certain cogent facts and logical conclusions. Banking means accepting deposits for the purpose of lending.

ii. Banking business has various risks like credit risk, market risk and operational risk etc. The full prepayment by a borrower generates re-investment risk for the bank. The re-investment risk cannot be passed on to the depositors.

iii. The issue of Asset Liability Mis-matches is genuine commercial realities and the fundamental issue which banks and financial institutions face and therefore necessitate banks to stipulate prepayment charges in order to adequately address such mis-matches.

iv. The applicable prepayment charges and related terms and conditions are informed clearly to the borrowers upfront as required regulatory and as a good commercial and consumer friendly practice. ICICI bank duly communicates and obtains consent of the borrowers with respect to all applicable terms and charges for the loan facility.

v. Interests rate and charges levy by the banks are well governed and monitored by RBI and the same are not subject to judicial review so far as they fall within the ambits of the rules and the regulations prescribed by the RBI. Such levying of charges cannot be deemed to be a concerted effort or a collusive activity.

vi. With respect to ICICI bank, the practice of levying such charges was in existence even prior to the referred IBA meeting and therefore ICICI bank cannot be deemed to be part of any concerted effort. RBI has not held the activity prohibitory of law but simply required the

transparency so that the borrower can make reasoned decision at the time of availing a facility.

vii. Further, it is contractual arrangement between a lender and debtor, based on law of contract, under which borrower avails a loan facility under certain terms and conditions.

viii. Prepayment charges are just one of such terms. There exists concepts such as 'Early Redemption Charges (ERC)' and 'Early Settlement' in the banking practice prevalent in United Kingdom. Since 31.10.2004 most residential mortgages have been regulated by Financial Services Authority (FSA) which requires a section in the key financial information given to the customer and also mortgage offer itself describing whether and when any ERC may be payable. This clearly evident the practice of levying prepayment charges being prevalent in other jurisdiction as well. Further, since the practice adopted in EU is not very clear we should not deduce that the levy of prepayment charges is held violative of law.

ix. In the case of *State Bank of India vs. Dr. (Mrs.) Ushas Vaid &Othes*., the borrower who had taken a loan from Standard Chartered Bank, got the loan transferred to the appellant bank, State Bank of India as the

appellant bank issued an advertisement to the effect that they were offering a low rate of interest to housing loan customers **with no prepayment charges.** However the consumer realizing that ICICI Bank was charging a lesser rate of interest, approached the appellant bank for transfer of the loan from the appellant bank to the ICICI Bank for the obvious reasons that the rate of interest was much lower in the ICICI Bank. In spite of their advertisement, the appellant bank charged Rs. 42,300/- as prepayment charges. The Commission held that the sum could not have been claimed by the appellant bank as it was not prepayment but taking over. Such judgment was passed by State Commission Dispute Redressal Forum and was thus upheld by National Commission Dispute Redressal Forum and Supreme Court. This case did not determine whether levying of prepayment charges was justified or not. Further, the Supreme Court mentioned in its judgment that the question of law is still open and is left to be decided in an appropriate case.

x. ICICI Home Finance Company had started levying prepayment fees with effect from June 5, 2001. Since incorporation of ICICI Bank Limited, the practice of levy of prepayment charges has been continued as

had been followed by ICICI Home Finance Company. Accordingly, it is humbly submitted that prepayment charges were being levied by ICICI Group even prior to the IBA meeting ("Meeting"), at which the advent of this concept has been stated in the Report. To elucidate, Section 3(3) of the Act, prohibits "agreement" between enterprises, "practices" carried on "decision" taken by an association of enterprises.

xi. It is submitted that ICICI Bank has not entered into an agreement, taken a decision or begun any new practice post the Meeting and therefore cannot be deemed to be part of the cartel as mentioned in the Report. Considering the fact that levying of prepayment charges was already prevalent in market and industry appreciated the requirement of the same, the discussions at the IBA meetings can be deemed to be 'parallel behaviour', as explained in paragraph 4.3-3 of Raghvan's report on Competition Law.

xii. This concept has also been upheld in the European Court of Justice. In the light of all the arguments raised herein above, The object of the Meeting was not anti-competitive. The decisions taken at the Meeting do not cause an Appreciable Adverse Effect on Competition in India and therefore will not fall within the ambit of Section 19 (3) of the Act. CRISIL research report of

March 2009, mentioned that the home loan market had registered a growth of 43% from 2000-01 to 2004-05, that is during the period after the issue of the IBA circular. It is submitted that this growth is mainly attributable to the entry of Scheduled Commercial Banks in to the market and IBA circular and the practice of charging prepayment penalty has not in any way limited or controlled the availability of home loan products. Also, such levy of charges has not imposed any entry barriers in the market.

xiii. National Housing Bank (NHB), the regulatory authority has been receiving applications of 3 more HFCs are pending with NHB as of date. If practice of charging prepayment penalty has any correlation entry into market, then there would not be new applications for registrations before NHB. As mentioned earlier in the reply, such a levy was primarily to correct the asset liability mismatch in the books of lending institutions.

13.9 Opposite party No.9, Indian Bank : The opposite party No.9 in its reply contended that

i. Deputy Director General in his report after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' and having found that the practice has **reasonable economic justification,** has

given a finding that the practice is not violative of Sec. 3(1) of the Competition. He has also rejected the allegations of market dominance and abuse thereof by the Banks and Financial Institutions and found that Banks and Financial Institutions and IBA have not violated Section 4(1), 4(2)(a)(i) of the Act. Therefore, it is submitted that Deputy Director General having given a finding that the practice of charging prepayment penalty is **economically reasonable** and the persons investigated are not in dominant position in the market to determine prices or control services, ought not have come to a contrary and inconsistent conclusion that Banks and Financial Institutions have violated Section 3(3) of Competition Act, 2002.

ii. It has been contended that Director General relies heavily on the language of the internal circulars of Banks and Financial Institutions and IBA Circular dated 10.09.2003 and contends that the purport/intent is to discipline the customer and to increase income. He concludes that the language being monopolistic, the practice of charging prepayment penalty is per se anti competitive under Sec. 3(3) of the Act. It is settled law that the language and form of agreements cannot be the criterion but the **economic consequences are the criterion in** any anti competition investigation.

Under Section 3(3) of Competition Act, Law permits the Commission to presume violation without further enquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Sec 3(3) in relation to relevant market falls foul of any of those parameters. There is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although it is concluded that the practice is violative of Sec 3(3)(b) of Competition Act, 2002.

iii. It has been contended that practice of charging prepayment penalty does not have predictable and pernicious anti-competitive effect and ought not to be invalidated under '*per se rule*' viz. Sec. 3(3) of Competition Act, 2002. The recommendations are mere sweeping generalizations and not conclusions based on evidence and material. It is fact that there is intense healthy but stiff competition in the relevant product market, namely home loan market, as there are large numbers of players. The borrower has multiple choices with regard to products and credit purveyors.

iv. Further, the market participants are highly regulated by the Government RBI and NHB whose mandate is protection of public interest. None of the service

providers is dominant the market. It is an observed fact that

(i) there is no interdependence as to price

(ii) there is no market sharing

(iii) there is no price leadership

(iv) there are no entry barriers.

If these elements had been present, home loan market would not have witnessed steady decline of interest rates and consequent exponential growth of market after scheduled commercial banks were allowed to grant home loans by RBI. As on date, the interest rates are very competitive among the market participants is an acknowledged fact. Any practice before being declared as *per se* anti-competitive due to AAEC under Section 3 factors enumerated under Section 19 of the Competition Act has to be considered.

v. DG in his report did not have due regard to any of the above factors in relation to relevant market. He has straight away declared without any evidence the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a), (c), (d).

vi. There is no evidence to show that practice of charging prepayment penalty has in anyway deterred the new entrants into the market and foreclose competition.

vii. Therefore, findings of DG are devoid of substance. Prepayment decisions of the customer are an action based on movements of rate of interest and raising income level. The prepayments could be cyclic prepayments and structural prepayments. Prepayments decisions are not influence by prepayment penalties. It is elementary that banking means accepting deposits for the purpose of lending. Banks secures funds by way of deposits which is a liability to the bank for specified period at a fixed rate. Pricing of loan is linked to cost of funds banking business has various risks, credit risk, market risk and operation risk etc. Banks are required to manage re-investment risk and it is not feasible to factor the same in the rate of interest alone. Considering the competition in the market to acquire the customer. This process of managing re-investments risks by the banks and financial institutions are known as Asset Liability Management (ALM) and that was the justification offered by the bank, which was brushed aside nonchalantly by the respected DG as not enough justification.

13.10 Opposite party No.10, Indian Overseas Bank (IOB) :

The Opposite party No.10 contended that

i. Deputy Director General in his report on the practices of charging of prepayment penalty by banks and financial institutions after collection information through various circulars of banks and financial institutions and communication of IBA dated 10.09.2003 to its members has opined that the information, the documents and findings gathered by him do not support the allegations of informer that the banks and financial institutions have violated Section 3(1),3(2) and Section 4(1), (2)(a) (i) of the Act. Therefore, there should be no other conclusions with regard to the challenge given by the informer, other than what the Deputy Director General has held in his comprehensive report. Section 3(1) read with Section 3(2) is in *pari* materia with Section 1 of Sherman Act, 1890 of USA, which is based on 'rule of reasonableness' initiated by the Courts in USA and followed by Indian Courts under MRTPC Act.

ii. Deputy Director General in his report after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' and having found that the practice has reasonable economic justification has given a finding that the practice is not violative of

Section 3(1) of the Competition Act. He has also rejected the allegations of market dominance and abuse thereof by the banks and financial institutions and found that the banks and financial institutions and IBA have not violated the Section 4(1), 4(2)(a)(i) of the Act. Therefore, the Deputy Director General having given a finding that the practice of charging prepayment penalty is economically reasonable and the persons are investigated are not in dominant position in the market to determine prices or control services ought not have come to a contrary and inconsistent conclusion on the basis of same evidence that banks and financial institution have violated Section 3(3) of the Competition Act.

iii. Director General in his report relies heavily on the language of the internal circulars of banks and financial institutions and IBA circular dated 10.09.2003 and contends that the stated intent is to discipline the customer and to increase the income. He concludes that the language being monopolistic, the practice of charging prepayment penalty is *per se* anti-competitive under Section 3(3) of the Competition Act. It is settled law that the language and the form of the agreement cannot be the criterion but the economic consequences are the criterion in

any anti-competition investigation. Therefore, a practice which is not anti-competitive by application of 'rule of reason' cannot by any stretch of imagination be inherently anti-competitive calling for application of '*per se* rule*'* as is concluded by DG in his report.

iv. For the purpose of invoking Section 3(3) of the Act the practice of charging prepayment penalty should *ex-facie* result in or shall have the probability of resulting in any or any economic consequences enumerated under Section 3(3) (a) to (d). There is no discussion in the DG report whether the practice of charging prepayment penalty *ex-facie* leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3). Thus, the findings and the recommendations are mere sweeping generalization and not conclusions based on evidence and material. In order to presume any practice as violative of Section 3(3) of the Competition Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly prices in the relevant market. There is no evidence in this regard. It is an observed fact that there is intense

competition in relevant product market, as there are large numbers of service providers.

v. The HFCs are not members of IBA. It is settled under Competition Law that presence of highly regulated entities is antithetical to existing of price monopolies. According to CRISIL's research report of March, 2009, the home loan market has registered a growth of 43% from 2000-01 to 2004-05, that is during and after the IBA circular. Any practice before being declared as *per se* anti-competitive due to AAEC under Section 3, factors enumerated under Section 19 of the Competition Act shall be considered.

vi. The practice of charging prepayment penalty to be anti-competitive *per se*, shall *ex-facie* disclose presence of absence, as the case may be, of any or all factors given in Section 19(3). DG report did not have due regard to any of the factor enumerated in Section 19(3) in relation to relevant market. It has straight away declared without any evidence the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a), (c), (d). The evidences does not support the findings that prepayment penalties influence decisions of new entrants and thus having regard to the factors under Section 19(3)(a),(c),(d), it has AAEC.

vii. It is elementary the banking means accepting deposits for the purpose of lending. Banking business has various risks like credit risk, market risk and operation risk etc. Prepayment by a borrower generates re-investment risk for the bank. Banks are required to manage this re-investment risk and it is not feasible to factor the same in the rate of interest alone considering the competition in the market to acquire a customer. The re-investment risk cannot be passed on to the depositors.

viii. RBI in its letter dated 11.12.2009 to the Deputy DG has categorically acknowledge prepayment adversely impacts Asset Liability Management (ALM). This aspect was completely ignored by the DG.

ix. DG has misdirected himself in restricted his investigation to individual consumer interest and failed to consider to totality of economic factor and interest of all classes of consumer required to be considered under Competition Act, 2002.

x. In US, home loan market is regulated both by Federal Legislation as well as legislation of respective States. In analogy to this in Indian context is that the banks and HFCs are regulated by the Law of Parliament; namely Banking Regulation Act and

National Housing Bank Act and money lenders are regulated by Money Lender's Act of the respective State.

xi. In US the law combines both regulation and consumer protection, whereas India has a overarching Consumer Protection Act. After the amendment in 2002, the scope of Consumer Protection Act has been widened to include both consumer protection law and Unfair trade Practices. The findings of the DG that prepayment penalty is banned in US is based on misreading of law and regulation in the USA.

xii. Further, reference of newsletter of Fair Trade Commission (FTC), Taiwan to buttress his argument and finding that the prepayment penalty impedes allocation of capital and interest rate competition in the market is quoted out of the context and is not relevant to the investigation whether the prepayment penalty is anti-competitive. FTC, Taiwan's decision is with reference to Far Eastern International Bank (FEIB) that the dominant marketing, Taiwan. The investigation of DG and the findings are to the effect that the practice of charging prepayment penalty are unjustified costs on consumers (Report uses word 'usurious' in paragraph 10.3) and therefore anti-

competitive. If prepayment penalty should be prohibited on the ground of 'usury', then only Consumer Courts will have the jurisdiction to do it as cost considerations purely from the perspective of individual consumer is outside the realm of Competition Law in India.

xiii. The judgment of consumer courts relied on by the DG in support of his findings was under Consumer Protection Act, 1986. Even in those judgments there is no whisper as to whether the practice of charging prepayment penalty is a restrictive trade practice imposing unjustified costs on the individual consumers. The judgment was based facts, which disclosed that prepayment charges were levied in that case even though loan was not disbursed and merely because the complainant has chosen to avail the loan from other bank instead of respondent bank. The consumer courts rightly held that what was charged was not prepayment penalty but penalty for not taking the loan though the Bank was ready to give the loan. The case is not at all representative of instances, where banks charge prepayment penalty for prepayment after loan was disbursed and utilized by the borrowers. The order of Supreme Court in the case is not an authority for the proposition that Banks

cannot charge prepayment penalty. The reliance on the judgment is misplaced.

13.11 Opposite party No.11,Oriental Bank of Commerce : The opposite party No.11 in its reply contended that

i. Deputy Director General in his report on the practice of charging of pre-payment penalty by banks and financial institutions has collected all the internal circular of Banks and a communication of IBA dated 10.09.2003 to its members and relied on their contents for the purpose of his conclusion. He has held that the information, documents and evidence gathered by him do not support the allegation of informer that Banks and Financial institutions have violated Sections 3(1), 3(2) and Section 4(1), 4(2)(a)(i) of the Act. Having held that the practice of charging prepayment penalty is violative of Sections 3(1), 3(2) and 4(1), 4(2)(a)(i) of the Act, the conclusion that the practice is violative of Section 3(3) is not correct. Section 3(1) read with Section 3(2) is in *pari materia* with Section 1 of Sherman Act 1890 of United States of America, which is based on 'rule of reasonableness' enunciated by the courts in United States and followed by Indian Courts under MRTPC, which now stands repealed and replaced by Competition Act.

ii. Deputy Director General in his report after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' and having found that the practice has reasonable economic justification has given a finding that the practice is not violative of Section 3(1) of the Competition. He has rejected the allegations of market dominance and abuse thereof by the Banks and Financial Institutions and found that Banks and Financial Institutions and IBA have not violated Section 4(1), 4(2)(a)(i) of the Act. Therefore, it is submitted that the Deputy Director General having given a finding that the practice of charging prepayment penalty is economically reasonable and the persons investigated are not in dominant position in the market to determine prices or control services, ought not to have come to a contrary and inconsistent conclusion, on the basis of same evidence that Banks and Financial Institutions have violated Section 3(3) of the Act.

iii. DG in his report relies heavily on the language internal circulars of banks and financial institutions and IBA circular dated 10.09.2003 and contends that the stated intent is to discipline the customers and to increase the income. He concludes that the language being monopolistic, the practice of charging

prepayment penalty is *per se* anti-competitive under Section 3(3) of the Competition Act.

iv. It is settled law that language and the form of agreements cannot be the criterion but the economic consequences are criterion in any competition investigation. Thus, therefore, a practice which is not anti-competitive by application of 'rule of reason' cannot, by any stretch of imagination, be inherently anti-competitive calling for application of *per se rule* as is concluded by DG report.

v. It is settled law that for the purpose of invoking Section 3(3) of the Competition Act, the practice of charging prepayment penalty should *ex-facie* result in or shall have the probability of resulting in any or all economic consequences enumerated under Section 3(3)(a) to (d). There is no discussion in DG report whether the practice of charging prepayment penalty *ex-facie* leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3). Thus, the findings and recommendations are mere sweeping generalizations and not conclusions based on evidence and material. There is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although

vi. it is concluded in the report of DG that the practice is violative of Section 3(3)(b) of the Competition Act. In order to presume any practice as violative of Section 3(3) of the Competition Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly prices in the relevant market. There is no evidence in this regard.

vii. It is an observed fact that there is intense competition in relevant product market, as there are large number of service providers. Further, the market participants are regulated by the Government, RBI, NHB, whose mandate is protection of public interest. It is settled in Competition Law that presence of highly regulated entities is antithetical to the existence price monopolies. HFCs are not members of IBA. According to CRISIL research report of March 2009, the home loan market has registered a growth of 43% CAGR from 2000-01 to 2004-05, that is during and after the period of IBA circular. The said growth is mainly attributable to the entry of Scheduled Commercial Banks in to the market and IBA circular and the practice of charging prepayment penalty has

not in any way limited or controlled the availability of home loan products.

viii. Any practice before being declared as *per se* anti-competitive due to AAEC under Section 3, factors enumerated under Section 19 of the Competition Act shall be considered. The practice of charging prepayment penalty to be anti-competitive *per se*, shall *ex-facie* disclose presence of absence, as the case may be, of any or all factors given in Section 19(3). DG report did not have due regard to any of the factor enumerated in Section 19(3) in relation to relevant market. It has straight away declared without any evidence that the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a), (c), (d).

ix. The evidences does not support the findings that prepayment penalties influence decisions of new entrants and thus having regard to the factors under Section 19(3)(a),(c),(d), it has AAEC. Further, there is no evidence to show that the practice of charging prepayment penalty has in anyway deterred the new entrants into the market and foreclosed the competition. The levy of prepayment charges by NHB, a 100% subsidiary or RBI, which is a refinancing bank has been upheld by the DG as according to him “this

imposition of prepayment levy by NHB was a business decision and cannot be said to be anti competitive. It is absolutely misconceived to hold the said practice on part of banks and financial institutions (FIs) as anti-competitive and holding at the same time the similar levy by NHB as business decision. CRISIL report demonstrates that prepayment decisions are a function of movement of rates of interest and raising income level called cyclical prepayments and structural prepayments respectively. Prepayment decisions are not influenced by prepayment penalties. It is demonstrated that cyclical prepayments were increasing till 2006-07 due to falling interest rates and were negative during the year 2006-07 due to increase in the interest rates. Structural prepayments had been increasing till 2007-08, but it had slowed down during 2008-09 due to global melt down and decreasing income levels. Therefore, the findings that prepayment penalties creates a demand side constraints is not correct and is based on considerations other than considerations of relevant market. At present only cyclical prepayments attract prepayment penalty. It would be obvious that cyclical prepayment would happen only when marginal cost of refinance is insignificant and there is comparative cost advantage in taking new

loan. It is demonstrated in the CRISIL report that cyclical repayments had shown increasing rend during the years 2000-01 to 2003-04 due to falling interest rates. It turned negative during 2006-07 due to sharp rise in interest rates and it has again increased during the year 2007-08 and 2008-09. It is expected to show increasing trend from 2009-10 onwards. Prepayment penalties were present during all these years, as has been stated in the DG report.

x. It is elementary the banking means accepting deposits for the purpose of lending banking business has various risk like credit risk, market risk and operation risk etc. Prepayment by a borrower generates re-investment risk for the bank. Banks are required to manage this re-investment risk and it is not feasible to factor the same in the rate of interest alone considering the competition in the market to acquire a customer. The re-investment risk cannot be passed on to the depositors. The process of managing the re-investment risk by the banks and FIs are known as Asset Liability Management (ALM) and that was the justification offered by the bank, which unfortunately was brushed aside nonchalantly by the DG as not enough justification.

xi. It has been contended that prepayment penalty ALM tools is eminently reasonable as long as it is meant to cover the costs associated with re-investment risk. RBI while giving reply by its letter dated 11.12.2009 to Deputy Director General has categorically acknowledged that prepayment adversely impacts asset liability management. This aspect was completely ignored by the DG. DG misdirected himself in restricting his investigation to individual consumer interest and failed to considerer the totality of economic factor and interest of all classes of consumer required to be consider under Competition Act, 2002.

xii. In US, home loan market is regulated both by Federal Legislation as well as respective States. In analogy to this in Indian context is that the banks and HFCs are regulated by the Law of Parliament; namely Banking Regulation Act and National Housing Bank Act and money lenders are regulated by Money Lender's Act of the respective State. In US the law combines both competition regulation and consumer protection, whereas India has a overarching Consumer Protection Act. After the amendment in 2002, the scope of Consumer Protection Act has been widened to include both Restrictive and Unfair Practices.

xiii. The findings of the DG that prepayment penalty is banned in US is based on misreading of law and regulation in the USA. Further, reference of newsletter of Fair Trade Commission (FTC), Taiwan to buttress his argument and finding that the prepayment penalty impedes allocation of capital and interest rate competition in the market is quoted out of the context and is not relevant to the investigation whether the prepayment penalty is anti-competitive. FTC, Taiwan's decision is with reference to Far Eastern International Bank (FEIB) that the dominant marketing, Taiwan.

xiv. The prepayment penalty is a cost to the consumer and is included in the price of services offered by the Banks and Financial Institutions. Section 3 of Competition Commission Act, 2002 declares void, practices in the nature of predatory or monopoly or oligopoly pricing in the market. The Act does not concern itself with the restrictive or unfair price terms. Jurisdiction with respect to restrictive or unfair price terms is with Consumer forums under Consumer Protection Act, 1986.

13.12 Opposite Party No.12, Punjab & Sindh Bank : The opposite party No.12 contended in its reply/objections that

i. In the report it is held that charging prepayment charges is anti-competitive under Section 3(3) and Section 19(3) of the Competition Act. It is settled law that for the purpose of invoking Section 3(3) of the Act, the practice of charging prepayment penalty should *ex-facie* result in or shall have the probability of resulting in any or all the economic consequences enumerated under Section 3(3)(a) to (d). There is no discussion in DG report whether the practice of charging prepayment penalty *ex-facie* leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3). Thus, the findings and recommendations are mere sweeping generalizations and not conclusions based on evidence and material.

ii. The DG in his report on practice of charging prepayment penalty by banks and financial institutions has collected all the internal circulars of banks as well as communications of IBA dated 10.09.2003 to its members and relied on their contents for the purpose of his conclusion. The IBA is an Industry Association of Scheduled Commercial Banks formed way back in 1946 with the main objective of acting as a coordinator between Government of India, RBI and commercial Banks. Further IBA acts as a clearing

house for dissemination and exchange of statistical data, information, views and opinions on the systems, procedures and practices, and organization and methods of banks and on the structure, working and operations of the banking system and to explore, plan, co-ordinate and organize detailed surveys on banking, business, resources, personnel and management development programmes of banks and the banking industry. Banks do not decide fixing of their prices/interest rates or other charges under the umbrella of IBA. As such there is no cartel, hence the provision of Section 3(3) are not applicable to the bank.

iii. The Deputy Director General in his report has held that the information, documents and evidence gathered by him do not support the allegation of the informer that banks and financial institutions have violated Sections 3(1), 3(2) and Sections 4(1), 4(2)(a)(i) of the Act.

iv. The Deputy Director General has given finding in his report the practice of charging prepayment penalty is economically reasonable and the persons investigated are not in dominant position in the market to determine prices or control services, therefore, the other conclusion in the same report having held that

the banks have violated Section 3(3) of the Competition Act is contrary and inconsistent conclusion to the earlier conclusion. It is submitted that that DG in his report relies heavily on the language of the internal circulars of Banks and Financial Institutions and IBA circular dated 10.09.2003 and contends that the stated intent is to discipline the customer and to increase income. DG in its report concluded that the language of the circular, being monopolistic, the practice of charging prepayment penalty is *per se* anti-competitive under Section 3(3) of the Act. It is settled law that the language and form of agreements cannot be the criterion but the economic consequences are the criterion in any anti-competition investigation. The argument in the DG report is not to the effect that the practice of charging prepayment penalty is inherently anti-competitive and no other conclusion is possible. Practice of charging prepayment penalty does not have predictable and pernicious anti-competitive effect and ought not to be invalidated under '*per se* rule' viz. Section 3(3) of Competition Act. Under Section 3(3) law permits the Commission to presume violation without further inquiry only and only if any trade practice tested on the parameter laid down in clauses (a) to (d) of Section 3(3) in relation to relevant market

falls foul of any of those parameters. Therefore, evidence gathered and documents collected during the investigation shall be evaluated from the prospective of presence or otherwise of the parameters laid down in clauses (a) to (d) of Section 3 (3) in relation to relevant market.

v. Neither the DG nor the Deputy Director General had gathered any evidence or data in this regard. Further, there is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although it is concluded that practice is violative of Section 3(3)(b) of Competition Act. In order to presume that any practice has predictable and pernicious anti-competitive effect and violates Section 3(3) of the Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly pricing in the relevant product market. There is no evidence in that regard. It is an observed fact that there is intense competition in the relevant product market, namely home loan market, as there are large numbers of service providers (sellers to use economics expression), namely Housing Finance Companies (HFCs) (43), Public Sector

Banks(27), Urban Cooperative Banks (53) that are operating the market. Further, the market participants are highly regulated by the Government, RBI, NHB whose mandate is protection of public interest. It is settled under Competition Law that presence of highly regulated entities is antithetical to existence of price monopolies. Punjab & Sind bank has negligible share in the market for housing loan segment, which is grossly inadequate to exercise monopolistic control of market.

vi. Director General in his report while concluding that the practice of charging prepayment penalty has AAEC, failed to have due regard to the provisions of Section 19(3) of the Act in relation to relevant market. He has straight away declared without any evidence that the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a), (c), (d). Evidence does not support the findings that prepayment penalty influence decisions of new entrants and thus having regard to the factors under Section 19(3) (a), (c),(d), it has AAEC.

vii. In housing finance market entry barriers are virtually absent for the HFCs. NHB, the regulatory authority, has been receiving applications from new HFCs. Similarly, it is an observed fact that the banking

industry has seen entry of new private sector banks in considerable numbers in the last decade. There is no evidence to show the practice of charging prepayment penalty has in anyway deterred the new entrants into the market and foreclosed competition. The practice of charging prepayment penalty has no correlation at all to entry of new entrants and competition in the home loan market much less a strong correlation to hand down a finding that the practice has appreciable adverse effect on competition *per se.* It is submitted that in order to support a finding to the effect that prepayment penalties influence market entry decisions of new entrants and forecloses competition, evidence should clearly show that prepayment penalty creates a demand side constraint forcing the new entrants to defer or decide against their entry into the market. Observed facts in the home loan market are otherwise. CRISIL report demonstrates that prepayment decisions are a function of movement of rates of interest and raising income level called cyclical prepayments and structural prepayments respectively. Prepayment decisions are not influenced by prepayment penalties. It is demonstrated that cyclical repayments were increasing till 2006-07 due to falling interest rates and were negative during the year 2006-07 due to increase in the interest rates.

Structural prepayments had been increasing till 2007-08, but it had slowed down during 2008-09 due to global melt down and decreasing income levels. Therefore the findings that prepayment payment penalties create a demand side constraint are not correct and are based on considerations other than considerations of relevant market.

viii. The practice of prepayment penalty is highly unlikely to operate as demand side constraints creating entry barriers to new entrants. This is because a decision to prepay home loan depends on cyclical factors and structural factors. Almost none of the banks and financial institution in the market levy prepayment penalty in case of structural prepayment, that is to say prepayment out of one's own funds. At present only cyclic prepayments attract prepayment penalty. It is demonstrated in the CRISIL report that cyclical repayments had shown increasing trend during the years 2000-01 to 2003-04 due to falling interest rates. It turned negative during 2006-07 due to sharp raise in interest rates and it has again increased during the years 2007-08 and 2008-09. It is expected to show increasing trend from 2009-10 onwards. Prepayment penalties were present during all these years.

ix. It is elementary that banking means accepting deposits for the purpose of lending. Banking business has various risks like credit risk, market risk and operation risk etc. Prepayment by a borrower generates re-investment risk for the bank. Banks are required to manage this re-investment risk and it is not feasible to factor the same in the rate of interest alone considering the competition in the market to acquire a customer. The re-investment risk cannot be passed on to the depositors.

x. RBI while giving reply by its letter dated 11.12.2009 to the Deputy DG has categorically acknowledge prepayment adversely impacts Asset Liability Management (ALM). This aspect was completely ignored by the DG. DG has misdirected himself in restricted his investigation to individual consumer interest and failed to consider to totality of economic factor and interest of all classes of consumer required to be considered under Competition Act, 2002. The stated objective of Competition Act, 2002 as per its preamble is to prevent practices having adverse effect on competition, to promote and sustain competition in the markets, to protect the interests of the consumers. The term 'the Consumer' under the Competition refers to all classes of consumers and not individual

consumers. Therefore, the Commission while investigating the practices in the market is required to holistically consider whether the practice affects all classes of consumers. If the alleged practice is not that beneficial to one class of consumers but are beneficial to another class of consumers, the Commission cannot take the side of only one class of consumers and declare the practice as illegal.

xi. The DG failed to appreciate the difference between Restrictive Trade Practice and a practice having appreciable adverse impact on competition and thus misdirected himself in assuming jurisdiction of the Commission. The investigation of DG and the findings are to the effect that the practice of charging prepayment penalty unjustified cost on consumer (word 'usurious' is used in the report) and therefore anti-competitive. It is submitted that if prepayment penalty should be prohibited on the grounds of 'usury', then only Consumer Court will have the jurisdiction to do it as cost consideration purely from the perspective of individual consumer is outside realm of Competition Law in India. The order of Hon'ble Supreme Court in the case is not an authority for the proposition that banks cannot charge prepayment penalty. The reliance on the judgment is misplaced.

13.13 Opposite party No.13, Punjab National Bank : The opposite party No.13 in its reply contended that

i. at the Commission has no jurisdiction in regard to inquiry into prepayment charges levied by banks and HFCs on the ground that the banks and HFCs are regulated by the RBI and the NHB respectively.

ii. Having held that the practice of charging prepayment penalty is not violative of Sections 3(1), 3(2) and Sections 4(1), 4(2)(a)(i) of the Act, the conclusion that the practice is violative of Section 3(3) is not correct.

iii. Deputy Director General in his report on the practice of charging of prepayment penalty by banks and financial institutions has collected all the internal circulars of banks and a communication of IBA dated 10.09.2003 to its members and relied on the their contents for the purpose of his conclusion. Deputy Director General having given a finding that the practice of charging prepayment penalty is economically reasonable and the persons investigated are not in dominant position in the market to determine prices or control services, ought not have come to a contrary and inconsistent conclusion on the basis of same evidence that Banks and Financial

Institutions have violated Section 3(3) of Competition Act, 2002.

iv. The DG in the report has unnecessary and without any basis relied heavily on the language of the internal circulars of Banks and Financial Institutions and IBA letter dated 10.09.2003 and contends that the stated intent is to discipline the customer and to increase income. He concludes that the language being monopolistic, the practice of charging prepayment penalty is *per se* anti-competitive under Section 3(3) of the Act. Finding of the DG is incorrect and against the legal provisions of Competition Act.

v. There is no agreement, any arrangement or understanding or action in concert amongst various banks and HFCs. This position is also clear from the report itself that various banks have been charging prepayment penalty beginning from different time and different rates. In view of this how charging or prepayment charges can be said to be result of any agreement as contained in the Act. It is settled law that the words used in the individual circular issued by the banks, cannot be the criterion for any activity to be anti-competitive but the economic consequences are the criterion of any anti-competition investigation. It is settled law that for the purpose of invoking Section

3(3) of the Act the practice of charging prepayment penalty should *ex facie* result in or shall have the probability of resulting in any or all the economic consequences enumerated under Section 3(3) (a) to (d).

vi. There is no discussion in the DG report whether the practice of charging prepayment penalty *ex facie* leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3). Thus the findings and the recommendations are mere sweeping generalizations and not conclusions based on evidence and material on record.

vii. Under Section 3(3) law permits the Commission to presume violation without further enquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to relevant market falls foul of any of those parameters. Therefore, evidence gathered and documents collected during the investigation shall be evaluated from the perspective of presence or otherwise of the parameters laid down clauses (a) to (d) of Section 3(3) in relation to relevant market. Neither the DG nor the Deputy Director General had gathered any evidence or data in this regard. Further there is no discussion in this regard. Further there is no discussion in the report

as how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although it is concluded that the practice is violative of Section 3(3)(b) of Competition Act, 2002.

viii. In order to presume that any practice has predictable and pernicious anti-competitive effect and violates Section 3(3) of the Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly pricing in the relevant product market. There is no evidence in that regard in the report. It is an observed fact that there is intense competition in the relevant product market. Further, the market participants are highly regulated by the Government, RBI, NHB, whose mandate is protection of public interest. It is settled under Competition Law that presence of highly regulated entities is antithetical to existence of price monopolies.

ix. According to CRISIL report of March 2009, the Home Loan Market has registered a growth of 43% CAGR from 2000-01 to 2004-05, that is during and after the period of IBA circular. It is submitted the growth is mainly attributable to the entry of Scheduled Commercial Banks in to the market and IBA circular

and the practice of charging prepayment penalty has not in any way limited or controlled the availability of home loan products. The evidence does not support the findings that prepayment penalties influence decisions of new entrants and thus having regard to the factors under Section 19(3)(a), (c) (d) above, it has appreciable adverse effect on competition.

x. Even a lay observer of the housing finance market would agree that entry barriers are virtually absent for HFCs NHB, the regulatory authority has been receiving applications from new HFCs. It had granted licenses for 3 HFCs during the year 2008. Applications of 3 more HFCs are pending with NHB as of date. If practice of charging prepayment penalty has any correlation to entry into market, then there would not be new applications for registrations before NHB. Similarly it is an observed fact that Banking Industry has seen entry of new private sector banks in considerable numbers in the last decade. There is no evidence to show that practice of charging prepayment penalty has in any way deterred the new entrants into the market and foreclosed competition. The practice of charging prepayment penalty has no correlation at all to entry of new entrants and competition in the home loan market much less a

strong correlation to hand down a finding that the practice has appreciable adverse effect on competition *per se*. CRISIL report demonstrates that prepayment decisions are a function of movement of rates of interest and raising income level called cyclical prepayments and structural prepayments respectively. Prepayment decisions are not influenced by prepayment penalties. It is demonstrated that cyclical repayments were increasing till 2006-07 due to increase in the interest rates. Structural prepayments had been increasing till 2007-08, but it had slowed down during 2008-09 due to global melt down and decreasing income levels. It is expected to show an increasing trend as the income levels improve. Therefore the findings that prepayment payments penalties create a demand side constraint are not correct and are based on considerations other than considerations of relevant market. The practice of prepayment of penalty is highly unlikely to operate as demand side constraint creating entry barriers to new entrants. This is because a decision to prepay a home depends on cyclical factors and structural factors.

xi. It has been submitted that ***PNB and many other Banks do not*** levy prepayment penalty in case of structural prepayments, that is to say prepayment out

of one's own funds and the said fact is accepted by DG in his report. At present only cyclical prepayments attract prepayment penalty. It would be obvious that cyclical prepayment would happen only when marginal cost of refinance is insignificant and there is comparative cost advantage in taking new loan. The finding of DG report that the practice of charging prepayment penalty does not result in any benefit to consumers and this factor enumerated in Section 19(3)(d) is present. However, the finding is not tenable and is based on mere conjectures and surmises and not based on facts and conditions of the relevant market.

xii. In the Indian market, prepayment penalties are finite and not infinite or ballooning as in other markets world over. It can be seen from page 14 of the Deputy DG report that the rates are heterogeneous and nominal ranging between 1% to 2% among the investigated banks and financial institutions. One of them, namely Axis Bank does not impose any prepayment penalty. Further, prepayment penalties are imposed by the banks and financial institutions only on cyclical repayments and not structural repayments. In other words, prepayment penalty is applicable only when the customer chooses to refinance the home loan and

not otherwise. Finding in the report that prepayment penalties are anti-consumer is baseless for another reason also. Banking means accepting deposits for the purpose of lending. Banking business has various risks like credit risk, market risk and operational risk etc. Prepayment by a borrower generates re-investment risk for the bank. Banks are required to manage this re-investment risk it is not feasible to factor the same in the rate of interest alone considering the competition in the market to acquire a customer. The process of managing re-investment risks by the banks and financial institutions is known as Asset Liability Management (ALM) and that was the justification offered by the bank, which unfortunately was brushed aside nonchalantly by the respected DG as not enough justification. Prepayment penalty as ALM tool is eminently reasonable as long as it is meant to cover the costs associated with re-investment risk. The RBI while giving reply by its letter dated 11.12.2009 to the Deputy Director General has categorically acknowledged that prepayment adversely impacts ALM. This aspect was completely ignored by the DG. The term 'the Consumer' under the Competition refers to all classes of consumers and not individual consumers. Therefore, the Commission while investigating the practices in the market is

required to holistically consider whether the practice affects all classes of consumers. If the alleged practice is not that beneficial to one class of consumers but are beneficial to another class of consumers, the Commission cannot take the side of only one class of consumers and declare the practice as illegal.

xiii. In US home loan market is regulated both Federal Legislation as well as respective States. In Indian context banks and HFCs are regulated by the law of Parliament. In US the law combines both regulation and consumer protection whereas India has an overreaching Consumer Protection Act which, after amendment in 2002, included both unfair and restrictive trade practices. Further, reference of newsletter of Fair Trade Commission (FTC), Taiwan to buttress his argument and finding that the prepayment penalty impedes allocation of capital and interest rate competition in the market is quoted out of the context and is not relevant to the investigation whether the prepayment penalty is anti-competitive. FTC, Taiwan's decision is with reference to Far Eastern International Bank (FEIB) that the dominant marketing, Taiwan. The investigation of DG and the findings are to the effect that the practice of charging prepayment penalty are

unjustified costs on consumers (Report uses word 'usurious' in paragraph 10.3) and therefore anti-competitive. If prepayment penalty should be prohibited on the ground of 'usury', then only Consumer Courts will have the jurisdiction to do it as cost considerations purely from the perspective of individual consumer is outside the realm of Competition Law in India. The order of Supreme Court in the case is not an authority for the proposition that Banks cannot charge prepayment penalty. The reliance on the judgment is misplaced.

13.14 Opposite party No.14, State Bank of Hyderabad : The opposite party No.14 in its reply contended that

i. There is no agreement entered between the Banks for charging the prepayment interest. It is left to the individual bank whether to charge or not. Even otherwise charging of prepayment interest/charges increases efficiency in the banking services and falls within the exception under Section 3.

ii. State Bank of Hyderabad (SBH) is not charging prepayment charges/interest on all retail loans and even in case of housing loans only if the loan is repaid by taking over by another bank or where amount is prepaid in excess of the EMI payments. The charging

of prepayment interest is not the rule, it is only exception.

iii. The market is vast and there are at present 27 public sector banks and 25 private banks apart from 32 foreign bank branches on as on March 2009. Any person can approach any bank at his choice for availing any finance. The prospective buyer after going through the prevailing interest rates, terms of payment, period of payment, facilities and other services available, can go to the bank of his choice. The question of dominant position thus does not arise. It is submitted the SBH is charging prepayment of charges only in respect of Housing Loans that too in specified conditions. This prepayment clause is not applicable to other borrowers or other types of loans as stated above. Further the section itself recognizes (explanation to section) the discriminatory conditions or prices may be adopted to meet the competition or when its limits or restricts services development of services etc.

iv. Even otherwise it is submitted that the market share of SBH in all scheduled commercial banks (ASCB) is limited only to merely 1.50%. So by any stretch of imagination it cannot be said the bank is in a

dominating position. As such the question of abuse of its dominant position does not arise.

v. The international practice appears to be in favor of charging prepayment charges. The prepayment charges are also being levied by World Bank and other institutions. International Bank for Reconstruction & Development will charge prepayment premium to cover the cost to IBRD of redeploying prepaid funds. The calculation of redeployment cost for all or any portion of FSL (Fixed Rate Single Currency Loans) that has not been converted is carried out in accordance with the guidelines framed.

vi. The World Bank also charges prepayment penalty of 2 %. No law or directions of RBI prohibits charging prepayment penalty. So the agreement entered by borrower is valid.

vii. It is borrower who enters the agreement with the bank. The party makes a proposal/offer to avail finance from the Bank on its terms. Then on processing the proposal/offer bank make a counter offer of terms of sanction including its intention to charge prepayment charge/interest. Then on examining the party may accept may reject terms of

sanction. During negotiation while processing the loan the party is also informed about the terms levied for housing loans. So with the willingness and full awareness the party accepts the proposal/sanctioned terms of Ban and executes the loan document. So, this process will not violate any of the provisions of Competition Act. It is the individual decision of the Banks. As such it is denied that all Banks join together/form cartel in respect of charging prepayment interest. Having held that the practice of charging prepayment penalty is not violative of Sections 3(3), 3(2) and Sections 4(1),4(2)(a)(i) of the Act, the conclusion is that the practice is violative of Section 3(3) is not correct.

viii. Deputy Director General in his report relies heavily on the language of the internal circulars of the banks and a communication of IBA dated 10.09.2003 and contents that stated intent is to discipline the customer and increase income. He concludes that the language being monopolistic, the practice of charging prepayment penalty is *per se* anti-competitive under Section 3(3) of the Act. However, the same is not applicable to SBH, as circulars of SBH does not subscribe to their views/language and charging of

prepayment penalty was introduced vide ADV circular no. 2002-03/21 dated 13.06.2002.

ix. Further, it is settled law that the language and the form of agreement cannot be the criterion in any anti-competition investigation. A practice which is not anti-competitive by application of 'rule of reason' cannot by any stretch of imagination be inherently anti-competitive calling for application of '*per se* rule' as is concluded in DG report. For the purpose of invoking Section 3(3) of the Act the practice of charging prepayment penalty should *ex-facie* result in or shall have the probability of resulting in any or any economic consequences enumerated under Section 3(3) (a) to (d).

x. There is no discussion in the DG report whether the practice of charging prepayment penalty *ex-facie* leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3). Thus, the findings and the recommendations are mere sweeping generalization and not conclusions based on evidence and material. Under Section 3(3), law permits the commission the presume the violation without further inquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to the relevant

market falls foul of any of those parameters. No evidence or data in this regard had been gathered by the DG.

xi. Further, there is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provisions of financial services, although it is concluded that the practice is violative of Section 3(3)(b) of Competition Act, 2002. Any practice before being declared as *per se* anti-competitive due to AAEC under Section 3, factors enumerated under Section 19 of the Competition Act shall be considered. The practice of charging prepayment penalty to be anti-competitive *per se*, shall *ex-facie* disclose presence or absence, as the case may be, of any or all factors mentioned in Section 19(3). DG in his report did not have due regard to any of said factors in relation to relevant market and has straight away declare without any hindrance that the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a),(c), (d). The finding of the DG that the practice of charging prepayment penalty does not result in any benefit to consumers and thus factor enumerated in Section 19(3) (d) is present in the practice is not tenable and is based on

mere conjectures and surmises and not based on facts and conditions of the relevant market.

xii. In the Indian market, prepayment penalties are finite and not infinite or ballooning as in other markets world over. It can be seen from page 14 of the Deputy Director General report that the rates are heterogeneous and nominal ranging between 1% to 2% among the investigated banks and financial institutions. One of them, namely Axis Bank does not impose any prepayment penalty. Further, prepayment penalties are imposed by the banks and financial institutions only on cyclical repayments and not structural repayments. RBI while giving reply by its letter dated 11.12.2009 to Deputy Director General has categorically acknowledged that prepayment adversely impacts asset liability management. This aspect was completely ignored by the DG.

xiii. Prepayment penalty is a cost to the consumer and is included in the price of services offered by the Banks and Financial Institutions. Section 3 of Competition Commission Act, 2002 declares void, practices in the nature of predatory or monopoly or oligopoly pricing in the market.

xiv. The Act does not concern itself with the restrictive or unfair price terms. Jurisdiction with respect to restrictive or unfair price terms is with Consumer forums under Consumer Protection Act, 1986. It is humbly submitted that restrictive or unfair price terms would come within the definition of anti-competitive practice only when all class of consumer are affected and the price terms are dictated by a monopolist or oligopolies. The practice of prepayment penalty does not affect all classes of consumers that is to say it affects the cost of only borrowers, who are only one class of consumers for the Banks.

xv. Prepayment penalties are good for depositors and stakeholders of Banks. As has been stated earlier if any practice is good for one class of consumers but not so good for another class, then Competition Act, 2002 is not applicable, since prohibiting the practice would adversely affect another class, which in turn leads to misallocation of capital and economic inefficiency. Therefore, the practice of prepayment penalty is beyond the jurisdiction of the Hon'ble Commission.

xvi. The investigation of DG and the findings are to the effect that the practice of charging prepayment penalty are unjustified costs on consumers (Report

uses word ‘usurious’ in paragraph 10.3) and therefore anti-competitive. If prepayment penalty should be prohibited on the ground of ‘usury’, then only Consumer Courts will have the jurisdiction to do it as cost considerations purely from the perspective of individual consumer is outside the realm of Competition Law in India.

xvii. The judgment of consumer courts relied on by the DG in support of his findings do not even whisper as to whether the practice of charging prepayment penalty is a restrictive trade practice imposing unjustified costs on the individual consumers. Further, the Supreme Court has specifically said in the SBI case that the question of law is left open to be decided in appropriate case.

13.15 Opposite party No.15, State Bank of India (SBI) : The opposite party No.15 State Bank of India contended in its reply / objections that

i. Director General relies heavily on the language of the internal circulars of Banks and Financial Institutions and IBA Circular dated 10.09.2003 and contends that the purport/intent is to discipline the customer and to increase income. He concludes that the language being monopolistic, the practice of charging

prepayment penalty is per se anti competitive under Sec. 3(3) of the Act.

ii. It is settled law that the language and form of agreements cannot be the criterion but the **economic consequences are the criterion** in any anti competition investigation.

iii. Under Section 3(3) law permits the Commission to presume violation without further enquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to relevant market falls foul of any of those parameters. Therefore, evidence gathered and documents collected during the investigation shall be evaluated from the perspective of presence or otherwise of the parameters laid down clauses (a) to (d) of Section 3(3) in relation to relevant market. Neither the Director General nor the Deputy Director General had gathered any evidence or data in this regard. Further there is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although it is concluded that the practice is violative of Section 3(3)(b)of Competition Act, 2002.

iv. In order to presume that any practice has predictable and pernicious anti-competitive effect and violates Section 3(3) of the Act, the relevant market in which the practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly pricing in the relevant product market. There is no evidence in that regard. It is an observed fact that there is intense competition in the relevant product market. Further, the market participants are regulated by the Government, RBI, NHB, whose mandate is for the protection of public interest.

v. It is settled under Competition Law that presence of highly regulated entities is antithetical to existence of price monopolies. Elements of price oligopoly are absent in the relevant market. Any practice before being declared as anti-competitive due to adverse effect on competition under Section 3, the factors enumerated under Section 19 of the Act shall be considered. To establish the practice of charging prepayment penalty is anti-competitive, the presence or absence, as the case may be of any or all the factors enumerated under Section 19 of the Competition Act is necessary. The DG report has not given due regard to any of the above factors. The DG

has straight away declared without any evidence that the practice of charging prepayment penalty has adverse impact on the competition, since its leads to factors under Section 19(3)(a), (c) and (d). CRISIL report demonstrates that prepayment decisions are a function of movement of rates of interest and raising income level called cyclical prepayments and structural prepayments respectively. Prepayment decisions are not influenced by prepayment penalties. It is demonstrated that cyclical repayments were increasing till 2006-07 due to falling interest rates and were negative during the year 2006-07 due to increase in the interest rates. Structural prepayments had been increasing till 2007-08, but it had slowed down during 2008-09 due to global melt down and decreasing income levels. It is expected to show an increasing trend as income levels improve. Therefore the findings that prepayment penalties create a demand side constraint are not correct and are based on considerations other than considerations of relevant market. The findings that prepayment penalties create a demand side constraint are not correct and are based on considerations other than considerations of relevant market.

vi. The finding of the DG that the practice of charging prepayment penalty does not result in any benefit to consumers and thus factor enumerated in Section 19(3) (d) is present in the practice is not tenable and is based on mere conjectures and surmises and not based on facts and conditions of the relevant market. In the Indian market, prepayment penalties are finite and not infinite or ballooning as in other markets world over. It can be seen from page 14 of the Deputy Director General report that the rates are heterogeneous and nominal ranging between 1% to 2% among the investigated banks and financial institutions. One of them, namely Axis Bank does not impose any prepayment penalty.

vii. Further, prepayment penalties are imposed by the banks and financial institutions only on cyclical repayments and not structural repayments. It is elementary that banking means accepting deposits for the purpose of lending. Banks secures funds by way of deposits which is a liability to the bank for specified period at a fixed rate. Pricing of loan is linked to cost of funds banking business has various risks, credit risk, market risk and operation risk etc. Banks are required to manage re-investment risk and it is not feasible to factor the same in the rate of interest alone.

Considering the competition in the market to acquire the customer. This process of managing re-investments risks by the banks and financial institutions are known as Asset Liability Management (ALM) and that was the justification offered by the bank, which was brushed aside nonchalantly by the respected DG as not enough justification.

viii. RBI in its reply to the Commission has categorically acknowledged that prepayment adversely impacts ALM. This aspect was completely ignored by the DG. The stated objective of Competition Act, 2002 as per its preamble is to prevent practices having adverse effect on competition, to promote and sustain competition in the markets, to protect the interests of the consumers.

ix. The term 'the Consumer' under the Competition refers to all classes of consumers and not individual consumers. Therefore, the Commission while investigating the practices in the market is required to holistically consider whether the practice affects all classes of consumers. If the alleged practice is not that beneficial to one class of consumers but are beneficial to another class of consumers, the Commission cannot take the side of only one class of consumers and declare the practice as illegal.

x. The DG failed to appreciate the difference between Restrictive Trade Practice and a practice having appreciable adverse impact on competition and thus misdirected himself in assuming jurisdiction of the Commission. The investigation of DG and the findings are to the effect that the practice of charging prepayment penalty unjustified cost on consumer (word 'usurious' is used in the report) and therefore anti-competitive. It is submitted that if prepayment penalty should be prohibited on the grounds of 'usury', then only Consumer Court will have the jurisdiction to do it as cost consideration purely from the perspective of individual consumer is outside realm of Competition Law in India.

xi. The judgments of consumer courts relied upon by the DG in support of his findings were under Consumer Protection Act, 1986 and not under the Competition Law. Even in those judgments there is no whisper as to whether the practice of charging prepayment penalty is a restrictive trade practice imposing unjustified costs on the individual consumers. The judgment was based on facts, which disclosed that prepayment charges were levied in that case even though loan was not disbursed and merely because the complainant has chosen to avail the loan from other Bank instead of

respondent Bank. The consumer courts rightly held that what was charged was not prepayment penalty but penalty for not taking the loan though the Bank which was ready to give the loan. The case is not at all representative of instances, where Banks charge prepayment penalty for prepayment after loan was disbursed and utilized by the borrowers. The order of Supreme Court in the case is not an authority for the proposition that Banks cannot charge prepayment penalty. The reliance on the judgment is misplaced. It is humbly submitted that whatever material respected DG has adverted to in his report refers to prepayment penalty for an unavailed and unutilized loan from which no parallel can be drawn. On this ground alone the findings of DG deserved to be rejected.

13.16 Opposite party No.16, Vijaya Bank : The opposite party No.16 Vijaya Bank in its reply/objections contended that

i. The Asset Liability Management (ALM) as justifications for levying the prepayment penalty charges by the Banks was not conceived by the DG or the Deputy Director General in its true perspective and has misconstrued and traced it as a root in preventing the customer from trying to get better bargain, disciplining the borrower and kill competition which has led the DG to arrive at the wrong conclusion. As regards the

argument put forth by DG on the issue of ALM is concerned, that if sometime the bank loses in a declining interest scenario, it also gains in increasing interest scenario and all such eventualities are generally factored into by working out the cost of funds for either the fixed interest or floating rate lending's is not correct. This is because no bank can factor all these eventualities in their cost of funds. If large scale repayment of loans takes place. The presence of prepayment penalties offers incentive to the banks to apply upward interest rate changes. (in a typical scenario where rates are on rise) only to future customers and not to existing customers. Thus, a borrower choosing against refinance option gets the benefit of lower interest rate. Thus, this practice has given discernable benefits to the customers in the Indian Market.

ii. The prepayment penalty is an ALM tool. It is meant to cover the costs associated with reinvestment risk faced by the banks so that they can remain viable. This is proving to be beneficial to the depositor as explained above. It has been contended that prepayment penalty as ALM tool is eminently reasonable as long as it is meant to cover the costs associated with reinvestment risk. There is enough

evidence in the Indian Market that the rates of prepayment penalty ranging from 1% to 2% as quoted by the DG report are aimed at covering the cost of reinvestment risk for the banks so that they can remain viable and pay the depositors the agreed rates. That is the reason why government and RBI did not frown on those rates till date.

iii. Finding in the report that prepayment penalties are anti-consumer is baseless for another reason also. Banking means accepting deposits for the purpose of lending. Banking business has various risks like credit risk, market risk and operational risk etc. Prepayment by a borrower generates re-investment risk for the bank. Banks are required to manage this re-investment risk it is not feasible to factor the same in the rate of interest alone considering the competition in the market to acquire a customer. The process of managing re-investment risks by the banks and financial institutions is known as Asset Liability Management (ALM) and that was the justification offered by the bank, which unfortunately was brushed aside nonchalantly by the respected DG as not enough justification.

iv. The findings of the DG that NHB's imposition of prepayment charges is low and practically stable for a

reasonable period. Thus imposition of prepayment levy by NHB was a business decision and, therefore, not anti-competitive, but that being charged by other Banks or Home Loan Finance Companies are competitive is highly unsustainable and without any basis or merits. In fact levying prepayment charge is a business decision. The Law Lexicon has given the word “business” a wide import and it means a trade or profession at which one works regularly and business is ordinarily for profit.

v. In the present instance, NHB is doing wholesale bulk refinance for profit also and charging less prepayment charges as their customer base are very less which are mainly banks and HFC therefore, cost of prepayment charges are also less. But, the Banks who receives the amount from NHB disburses the same to lakhs of customers and hence, to maintain more customer base for prepayment charges the cost involved including cost of reinvestment risks is more. This will enable the bank to repay the prepayment charges to the NHB, if the banks receive prepayment from customer. It is like NHB charging lesser interest for bulk refinance to Banks, whereas Banks is charging more interest from their customers. Thus, the justification attributed to NHB for collection of

prepayment charges as “business decision” is equally applicable to banks. RBI while giving reply vide its letter dated 11.12.2009 to the Deputy Director General has categorically acknowledged that prepayment adversely impacts ALM. This aspect was completely ignored by the DG.

vi. The Competition Act does not override the provisions of the Banking Companies Act nor does it override the powers of the Regulatory Authority i.e. RBI. The respected DG failed to appreciate the said settled position and assumed jurisdiction in the matter which is totally unsustainable. Further, Section 3 of Competition Commission Act, 2002 declares void, practices in the nature of predatory or monopoly or oligopoly pricing in the market. The Act does not concern itself with the restrictive or unfair price terms. Jurisdiction with respect to restrictive or unfair price terms is with Consumers forums under Consumer Protection Act, 1986. It is humbly submitted that restrictive or unfair price terms would come within the definition of anti-competitive practice only when all class of consumer are affected and the price terms are dictated by a monopolist or oligopolies. The practice of prepayment penalty does not affect all classes of consumers that are to say it affects the cost of only

borrowers, who are only one class of consumers for the Banks. Prepayment penalties are good for depositors and stakeholders of Banks. As has been stated earlier if any practice is good for one class of consumers but not so good for another class, then Competition Act, 2002 is not applicable, since prohibiting the practice would adversely affect another class, which in turn leads to misallocation of capital and economic inefficiency.

vii. The practice of prepayment penalty is beyond the jurisdiction of the Hon'ble Commission. Further, VIjaya Bank does not levy prepayment penalty in case of structural prepayment. Only cyclical prepayment attracts prepayment penalty for the reason that marginal cost of prepayment is significant and there is comparative cost advantage in taking new loan. Under Section 3(3) law permits the Commission to presume violation without further enquiry only and only if any trade practice tested on the parameters laid down in clauses (a) to (d) of Section 3(3) in relation to relevant market falls foul of any of those parameters. Therefore, evidence gathered and documents collected during the investigation shall be evaluated from the perspective of presence or otherwise of the parameters laid down clauses (a) to (d) of Section 3(3) in relation to relevant

market. Neither the Director General nor the Deputy Director General had gathered any evidence or data in this regard.

viii. Further there is no discussion in the report as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services, although it is concluded that the practice is violative of Section 3(3)(b)of Competition Act, 2002. DG report did not have due regard to any of the factors given under Section 19(3) in relation to relevant market. He has straight away declared without any evidence that the practice of charging prepayment penalty has AAEC since it leads to factors under Section 19(3)(a), (c), (d).

14. **Indian Bank Association (IBA) :** The Indian Banking Association in its reply contended that

i. The banking industry in India is regulated by and under the provisions of the Banking Regulation Act, 1949 and the Regulatory Authority there under is the RBI. RBI has not found this practice of levying prepayment penalty as either unfair, or unreasonable, or restrictive or illegal. It is submitted that it is within the exclusive domain of the regulator to decide if a particular practice violates the essentials of the Banking system in the country. On the other hand, RBI has duly approved the said practice as

would be evident from the factual submissions made hereunder. As such, neither the DG nor this Hon'ble Commission would have the jurisdiction to go into the issue in view of the fact that the said practice of levying prepayment penalty is not only reasonable but also legal and legitimate. It is also in the larger interest of developing a strong and healthy Banking system in the country to support the economic development of the country.

ii. Prepayment penalty is levied in view of and under express terms of a contract entered into between the Bank and the Customer. If the terms of a contract are one sided or unconscionable (which is not a fact in the present case), the remedy would be to approach a Civil Court for the annulment of the contract as a whole or getting a declaration from the Competent Court that the particular provision is unconscionable. For this reason also this Hon'ble Commission ought not to interfere in a practice which has been long established and consistently followed by the entire banking industry and cannot by any stretch of imagination be considered as unfair or unconscionable.

iii. The parties are bound by the terms and conditions of the contract. DG has not considered the subject in issue raised by the informant comprehensively in his report. The evidences/documents collected by the DG during the said investigation/inquiry are highly inappropriate to come to a

definitive conclusion particularly on an issue which affects the banking and financial industry at large. DG in his report, on the one hand, stated that the concluded that the allegations made by the informant under Section 3(1), 3(2) read with 4(1), 4(2)(a)(i) are found to be untrue and on the other hand concluded that the practice of charging prepayment penalty levied by the banks/financial institution to the consumers is anti-competitive and is in violation of Section.

iv. Section 3(1) read with Section 3(2) is in *pari materia* with Section 1 of Sherman Act 1890 of United States of America, which is based on 'rule of reasonableness' enunciated by the courts in United States and followed by Indian Courts under MRTPC, which now stands repealed and replaced by Competition Act. Deputy Director General in his report after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' and having found that the practice has reasonable economic justification has given a finding that the practice is not violative of Section 3(1) of the Competition. He has rejected the allegations of market dominance and abuse thereof by the Banks and Financial Institutions and found that Banks and Financial Institutions and IBA have not violated Section 4(1), 4(2)(a)(i) of the Act. Therefore, it is submitted that the Deputy Director General having given a

finding that the practice of charging prepayment penalty is economically reasonable and the persons investigated are not in dominant position in the market to determine prices or control services, ought not to have come to a contrary and inconsistent conclusion, on the basis of same evidence that Banks and Financial Institutions have violated Section 3(3) of Act. DG report relies heavily on the language of the internal circulars of banks and financial institutions and IBA circular dated 10.09.2003 and erroneously concluded that the language of aforesaid letters are monopolistic, the practice of charging prepayment penalty is *per se* anti competitive under Section 3(3).

v. DG failed to consider that language in form of agreement cannot be the criterion and the economic consequences are the criterion in any anti competition investigation before coming to definitive conclusion.

vi. DG has not explained whether practice of charging prepayment penalty ex-facie leads or has led to predictable and pernicious economic consequences enumerated under Section 3(3) of the Competition Act.

vii. It is settled law that for the purpose of invoking Section 3(3) of the aforesaid Act, the DG has to give appropriate and sufficient reasons that the practice of

charging prepayment penalty should *ex-facie* result in or shall have probability of resulting in any or all the economic consequences enumerated under Section 3(3)(a) to (d) of the Act. The DG miserably failed to consider the above provisions and gave the sweeping findings/recommendations which are erroneous and misconceived. It has been further contended that the evidence gathered and documents collected during the investigation shall be evaluated from the perspective of inherent principles laid down under clauses (a) to (d) of Section 3(3) of the Act in relation to the relevant market. The DG during the investigation failed to gather any appropriate evidence or data in the aforesaid perspective and miserably failed to consider/explain as to how the practice of charging prepayment penalty *per se* limits or controls provision of financial services provided by the Banks and Financial Institutions to the Consumers and surprisingly came to the conclusion that the aforesaid practice is violative of Section 3(3)(b) of the Act, which is erroneous, misconceived and not in conformity with the legal principles involved on the subject in issue.

viii. DG in his report failed to consider in order to presume that any economic practice has any predictable and pernicious anti-competitive effect, which violates the provision of Section 3(3) of the Act, the relevant market in

which the said practice is carried on should necessarily be a monopoly or oligopoly market and the products are subjected to either monopoly pricing or oligopoly pricing in the relevant product market. It is pertinent to mention herein that no iota of evidence/documents has been collected and considered by the DG which proves the aforesaid market and pricing condition is present in the relevant market. On the contrary, there is ample evidence on record to general public that there is intense competition in the relevant product market (home loan market) as there are large numbers of service providers. The service providers in the said market are highly regulated by the relevant policies enunciated by the government, RBI and NHB whose mandate is protection of public interest at large.

ix. The DG failed to consider in his report that it is a settled law that presence of highly regulated entities are antithetical to existence of price monopolies or oligopolies. Therefore, the findings of DG that the practice of charging prepayment penalty is monopolistic and anti-competitive is a fallacy.

x. DG in his report miserably failed to consider relevant fact before coming to the conclusion the persons investigated under the relevant market control 95% of the market. It is pertinent to mention here that the aforesaid conclusion of

the DG in his report is a fallacy as the HFCs have a considerable share of 35% of the relevant home loan market and remaining share is with the banks and other institutions.

xi. The DG in his Report has in simpliciter manner accepted the allegations of the informer without any cogent evidence on record and has made unjustified and erroneous assumption on the basis of circular dated 10.09.2003 of IBA and the internal circular of Banks and Financial institutions that there exists an agreement among the service providers that limits or controls the provision of services in the relevant market within the meaning of Section 3(3) of the Act.

xii. The DG completely failed to appropriately consider the relevant circular of the RBI, although it was on record and completely misinterpreted the contents of the aforesaid circular just for the purpose of coming to the erroneous conclusion and justification that the aforesaid practice is anti-competitive as per the aforesaid relevant provision of the Act. It is further submitted that the DG also failed to consider that the relevant market had grown exponentially after the year 2003 and the said growth is mainly attributable to the entry of Scheduled Commercial Banks into the relevant market and therefore, the said IBA circular and the practice of charging prepayment penalty has not in any way

limited or controlled the availability of home loan products in the relevant market. Thus, the definitive conclusion of the presence of anti-competitiveness in the relevant market due to the aforesaid practice by the DG in his report is completely erroneous, misconceived and a fallacy.

xiii. The DG in his Report abysmally failed to consider/explain that any practice before being declared as *per se* anti-competitive due to appreciable adverse effect on the competition under Section 3(3) of the Act, the inherent factors enumerated under Section 19(3) of the Act ought to be considered. It is further submitted that the DG has not considered the aforesaid factors with sufficient reasoning in relation to the relevant market and straight away declared without any cogent evidence that the practice of charging prepayment penalty has appreciable adverse effect on the competition in the relevant market, which are devoid of any substance. It is pertinent to mention herein that there is ample evidence by which one can observe that there are eventually no barriers for the new entrants to enter into the relevant market as is evident from the fact that NHB which is regulatory authority for granting license to new HFCs has been receiving applications from new HFCs and had granted licenses to 3 new HFCs during the year 2008. It is relevant to mention herein that if the practice of prepayment penalty has any correlation to entry into the relevant market, then

there would not be new applications for registrations before NHB. Similarly, it is also a fact that Banking Industry has seen entry of new private sector banks in considerable numbers in the last decade and various applications for banking license are pending with RBI. Hence, there is ample evidence which can easily substantiate the fact that there is no entry barrier for new entrants in the relevant market much less a correlation to conclude a finding that the said practice has appreciable adverse effect on competition *per se*. It is pertinent to mention herein that the DG in his report completely failed to consider the well known fact that the prepayment decisions are a function of movements of rates of interest and raising income level, which is called as cyclical prepayments and structural prepayments respectively and therefore, the prepayment decisions are not influenced by prepayment penalties. It is also relevant to mention herein that the aforesaid facts can be demonstrated through the fact that cyclical repayments were increasing till the year 2006-07 due to falling interest rates and were negative during the year 2006-07 due to increase in the interest rates. The structural prepayments had been increasing till the year 2007-08 but it had slowed down during the year 2008-09 due to global melt down and decreasing income levels. It is very likely that the structural prepayments trend will show an increasing trend as the income levels of the consumer improved. Therefore, the

findings in the said DG report that the prepayment penalties create a demands side constraint is baseless as it is based on the considerations other than the relevant factors of the home loan market. It has further been contended that none of the banks and financial institutions in the market levy prepayment penalty in case of structural factors and the said fact is accepted by the DG in his report. It is further submitted that at present only cyclical prepayments attract a minimal prepayment penalty and it would be obvious that cyclical prepayment would happen only when marginal cost of refinance is insignificant and there is comparative cost advantage in taking new loan.

xiv. The DG in his report failed to consider appreciate the fact that the banks and financial institutions are financial intermediaries channel to put savings in the economy into the investment. In other words, the availability of credit to the consumers is a function of loan able funds. The banks and financial institutions have to consider the fact that the aforesaid loan able funds will be available at low cost and the benefit of the same should be provided to the consumers. It has further been contended that the Securitization is a disintermediation process that enables banks and financial institutions to raise funds from investors selling down loans backed by mortgage security. The investors buying securitization instruments besides good

rate of return for their investments also look for certainty in cash flows. It is empirically established in the structured finance literature that the practice of prepayment penalty enhances certainty of cash flow and serves as incentive for investors in securitization instruments. Therefore, as a natural corollary, the said incentive translates into lower rates on the securitized instruments, which in turn results in low cost loan able funds for the banks and financial institutions. The said low cost loan able funds reduces the interest rates and costs to the home loan borrowers in the relevant market. Thus, the practice of charging prepayment penalty enhances consumer welfare rather than affecting them adversely.

xv. DG in his report completely disregarded the ALM aspect and brushed aside nonchalantly as not enough justification, which is highly misconceived and erroneous proposition. In order to understand the reasoning behind prepayment charges levied by the various banks and financial institutions, it is necessary also to understand the ALM of the banking industry. Banks and other financial institutions exposed themselves to various kinds of risks such as credit risk, interest risk and liquidity risk. ALM is an approach and tool that provides these institutions with protection that makes such risks acceptable. ALM enables banks and financial institutions to measure and monitor risks and

provide appropriate strategies for their management. In today's global financial and commercial scenario ALM has become an integral feature essential for sustaining the banking industry. This is the reason why the RBI has issued various circulars and guidelines in this regard time to time but the same was erroneously not considered by the DG in his report. The RBI vide its circular dated 10.09.1998 has decided to introduced the ALM system as a part of risk management and control systems in banks.

xvi. DG in his report completely failed to consider the most essential part of the letter of RBI dated 11.12.2009, which has been sent by the RBI while giving reply to the query of the Deputy Director General during the course of the investigation. The said RBI letter categorically stated that the bank generally levy charges for foreclosure of loan as it adversely impacts their ALM. The RBI in its letter further stated that no further action is contemplated in the matter and also informed that there are no proceedings on prepayment penalties against any of the banks pending with the RBI. The DG in his report completely disregarded the aforesaid concluding part of the contents of the aforesaid letter of RBI.

xvii. The DG in his report failed to appreciate the totality of economic factors and interest of all classes of consumers required to be considered for the subject in issue in the

relevant market under the Act. It has been contended that the DG with misconceived notion misdirected the entire investigation and restricted it to only one segment of consumer interest and miserably failed to consider all the segments of consumers' interest.

xviii. DG in his report completely failed to consider the purpose and objective of the Act. As per preamble of the aforesaid Act, the Act has been passed to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in the markets in India, and for matters connected therewith or incidental thereto. Therefore, the main objective of this Hon'ble Commission is to protect the interest of consumers and to ensure freedom of trade carried on by other participants in the market and for that purpose the Hon'ble Commission have to maintain balance between the "*interest of consumers"* and "*freedom of trade*" under the Act.

xix. The DG in his report completely failed to maintain the aforesaid balance to achieve the purpose and objective of the Act and even considerably failed to appreciate the interest of consumers at large as he did not consider the

overall economic interests of all segments of consumers prevalent in the relevant market. As we have already submitted and demonstrated in the a foregoing paragraphs of this reply that the aforesaid practice of prepayment penalty is ultimately beneficial for the large segment of consumers and including the segment who is allegedly claiming herein that they are adversely affected by the aforesaid practice.

xx. Hence, the DG report is bad for ignoring the "*balancing of interest rule*" while applying the provisions of the Act. The Bankers deal with the money of the depositors, who are large segment of consumers dealing with banking industry at a large. This is the reason why there are host of regulations protecting depositors' interest and RBI is entrusted with the primary responsibility of protecting them. Therefore, the DG before establishing authoritative rules of conduct on the part of banks and gave finding that the said practice of prepayment penalty is anti-competitive which is highly erroneous and will affect immensely the interests of large segment of depositors whose hard earned savings would be at stake with every change in the way banks are allowed to conduct their business. It has been contended that if the aforesaid practice does not appeal to borrowers and to their narrow notions of justice and equity actuated by self interest would not make the practice *per se* anti-competitive as the

balance of interest rule and the overall economic scenario in the relevant market has been ignored by the DG in his report which is highly objectionable and therefore, the recommendation and findings of the said report ought to be rejected by this Hon'ble Commission.

xxi. The findings of the DG in his report by citing the example of USA and Taiwan market that the overwhelming international trend has been towards a situation where there is no exit load on the borrowers in the home loan market is highly misconceived erroneous as it is based on irrelevant material and fallacious reasoning. The Indian Home Loan Market is diametrically opposite to the relevant market in United States. The relevant Indian market is a developing market in comparison to the market of USA and the Indian Housing Finance Companies and banks offer plain vanilla loans to the home loan borrowers and are simple contracts, which do not contain complicated structures as in the case of USA. The relevant market in USA is regulated both by Federal Legislation as well as respective legislation passed by the States in this regard. In USA, the said law combines both regulation and consumer protection and there is no umbrella legislation to protect only the interest of the consumers as in the case of India where the consumer Commission/ Forums under the Consumer Protection Act, 1986 are functioning for over two decades. The scope of the Consumer Act has been

widened to include both restrictive and unfair trade practices to protect the interest of the Consumers exclusively.

xxii. The Consumer Financial Protection Agency Act, 2009 (hereinafter referred as “CPFA Act”) referred to by the DG in his report is umbrella legislation for consumer protection in USA to unify the existing rules and regulations on consumer protection at one place. The Act itself does not seek to ban the practice of prepayment penalty in the Home Loan Market. The amendments to Section 803 of the Alternative Mortgage Transaction Parity Act, 1982 (hereinafter referred as “AMTP Act”) by CPFA Act do not ban prepayment penalty in USA as suggested by the DG in his report. The background to the said amendment is that in many States in USA under their respective usury laws do not permit home mortgages except on the basis of fixed rate amortizing mortgages. The AMTP Act, 1982 was passed to override state laws and to allow banks to make loans with terms that may obscure the total cost of the loan. This led to various exotic new mortgages and many borrowers failed to understand impact of the same which led them to debt trap and default The said exotic mortgages are considered as the main reason for sub-prime crises. It is further submitted that the CFPA Act, 2009 by amending AMPT Act, 1982 has not brought the exotic mortgages within the purview of regulation by Consumer Financial Protection Agency.

Therefore, it is amply clear that the CFPA Act, 2009 does not ban exotic mortgages and only restricted the complete freedom of Banks to offer exotic mortgages.

xxiii. DG in his report referred to judgment of Consumer Courts in support of his findings and misconstrued the findings of the Consumer Forum. The Hon'ble Supreme Court in its order dated 19.02.2008 has categorically mentioned that the question of law relating to the subject in issue is raised in appeal before Hon'ble Supreme Court is left open to be decided in an appropriate case. This relevant portion of the said order of Hon'ble Supreme Court of Indian in said matter has been completely ignored by the DG in his report and DG erroneously came to the conclusion that the question of law relating to the subject in issue has been settled by the highest court law in India.

xxiv. DG in his report categorically given a finding that the imposition of prepayment levy by National Housing Bank is a business decision and cannot be said to be anti-competitive. If the said practice of NHB is not anti-competitive then why the same practice adopted by the banks and Financial Institutions to manage their Asset Liability Match to maintain the profitability of the organization and long term sustainability of the system, is in anyway anti-competitive under the provision the Act by the same analogy and reasoning/findings given by the DG in his report.

POINTS FOR DETERMINATION:

15.1 In identifying the key issues for determination in this case, it is important to be fully conscious of the fact that its various dimensions include significant macro-economic factors and financial stability implications on the one hand, and consumer interest on the other. For the banking sector, prepayment charges are part of their overall strategy and asset liability management, while the consumer tends to look at them as barriers to ease of exit. It is also to be borne in mind that related issues involved could attract other statutes also and may be spread over the domains of various agencies/entities like the Reserve Bank of India (RBI), Banks Ombudsman, Consumer fora under the Consumer Protection Act, 1986 etc.

15.2 The information apparently arises from a consumer perception that once an agreement is reached on a home loan with a bank, it uses its dominant position to levy a pre-payment charge if the borrower wants to prepay, even though new customers may be charged a lower interest rate by other banks or even by the same

bank. The issue has got exacerbated due to a continuing falling interest regime for several years till recently.

15.3 The banks perceive the issue more as a business issue in which they have to look after the interest of all the stake holders, including the depositors, and not only of the home loan borrowers. At any point of time, therefore, their interest regime, and consequential contractual obligations for loans advanced at that time, relate to their own internal financial calculations for asset liability match etc., over a medium/long term time horizon. Any transaction which deviates from the scheme of things, on the basis of which contractual loan agreements have been arrived at, is perceived as a cost by them and, therefore, they consider it a legitimate business requirement to recover in full or part such transaction fee for that particular transaction; transaction in the present instance being prepayment.

15.4 The Reserve Bank of India has given discretion to banks to take their own decision in regard to prepayment charges on home loans. This discretion has been exercised by different banks to come to different terms and conditions. This has resulted in significant variations in the various terms for prepayment of home loans and the

prepayment charges also vary. Ministry of Finance, Government of India has also issued certain directions on the subject on May 4/5/2010.

15.5 We have noted that prepayment charges are part of the overall agreement between a bank and a borrower, and are linked to the interest charged for the home-loans. This interest is itself part of the overall interest regime in the country, which in turn is one of the elements of the monetary policy laid down by the RBI, some of the other elements having been mentioned earlier in the order. It would, therefore, be useful to quickly review the macro-economic implications of interest rates before we move to actual identification and determination of key issues.

15.6 It is theorized that monetary policy can establish ranges for inflation, unemployment and economic growth, and a stable financial environment is created in which savings and investment can occur, allowing for growth of the economy as a whole. Interest rates play a crucial role in the macro management of an economy. Interest rates are a vital tool of monetary policy and are taken into account when dealing with variables like investment, inflation and unemployment.

For example, interest rates are the main determinant of investment on a macro-economic scale. Broadly speaking, if interest rates increase across the board, then investment decreases, causing a fall in national income. A central bank (RBI in India), can lend money to financial institutions to influence their interest rates as the main tool of monetary policy. Usually central bank interest rates are lower than commercial interest rates since banks borrow money from the central bank then lend the money at a higher rate to generate most of their profit. By altering interest rates, the central bank is able to affect the interest rates faced by everyone who wants to borrow money for economic investment. Investment can change rapidly in response to changes in interest rates and the total output. By setting interest rates the central bank can also affect the markets to alter the total of loans, bonds and shares issued. Generally speaking, a higher real interest rate reduces the broad money supply. And a reduction in money supply reduces inflation.

15.7 Monetary policy actions are transmitted to the rest of the economy and as specified by RBI in its report on currency and finance – 2008-09 through changes in financial prices (e.g., interest

rates, exchange rates, yields, asset prices, and equity prices) and financial quantities (money supply, credit aggregates, supply of government bonds, foreign denominated assets). The RBI also points out that in recent years, financial price channels have attracted greater attention, partly reflecting concerns about stability of money demand functions. With the short-term interest rates emerging as the predominant instrument of monetary signals worldwide, the interest rate channel is the key channel of transmission.

15.8 Let us now move on to the macro-economic importance of home-loans and the treatment given to these loans by RBI, within the overall interest rate regime. Home-loans channelize savings into real assets directly, fueling growth in other sectors through forward and backward linkages and thus ensuring growth in employment. It helps other sectors like steel, cement, brick, etc. to grow. People engaged in construction work largely belong to the lower pyramid of the economy. Hence, it provides employment to a larger section of the society, thereby contributing to achievement of the goal of inclusive growth and employment generation.

As per the priority sector lending circular by RBI, home loans to weaker sections of society are considered as priority sector lending and hence eligible for banks to charge lower interest rates on home loans. The circular further categorized housing loans as loans granted for construction, additions, alterations, repairs etc. as follows:

I. Direct housing loans to individuals by banks upto Rs. 10 lakh for construction of houses in urban and metropolitan areas will be eligible for inclusion under priority sector. Further, banks with the approval of their Boards may also extend direct housing loans upto Rs. 10 lakh in the rural and semi urban areas and cost be considered as part of priority sector advances.

II. Loans granted by banks upto Rs.1 lakh in rural and semi urban areas and Rs.2 lakh in urban areas for repairs, additions and alterations etc. to individual borrowers, would be reckoned as priority sector advances.

III. Assistance granted to any governmental agency for the purpose of construction of houses exclusively for the benefit of SC/STs, where the loan component does not exceed Rs.5.00

lakh per unit and all advances for slum clearance and rehabilitation of slum dwellers would be classified as priority sector advances as well as weaker section advances.

IV. Besides the governmental agencies, assistance given to non-governmental agencies approved by National Housing Bank (NHB) for the purpose of refinance will also be eligible for all the categories of borrowers as applicable to governmental agencies as priority sector advances.

V. All investments in bonds issued by NHB/Housing and Urban Development Corporation Limited (HUDCO) exclusively for financing of housing, irrespective of the loan size, per dwelling unit, will be reckoned for inclusion under priority sector advances.

15.9 Home loans even otherwise, are considered an important area of the loan portfolio of banks largely spurred by the pressure on housing. Financial Institutions specifically for housing finance such as HDFC were set up in this context. Involvement of banks and non-banking financial institutions in home loans is reflected in the large number of players and in competitive interest rates.

15.10 It is in the above backdrop that the decisions to establish the National Housing Bank (NHB) was announced in the Union Budget for 1987-88, which was then set up on July 9, 1988 under the National Housing Bank Act, 1987. NHB is wholly owned by RBI, and extends refinance to different primary lenders. The following table indicates the trend of refinance released during the last few years:-

Trend of Refinance released during last few years

Year	Disb. (Rs. Crore)
1998-99	758
1999-00	842
2000-01	1008
2001-02	1025
2002-03	2710
2003-04	3253
2004-05	8062
2005-06	5632
2006-07	5500
2007-08	8587
2008-09	10854

Source: NBH

15.11 The concept of, and issues relating to, pre-payment charges need to be appreciated and evaluated in the above context. We have also noted that NHB, which is also the regulator for Housing Finance Companies (HFCs), itself charges PPC of 1% as a refinancer of the retail home loans of the HFCs scheduled banks and other financial institutions. Even Government of India charges prepayment levies from PSUs and State Governments for making payment earlier than scheduled. It can also be argued that PPC is nothing but the premium for call options, and if this is not justified, could this logic be further extended to question the validity of the premium on call and put options in financial sector in general? We have also noted that prepayment charges are levied by banks for other loans also, like personal loan, car loan etc.

15.12 In the light of the above brief review, we feel that we need to be very careful in understanding the issues involved holistically, and then go on to selecting only those issues for our determination which fall within the four walls of the provisions of the Competition Act, 2002. We note that Section 62 clearly provides that the provisions of the Act are in addition to, and not in derogation of, the provision of other

statutes, and are conscious of the fact that there could be grey areas of overlap or apparent conflict between provisions of this Act and other statutes, and the domains assigned to different regulators/entities. We, therefore, need to adopt an approach of harmonious construction of the relevant provisions of the statutes and deal with issues before us in a manner which helps to bring greater clarity and consensus in the respective roles of CCI and other existing regulators/entities and not raise avoidable turf issues.

15.13 We have carefully considered, in the above background, the essential issues raised by the informant in the instant case, the submissions made by the opposite Parties before the DG and the fact unearthed by the DG in his report dated 16.12.2009 as also the replies filed by the parties in response to the notice of this Commission dated 05.01.2010. A copy of DG's report was also furnished to the informant who didn't respond. The following issues arise for consideration and determination in the case:-

1. Whether and what kind of pre-payment charges are being levied by banks/HFCs in regard to home loans?

2. Whether there is any agreement to impose prepayment charges among the opposite parties who are, in effect, supplying the service of home loans?

3. Whether there is any agreement of the nature mentioned under sub section (3) of section 3 or existence of any effect of the nature mentioned under clauses (a) to (d) to sub section (3) of section 3 of the act or some “appreciable adverse effect on competition” in India in the context of sub section (3) of section 19 due to imposing of pre payment charges by some banks?

4. Is there any evidence of dominance or its abuse in terms of Section 4 of the Act by any of the banks / HFCs investigated by the DG?

5. Does the fact that a borrower has to bear a cost for switching to another bank, or exiting altogether by paying balance amount due, by itself can be said to limit the competition in home loan market as it can be said to limit his/her choice in terms of changing the service provider or to exit altogether?

FINDINGS:

16. ISSUE NO.1: Whether and what kind of pre-payment charges are being levied by banks/HFCs in regard to home loans?

16.1 It is an admitted fact that the banks / HFCs investigated impose prepayment charges. This is also a finding by the DG, which has not been refuted by the Opposite Parties. The Commission therefore finds that at least the banks / HFCs questioned in the instant case do impose prepayment charges.

16.2 However, whether or not all banks/HFCs engaged in the business of offering retail home loans impose this charge is not brought out by the investigations by the DG. The Commission also notes that Axis Bank is at least one exception in this regard as it does not levy prepayment charges. The Commission further notes that the terms relating to prepayment charges vary from bank to bank, including in regard to the quantum of such charges and the conditions of their applicability as is apparent from the following table furnished by DG in his report:-

Sl.No.	Name of Banks	Prepayment penalty charged by the Bank
1.	Indian Overseas Bank	1% on the prepaid amount in case of term loan and other loans where the repayment of the loan exceeds one year.
2.	Punjab National Bank	2% on the amount outstanding at the time of prepayment
3.	Corporation Bank	1%-2% in the event of takeover of the loan by other Bank/FIs on the amount prepaid.
4.	ICICI Bank Ltd.	2% in the event of repay of entire outstanding dues.
5.	Allahabad Bank	In case of term loan upto Rs.10.00 lacs, if liquidated out of own sources/own generation – Nil. In case of availing loan from some other Banks/Institutions – 2% of outstanding loan plus tax. In case of term loan above Rs.10.00 lacs – 2% of outstanding loan plus tax.
6.	Vijaya Bank	1% to 2% in the event of takeover of the loan by other Banks/FIs on the amount prepaid.
7.	Oriental Bank of Commerce	In case of term loan - 1% on the amount outstanding and 2% in case of housing loan on the outstanding balance.
8.	Canara Bank	2% in the event of transfer of the loan to the other Bank/FIs on the outstanding amount.
9.	Punjab & Sind Bank	0.5% to 2% on the amount outstanding. In case of commercial loans – no charges, if the loan has run for at least 360 days.
10.	State Bank of Hyderabad	2% on the amount prepaid in the event of transfer of the loan to the other Banks/FIs.
11.	State Bank of India	2% penalty on the amount prepaid in excess of normal EMI dues should be levied in case of preclosure of home loans within 3 years from the date of commencement of repayment.
12.	LIC Housing Finance Ltd.	1% to 2% on the amount outstanding (levy of 1% of the amount prepaid as repayment charges if such prepayment is made within a period of 5 years from the date of first disbursement and the amount of loan sanctioned is over Rs.50,000.00.
13.	Deutsche Post Bank	Loan against Residential Property (LARP)/Top up/Easy

		Plus Loans Full prepayment – 3% on the outstanding principal plus taxes. Full prepayment within 6 months of the loan disbursement – 5% on the outstanding principal plus taxes. Part prepayment – 3% plus taxes on the amount repaid.
14.	HDFC Bank	For Auto Loan/Two Wheeler Loan – Foreclosure Fees ranging from 3% to 6%. For Personal/Business/Self Employed Professional Loans- Foreclosure fees of 4%. Waiver of charges, if any may be done by the relevant authority as per a Deviation grid designed for the purpose.
15.	HDFC Ltd.	<u>Adjustable Rate Home Loan (ARHL)</u> If a prepayment is made within 3 years of the first disbursement under Adjustable Rate Home Loan (ARHL) option early redemption charges of 2% of the amount being prepaid is payable if the amount being prepaid is more than 25% of the opening balance. <u>Fixed Rate Home Loan (FRHL)</u> Redemption charges of 2% of the amount being prepaid is payable.
16.	Indian Bank	For Term Loans at 2.25% and 2% for Home Loans (inclusive of Service Tax) of outstanding balance/Drawing limit whichever is higher.
17.	Axis Bank	No prepayment penalty.

16.3 As such, no uniform practice can be said to have been adopted by Banks/HFCs in regard to levy of prepayment charges.

17 ISSUE NO. 2: Whether there is any agreement to impose prepayment charges among the opposite parties who are, in effect, supplying the service of home loans?

17.1 The underpinning economic philosophy of Section 3 given in the Preamble to the Act (herein referred to as the Act) is "to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets". The term competition is not defined under the Act so we must rely on accepted linguistic definition of the word in the context of markets or business. Merriam-Webster dictionary defines competition in business as "the effort of two or more parties acting independently to secure the business of a third party by offering the most favorable terms."

17.2 Section 2 (b) of the Act defines "agreement" as follows:

"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;"

17.3 Section 3 (1) of the Act states, "No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India."

17.4 Section 3 (2) of the Act stipulates, "Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void."

17.5 To apply the provisions of Section 3 of the Act, it is imperative to understand the concept of market and appreciate the economic principles of competition. The basic requirement of any market is the existence of the forces of supply and demand. A good or service is supplied or demanded only because it has some utility. Elements or activities that go into creation of utility combine to form forces of supply while those that ultimately consume that utility represent forces of demand. The end consumer of any good or service is one who eventually consumes the utility of that

product. Entities that produce, distribute, store or control goods or services are entities that constitute suppliers. Entities who consume are consumers. The words "production", "supply", "distribution", "storage", "acquisition" or "control of goods or provision of services" all describe activities relatable to the supply side of any market. "Agreement" mentioned in Section 3 refers to any agreement entered into by parties in respect of activities as mentioned above. These activities being quintessentially on the supply side of a market, do not include "agreement" between a producer/service provider on the one hand and the end consumer on the other because no consumer can be said to be involved in activities such as production, distribution or control of any goods or services.

17.6 In the instant case, the service in question is the service of retail home loans. This service is provided by banks and non-banking housing finance companies. It is consumed by the individual borrower. Very clearly therefore, we have to put under our scrutiny any agreement that may have transpired between the suppliers or providers of the service in question for the purpose of section 3 of the Act.

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17.7 For an agreement to exist there has to be an act in the nature of an arrangement, understanding or action in concert

including existence of an identifiable practice or decision taken by an association of enterprises or persons. In this case, the allegation by the informant is that the act of charging prepayment interest/penalty is such an act. Furthermore, for an agreement, it is essential to have more than one party. According to the informant's allegation, 4 of the Opposite Parties are such parties entering into the alleged anti competitive agreement. The DG has further expanded the scope of allegation to include 12 more banks.

17.8 An agreement is a conscious and congruous act that has to be associated to a point in time. According to the report of the DG, the reference point for the alleged agreement is a meeting of the Indian Banking Association held on 28.07.2003 which resulted in a communication dt. 10.09.2003 from IBA to its members. In this context, the DG has observed,

> "*The advent of prepayment penalty/charges in India on mass scale is traced to the meetings of banks on 28.07.2003 and 28.08.2003 convened by the IBA with regard to prepayment charges. However, it is noted for LIC Housing Finance that prepayment penalty is mentioned in their loan agreement since 1995. It was deliberated in the*

meeting of IBA by member banks to have a common approach in fixing prepayment charges on loan. Accordingly, a circular dated 10.09.2003 was issued which specifically spelt out levying of 0.5%-1% prepayment charges as reasonable and the decision in this regard was left to banks to decide. It is noted that for banks augmenting fee based income through prepayment charges was seen as significant consideration in competitive market with pressure on interest spreads. It is noted from the meeting of IBA that the group of banks have come together and taken a collective decision to limit market competition and to generate fee based income."

17.9 Various banks in their replies filed before the DG and later before this Commission have contested the above observation. For instance, HDFC Ltd. in its letter dt. 07.06.2010 stated that it is not a member of IBA at present nor has it been a member for at least the past two decades. Moreover, it did not attend the alleged meeting of IBA and had never received the alleged IBA circular dated 10.09.2003. **LIC HOUSING FINANCE LIMITED** in its letter dt. 29.01.2010 said that it had been charging prepayment charges since 1995. Similarly, more than one bank has

informed that Axis Bank does not charge any prepayment charges/penalty even today. This Commission has not found any material on record in the report of the DG that would negate the averments made by these banks on this issue. In our opinion, from the facts made available to us through the report of the DG it is not possible to pinpoint any specific point in time as the reference point of the alleged agreement. It is useful to examine the content of the aforementioned IBA circular, as reproduced below:

> "*With a view to bring about discipline in availment of bank finance to borrowers and to encourage better management of funds, Reserve Bank of India had introduced in 1990 the practice of levying commitment charges on unutilized portion of the working capital limits. Commitment charges were levied at the rate of one percent per annum on the unavailed portion of operating limits. Following withdrawal of mandatory guidelines on credit monitoring by Reserve Bank of India, levy of commitment charges is no longer considered a regulatory prescription.*
>
> *Reintroduction of levy of commitment charges and adoption of a common approach by banks in this regard came up for discussion in the Managing Committee of the Association in its last meeting. The issue had come up in the context of the practice followed by some of the corporate borrowers who got line of working capital limit approved from banks*

but met funding requirements through market instruments like CPs, bonds etc. with a fallback option on committed line from banks without any commitment charges.

During discussions some of the members pointed out the international practice was in favour of levying commitment charges. It was pointed out that under proposed Basel-II norms for fixing economic capital, banks would be required to allocate capital in respect of committed lines of credit though not actually disbursed. The need for a common approach in fixing prepayment charges on loans was also stressed by some of the members. On the whole, members were of the view that levy of commitment charges and prepayment charges would help not only in terms of asset – liability management, but also in augmenting fee-based income of the banks. The later was seen as significant consideration in today's competitive market with pressures on interest spread. While members felt that charges in the range of 0.5% to 1% would be reasonable, the view was that a decision in this regard should be left to the banks to decide.

After detailed discussions, the Committee, while, fully appreciating the market dynamics, decided to inform members the above views expressed by the Management Committee so that they could take a decision on levy of commitment charges and prepayment charges."

It is apparent from a plain reading of the contents reproduced above that the meeting of the IBA was actually to discuss the growing practices of corporate borrowers who would avail of committed lines of credit by banks for working capital but would first look at other market options such as CPs, bonds etc. for funding and use line of credit only as a fallback. This put adverse pressure on asset-liability management by banks. It was only in the context of those discussions that some banks raised the issue of prepayment on housing loans also. The discussion on the subject was consequential and not initial. Even then, it merely resulted in a clear decision that it "*should be left to the banks to decide."* The lack of imperative voice and intent is evident from the language and content of the said circular of IBA. It would be patently unjust to use it as an evidence of either action in concert or process of combined decision making by banks. This rules out any element of contravention of sub section (1) of section 3.

17.10 The word "agreement" for the purposes of the Act has wide connotations as defined under Section 2 (b). However, it is imperative that existence of such an "agreement" is

unequivocally established. The European Court of Justice has clearly laid down this principle with respect to infringements of Article 81 (1) of the EC Treaty in Cases-204, 205, 211, 213, 217 and 219/00 P, and cases 29 & 30/83, Compagnie Royale Asturienne des Mones SA and Rheinzink GmbH v. Commission wherein that Commission has said that precise and coherent proof must be produced by the party or authority alleging infringement. In this case, the existence of any "agreement" cannot be conjectured or even circumstantially adduced. Mere fact that the IBA issued a circular dated 10.09.2003 mentioning concern of some member banks cannot in itself be said to form a basis for or evidence of an agreement between banks. The DG's report has not produced any precise or coherent proof of any agreement of the nature covered in Section 3.

17.11 The report of the DG observes categorically that there is infringement of section 3(3)(b) of the Act. It states,

> "*The allegation that the banks are imposing prepayment penalty/charges is found to be true. Further, with regard to allegation for violation of Section 3(3)(a)&(b) made by the information provider violation of Section 3(3)(b) of the Act is found to be true.*"

17.12 For the violation of Section 3(3)(b), it must be established that there exists an agreement, practice carried on or, decision taken by an any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provisions of services, which result in effects mentioned in clauses (a) to (d) of sub-section (3) of section 3 of the Act. These include acts that limit or control production, supply, markets, technical development, investment or provision of service**s.** The word association has not been defined under the Act or the Companies Act, 1956. Resorting once again to the accepted linguistic meaning of the word, as per concise Oxford Dictionary an association means “a group of people organized for joint purpose”. In the instant case, the Indian Banking Association (IBA) can be said to be an association of banks but there is no evidence on record which leads us to conclude that IBA has adopted the practice or taken a decision in the matter. The practice of charging prepayment penalty cannot be said to be a concerted decision of all the Banks/HFCs as all of them have not started charging prepayment penalty at one point of time. HDFC and LICHF are charging prepayment penalty since 1993 and 1995 respectively. The other Banks/HFCs started charging prepayment penalty after many years. It is noted that all HFCs are not members of IBA, which is an association of banks. Even out of the 150 plus member banks of IBA, the investigation covered only 12. There is no evidence on record

which suggests that above mentioned Banks/HFCs have formed any internal and discrete association for the purpose of charging prepayment penalty. In the present case as mentioned earlier the above mentioned Banks/HFCs are not charging the same rate of prepayment penalty. Thus congruence of action, which is an integral part of any agreement does not get established by the investigation of the DG.

17.13 In view of the foregoing discussion, the Commission has come to the conclusion that there is no agreement among the banks and HFCs investigated by the DG, for levy of prepayment charges that can be termed as action in concert. Whereas it has been found that some banks / HFCs are imposing prepayment charges there is no evidence to establish that this practice is a result of some action in concert or emerges from a collusive decision. Rather, it is a manifestation of individual, though similar business decisions. Therefore the point no. 2 is decided accordingly.

18 POINT NO. 3: Whether there is any agreement of the nature mentioned under sub section (3) of section 3 or existence of any effect of the nature mentioned under clauses (a) to (d) to sub section (3) of section 3 of the act or some “appreciable adverse effect on competition” in India in the context of sub section (3) of section 19 due to imposing of pre payment charges by some banks?

18.1 As seen above, the fact that some banks / HFCs are imposing prepayment charges is not disputed. It is also seen that this practice by those banks / HFCs is not a result of any agreement. Without prejudice to these findings, we would now examine whether this practice causes effects of the nature mentioned under clauses (a) to (d) of sub section (3) of section 3 of the Act or causes any "appreciable adverse effect on competition" in India in the context of sub Section (1) of Section 3 read with sub section (3) of section 19 .

18.2 Some banks, such as **Punjab National Bank and State Bank of Hyderabad** have argued that for the purpose of invoking Section 3(3) of the Act the practice of charging prepayment penalty should *ex facie* result in or shall have the probability of resulting in any or all the economic consequences enumerated under Section 3(3) (a) to (d).

18.3 Many of the banks including **ICICI Bank Ltd** and **ALLAHABAD BANK** have drawn attention of this Commission to CRISIL research report of March 2009 wherein it is observed that the home loan market had registered a growth of 43% from 2000-01 to 2004-05, that is during and after the period of the IBA circular. Similarly, banks such as **Canara Bank** and **Corporation Bank** amongst others have pointed out that in the last decade, there have been a number of banks and HFCs who have joined the home loan business. **Punjab & Sind Bank** has also stated that there are large numbers of service providers, namely Housing

Finance Companies (HFCs) (43), Public Sector Banks(27), Urban Cooperative Banks (53) that are operating the market of home loans.

18.4 There is no material evidence available to disagree with findings of a neutral and reputed research organization, nor has the report of the DG given any facts contrary to the contention of the banks regarding the state of competition in home loan sector or the appreciable growth seen in the last decade. This leads to the conclusion that there is no reason to believe that the practice of charging prepayment charges/penalties has resulted in limiting provision of home loans in the Indian market.

18.5 Looking at the history and growth of the Indian Banks' Association (IBA) we find that it was formed on the 26th September 1946 with 22 members. As on 31st May 2010 IBA has 159 members

Ordinary	117
Associate	42
Total	159

The members comprise

- Public Sector Banks
- Private Sector Banks
- Foreign Banks having offices in India and
- Urban Co-operative Banks.

18.6 In itself these figures represent a very healthy state of growth in the banking sector that shows no indication of any limiting of services provided by them, including that of home loans. Furthermore, the Commission has also studied a report by ICRA available at www.icra.in, which observes that since 2004 the total outstanding of all the banks/HFCs in the housing market has increased from Rs 12,480 Crores (124.80 billion) in 2004 to Rs 38,060 crores (380.6 billion) in 2009 with a CAGR of 24.9% from the financial year 2003-2004 to 2008-2009. From this, it is evident that though prepayment charges have been levied by banks/HFCs, it caused no negative impact in the growth of the home loan business.

18.7 Delving deeper into the intent and purpose of section 3 of the Act, we must now examine whether there is any appreciable adverse effect on competition of the alleged agreement within the framework outlined in section 19 (3). For applicability of Section 19(3)(a), (b) & (c), there should be an agreement of the nature defined under Section 2(b) of the Act, which creates barriers to new entrants in the market or forecloses competition by hindering entry into the market. As discussed

above, there is no material evidence to suggest such an effect. In any market, any firm is free to leave the market. In fact, competitors would welcome it. The barrier to entry for competing firms must not be confused with difficulties in exit, if any, faced by the consumers. Therefore, any aspect of any inconvenience or difficulty faced by consumers must be examined in the context of clause (d) of sub-section (3) of section 19.

18.8 Clause (d) of sub-section (3) of section 19 makes accrual of benefits to the customers as one of the determinant factors for assessing appreciable adverse effect. If a consumer finds it difficult to shift from one bank to another due to prepayment charges, that difficulty must be examined under this clause. Also, it must be kept in mind that such a movement would only occur when interest rates are falling and other banks are able to offer lower rates to new customers. A customer would like to switch banks only if the interest rates fall enough to outweigh the burden of prepayment charges. It must also be kept in mind that for a fresh loan, a bank is able to raise funds at a lower cost. An older loan would be backed by a higher costing fund on part of the bank. Accrual of benefit to the consumer should not translate to accrual of loss for the bank since eventually it would only drive out banks from the market of home loans or make them drastically reduce the amount of home loans exposure or significantly raise the bar

for home loan eligibility. Eventually, it would result in making borrowings for home loans more difficult for consumers. It may also be pertinent to point out that banks do mention a prepayment clause in their agreements, albeit not prominently.

18.9 The DG in his report has given the finding that the practice of charging prepayment penalty does not result in any benefit to consumers and thus factor enumerated in Section 19(3) (d) is present in the practice of charging prepayment charges/penalty.

18.9 In response, several banks have raised the issue of Asset Liability Management to give justification for the practice. **DEUTSCHE POSTBANK HOME FINANCE LIMITED, LIC HOUSING FINANCE LIMITED and ICICI Bank Ltd** amongst others have given detailed reasoning for these charges. These arguments include reasons that may be summarized as below:

- *This is done in order to prevent volatility and to meet the increase in capture cost.*
- *It is not penal in nature but is aimed to regulate cost of funds and is within fair practice guidelines of RBI.*

- The issue of Asset Liability Mis-matches are genuine commercial realities and the fundamental issue which banks and financial institutions face and therefore necessitate banks to stipulate prepayment charges in order to adequately address such mis-matches.

- The applicable prepayment charges and related terms and conditions are informed clearly to the borrowers upfront as required regulatory and as a good commercial and consumer friendly practice.

- The practice of prepayment penalty enhances certainty of cash flow and serves as incentive for investors in securitization instruments. Therefore, as a natural corollary, the said incentive translates into lower rates on the securitized instruments, which in turn results in low cost loanable funds for the banks and financial institutions. The said low cost loanbale funds reduce the interest rates and costs to the home loan borrowers in the relevant market. Thus, the practice of charging prepayment penalty enhances consumer welfare rather than affecting them adversely.

18.10 All the above arguments appear to have reasonable basis in terms of asset-liability management. A bank does not have any independent funds of its own other than those given to it by its depositors or funds that it borrows from other financial institutions. Moreover, for a bank there are two broad sets of

consumers: depositors and borrowers. Banks must conduct their affairs to balance the accrual of benefits to both these sets of consumers. This Commission also cannot ignore the factors that may purport to bring benefits to depositors. The DG report has not given any specific findings to counter the efficiency claims or financial justifications submitted by banks. Once the financial justification for charging prepayment charges/penalty is accepted, the question of extent or quantum does not remain an issue pertinent to the state of competition in India.

18.11 The report of the DG itself observes that the imposition of prepayment charges National Housing Bank (NHB) is a business decision and economically reasonable, therefore, not anti-competitive. In our opinion if the explanation of NHB is acceptable as being the business decision then the same principle and explanation is equally applicable to the retail finance by banks. We see no reason to differentiate between the business sense of NHB and other banks in the retail sector.

18.12 The Commission also notes that the borrowers have a lot of choice about the bank from which they would take the home loan, with terms and condition of each are known to them and included in their agreement/contract for taking the loan. Subsequent decisions/choice to opt out of this

agreement/contract, and any consequent pre payment charges, need to be viewed in the context of the implications dealt upon in the previous paragraphs.

18.13 The Commission also notes the investigative finding of the report of the DG that concludes that after having tested the practice of charging prepayment penalty on the anvil of 'rule of reason' it found that the practice has reasonable economic justification and hence the practice is not violative of Section 3(1) of the Act.

19 POINT NO. 4: Is there any evidence of dominance or its abuse in terms of Section 4 of the Act by any of the banks / HFCs investigated by the DG?

19.1 The DG's report has also rejected the allegation of market dominance and abuse thereof by the banks and financial institutions and found that banks and financial institutions and IBA have not violated Sections 4(1), (2)(a)(b) of the Act.

19.2 In respect of the observations relating to applicability of section 4 and in view of para 1.7 supra, we observe that none of the Banks/HFCs investigated can be said to be capable of "operating independently of competitive forces" and/or "affecting its competitors or consumers or the relevant market in its favour" by the sheer fact that no bank/HFC has more than 17% market share. Market share of the enterprise is one of the most decisive aspects for determining dominant

position. In the instant case, market concentration is fairly dilute. Applying the factors or determinants given in sub section (4) of section 19 of the Act, we find there are no facts that point toward dominant position of any of the banks / HFCs investigated. Size and resources of SBI, ICICI, HDFC, Citibank, etc. are quite comparable as also their economic power. There is no vertical integration of banks. There is also no obvious entry barrier for newer banks / HFCs to enter the home loan market.

19.3 Therefore, the Commission agrees with the Director General that none of the banks or HFCs investigated individually have any dominant position in the market of retail home loans. Hence provisions of section 4 of the Act are not attracted to the facts of the present case.

19.4 In our opinion, nothing in section 19 can survive in face of a categorical finding of investigation that there is no violation of sections 3(1) or 4(1) of the Act.

20. ISSUE NO. 5: Does the fact that a borrower has to bear a cost for switching to another bank, or exiting altogether by paying balance amount due, by itself can be said to limit the competition in home loan market as it can be said to limit his/her choice in terms of changing the service provider or to exit altogether?

20.1 For understanding and determining this issue, the entire process of availing home loan by a borrower, and his/her subsequent decisions/choice to prepay the entire amount may be divided into two parts, namely (a) Choice in the original selection of the bank/HFC for availing of the loan and entering into a contractual agreement with it, and (b) Choice in the decision to exit.

20.2 As far as the (a) is concerned, it has been established beyond any doubt that the home loan market is a vibrant, growing, competitive market. The borrower has a wide choice of banks/HFCs, as also in the variety of products available to him. Price is only one of the elements of the totality of factors he/she would consider while exercising a free competitive choice in this market. This is obvious from the very fact that though Axis Bank does not levy PPC, it is not amongst the more significant and bigger lenders of home loans. There could be several non-price competitive factors in selecting bank/HFC, as mentioned in the earlier part of this order.

20.3 Once the borrower has made the choice fully, he/she enters into a contractual agreement with the selected bank/HFC. Provisions in regard to PPC, if any, are part of this agreement. This agreement so entered into is entirely voluntary, with full knowledge of all the provisions, and cannot be in any way confused with an agreement entered into without choice due to abuse of dominance by a provider of goods/services attracting the provisions of Section 4 of the Act.

20.4 Coming to the decision to exit mentioned in para (b) above, the borrower is free to exit subject to paying the PPC. Thus the exit is not prohibited, and only has a cost attached to it. The reasons and justification given for this cost have been covered earlier, including being on account of cost incurred due to loss of interest, holding cost of money till it is redeployed, possibility of fresh deployment being at a lower interest rate (since switching typically is resorted to by borrowers in a falling interest rate regime) etc. This part of the transaction has, therefore, to be seen

in terms of the Indian Contract Act, 1872, since the costs/prices to be charged in a competitive market are determined by the market and is not an issue to be determined by a competition regulator. This would become a competition issue only if this is sought to be manipulated through anti-competitive agreement(s) or abuse of dominance. It is, therefore, necessary to take up a harmonious construction of Competition Act, 2002 and Indian Contract Act, 1872.

20.5 Section 62 of Competition Act, 2002 reads as follows:-

"The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force."

20.6 In the Indian Contract Act, 1872 Sections 73 and 74 are relevant in this context, extracts from which read as follows:-

Section 73: Compensation for Loss or Damage caused by breach of Contract.

"When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it."

Section 74: Compensation for breach of contract where penalty stipulated for:-

"When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining fo the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for."

20.7 It is, therefore, clear that in regard to this issue the provisions of the Contract Act are attracted which clearly provide that in case of breach of a contract, the party which wants to exit has to pay for consequential loss/damage to the other party. Indeed, if this were not the case, wherever in any competitive market the price of a product comes down all the long-term contract buyers would like to break the contract, and if the product prices went up all the suppliers/sellers would like to exit. This kind of situation could create huge uncertainties in any product market, with inevitable negative macro-economic impact.

20.8 In the present instance, based on the data and analysis in earlier part of the order, it is clear that PPCs cannot be seen to be anti-competitive in terms of Issue No. 5. The question as to whether the quantum of PPC charged, with wide variations between different banks/HFCs, is fair or not would be determined by the market or by other appropriate fora.

20.9 As regards the citations of judicial pronouncements relied upon by the DG, it is felt that the facts of the case in TT Ltd. Vs Industrial Finance Corporation India Ltd. (Hon'ble High Court of Delhi) , Hotel Vrinda Prakash *Vs.* Karnatka State Financial Corporation, (Hon'ble Karnataka High Court) and State Bank of India *Vs*. Dr. (Mrs.) Usha Vaid (Hon'ble Supreme Court of India) do not support any findings of the DG.

20.10 In the above said first two cases the respective Hon'ble High Courts of Karnataka and Delhi have given judgment in favour of levying prepayment penalty by the financial institutions. Whereas, on perusal of Hon'ble Supreme Court order dated 19.09.2008 in the said case it is found that the Hon'ble Court has left the question of law open to be decided in an appropriate case and have dismissed the particular Special Leave Petition (SLP) finding no ground to interfere in the matter. Therefore, it cannot be held that the Hon'ble Supreme Court is not in the favor charging of prepayment penalty.

21. **Decision**

21.1 This is a multi-dimensional case involving macro-economic as well as consumer issues. We have, therefore, identified and determined the issues in this case very carefully within the four walls and boundaries laid down by the Act. It is evident from our analysis and determination of these issues earlier in the order that there is a vibrant market in provision of home loans, with the number of service providers and the variety in products growing consistently and continuously over a period of years. There is no bank/HFC in the market which can be deemed to be dominant by any of the parameters used for determining dominance. The question of abuse of dominance, therefore, does not arise. It is equally clear that there is no agreement amongst the various service providers i.e. the banks/HFCs, nor is there any uniform practice being followed by them. They are operating as competitors in a vibrant competitive market. Neither the violation of Section 3 or Section 4 of the Act has been established, nor is there any evidence

whatsoever of an appreciable adverse effect on competition in the home loan market in India in this context.

21.2 In view of the discussion above, this Commission does not find any contravention of Section 3 or Section 4 of the Act. Accordingly, the proceedings are hereby closed.

21.3 Secretary is directed to inform the parties accordingly.

Member (G) Member (GG)

Member (AG) Member (T)