COMPETITION COMMISSION OF INDIA

2 December, 2010

Case No. 5 of 2009

Neeraj Malhotra **Informant**

v.

Deustche Post Bank Home Finance Ltd. & Ors. **Opposite Parties**

O R D E R

Per P N Parashar, Member (dissenting):

Shri Neeraj Malhotra, Advocate ('the Informant'), has filed the present information under section 19 of the Competition Act, 2002 ('the Act') to advocate and espouse the cause of the consumers who avail home loans and are required to pay pre-payment penalty ('PPP/ pre-payment charges') on foreclosure of such loans.

2. As the facts have been set out in detail in the majority order, I therefore do not wish to burden this order by reproducing the same again. However, I will refer to some significant aspects and facts which have a crucial bearing upon the issues dealt with in this order. Since the replies of the opposite parties to the findings of the DG have also been noted in detail in the majority order, I would therefore refrain from restating the same and a brief account thereof will be given at the appropriate stages.

Facts

3. The informant has filed the instant information alleging, *inter alia*, that the practice of levying PPP on the pre-payment of home loans by the following banks and Housing Finance Companies ('the HFCs') is in contravention of the provisions of sections 3 and 4 of the Act.

(i) Deutsche Post Bank Home Finance Limited,
(ii) Housing Development & Finance Corporation Limited,
(iii) HDFC Bank Limited and
(iv) LIC Housing Finance Limited.

4. The informant has further alleged that the acts/practices carried on and the decisions taken by the opposite parties are violative of provisions of the section 3(1), 3(3)(a) and 3(3)(b) read with section 4(1), 4(2)(a)(i) of the Act. The informant has prayed, *inter alia,* that after conducting an enquiry into the matter, the enterprises committing contravention of these provisions be penalized and be directed to discontinue with the decisions and practices adopted by them in this regard.

5. The gravamen of the information is that the opposite parties are banks and HFCs which are offering home loans to the general public and have, jointly and severally, agreed upon recovering foreclosure charges as PPP ranging from 1% to 4% on the loan amount. It has been alleged that the above mentioned PPP is being charged if the borrowers choose to close their loan accounts by pre-paying the loan amount. It is further alleged that the opposite parties have been charging PPP on the entire loan amount and not merely on the outstanding loan amount, which indirectly determines the sale price of the services. According to the informant, the same also limits the supply/provisions of services thereby causing an appreciable adverse effect on competition within India. As per the Informant, the opposite parties are also abusing their dominant position in the relevant market by imposing unfair and discriminatory conditions on the purchase of services thereby preventing their

borrowers from switching over to other banks / HFCs offering similar services at cheaper rates which is an anti-competitive practice.

6. The Commission, on examining the matter, took a view that there exists a *prima facie* case and passed an order dated 10.09.2009 under section 26 (1) of the Act whereby the Director General (DG) was directed to make an investigation into the matter.

7. The DG submitted his report dated 16.12.2009 to the Commission by concluding that the opposite parties along with the following banks have contravened the provisions of section 3(3)(b) of the Act.

(i) Allahabad Bank;
(ii) Canara Bank;
(iii) Corporation Bank;
(iv) ICICI Bank Ltd.;
(v) Indian Bank Ltd.;
(vi) Indian Overseas Bank;
(vii) Oriental Bank of Commerce;
(viii) Punjab & Sind Bank;
(ix) Punjab National Bank;
(x) State Bank of Hyderabad;
(xi) State Bank of India; and
(xii) Vijaya Bank

8. It is clarified that the informant had filed information against only four banks/enterprises but the DG added twelve more enterprises as opposite parties. Out of these sixteen opposite parties, HDFC Corporation Ltd. and HDFC bank Ltd have filed common replies. Hence, effectively there remained fifteen opposite parties. The Commission during the course of enquiry issued notice to IBA which has also filed a detailed reply as an opposite party. Therefore, if all such opposite

parties are counted there are a total of seventeen opposite parties in the present matter. All the above referred opposite parties were asked to file written objections/replies against the DG report. These parties have filed detailed written submissions before the Commission which are on record. They have also been heard at length. The Commission during the course of enquiry also sought clarifications from these parties on some points. It may be pointed out that a copy of the DG report was sent to the informant also and a notice was issued to him to file his submissions/comments etc., but he neither appeared on the date fixed for the hearing i.e. 15.11.2010, nor did he prefer to file any submissions before the Commission. The present matter is, therefore, being disposed of on the basis of the entire material available on record.

9. I have had the advantage of reading the draft erudite order prepared by my learned brethren. The majority is of the opinion that there exists no contravention of the Act as alleged by the Informant. I am in agreement with the majority opinion on their findings on non-contravention of the provisions of section 4 of the Act. However, with respect, I find myself not able to agree with the majority view on the remaining findings for the reasons to be stated in this order.

Consumer Interests and Competition Law

10. At the outset, I deem it necessary to discuss the co-relationship between the consumers' interests and the competition law.

11. The modern competition law usually seeks to protect the process of free market competition in order to ensure efficient allocation of economic resources. It is commonly believed that competition law is ultimately concerned with the protection of the interest of the consumers. Conversely, it may be said that consumers' detriment is generally presumed to be present when the competitive process is thwarted or damaged.

12. Consumer is considered to be King in a free market and the sellers are supposed to be guided by the will of a consumer in such markets. There is a constant need for harmonizing the protection of consumer rights with promoting free markets. In *Awaz* v. *Reserve Bank of India* and *DCM Financial Services Ltd.* v*. Mukesh Rajput,* 2008 Bus L R764 (NCDRC), the National Consumer Disputes Redressal Commission, while deciding the issue of interest on credit taken on the basis of credit cards, in its joint order disposing both cases observed:

> "… [E]*ven in any free economy/deregulated economy exploitation of the borrower/debtor is prohibited and is considered to be unfair trade practice. Free economy would not mean licence to exploit the borrowers/debtors by taking advantage of their basic needs for their livelihood. This cannot be permitted in any civilized society – maybe a de-regulated free market economy. "*

13. Hence, in the context of general consumer welfare the role of competition authorities while enforcing competition law is to be properly understood. This role of competition authorities has been highlighted by K. J. Cseres in his article 'The Controversies of the Consumer Welfare Standard' (Vol. 3 Issue 2 pp 121-173, March 2007) I consider it appropriate to quote the following extracts from the said article:

> *'Competition authorities all around the world are becoming more conscious of the impact that competition policy and law enforcement has on consumers. They seem to be ever more anxious to declare and demonstrate the significant role they play as enforcers of competition law in consumers' economic life. The European Commission is no exception. The European Commission emphasizes that anti-competitive practices raised the price of goods and services, reduce supply and hamper innovation, which in turn increase the input cost for European businesses and as a result, consumers end up paying more for less quality (European Commission, Annual Report, 2005, P 7)'.*
>
> ……. ……. …….
>
> *'In the footsteps of former EC Commissioner Mario Monti, Neelie Droes formulated the competition policy message of her cabinet as the following, 'Our aim is simple to protect competition in the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources.' (European Commissioner for competition speech at the European Consumer and Competition Day, London 15 September 2005). Director General of DG Competition, Philip Lowe emphasized that,*

'competition is not an end in itself, but an instrument designed to achieve a certain public interest objective, consumer welfare'.

……. ……. …….

"The European policy makers finally synchronize with other enforcement agencies around the world. In the United States antitrust enforcement has a much longer tradition. Besides the Antitrust Division of the Department of Justice, 'the FTC acts to ensure that markets operate efficiently to benefit consumers.' In the United Kingdom the Office of Fair Trading's Statement of purpose declares, "The OFT's goal is to make markets work well for consumers'. These and similar statements imply that competition policy works towards the improvement of consumer interests. Who are the consumers and which are the interests consumer welfare as the goal of competition policy refers to?"

14. It may also be noted that the Competition Act of Republic of South Africa provides for an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and is focused on development that will help its citizens. Further, it strives for markets in which consumers have access to, and can freely select the quality and variety of goods and services they desire. Similar objectives are to be found in the competition laws of other jurisdictions as well.

15. In India, the competition legislation has been enacted to provide, keeping in view the economic development of the country for the establishment of a commission to (a) prevent practices having adverse effect on competition; (b) to promote and sustain competition in market; (c) to protect the interests of consumers; and (d) to ensure freedom of trade carried on by other participants in markets, in India.

16. These objectives are further reflected in the various provisions of the Act and, in particular, under section 18 of the Act as per which the Commission is enjoined upon, *inter alia,* to protect the interests of consumers and ensure freedom of trade carried on by other participants in the markets. Further, from the provisions contained in section 19(3) of the Act, it is manifest that accrual of benefits to consumers is to be taken into consideration by the Commission while determining whether an agreement has an appreciable adverse effect on competition or not.

17. Recently, the Hon'ble Supreme Court of India in the case of *Competition Commission of India* v. *Steel Authority of India Ltd.,* Civil Appeal No.7779 of 2010 *vide* its decision dated 09.09.2010 observed as under:

> *'[T]he principle objects of the Act, in terms of its Preamble and Statement of Objects and Reasons, are to eliminate practices having adverse effects on the competition, to promote and sustain competition in the market, to protect the interest of the consumers and ensure freedom of trade carried on by the participants in the market, in view of the economic developments of the country. In other words, the Act requires not only protection of trade* ***but also protection of consumer interest****.'*

18. Thus it can be noticed that protection of consumers' interest has engaged the parliamentary attention while enacting the Competition Act and the same has also been reiterated by the Hon'ble Supreme Court. Therefore, the function of the Competition Commission of India is not only to supervise and sustain competition in the market but also to protect the interests of the consumers. The Commission has been vested with wide authority and discretion to deal with the information as can be noticed from the following observations of the Hon'ble Supreme Court in the *Steel Authority's* case *(supra)*:

> *'Under the scheme of the Act, this Commission is vested with inquisitorial, investigative, regulatory, adjudicatory and to a limited extent even advisory jurisdiction. Vast powers have been given to the Commission to deal with the complaints or information leading to invocation of the provisions of Sections 3 and 4 read with Section 19 of the Act.'*

19. I may also refer to the budget speech delivered by the Hon'ble Finance Minister for 2009-2010:

> *'The government has established competition commission of India, an autonomous regulatory body to promote and sustain competition and market, protect interests of consumers and to prevent practices having adverse effect on competition.…*
> *…. The benefits of competition should now come to more sectors and their users and consumers. Now is the time for us to work on these aspects to eliminate supply bottle necks, enhance productivity, reduce costs and improve quality of goods and services supplies to consumers.'*

20. Thus, the Commission has to exercise its powers keeping in view the legislative intent as reflected in the provisions of the Act and as explained by the Hon'ble Supreme Court.

21. Before adverting to the issues involved and the contentions urged, it would be useful to set out in brief the concept of practice of levying PPP by Banks/HFCs.

22. Pre-payment charges/ PPP is an amount which a bank or retail home loan institution charges a borrower when such borrower returns the money borrowed/advanced before the stipulated tenure of the loan. Resultantly, a customer may migrate to a lower-cost source of funds or return the loan before the due date only if he pays an additional sum as calculated by the banks. This, on the face of it, creates an exit load on borrowers.

23. In the setting of the above conceptual background and after going through the entire relevant material and on considering the written as well as oral submissions of the parties, I, now proceed to formulate the points which need to be determined for adjudicating this matter.

Points for Determination

24. In light of the foregoing, the following points arise for determination in the instant matter:

(i) Whether the present information is maintainable as the PPP is charged pursuant to the allegedly valid contract entered into by and between the parties?

(ii) Whether the provisions of section 3(1) of the Act are attracted in this case?

(iii) Whether the opposite parties have contravened the provisions of section 3(3)(a) of the Act? If so, its effect?

(iv) Whether the opposite parties have contravened the provisions of section 3(3)(b) of the Act? If so, its effect?

(v) What order(s), if any, may be passed under the Act?

Point No.(i)

Whether the present information is maintainable as the PPP is charged pursuant to the allegedly valid contract entered into by and between the parties?

25. Before I advert to the main issues, I may note that the argument of having knowledge about levy of PPP at the time of entering into the contract with the bank and the same being incorporated as one of the terms and conditions and hence the levy of PPP cannot be impugned, is misconceived. As noted above, section 3(1) of the Act prohibits any agreement with respect to 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. Further, section 3(2) of the Act provides that any agreement in contravention of this provision shall be void. Thus, a clause in the agreement charging a PPP being contrary to law can always be assailed by the aggrieved person and he cannot be estopped from attacking the same as it is well settled that there can be no estoppel against the law. Even otherwise, an interpretation to the contrary, would render the entire competition law redundant, otiose and nugatory.

26. It is pertinent to mention here the following observations of the Hon'ble Supreme Court in the case of *Central Bank of India* v. *Ravindra,* (2001) 107 Comp Case 416 (SC):

> *'… Banking is an organised institution and most of the banks press into service long-running documents wherein the borrowers fill in the blanks, at times without caring to read what has been provided therein, and bind themselves by the stipulations articulated by the best of legal brains. Borrowers other than those belonging to the corporate sector, find themselves having unwittingly fallen into a trap and rendered themselves liable and obliged to pay interest the quantum whereof may at the end*

prove to be ruinous.… Statements of accounts supplied by banks to borrowers many a time do not contain particulars or details of debit entries and when written in hand are worse than medical prescriptions putting to test the eyes and wits of the borrowers.'

27. In view of the above, I am unable to accept the contentions raised by some of the opposite parties on this point. It may be noted that today consumers enter into various types of standard forms of contracts which contain unilateral or one sided terms and conditions and consumers have no real choice in signing such contracts. Thus, if it were to be held that the consumers knowingly entered into such contracts and therefore, they are disabled from challenging the terms by invoking the provisions relating to anti-competitive agreements, then, such an interpretation would sound a death knell to the entire competition regulatory law.

28. The opposite parties have also contended that PPP is protected under the provisions of sections 73 and 74 of the Indian Contract Act, 1872, which enable the aggrieved party to claim damages to cover the losses suffered in the event of breach of contract. It is contended that the loan agreement has been duly signed by the customers and PPP being a part thereof, the customers cannot resile therefrom. From the scheme of the Act, it is apparent that once an agreement has been determined as causing or likely to cause an appreciable adverse effect on competition, such an agreement, being *void*, cannot be enforced by the parties in a court of law. It may also be pointed out that even the jurisdiction of civil courts is barred in relation to the issues covered within the jurisdiction of the Commission under the Act as per the provisions contained in section 61 of the Act.

29. Moreover, by virtue of the provisions contained in section 60 of the Act, the provisions of the Act have an overriding effect in the event of any inconsistency with any other law for the time being in force. Thus, the provisions contained in sections 3(1) and 3(2) of the Act have to be given full effect and if any agreement is found to be in contravention thereof, the same needs to be declared *void*. Moreover, it may also be noticed that the provisions of the Act are in addition to and not in derogation

of, the provisions of any other law for the time being in force by virtue of section 62 of the Act.

30. A combined reading of the provisions of sections 60, 61 and 62 of the Act, in the context of other provisions of the Act, particularly section 3(2) of the Act, therefore, will remove all doubts about the jurisdiction of the Commission in relation to anti-competitive agreements which have to be examined within the perspective of the Act.

31. In view of the above discussion, I am of the opinion that the plea raised by the opposite parties regarding lack of jurisdiction of the Commission to entertain the information is baseless and is hereby rejected. Point no. (i) is, therefore, decided accordingly.

Point Nos. (ii), (iii) and (iv)

Whether the provisions of section 3 (1) of the Act are attracted in this case; Whether the opposite parties have contravened the provisions of section 3 (3) (a) of the Act; and Whether the opposite parties have contravened the provisions of section 3 (3) (b) of the Act.

32. Before I deal with these points on merits, I deem it proper to narrate the factual background of the alleged common approach/practice adopted by the opposite parties. The narration and analysis of these facts is essential for proper adjudication of the common aspects involved in these points.

33. The DG has noted that this practice was started by HFCs in and around the year 1993. The available evidence suggests that, perhaps, for the first time such a levy was made by HDFC Ltd. The following extracts from a circular dated 12.09.1994 of HDFC Ltd. throw some light on existence of this practice in the financial year 1993-94:

'HDFC Ltd. in financial year 1993-94, collected Rs. 3.20 crores as early redemption charges on pre-payment of an amount of Rs. 154 crores i.e. 2% of the amount prepaid."
(Para 3 of internal circular dated 12.09.1994 of HDFC Ltd.)

"Loan to non-residents' being short term loans give HDFC higher yields. There is also an element of risk in the event of the individual returning to India earlier than scheduled. It has, therefore, been decided not to levy any early redemption charges for loans to non-residents Indians…...'
(Para 7 of internal circular dated 12.09.1994 of HDFC Ltd.)

34. From the above, it can be seen that it was decided not to levy any PPP in case of non-residents, as it may result in a loss to the banks if the Non-Resident Indian returns to India before the scheduled date and the rate of interest goes down.

35. It is further noted that the LIC Housing Finance Ltd., is following the practice since the year 1995. In the case of HFCs this kind of levy was started by the then existing dominant players in the market after the entry of newer and more aggressive home loan companies. Thus, it appears that the first one to levy a PPP was HDFC Ltd., around 1993, followed by LIC Housing Finance Ltd. in 1995. It is understood that at the time of formation of LIC Housing Finance Ltd., the only worthwhile competitor was HDFC Ltd. Subsequently, the LIC Housing Finance Ltd. felt the heat of competition from later entrants such as ICICI Ltd., etc. Thus, as the initial trend shows the main objective of the imposition of PPP was to deter competition and to prevent the flight of loan accounts from the existing HFCs/banks to the other entrants offering similar services at a lower cost and to earn more profit in the housing finance sector. It is also seen that the State Bank of Hyderabad started levying a PPP on floating rate loans from June, 2001 and on both types of loans from August, 2004. However, the practice of charging the PPP was not as widespread till 2003 as it is today.

<u>Meetings of Indian Banks' Association and Circulars issued by it</u>

(Concerted Approach)

36. In the year 2003, the Indian Banks' Association (IBA) conducted meetings on banking issues related to commitment charges and pre-payment charges. It is crucial to notice that the managing committee of the IBA discussed and deliberated the need for a common approach in fixing pre-payment charges on loans in its meeting held on 28.08.2003. It would be evident from the minutes of the IBA meeting that the matter was discussed as an avenue for earnings and it would be appropriate to quote from the said minutes which are as under:

> *'...[W]hile discussing the issue members had expressed divergent views on the subject. While one view was that commitment charges on non-availment of committed line of credit would improve the fee-based income of banks. Suggestions were made that we should also think of* ***uniform norms*** *for pre-payment charges when a borrower chooses to pre-pay the loan availed. With the interest spread narrowing under* ***intense market competition****, it was felt that banks should look for other avenues for earnings. It was therefore suggested that IBA could suggest to reintroduce commitment charges on unutilized portion of working capital limits and* ***decide on levy of pre-payment charges*** *with the decision as to the extent of charges to be levied being left to the banks...'*

37. The meeting of 28.08.2003 of the IBA resulted in a communication dated 10.09.2003 from IBA to its members, the extracts thereof are quoted below:

> *'On the whole, members were of the view that levy of commitment charges and pre-payment charges would help not only in terms of asset-liability management, but also in augmenting fee based income of the banks. The latter was seen as significant consideration in today's* ***competitive market with pressures*** *on interest spread. While members felt that charges in the range of .5%-1% would be reasonable, the view was that a decision in this regard should be left to the banks to decide ….'*

38. Thus, it can be seen that the member banks of IBA in the meeting have deliberated and discussed the issue of levy of PPP and collectively agreed to have unity and unanimity in having a *common approach* in fixing a PPP on loans. It is evident that the group of banks had come together and took a common decision to

limit market competition and to generate fee based income. These minutes clearly reflect and convey the intention, the motive and the objective for taking the decision for adopting uniform norms for pre-payment charges.

39. Moreover, it would be useful to refer to and quote the reply submitted by the IBA dated 9.11.2009 to the notice issued by the DG as under:

> *'… When the issue was again taken up at eh ext meeting held on 28.08.2009, some of the members pointed out that the international practice was in favor 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 through not actually disbursed.* ***At the meeting the need for a common approach in fixing pre-payment charges on loans was also suggested by some of the members. After detailed discussions, 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 pre-payment charges. …****'*

From this letter, the motive, objective and the desire of the banks in taking the common decision on the subject stands fully verified and confirmed.

40. Further, from the material available on record on the file of DG including the circular letters issued by the opposite parties, as noted below, it is clear that the banks/HFCs, pursuant to the aforesaid circular of the IBA, Dated 10.09.2003 adopted/changed their policies and levied PPP accordingly which goes on to show the concerted and collaborated action by the opposite parties in executing the decision taken in the meeting dated 28.08.2003.

(i) *LIC Housing Finance Ltd.*

41. It may be noted that LIC Housing Finance Ltd., one of the opposite parties, pursuant to and in furtherance of the aforesaid circular of the IBA dated 10.03.2003 issued a letter, within a few days thereafter, i.e. on 15.09.2003 to all regional managers/area managers, officers-in charge of extension counters conveying its

decision to charge 2% PPP for all schemes except for Griha Shobha Scheme. The relevant portion of this letter is extracted below:

> *'Pre-payment Levy Charges*
>
> *When the loan is prepaid either in part or in full, we now charge 1.5% Levy Charges for all the schemes except for Griha Shobha, Griha Vikas and Apna Office Schemes.*
>
> *Taking into account the **revision of interest rates**, increasing overheads and also to arrest increasing turnover of closures it has been decided to charge 2% pre-payment levy charges for all our schemes except for Griha Shobha Scheme.'*

(ii) *Punjab National Bank*

42. Similarly Punjab National Bank also pursuant to the letter dated 10.09.2003 of IBA issued a letter dated 10.03.2004 to all offices on the issue of, *inter alia*, pre-payment charges to the following effect:

> *'Pre-payment Charges*
>
> ***In order to dissuade the borrowers from shifting to other banks**, it has been decided to introduce levy of pre-payment charges @2% on the outstanding, pre-paid in loans. These charges will be applicable on all Term Loans to be sanctioned on or after 01.04.2004. Such charges will be applicable only in respect of the borrowers who shift to other banks by pre-paying the loans. In case the loans are pre-paid by the borrowers from their own sources, the same may not be levied. Further, ZMs may relax/waive these charges, to the full extent, on merits of each case.*
>
> *The above amendments would be effective from 01.04.2004. Other guidelines on the subject will remain unchanged.'*

(iii) *Indian Bank*

43. Indian Bank *vide* its letter dated 20.08.2005 communicated to the officers as under:

> *'It is observed that in a few accounts Term Loans are pre paid by borrowers with funds from various sources including shifting of the accounts to other banks.*
>
> *We have not been so far stipulating pre payment penalty from the customers at the time of pre payment of the contracted loan as a general*

condition. In existing sanctions, in many cases, such a condition is not there.

We have examined the issues involved in this regard with a view to recovery of pre-payment charges even without any such specific condition being stipulated unless other specifically agreed not to levy pre-payment penalty at the time of sanction.

Based on the opinion received from HO: Legal Department it has been decided that:

1. In respect of all existing Term Loans, whenever pre payment is resorted, to issue a letter on the lines suggested below to the borrowers.

"as per Term Loan agreement the customer is to repay in monthly/quarterly installments Rs……..over a period of…months whereas now the customer has requested to prepay the entire outstanding in one lumpsum contrary to the agreed arrangements. In view of the breach, the Bank is stipulating that pre-payment charges of……..% be paid so that bank can accept such pre-payment and release the securities held against the said term loan."

2. In all further sanctions, pre-payment charges at 2% of outstanding balance/Drawing limit of the Term loan, is to be stipulated as a sanction condition, unless specifically waived by the sanctioning authority.

You are requested to arrange to comply with the above direction and inform the branches under your control accordingly.'

(iv) *Indian Overseas Bank*

44. Indian Overseas Bank vide its circular dated 11.02.2004 issued to all its branches/regional offices in India conveyed as under:

'1.1 As per Risk Management Guidelines, one of the important risks that banks are advised to identify, measure and manage is liquidity risk. The management of liquidity risk depends on efficient asset-liability management.

1.2 In order to inculcate a sense of discipline among the borrowers in availment of bank finance, and to encourage better management of funds the members of the Managing Committee of IBA, were of the view that levy of commitment charges and pre-payment charges would help not only in terms of asset-liability management but also in augmenting fee-based income of the banks.

1.3 The matter was reviewed in the context of the above and it has been decided to levy pre-payment charges on loans with maturity of more than

one year. The operational instructions in this regard are enumerated below.

2.0 Operational Instructions:

2.1 Branches are advised to levy-a pre-payment charge of 1% on the pre-paid amount in case of term loans & other loans (irrespective of residual period of loan) where the repayment of the loan exceeds one year.

2.2 While sanctioning these loans, borrowers have to be put on notice that they are liable for pre-payment/foreclosure charges. This notice should form an integral part of the sanction letter as one of the terms and conditions (of sanction).'

(v) *Deutsche Postbank Home Finance Ltd.*

45. Deutsche Postbank Home Finance Ltd vide its circular dated 28.09.2005 decided to revise pre-payment charges as under:

'Circular ref no: Ops/ROI & FEES/007/05-06 Date: 28.09.2005

Subject: Modification in Prepayment charges policy

In order to make our product more competitive and in harmony with the market practice, the management has decided to modify the existing policy on prepayment charges in respect of loans under ***both fixed and variable interest rate category****.*

*The modified pre-payment charge (****both Fixed & variable interest rate category****) is explained as below:*

Type of Pre-payment	%age rate on the amount pre-paid
Part Pre-payment	No prepayment charges to be levied
Full Pre-payment	2% on the amount prepaid on the date of pre-closure **plus all amounts of prepayment made during the last one year from the date of final prepayment/pre-closure.**

The modification will only be applicable for newly logged in cases after implementation of Finn one.'

(vi) *State Bank of India*

46. State Bank of India reviewing its policy on pre-payment charges *vide* its circular dated 13.04.2004 communicated to its branches /offices as follows:

'…ii. The bank shall recover a pre-payment charge at the rate of 2% of the pre-paid amount for both floating interest rates term loans and fixed interest rate term loans.

iii. No pre-payment charge will be applicable up to pre-payment of Rs.10 lacs except in cases where the loan is prepaid for reasons of take over by another bank/financial institution (the cap has been reduced from Rs. 50 lacs to Rs. 10 lacs with the objective to exclude only small borrowers in AGL, SIB and C&I segments).'

It is also useful to quote the SBI circular dated 09.04.2001 of the bank which is as under:

'As you are aware, presently there is no policy in the Bank to recover a charge for premature closure of term loans. The matter was reviewed and it has been decided as under:

- *Henceforth, all term loans with floating interest rates, to carry a covenant to the effect that the Bank will be entitled to recover a charge on pre-payments, up to a maximum extent of 1% on the pre-paid amount, for the residual period.*
- *The actual levy to be decided with the approval of the concerned Group Executive who may consult DMD & CFO in the matter.*
- *Pre-payments up to Rs.5 crores to be exempted from the levy.*

2. Please advise the branches accordingly.'

(vii) *Corporation Bank*

47. Corporation Bank *vide* its circular dated 02.09.2004 on 'Corp Home Loan Scheme-Revision of Fixed Rate of Interest' noted, *inter alia*, as under:

'3.4 For Pre-payment penalty, the extant guidelines under Corp Home Scheme are as under:

Category of Loan Pre-payment	***Penalty Applicable***
Floating Rate Loans	*No PPP*
Fixed Rate Loans	
i) Pre-payments after completion of 5 years from the date of availing the loan *ii) Pre-payments before completion of 5 years from the date of availing the loan*	*No penalty*
a) Pre-payment amount not exceeding 10 EMIs/ 2 quarterly / one	*No Penalty*

half yearly / yearly instalments	
b) Pre-payment amount more than 10 EMIs/ 2 quarterly / one half yearly / yearly instalments	*Penalty at 1% on the entire amount prepaid shall be levied.*

Note: The borrower has the option to prepay the loan after a period of 5 years without any pre-payment charges, in case the borrower is not agreeable for the rate of interest refixed by the bank at the end of 5th year.'

(viii) *ICICI Bank*

48. ICICI Bank *vide* its circular dated 13.06.2005 revised pre-payment charges as under:

'Charges

Full & Final Pre-payment Fee for all products- 2%+applicable Service Tax & Surcharge @ 10.2%.

Pre-payment Documentation Charges (Applicable for cases where the First Disbursement has happened on or after December 1, 2004)- Rs.500/- + Service Tax & Surcharge @ 10.2%.'

(ix) *Vijaya Bank*

49. Vijaya Bank vide its reply dated 06.11.2009 to the notice issued by the DG submitted as follows:

'The bank has introduced pre-payment, pre-closure charges in line with the system prevalent in the banking industry. The chief reason for levying pre-payment charges is to protect the bank from interest rate risk and Asset Liability Mismatch. Presently, interest rates/other charges offered by our Bank are competitive in comparison to other banks. However, a number of requests are coming for reduction in interest rates, mainly due to threat of take over by other banks. Instances have also come across of unethical practices of getting letters from some other banks and bargaining with our Bank for interest reduction. The letters in many of such cases are only in-principle interest shown by the banks and not a final decision after credit sanction. This in turn was leading to asset flight and impacted respective loan books. ***The pre-payment charges were intended to make exists expensive****. This effectively meant that the charges could be as high as two percent of the outstanding as on date. Therefore, it was decided that wherever interest on term loan is refixed at a lower rate, a condition shall be stipulated in the sanction communication that in case of pre-closure of the loan the borrower shall be liable to pay 2% on the outstanding as on date or ½ % per year for the remaining tenure of the loan, whichever is lower. All these terms are indicated in the*

sanction communication to the borrower in advance. Further, our bank does not levy pre-closure charges in case of term loans where the closure is out of owned funds of the borrower. In case of education loan we have provided total waiver of pre-payment/pre-closure charges in order to encourage the students to pre-pay/pre-close their Education Loans, whenever they have surplus funds.'

50. Thus, in the above context, the contents of the circular dated 24.02.2005 of the bank may be noted:

'The bank has introduced pre-payment, pre-closure charges to fall in line with the system prevalent in the banking industry. Presently, interest Rates/other charges offered by our bank are competitive in comparison to other banks. This has been offered to support our field functionaries for credit retention/expansion.

…

In this regard, our Chairman & Managing Director, while according sanction for a reduction of interest as a special case in one of the borrower accounts, directed that-

'Whenever we agree for a reduction in interest, a condition should be additionally stipulated as to pre-closure charges at 2% on the outstanding as on date or ½ % per year for the remaining tenure of the loan whichever is lower.'

(x) *Canara Bank*

51. Canara Bank *vide* its circular dated 15.10.2003 noted as follows:

'Imposition of Pre-payment Penalty

1. In our Bank, presently, no pre-payment penalty is being levied in respect of takeover of loan accounts by other banks/HFIs.

2. With a view to prevent migration of borrowal accounts from our Bank to other banks/HFIs, it has been decided to impose a pre-payment penalty of 2% on the outstanding liability wherever requests for transfer of housing loan accounts to other banks/HFIs are received w.e.f. 01.11.2003.

3. However, for pre-closure of loan by the borrower which do not involve transfer of accounts to other banks/HFIs, no penalty need be levied.'

52. Further, it may be noted from the Manual of Instructions issued by the bank that PPP was imposed to prevent migration of borrowal accounts as is reflected from clause 2.20 and the same is quoted below:

'To prevent migration of borrowal accounts from our Bank to other banks/HFIs, a pre-payment penalty of 2% on the outstanding liability wherever requests for transfer of housing loan accounts to other banks/ HFIs are received, shall be imposed w.e.f. 1.11.2003.'

(xi) *Oriental Bank of Commerce*

53. Oriental Bank of Commerce *vide* its circular dated 15.01.2004 addressed to all its branches etc. communicated to the following effect:

'Introduction of Pre-payment penalty

Housing Finance market being extremely interest-sensitive, there remains a tendency amongst the customers to switchover to other bank/FI with a slight variation in interest rate.

In order to check this tendency, it has been decided to introduce one-time pre-payment penalty of 2% on the outstanding balance in case a customer intends to transfer account to other bank/F1directly/indirectly.However, pre-payment upto 25% per annum shall not attract any penalty.'

(xii) *Punjab & Sind Bank*

54. Punjab & Sind Bank in its reply dated 20.10.2009 to the notice issued by the DG noted as under:

'…In October 1994, the bank's regulatory authority i.e., Reserve Bank of India gave freedom to the banks for fixing interest and service charges. Further in a meeting under the aegis of ***IBA on 10.09.2003****, the levying of pre-payment charges was agreed to by the member banks.*

In line with established banking practice, the bank has a well defined policy on pre-payment charges for foreclosure of loan accounts, duly published on the official website...'

55. Further, from the circular dated 28.07.2009 issued by the bank it may be noted as under:-

Pre-payment Charges

'1. If the facilities availed from the bank is upto Rs.1 crore and the account is adjusted through takeover of loan by another bank before 360 days from the date of disbursement, then a pre-payment charges of 2%

on the WC limit, 1% on term loan outstanding and non fund limits on the adjustment be recovered;

2. If the facilities availed from the bank is above Rs.1 crore and the account is adjusted through takeover of loan by another bank before 360days from the date of disbursement, then a pre-payment charges of 1% on the WC limit and on term loan outstanding and 0.5% on non fund limits on the date of adjustment be recovered;

3. All accounts under Personal, Car, Conveyance, Housing Schemes be levied a pre-payment charges of 1% on the balance outstanding on the date of adjustment if the account is adjusted through takeover of loan by another bank;

4. The borrowers under this schematic lending be allowed to make part pre-payment without any penalty in case he receives any lump-sum amounts from verifiable legitimate sources i.e. on receipt of retirement benefits, maturity proceeds of NSC, LIC etc. and wants to reduce his interest burden;

5. In addition to the above, in case of this schematic lending, no pre-payment charge be levied, if the borrower adjusts the account in full and final before scheduled time from his own verifiable legitimate sources i.e. on receipt of retirement benefits, maturity proceeds of NSC, LIC etc.

6. If the processing charges are also waived for the party and the account is adjusted through takeover of loan by another bank account is adjusted through takeover of loan by another bank before 36o0 days from the date of disbursement, then, these processing charges be recovered in addition to the pre-payment penalty as stipulated for the borrower.

All the sanctioning authorities are advised to insert relevant clause/condition in the sanction letter as applicable in terms of guidelines on Fair Practice Code. Necessary undertaking in this regard be also obtained from the borrower.'

(xiii) *Allahabad Bank*

56. From the circular dated 30.10.2008 issued by Allahabad Bank, the following may be noted:

'Pre-payment Charges for Loans Other Than Retail Credit

At present there is no specific rate for pre-payment charges in the circular, and it is stipulated on case-to-case basis in the sanction letter. However, it is recommended to consider the same as under:

Term Loan Amount	Revised Rates
All loans upto Rs. 10.00 Lac	In case of Term Loan, If liquidated out of own source/own generation- Nil. In case availing loan from some other Bank/Institution -2% of the outstanding loan plus tax
All loans above Rs.10.00 lac	2% of the outstanding loan plus tax.

……..'

(xiv) *State Bank of Hyderabad*

57. It is pertinent to quote the circular dated 22.06.2001 issued by the State Bank of Hyderabad to the following effect:

> *'As you are aware, presently there is no policy in the Bank to recover a charge for premature closure of term loans. The matter has been reviewed and it has been decided to lay down the following guidelines.*
>
> *a) All term loans with floating interest rates, should hereafter carry a covenant to the effect that the Bank will be entitled to recover a charge on pre-payments, up to a maximum of 1% p.a. on the pre-paid amount, for the residual period.*
>
> *b) The actual levy would be decided/ approved by the Managing Director.*
>
> *c) The levy is applicable for pre-payments of above Rs. 5 crores.*
>
> *d) In respect of all consortium advances the decision of the leader of the consortium shall be final.*
>
> *2. Branches are advised that henceforth in all the agreements and sanction letters for term loans of Rs. 5 crores and above, the following clause should be included.*
>
> *"For the Term Loan with floating rate of interest, the bank shall be entitled to recover a charge on pre-payment, subject to a maximum of 1% p.a, on the pre-paid amount for the residual period and the borrower and the guarantor (s) shall pay the same without demur."*
>
> *3. Please bring the contents of the circular to the notice of all the staff concerned.'*

58. Further, the circular dated 03.08.2004 issued by the bank is instructing and the same is quoted below:

> *'The Bank shall recover a pre-payment charge at the rate of 2% of the pre-paid amount for both floating interest rate term loans and fixed interest rate term loans.'*

(xv) *HDFC Limited*

59. HDFC Limited provided a circular dated nil on the pre-payment charges and the same is quoted below:

> *'Adjustable Rate Home Loan (ARHL)*
>
> *If a pre-payment 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.*
>
> *Fixed Rate Home Loan (FRHL)*
>
> *Redemption charges of 2% of the amount being prepaid is payable if the amount being repaid is more than 25% of the opening balance.*
>
> *In case of commercial refinance under both the FRHL and ARHL an early redemption charge of 2% is payable. You may be required to submit copies of your Bank Statements or any other documents that HDFC deems necessary to verify the source of pre-payment.'*

60. From the narration and sequence of events as noted above, it transpires that members of IBA felt a need for a *common approach* in fixing pre-payment charges on loans and the issue was discussed and deliberated in the IBA meeting on 28.08.2003 which culminated in the circular dated 10.09.2003 issued by IBA to all chief executives of its member banks. It was noted therein that pre-payment charges in the range of 0.5% to 1% would be reasonable. However, decision in this regard was left to the individual discretion of banks. Thus, this meeting on 28.08.2003 was the first common meeting of banks and this even assumes significance so far as the common approach on the subject by the opposite parties is concerned.

61. Accordingly, as noted above, various banks issued circulars/letters for imposing a PPP on the pre-payment of loans. Thus, it can be seen that the *common approach* deliberated in the meetings of IBA and the collective decision taken finally led to a common practice and resulted into the levy of pre-payment charges and accordingly, it is manifest that the said action of the banks is concerted and result of common understanding and decision amongst them.

62. From the forgoing, it emerges that after the meeting of IBA on 28.08.2003 and pursuant to and in furtherance of its circular dated 10.09.2003, the opposite parties started adopting/modifying their approach towards pre-payment charges and the common behavioral pattern of opposite parties becomes apparent from the following table:

S.No.	**Bank**	**Practice on Pre-payment charges**	
		Prior to 2003 (Approx.)	**Post-2003 (Approx.)**
1	LIC Housing Finance Ltd	1%	2%
2	Punjab National Bank	Nil	2%
3	Indian Bank	Nil	2%
4	Indian Overseas Bank	Nil	1%
5	Deutsche Postbank HomeFinance Limited	N/A	2%
6	State Bank of India	1%	2%
7	Corporation Bank	N/A	1%
8	ICICI Bank	N/A	2%
9	Vijaya Bank	Nil	2%
10	Canara Bank	Nil	2%
11	Oriental Bank of Commerce	Nil	2%
12	Punjab & Sind Bank	N/A	1-2%
13	Allahabad Bank	Rate not specified Case to case basis	2%
14	State Bank of Hyderabad	1%	2%
15	HDFC Ltd.	N/A	2%

63. On analyzing the above table, it can be inferred that out of the above fifteen opposite parties, about twelve have adopted the uniform practice of charging PPP after the meeting of IBA. In case of the remaining three i.e. (1) Indian Overseas Bank, (2) Corporation Bank and (3) Punjab and Sind Bank, the practice of charging a PPP of 1% to 2% was adopted only after 2003 and before that these banks were not charging any PPP.

64. At this stage, it would be useful to quote the below table from the DG report to highlight the pre-payment charges currently levied by various banks which further fortifies the above conclusion on common approach adopted by the banks/ HFCs:

S. No.	Name of Bank	Pre-payment penalty
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 pre-payment.
3	Corporation Bank	1%-2% in the event of take over 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 lac, if liquidated out of own sources/own generation-NIL. In case of availing loan from some other Banks/Institutuions-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 take over of the loan by other bank/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 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 other bank/FIS
11	State Bank of	2% penalty on the amount prepaid in excess of normal EMI dues should be levied

	India	in case of pre-closure 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 pre-payment charges if such pre-payment 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/-
13	Deutsche Post Bank	Loan against Residential Property (LARP)/Top up/ Easy Plus Loans Full Pre-payment-3% On the outstanding principal plus taxes Full pre-payment within 6 months of the loan disbursement-5% on the outstanding principal plus taxes Part Pre-payment-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.	***Adjustable Rate Home Loan (ARHL)*** If a pre-payment 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. ***Fixed Rate Home Loan (FRHL)*** Redemption charges of 2% of the amount being prepaid are payable if the amount being repaid is more than 25% of the opening balance. In case of commercial refinance under both eh FRHL and ARHL an early redemption charge of 2% is payable.
16	Indian Bank	For Terms 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 pre-payment penalty.

On scrutiny and analysis of this table also, it is found that after 2003 the practice of charging a PPP has virtually remained unchanged.

65. From the above analysis, it can be safely deduced that the understanding and decision arrived at in the meeting of IBA on 28.08.2003 was implemented and executed by it by issuing a subsequent circular letter dated 10.09.2003. The

directions contained in the circular letter prescribing guidelines for adopting the policy and practice were followed by the opposite parties by issuing various circular letters referred to above. The adoption of parallel practices or common practice by the opposite parties was based on meeting of minds and unity of action on the part of the opposite parties on the subject.

66. The uniformity of the practice is clearly reflected in the tables drawn above which show that as a general practice, most of the opposite parties started levying a PPP at the rate of 2%. It is significant to note that some of the opposite parties also participated in the meetings of IBA and issued circular letters in furtherance of common approach adopted and the same were in consonance with the circular letter issued by the IBA. On perusal of the circular letters of opposite parties referred to above, the following conclusions may be drawn:

(i) Prior to the meeting of the IBA, there was no consensus amongst the banks for levying PPP;

(ii) Prior to the meeting of the IBA, there existed no policy guidelines of banks and HFCs nor was there any uniform practice for levying PPP;

(iii) In the meeting of IBA, a concerted decision to adopt a common approach was arrived at by the banks for the first time. Thus the meeting of members of IBA can be treated as meeting of minds of the members for taking a concerted action against the home loan borrowers who opt to pre-pay the loan.

(iv) As very clearly stated in the circular of Punjab National Bank and implicit in the circulars of the other banks, the decision to levy a PPP was taken (a) in pursuance of the circular of IBA; and (b) to prevent the switching over by the consumers.

67. A common plea taken on behalf of the opposite parties is that there was no agreement amongst the opposite parties and therefore it cannot be said that the practice of charging PPP is consequential upon any agreement and thus the

provisions of section 3 of the Act are not attracted. On behalf of HDFC, in particular, it has been submitted that it was neither the member of IBA nor attended any meeting of the IBA nor received its circulars. In order to deal with the contentions of the opposite parties, in this regard, it is desirable to understand the meaning and the scope of the term 'agreement' as appearing in section 3 of the Act and as defined under section 2(b) of the Act.

68. The term 'agreement' is defined in section 2 (b) of the Act as follows:

> *'2(b) "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;'*

69. It is clear that the definition includes *any* arrangement or understanding or action in concert whether or not formal or in writing or is intended to be enforceable by legal proceedings. Thus, it may be noticed that the definition is inclusive and not exhaustive. Further, the same has been worded in a wide manner and the agreement does not necessarily have to be in the form of a formal document executed by the parties. Thus there is no need for an explicit agreement and the existence of the agreement can be inferred from the intention and objectives of the parties. In the cases of conspiracy the proof of formal agreement may not be available and may be established by circumstantial evidence only. The concurrence of parties and the consensus amongst them can, therefore, be gathered from their common motive and concerted conduct.

70. The World Bank/OECD Glossary states that agreements '*may be implicit, and their boundaries are nevertheless understood and observed by convention among the different members*' and '*most agreements which give rise to anti-competitive*

prices tend to be covert arrangements that are not easily detected by competition authorities'.

71. In *Technip S.A.* v. *S.M.S. Holding Pvt. Ltd.*, (2005) 5 SCC 465 at 485, the court took note of the decision in the case of *Guinness Plc* v. *Distillers Co. Plc* where the Takeover Panel was to determine whether Guinness had acted in concert with Piptec when Piptec purchased shares in Distillers Co. Plc. The Panel observed:

> *'The nature of acting in concert requires the definition to be drawn in deliberately wide terms. It covers an understanding as well as an agreement, and an informal as well as a formal arrangement which leads to the purchase of shares to acquire control of a company. This is necessary as arrangements are often informal, and the understanding may arise from a hint. The understanding may be tacit, and the definition covers situations where the parties act on the basis of a nod or a wink ...unless persons formally declare this agreement or understanding, there is rarely direct evidence of action in concert and the panel must draw upon its experience and common sense to determine whether those involved in any dealings have some form of understanding and are acting in cooperation with each other.'*

72. In *Registrar of Restrictive Trade Agreements* v. *W. H. Smith and Sons*, (1968) 3 All ER 721, the court observed:

> *'People who combine together to keep up prices do not shout it from the house tops. They keep it quiet. They make their own arrangements in the cellar, where no one can see. They will not put anything into writing nor even into words. A nod or wink will do. Parliament as well is aware of this. So it included not only an "agreement" properly so called but any "arrangement", however informal'.*

73. It may thus be observed that physical participation of the conspirators or members of a cartel need not be proved for establishing their common understanding, common design, common motive, common intent or commonality of their approach. These aspects can be found from the activities carried on by them and from the objects attempted to be achieved, for which evidence may be gathered from the precedent and subsequent relevant surrounding circumstances. It is also not necessary that all those sharing the common intent or common agreement must be parties to the association or present at its meeting where the decision is taken.

Parties outside the group can also participate by following the decision or practice of the group. Similarly, it is also not necessary that all the conspirators or participants implement the decision at the same time. Even joining the common practice later may prove such participation as part of the concerted action. Therefore, the 'decision' to be covered within the provisions of section 3(3) of the Act need not necessarily be simultaneous or taken at the same point of time by all parties.

74. In view of the above, the contentions raised by HDFC Ltd., that it was neither a member of the IBA not participated in the IBA meeting held on 28.08.2003 does not hold any force and hence is liable to be rejected.

75. Besides, as noted above most of the opposite parties started levying pre-payment charges only after the meetings of IBA held on 28.08.2003. Pursuant to the said meeting and in furtherance thereof the opposite parties issued circulars, as mentioned above, to their branches advising them to levy pre-payment charges as per the rates prescribed therein. From perusal of the aforesaid circulars of the opposite parties and replies submitted by them before the Commission, it transpires that the opposite parties have given different justifications for imposing the said penalty ranging from asset liability mismatch to retention of customers. As can be seen from the discussion below, it is manifest that the said concerted approach adopted by the opposite parties is anti-competitive as the same falls within the mischief of section 3 of the Act.

76. In view of the foregoing discussion I am of the opinion that there was an agreement amongst the opposite parties under which agreement and understanding they adopted a 'common' approach for charging a PPP. The common approach agreement was in respect of provision of banking services in which the opposite parties are engaged. Thus the provisions of section 3(1) are fully attracted in this matter. Consequently, the finding on point no. (ii) is recorded in the affirmative.

Point Nos. (iii) and (iv)

77. Now I proceed to deal with the scope and applicability of section 3(3)(a) of the Act to the facts of the present matter. The submission of the informant is that the common approach adopted by the opposite parties had the effect of directly or indirectly determining the sale prices of services. I would like to deal with this submission in the context of provisions contained in section 3(3)(a) of the Act first and in the light of factual analysis made as above.

78. It may be noted that section 3 (3) of the Act, *inter alia*, states that any **agreement** entered into between enterprises or associations of enterprises or persons or association of persons or between any person and enterprise or **practice** carried on, or **decision** taken by, any association of enterprises or association of persons including cartels engaged in identical or similar trade or goods or provision of services which directly or indirectly determines purchase or sale prices or limits of controls production, supply markets, technical development, investment or provision of services etc. shall be presumed to have an appreciable adverse effect on competition.

79. Most competition laws treat practices such as those mentioned in section 3 (3) as particularly grave violations of the law and usually subject these to the *per se* rule. I may also note again that the term 'agreement' has been defined widely in the Act as discussed earlier. Moreover, section 3 (3) of the Act includes, apart from an agreement, a practice carried on, or a decision taken by an association.

80. It may be emphasized that trade associations undertake activities to further the broader interests of the particular industry. However, often a trade association can function as a vehicle for cartel-type agreements whose main objective may be to manipulate the market through fixing prices, controlling/ limiting production, supply or provision of services, allocating territories or rigging bids. Frequent meetings or exchange of information in trade associations can facilitate such agreements. It is

thus important for associations to be wary of the boundaries of their legitimate activities vis-à-vis the competition law.

81. Price fixing refers to an agreement or conspiracy among competing firms to raise, fix, or maintain the price of the goods or services they are selling. There are a myriad of ways in which firms may conspire to fix prices, such as the adherence to price schedules, adherence to formulas for setting prices, the elimination or reduction of discounts, and agreements not to lower prices or to start a price war. Not surprisingly, the pricing patterns that could trigger an investigation include the following:

(i) Identical prices may indicate a price-fixing conspiracy, especially when:
    (a) prices stay identical for long periods of time; or
    (b) prices previously were different; or
    (c) price increases do not appear to be supported by increased costs.
(ii) Discounts are eliminated, especially in a market where discounts historically were given.
(iii) Vendors are charging higher prices to local customers than distant customers. This may indicate local prices are fixed.

The pricing patterns described above suggest one potential test for collusive behavior - a test that focuses on whether pricing in a market is particularly stable.

82. There are many ways to implement such a test, and one economic approach is to evaluate whether the variance in prices over time is or has been relatively stable. Under this approach, highly variable pricing over time would be inconsistent with collusive pricing and stable pricing over time would be consistent with collusive pricing. The economic foundation for a price variance test is that collusion will dampen price movements because competing firms are (a) coordinating prices and (b) less likely to react to changes in their costs of production for fear of disturbing the collusive arrangement.

83. Use of a variance test requires a determination of the variation in price that would be expected in a competitive market. This is because the analysis involves a test of whether the actual price variation observed in the industry at hand is significantly less than the expected variation. If the price variation in a particular period of time is significantly lesser than expected, then the screen would have identified a situation consistent with potential price-fixing behavior. Such a test is easier to implement when a clearly defined period of collusion is suspected in an industry. In such instances, it is possible to use the observed variation in prices during the competitive period as the competitive benchmark and to compare it to the level of price variation observed during the period of suspected collusion.

84. In light of the above propositions and from the analysis of the sequence of events as narrated above, it is apparent that the opposite parties have resorted to a practice which is covered within the mischief of section 3 (3) (a) of the Act. It is instructing to note that section 3 (3) (a) of the Act includes, apart from an agreement, a practice carried on, or a decision taken by an association also. It appears, therefore, that this might cover any practice or decision of an association relating to an activity mentioned in sub-section (3) even if some of the members of the association have not agreed with the particular decision. This aspect has been elaborated in this order while dealing with the submissions of HDFC Ltd., which claimed to be not the members of the IBA.

85. Accordingly, it is held that the agreement/ practice/ decision taken by the opposite parties falls within the purview of section 3(3)(a) of the Act as it has the effect of directly or indirectly determining or fixing the prices. Point no. (iii) is therefore decided in the affirmative.

86. Now I proceed to deal with the nature of ‘agreements’ and ‘practices’ which are covered under section 3(3)(b) of the Act. It is to be seen as to whether or not the ‘agreement’ or ‘understanding’ or the ‘practices’ adopted by the opposite parties

have the effect of limiting or controlling the provision of services, *viz*., retail home loans to the consumers and are covered within the purview of section 3(3)(b) of the Act.

87. Horizontal agreements of the nature covered under section 3(3) of the Act are presumed to have an appreciable adverse effect on competition. These are agreements, including cartels, which (a) directly or indirectly determine purchase or sale prices; (b) limit or control production, supply, markets, technical development, investment, or provision of services; (c) share the market or source of production or provision of services by way of allocation of geographical market, or type of goods or services, or number of customers in the market; and (d) directly or indirectly result in bid rigging or collusive bidding. Thus, cartels and similar horizontal agreements are placed in a special category and are subject to the adverse presumption of being anti-competitive. This is also known as '*per se*' rule.

88. The *per se* rule and its rationale were explained by the US courts in a number of cases, e.g*., Northern Pacific Railway Co* v. *United States* 356 U.S.1(1958), *Arizona* v. *Maricopa Country Medical Society*, 457 U.S. 332 (1982) and *Continental T.V.* v. *GTE Sylvania Inc* 433 U.S. 36 (1977). In *Northern Pacific Railway*, the court observed that 'there are certain agreements or practices which because of their pernicious effects on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and, therefore illegal without any elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints that are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable-an inquiry so often wholly fruitless when undertaken. In *Jefferson Parish Hospital Distt. No.2* v. *Hyde*, 466 US 2 (1984), the court observed that the rationale for *per se* rule, in part, is to avoid a burdensome inquiry into the

actual market conditions in situations where the likelihood of anti-competitive conduct is so great as to render unjustified the costs of determining whether the particular case at bar involves anti-competitive conduct. The *per se* rule, as opposed to the rule of reason, has been applied by the courts in respect of particularly harmful agreements such as agreements relating to price fixing, allocation of territories, bid rigging, group boycotts, concerted refusal to deal, and resale price maintenance. It should be noted, however, that in recent years the approach of the US courts has undergone a transition from a dichotomous approach based on two distinct rules, the *per se* rule and the rule of reason, to a more nuanced and case-specific inquiry tailored to the suspect conduct in each particular case.

89. In *Cooperatieve Vereniging "Suiker Unie" UA* v. *Commission of the European Communities,* European Court reports 1975 Page 01663, it was observed that the applicant association assumed all the rights and liabilities of the four cooperatives of the old association, it must be treated as the economic successor both of the old association and of its members, which indeed is what those members intended. The applicant association did not claim before the court that its conduct on the sugar market differed from that of the former association. The conduct of the applicant and its predecessor was in continuity, which means that the whole of the behaviour is to be attributed to the applicant. The court observed:

> *'The concept of a 'concerned practice' refers to a form of coordination between undertakings, which, without having been taken to the stage where an agreement properly so-called has been concluded, knowingly substitutes for the risks of competition, practical cooperation between them which leads to conditions of competition which do not correspond to the normal conditions of the market, having regard to the nature of the products, the importance and number of the undertakings as well as the size and nature of the said market.*
>
> *Such practical cooperation amounts to a concerted practice, particularly if it enables the persons concerned to consolidate established positions to the detriment of effective freedom of movement of the products in the common market and of the freedom of consumers to choose their suppliers.*

These criteria of 'coordination' and 'cooperation' laid down by the case-law of the court, which in no way require the working out of an actual plan, must be understood in the light of the concept inherent in the provisions of the treaty relating to competition that each economic operator must determine independently the policy which he intends to adopt on the common market including the choice of the persons and undertakings to which he makes offers or sells.'

90. In Bayer AG v. Commission of the European Communities, European Court reports 2000 Page II-03383, it was observed:

'The proof of an agreement between undertakings within the meaning of Article 85 (1) of the Treaty (now Article 81 (1) EC) must be founded upon the direct or indirect finding of the existence of the subjective element that characterizes the very concept of an agreement, that is to say a concurrence of wills between economic operators on the implementation of a policy, the pursuit of an objective, or the adoption of a given line of conduct on the market in accordance with the terms of that agreement is expressed. The Commission misjudges that concept of the concurrence of wills in holding that the continuation by wholesalers of their commercial relations with a manufacturer when it adopts a new policy, which it implements unilaterally, amounts to acquiescence by those wholesalers in that policy, although their de facto conduct is clearly contrary to that policy'.

91. In *Northern Pacific R. Co*. v. *United States*, 356 U.S.1 (1958), it was observed by the US Supreme Court as under:

'However, there are certain agreements or practices which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable, and therefore illegal, without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of every one concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable – an inquiry so often wholly fruitless when undertaken.'

92. The above observation of the US Supreme Court was also followed in the case of *United States* v. *General Motor Corp*., 384 U.S. 127 (1966).

93. Section 3 (3) of the Act also covers cartels. A cartel is defined in section 2 (c), which states that a cartel 'includes an association of producers, sellers, distributors, traders, or service providers, who, by agreement amongst themselves, limit, control, or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.' This definition is inclusive and wide. A cartel of producers or sellers usually seeks to do two things: raise prices and limit output. Cartelization is regarded as the most pernicious offence since it has no redeeming feature, and there is no question about the harm that it causes to the consumers and to the economy.

94. From the above discussion. it is evident that the decision/practice uniformly adopted had the effect of:

a. putting an entry barrier to other banks which wanted to provide loans at a lower rate of interest to the existing borrowers in the housing loan market;
b. preventing borrowers from switching over and consequently curtailed their choice/option which amounted to controlling the supply of services; and

95. In view of the above it is found and held that action, conduct, decision, understanding and adoption of practice by the opposite parties in fixing common and uniform rates for charging PPP has resulted into limiting and controlling the provision of services in the banking sector particularly in the relevant market of home loans. In the result the conduct, action, decision and practice adopted by the opposite parties bring them within the purview of culpable cartel like conduct and collusive concerted practice which sufficiently proves infringement and breach of the provisions of section 3 (3)(b) of the Act and thus their 'conduct', 'action' and 'practice' are presumed to have appreciable adverse effect on competition as laid down in section 3(3) of the Act.

96. The concept and meaning of 'shall presume', used in section 3 (3) of the Act, has been explained by the courts in India in numerous cases such as in *Sodhi*

Transport Co. v. *State of Uttar Pradesh,* AIR 1980 SC 1099 and *R.S. Nayak* v. *A.R. Antulay,* AIR 1986 SC 2045. In *Sodhi Transport Co.*, the court observed that 'the words "shall presume" have been used in the Indian judicial lore for over a century to convey that they lay down a rebuttable presumption in respect of matters with reference to which they are used ….. and not laying down a rule of conclusive proof.' The court also observed that ' a presumption is not in itself evidence but only makes a *prima facie* case for the party in whose favour it exists. It indicates the person on whom the burden of proof lies. But when the presumption is conclusive, it obviates the production of any other evidence. But when it is rebuttable, it only points out the party on which lies the duty of going forward on the evidence on the fact presumed, and, when that party has produced evidence fairly and reasonably tending to show that the real fact is not as presumed, the purpose of presumption is over'. This suggests that in the case of horizontal agreements listed in section 3 (3) of the Act, once it is established that such an agreement exists then it will be presumed that such an agreement is anti-competitive and has an appreciable adverse effect on competition in the market.

97. Thus the presumption laid down under section 3(3) of the Act is rebuttable. The opposite parties have attempted to rebut the presumption by submitting detailed arguments. However, the grounds taken for rebutting the presumption are to be tested on the touch stone of guiding factors laid down under section 19(3) of the Act which are being reproduced as under:

> *Section 19 (3)*
>
> *The Commission shall. While determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard, to all or any of the following factors, namely:-*
>
> *(a) creation of barriers to new entrants in the market;*
> *(b) driving existing competitors out of the market:*
> *(c) foreclosure of competition by hindering entry into the market*
> *(d) accrual of benefits to consumers*
> *(e) improvements in production or distribution of goods or provision of services: or*

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

98. A combined reading of section 3(3) and section 19(3) of the Act suggests that although the term 'appreciable adverse effect on competition', used in section 3 (1) has not been defined, however, section 19 (3) of the Act states that while determining whether an agreement has an appreciable adverse effect on competition under section 3 of the Act, the Commission shall have due regard to all or any of the above mentioned factors. The first three factors laid down in section 19(3) of the Act, *viz.,* (a), (b) and (c) relate to negative effects on competition while the remaining three relate to beneficial effects. Thus, in assessing whether an agreement has an appreciable adverse effect on competition, both the harmful and beneficial effects, as reflected in the above factors, are to be considered.

99. In the context of the foregoing analysis, if I examine the issue at hand then it becomes apparent that the pre-payment charges act as entry barriers to new entrants, hence factor (a) creation of barriers to new entrants in the market is present. Further, factors (b) driving existing competitors out of the market and (c) foreclosure of competition by hindering entry into the market are also found to be present. Moreover, factors (d) accrual of benefits to consumers; (e) improvements in production or distribution of goods or provision of services; and (f) promotion of technical, scientific, and economic development by means of production or distribution of goods or provision of services are found to be totally absent in the present matter. Thus, it can be concluded that factors which relate to negative effects on competition are present and the factors which relate to beneficial effects are found to be absent.

100. Besides the above, in particular, It may be noted with emphasis that one of the most prominent and important factor mentioned in section 19 (3) of the Act is accrual of benefits to consumers. The opposite parties have woefully failed to adduce an *iota* of evidence to suggest that the imposition of pre-payment charges

has resulted into accrual of benefits to consumers. On the contrary, it is found that the said practice is detrimental to and adversely affects the interest of consumers. Therefore, I am of considered opinion that the 'agreement' reached amongst the opposite parties is covered within the *per se* rule contained in section 3 (3) of the Act even on considering the replies of the opposite parties and evidence adduced in rebuttal of this presumption by them, it is concluded that the opposite parties have failed to demolish the presumption contained therein. Rather, the said presumption is strengthened by the detriment which this practice causes to the interest of consumers. On the basis of the aforesaid discussion, point no. (iv) is to be determined against the opposite parties and is decided in the affirmative.

Common plea of asset liability mis-match

101. The opposite parties have sought to raise the main plea of asset liability mis-management as justification for the practice of levy of pre-payment charges and I therefore deem it necessary to specifically deal with their contentions in this regard.

102. The opposite parties have argued that PPP is levied in order to prevent volatility and to meet the increase in capital cost; it is not penal in nature but is aimed to regulate cost of funds and is within fair practice guidelines of the RBI; the issue of asset liability mismatch are genuine commercial realities and is a fundamental issue which banks and financial institutions face and therefore, necessitate banks to stipulate pre-payment charges in order to adequately address such mismatch; the applicable pre-payment charges and related terms and conditions are informed clearly to the borrowers upfront as required by the regulatory authorities and as a good commercial and consumer friendly practice, the practice of PPP 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 loanable funds reduce the interest rates and costs to the home loan borrowers in the

relevant market. Thus, the practice of charging pre-payment penalty enhances consumer welfare rather than affecting them adversely.

103. I have carefully considered the above submissions made by the opposite parties on the issue of asset liability mis-match and having given my thoughtful consideration thereon, I don't find any force in the same. There may be economic hardships but the same cannot be taken note of in abstract by the Commission unless these points are brought within the purview of the factors enumerated in section 19 (3) of the Act to demolish the presumption of appreciable adverse effect on competition as contained in section 3 (3) of the Act.

104. The asset liability mis-match argument does not support a penalty charge at the rate of around 2% or otherwise. Moreover, in an increasing interest rate scenario, the lender may actually be benefited by a pre-payment of the loan because the lender would have raised the money at a lower rate of interest and can now post receipt of the funds, re-deploy the same at a higher rate, so there is no substance in the argument that prepayment charges are levied to compensate the loss by the banks/ HFCs. Further, ALM is not account specific and there is no evidence to show that it matches the tenors of all deposits with all loans. Hence, it may be appropriate to state that neither the 'asset' is defined and quantified at relevant stages nor the 'liability' is worked out and specified on the basis of cost transactions. Thus, neither the 'fund' is identified nor the cost of the fund is furnished. In absence of such details and data, the plea of 'mis-match' of 'asset- liability' or risk of 'fund-management' are to be treated as only a theoretical notion and not pragmatic and empirical factors. Besides, the opposite parties have totally failed to show as to how PPP is beneficial to the consumers.

105. It may further be observed that through the pre-payment of loan, the principal money is repaid well in advance to the banks through foreclosure. Even if it is paid through switching over from one bank to another, the banks get their principal money well before the tenure of the loan and this provides an opportunity to the

banks to further increase the money supply to the market. Hence, PPP is in effect an enhancement of interest rate from backdoor. The lenders advertise a lower interest rate but in effect charge a higher rate due to such hidden penal charges. Further, the argument that if banks will not charge a PPP they will try and charge some other amount as to cover the costs, is fallacious as it seeks to justify the current practice on a hypothetical or conjectural basis.

106. It may be noted that if we calculate the equated monthly installments (EMI) and the 'time value for money', it will be evident that banks are unreasonably charging foreclosure amount as the consumer is bound to pay more first in terms of interest portion in the initial months of the payments and later, he is made to pay in terms of pre-payment charges if he decides to foreclose for better options. The banks/ HFCs also recover their administrative expenses at the time of disbursement of loan and also recover the interest portion through the initial installments.

107. Moreover, it is pertinent to mention that some of the banks/HFCs in their internal circulars have indicated reasons for levying pre-payment charges, viz., to dissuade the customers from switching their loans from one bank to another. Thus, it is apparent that the plea advanced by such banks on the grounds of asset liability mis-match is an afterthought and needs to be rejected.

108. In any event, the opposite parties have miserably failed to give any economic justification for levying such charges which may be considered for the purposes of assessment of competition within the ambit of the Act. Therefore, the plea of the opposite parties on this ground being without any justification/data is wholly misconceived and deserves to be rejected.

109. In view of the above discussion, I hold that the common approach adopted by the opposite parties in levying the PPP can not be justified on the grounds of asset-liability mis-match and the same is violative of the provisions of section 3(3)(a) and 3(3)(b) of the Act.

110. At this stage, it is interesting to note another submission made by the opposite parties on the basis of the research report of CRISIL dated March, 2009 wherein it is observed that the home loan market has registered a growth of 43% from 2000- 2001 to 2004-2005 i.e. during and after the period of the IBA circular. The opposite parties have argued that there is no material evidence available to disagree with findings of a neutral and reputed research organization nor has the DG report given any facts contrary to the contentions of the opposite parties regarding the state of competition in the home loan sector or the appreciable growth seen in the last decade. Accordingly, it has been canvassed that there is no reason to believe that the practice of charging PPP has resulted in limiting provision of home loans in the Indian market.

111. On considering the entire material, I am not persuaded to accept the contention urged by the opposite on the issue of reliance upon the report of CRISIL which is claimed to be a neutral and reputed research organization. Firstly, in the absence of any material relating to the methodology and sample size adopted by the organization, it is not possible to rely upon the report. There may be diverse reasons for the growth in the relevant sector and it is very difficult to speculate, in the absence of any concrete material, the reasons for such growth. In any event, it is nobody's case that imposition of PPP has resulted into such growth.

Approach of Regulators, Competition authorities, Forums and Courts

112. Some of the opposite parties have argued that they are also subject to pre-payment charges for borrowings as per the terms of the contract with banks and other lending institutions. It has been further argued that even the NHB which itself is a regulator of housing bank companies levies pre-payment charges on the amount proposed to be prepaid before the due date. As the opposite parties in their submissions have repeatedly referred to the decisions of regulators like RBI and NHB and have also referred to various decisions, I consider it necessary to deal with

the approach on the subject by the regulators, domestic and foreign, competition authorities, forums and courts.

Approach of National Housing Bank (NHB)

113. The NHB provides refinance to the HFCs and the commercial and cooperative banks under its Charter in the NHB Act. The refinance assistance is provided by way of bulk/wholesale financing to these institutions, with NHB acting as the apex backstop financing institution. In order to meet its fund requirements, NHB raises funds on wholesale basis from the market and other institutions including external funding from multilateral agencies.

114. Thus, it was to be submitted before the D.G. by NHB that the business model for NHB is very different from that of the primary lending institutions, viz., HFCs and commercial banks. The latter's business is essentially of retail nature, which provides adequate flexibility in their operation, even on day-to-day basis. In view of the retail nature of their business operations, they also have flexibility in mobilizing funds and making changes in their lending rates quite frequently. As a wholesale refinancing institution, NHB has a very different nature of business operations, including its asset-liability profile as compared to a retail lending institution. Accordingly, NHB raises and deploys bulk finance under the prevailing market conditions. Also, in such role, NHB does not have the flexibilities, as available in the retail business, in either mobilizing funds or in its deployment, in terms of quantum of funds as well as interest rates. While the PLIs can relent the amounts received from their borrowers, at different rates of interest, NHB's lending rates are stable and fixed over a longer period of time.

115. It has been explained that the NHB seeks to channelize long term funds to the housing sector, as part of its Charter and policy. This, in turn, requires raising long term funds and lending for long periods for better affordability. This aspect, together with bulk lending feature, results in certain in-built risks in the business

model of NHB, different from that of the retail lending institutions. As a matter of policy, therefore, NHB disincentivises the pre-payments (bulk amounts) from its client institutions by way of imposing a PPP which is currently a flat rate of 1% of the amount prepaid. Moreover, NHB's refinance to its client institutions normally does not exceed 20-25% of their funds requirements.

116. I have very carefully considered the submissions made by some of the opposite parties on the issue with reference to the practice followed by NHB. At the outset, I may mention that NHB is not a party in these proceedings, nor any information there against has been filed before the Commission in this regard. Besides, the Commission has to examine the practice of levying PPP by the banks/HFCs in the light of the provisions contained in the Act and not by reference to any such practice being adopted by NHB or any other entity. Thus, the submissions of the opposite parties by referring to and relying upon the practice of imposition of PPP by NHB to justify their practice are wholly misplaced and thoroughly misconceived and accordingly the same need to be rejected.

117. Be that as it may, I have referred to the reply of the NHB in detail only to highlight that the business model followed by the NHB is different and is accordingly distinguishable from the business model followed by banks/HFCs. Besides, it may be noted that NHB is also a regulatory body and in the circumstances and in the light of the above discussion, no sustenance can be derived from the practice followed by the NHB to justify or to legitimize the practice followed and adopted by the opposite parties.

118. At this stage, I may also refer to the latest circular dated 18.10.2010 issued by the NHB to all registered HFCs on the issue of PPP on pre-closure of housing loans and the same is quoted below for ready reference:

> *'Pre-payment penalty on pre-closure of housing loans*
>
> *The issue of levying pre-payment penalty or pre-payment charges by housing finance companies on pre closure of housing loans by the*

borrowers out of their own sources has been considered by the National Housing Bank and it has been decided that housing finance companies should not charge pre-payment levy or penalty in such cases.

2. ***It is, therefore, advised that pre-payment levy or penalty should not be collected from the borrowers when the housing loan is pre-closed by the borrowers out of their own sources****. All HFCs are advised to ensure compliance of the above with immediate effect.*

3. Please note that non-compliance with the above advisory may attract penal consequences under the National Housing Bank Act, 1987.'

119. Thus, it can be noticed that the NHB has not fully approved the practice of imposition of pre PPP on pre-closure of housing loans. The letter is totally silent on the issues relating to imposition of PPP if the loan is pre-paid by switching over or refinancing from other banks. No positive or future guidelines have been provided in this letter. In any case the NHB has never expressly approved the uniform approach and the fixed rates for charging PPP as has been practiced by the opposite parties.

Approach of Reserve Bank of India

120. The DG vide its letter dated 05.11.2009 addressed to the Reserve Bank of India (RBI) requested that the views of the RBI on current status of the proceedings on PPP, if any, pending with the RBI as well as the claim of the banks justifying the PPP may be informed.

121. In reply, the RBI *vide* its letter dated 11.12.2009 stated as under:

'… We advise that as regards pre-payment/foreclosure charges, RBI has not issued any specific guidelines. Banks generally levy charges for foreclosure of loans as it adversely impacts their asset-liability management. In terms of extant instructions, in the context of granting greater functional autonomy to banks, operational freedom has been given to scheduled commercial banks on all matters pertaining to banking transactions, including pre-payment/foreclosure charges on loans. With effect from September, 1999, banks have been given the freedom to fix service charges for various types of services rendered by them. While fixing service charges, banks should ensure that the charges are reasonable and not out of line with the average cost of providing these services. Further, in terms of the Fair Practices Code for Lenders issued

by RBI, (extract enclosed) banks have been advised that loan application forms should be comprehensive and should include information about the fees/charges, if any, payable for processing, the amount of such fees refundable in the case of non acceptance of application, pre-payment options and any other matter which affects the interest of the borrower, so that a meaningful comparison with that of other banks can be made and informed decision can be taken by the borrower. Also, in terms of RBI's circular DBOD. No. Dir. BC.56/13.3.00/2006-2007 dated February 2, 2007 on "Principles for ensuring reasonableness in fixing and communicating the service charges" (copy enclosed), banks have been advised that they should make basic banking services available at reasonable prices/charges to customers.'

122. Thus, from the aforesaid reply of RBI as also the letters/ Fair Practices Code mentioned therein, it is manifest that RBI has given banks the freedom to fix service charges for various types of services rendered by them including pre-payment charges on loans. However, RBI has stressed that while fixing service charges, banks should ensure that the charges are reasonable and not out of line with the average cost of providing these services. Moreover, in terms of the 'Guidelines on Fair Practices Code for Lenders' issued by RBI, banks have been advised that loan application forms should be comprehensive and should include information about the fee/charges, if any, payable for processing, the amount of such fee refundable in the case of non-acceptance of applications, pre-payment options and any other matter which affects the interests of the borrower, so that a meaningful comparison with other banks can be made and an informed decision can be taken by them. Therefore, while banks have the freedom to levy service charges on all matters pertaining to banking transactions, including pre-payment/foreclosure of loans, banks are required to ensure transparency in providing information regarding such charges with the expectation that the freedom given to the banks will foster healthy competition amongst banks to keep service charges at reasonable levels which would ultimately benefit the customer.

123. It would be appropriate to make a reference to a news item appearing in the Economic Times on **18.10.2010** under the caption '*RBI sets its face against pre-payment penalty*' wherein it has been reported that in a meeting with Chief Executives of Banks last week, RBI Deputy Governor KC Chakrabarty took the

stance that banks waive the clause on pre-payment penalty in mortgage documents since it is anti-competitive as the RBI sees no case for such a levy given that lenders don't play a fair game with borrowers.

Thus this regulator too has not prescribed any policy guidelines for charging a PPP.

Approach of Consumer Courts

124. The State Consumer Disputes Redressal Commission, Delhi in Appeal No. 07 of 130 decided on 27.04.2007 dealing with the issue of pre-payment charges held as under:

> *'7. Any consumer availing such a loan always avails service of those banks which charge lesser rate and if he is not aware of the lesser rate being charged by particular bank and avail the service of government bank which normally and ordinarily is supposed to charge not more than what the private banks are charging and if at later stage he finds that government bank is charging much higher rate of interest he would naturally make request for transfer of the loan amount and therefore such a request cannot come within the ambit of terminology of "pre-payment" as it has to be deemed a case of "takeover".*
>
> ---
>
> *"9. No bank or for that purpose finance companies can be allowed to indulge in restrictive trade practice by binding the consumer to go on availing loan even if rate of interest charged by the said bank is much higher than the other banks and any such clause which operates adversely to the consumer like clause 4 has to be held as void and therefore not enforceable.'*

125. A revision petition was preferred against the aforesaid decision of the State Commission before the National Consumer Disputes Redressal Commission being Revision Petition No. 2466 of 2007. However, the National Commission *vide* its order dated 26.07.2007 summarily dismissed the same by observing that the consumers' right to avail loan facility at a lesser rate of interest should not be curtailed by certain clauses of the alleged agreement between the parties.

126. It may be noted that a special leave petition was filed against aforesaid decision of the National Commission before the Hon'ble Supreme Court of India. The Hon'ble Supreme Court of India vide its order dated 19.09.2008 in SLP (Civil) No. 16345 of 2007 found no ground to interfere with the same and dismissed the petition by keeping the question of law to be decided in an appropriate case.

127. However, it may be observed that the practice of PPP is found to be to the detriment of consumers. Although the judgment is in the context of Consumer Protection Act but the rationale is suggestive of the approach that courts have deprecated the unreasonable practices and restrictive practices in the banking sector.

Approach of the Banking Ombudsman

128. I may also refer to the news item appearing on www.livemint.com posted on **10.10.2010** under the caption '*Cheap Home Loans the Next Big Issue?*' which states that recently, the banking ombudsman in Delhi ruled in favour of two home loan borrowers against a bank. Both claimed that they had not received the benefit of a floating rate of interest on the loan they had taken and had been paying high interest rates even when new borrowers were being charged less. Also, when they wanted to prepay their loans, the bank did not allow them to do so without a pre-payment penalty. The ombudsman has directed the bank to waive the penalty if they choose to prepay their loans or give them the benefit of a lower interest rate being offered to new borrowers.

Approach in Foreign Jurisdictions/Decision of French *Conseil*

129. Now, I may also refer to a decision dated 19.09.2000, of the *Conseil de la concurrence* which penalized several major banks and credit establishments, whien it found guilty of implementing an anti-competitive agreement in the sector for property loans to private individuals in 1993 and 1994.

130. In the early 1980s, long-term mortgage rates peaked at 20%, before dropping sharply within a few financial quarters from 1985, stabilizing at around 12% in late 1992, when they registered another substantial drop until 1994. They then reached a level of between 7.5 and 9%.

131. During periods of falling rates, when the difference between the rates practiced for new property loans and the rates practiced in the previous period reaches around 2%, there was an advantage for holders of loans with over five/seven years still to run either to renegotiate their loan conditions with their bank, or to profit from competition between banks by paying off their loan early and renegotiating a new loan with a new lender.

132. These loans could therefore lead to an early redemption at the initiative of the borrower, for compensation which, under the consumer code, shall not exceed the equivalent of six months of interest and at the most 3% of capital still outstanding.

133. The *Conseil de la concurrence* found that, faced with this situation, the main investment establishments had reached an “inter-bank non-aggression pact”, under which each of them refrained from making offers to customers of other banks who wished to renegotiate their property loans.

134. Besides aiming to prevent competition between banks, this agreement enabled each of them to better resist requests by their own customers to renegotiate their loans, since the customers in question were subsequently unable to turn to another bank in the event of their request being refused. Such concerted action between the main players in a market, aimed at distorting price competition, was found to be prohibited by the Ordinance of 1st December 1986 relative to price freedom and competition. In addition, it constituted an anti-competitive practice that was viewed as particularly serious by all competition authorities.

135. The *Conseil de la concurrence*, which had assumed jurisdiction on its own initiative, indicated that whilst banking activities are governed by specific regulation, like all other service activities, whether regulated or not, they are still subject to competition law. The *Conseil* also indicated that the competitive workings of the market are based on the independence and autonomy of the players involved. It stated that when concertation practices lead to the removal of any uncertainty they effectively distort competition, since each establishment is assured that the other banking networks will apply the same commercial policy.

136. The *Conseil* noted that, even if a cartel agreement between banks was not applied in a uniform manner, borrowers were deprived of the option of significantly reducing their property debts, whereas property represents the most substantial investment by households, and the repayment of loans required for this investment accounts for 30% of their disposable income.

Approach of OECD

137. The OECD in its policy roundtable in 2006 on "*Competition and Regulation in Retail Banking*" has stated:

> *'Customer mobility and choice is essential to stimulate retail-banking competition. … Switching costs are costs that existing customers have to incur when changing suppliers. Conceptually, we can distinguish between the fixed transactional (or technical) costs of switching a bank and informational switching costs…'*
>
> *'We consider three different but complementary means to reduce switching costs, which are:*
>
> *(a) First, greater consumer education and financial literacy about financial alternatives may help to promote greater willingness of consumers to switch from one institution to another and reduce bank rents from switching costs. Information about prices and more transparency is desirable to promote consumers' possibilities to compare financial institutions.*

(b) Second, switching "packs" that simplify the administrative steps for switching should be promoted. Setting up "switching arrangements" or "switching packs" can reduce the administrative burden and hence reduce the costs of switching.

(c) Third, account number portability may merit further consideration if its potential benefits would clearly outweigh the undoubtedly high costs.'

'Closing charges, when applied, can be an important transactional switching cost. A clear distinction should be made between closing charges related to administrative costs (e.g.; when closing an account) versus closing charges that are related to interest rate exposure (e.g. when prepaying a mortgage). Closing charges related to administrative costs differ dramatically across banks and countries, with some banks having no closing charges whereas others (like in Italy) fall in the range of 15 to 60 €. These charges should be abolished, as they may hinder switching and ultimately relax competition. But closing charges that are related to interest rate exposure may reflect underlying costs that financial institutions incur. For example, mortgage pre-payments generate reinvestment risks for financial institutions, as pre-payments typically happen when interest rates drop, implying that financial institutions then must reinvest at lower rates. To the extent that closing charges related to interest rate exposures reflect the underlying risks that banks and borrowers incur, and customers and banks can contract these closing charges, these options may be valuable to both banks as firms as they allow desirable risk sharing between banks and customers. As a reference, fixed-rate loans without pre-payment options might exhibit lower loan rates than with pre-payment options present. Other technical switching costs related to prepaying mortgages that do not reflect economic fundamentals should be abolished.'

Thus it can be noted that imposing switching costs hinders mobility of consumers and ultimately, affects competition.

138. Now, I shall advert to the issue of transparency/ reasonableness/ justification by the opposite parties for levying a PPP.

Transparency/ Reasonableness/ Justification of Pre-payment Charges

(Asset Liability Mismanagement)

139. On perusal of the replies filed by the opposite parties to the notices issued by the DG or the replies/comments/objections filed by the opposite parties to the report

of the DG, it appears that the opposite parties have not succeeded in explaining the rationale and justification for levying the PPP.

140. The Commission during the course of hearing on 19.05.2010 sought certain clarifications from the opposite parties which, *inter alia*, related to the rationale behind fixing the pre-payment penalty at the rate in the range of 2% to 2.5% (and not 1% or 0.5%).

141. In response thereto, the Indian Bank submitted in its reply dated 03.06.2010 that banks secure funds by way of deposits at a fixed rate of interest, which is a liability to the bank. Such funds are deployed in lending on contracted period at a contracted rate. Pre-payments are unexpected receipts which require to be redeployed for better yields/returns, and disturb asset liability match. Such unplanned receipts distort asset liability planning. It has also been submitted that the RBI has acknowledged the fact that pre-payment adversely impacts the ALM of the banks. The unexpected receipts are kept in current accounts with RBI, which carries no interest or are deployed in money market at a low rate of interest. In order to compensate the loss due to interest difference (interest earned on such surplus funds and the deposit interest rates), banks charge pre-payment charges. Normally, the unpaid installments are charged with penal interest of 2 to 2.5%. Banks also charge pre-payment charges around 2 to 2.5%. The average loss incurred by banks on alternate investment may be estimated around 2 to 2.5%. For the investment risk it is not feasible to factor the same with the rate of interest alone considering the cost and time involved in acquiring a new customer. Taking a holistic view of the above, the rationale behind charging the pre-payment charges of 2% may be appreciated.

142. Similarly, the Indian Overseas Bank *vide* its reply dated 03.06.2010 has very conveniently evaded the queries by not dealing with the same at all and therefore, the only conclusion which may be drawn from this is that the bank has no data to justify the PPP or the rate of 2%.

143. The State Bank of Hyderabad *vide* its reply dated 03.06.2010 has submitted that PPP is levied by the bank are in accordance with the letter dated 04/05 May, 2010 issued by the Ministry of Finance to all public sector banks whereby it has been mandated that no pre-payment charges are to be levied when the loan amount is paid by the borrowers out of their own sources. The pre-payment charges, if any, to be imposed by the banks on housing loans, the same need to be reasonable and not out of line with the average cost of providing these services.

144. However, it may be noted that the SBH in its reply has not addressed the query raised by the Commission and accordingly the same inference has to be drawn against this bank as well. The SBH in its aforesaid reply has stated that it levies a PPP of 2% on housing loans which in fact may not even cover the costs incurred by the bank in respect of grant of such housing loans. Thus, it can be seen that the reply of the bank is vague and does not address the points raised by the Commission. No details or data have been provided by the answering bank to support such plea.

145. Thus, from the analysis of the replies furnished by the opposite parties, it appears that no details/data or working of transaction cost or of liabilities have been supplied to support or to justify the levy of PPP.

146. It may be noted that even in competitive markets serious consumer problems may arise. These are principally related to information failures that may lead to situations where consumers are not able to take the advantages made possible by effective competition. Consumers might have insufficient information about the choices they can make or they face high search and switching costs and consequently, conclude bad deals or get disconnected to certain markets. In such situations consumers are unable to activate competition and this ultimately retards competition. Consumer protection has a comparative advantage in addressing information failures like imperfect information and information asymmetries. Its true

focus is to provide good quality and cost of consumer information and to make well-informed decisions possible.

147. Consumer information problems actually form relevant issues for competition law as well. Information failures can distort the working of an otherwise competitive market and can lead to sub-optimal effects and inefficiency. The cause of ineffective competition might be rooted in consumer information asymmetry and welfare losses might be the result of search and perceived or actual switching costs of consumers. Therefore in certain situations the impact of information asymmetries and the exercise of consumer choice form an important part of a careful market assessment. While information imperfections may not warrant competition scrutiny on the basis of the rule of law, they might exacerbate anti-competitive effects or provide an efficiency justification for such a conduct.

148. On perusal of the replies filed by the opposite parties to the notices issued by the DG or the replies/comments/objections filed by the opposite parties to the report of the DG, it appears that the opposite parties have not come clean for justifying levying of PPP on the ground of transparency also.

149. At this stage, it would be relevant to mention that the opposite parties have very conveniently evaded the queries raised by the DG and the same would become apparent from the quotation thereof. It would be appropriate to quote illustratively the questionnaire dated 05.10.2009 whereby the following information was sought by the DG from the Indian Bank:

> '….(i) The reasons for and basis of charging any prepayment charges, by whatever name called, if the loan is returned before it is due, whether in part or in full, as it does not result in any advantage to the borrower but it restrains him/her, in whichever way, from availing any cheaper loan, if available, from elsewhere.
>
> (ii) Certified copies of the circulars issued by the Bank regarding foreclosure/prepayment charges/penalties on various types of consumer loans, since the date of initiation of such charges/penalties.
>
> (iii) Background discussion papers/material if any on such prepayment charges.

(iv) Whether any internal principles and procedures have been laid out for usurious interest, processing and other charges as advised by RBI…..'

150. Similarly, it would be further necessary to quote the further questionnaire dated 10.11. 2009 sent by the DG to the Indian Bank as under:

'….(i) Please confirm whether any representative on behalf of your bank has attended the Indian Bank Association (IBA) meeting held on 10.09.2003 with regard to pre-payment penalty. If yes, provide the background note, agenda and minutes of the IBA meeting dated 10.09.2003 and circular, if any, issued after the meeting.

(ii) Reference is drawn to your circular No.ADV/133/05-06 dated 18.01.2006, page 4, under the caption "Others" which states that: "Prepayment charges of 2% on the drawing limit is applicable for loans sanctioned with effect from 01.08.03. Now pre-payment clause i.e. Penalty clause may be waived, provided, the loan is closed out of the own resources and it is not by shifting of loan account to other Bank/Institutions……..". This shows that the main focus of levying the pre-payment penalty is to prevent existing borrowers to benefit from lower interest rate available by competing banks than the Asset Liability Management (ALM). The said act of bank to prevent its existing borrowers from availing the best prevalent market rate, on the fact of it, is anti-competitive in terms of Section 3 of the Competition Act, 2002. You may submit your views on this.

(ii) RBI *vide* circular DBOD.BP.BC.8/21.4.098/99 dated February 10, 1999 on Asset Liability Management (ALM) has specified prudent guidelines which covers among others, interest rate risk and liquidity risk of the banks. The said guidelines through Maturity Profile-Liquidity, Statement of Structural Liquidity and Short term Dynamic Liquidity specify management of cash out flow and cash inflow of banks. In context of a bank, asset-liability management refers to the process of managing the net interest margin (NIM) within a given level of risk. You are requested to clarify how imposition of prepayment penalty is justified in managing the gap (mismatch of cash outflow and cash inflow) in context of Asset Liability Management of the Bank?

(iv) Does the bank offer Reverse Mortgage Loan (RML)? If yes, does bank levy prepayment charges on Reverse Mortgage Loans as well? …. '

151. As noted elsewhere, the replies filed by the opposite parties have not adverted to or dealt with the queries raised by the DG in his aforesaid questionnaires and resultantly I am constrained to hold that the opposite parties do not have any economic data to support their contention for levying a PPP.

152. It may be observed that the RBI has given freedom to banks to fix service charges for various types of services rendered by them including pre-payment

charges on loans. However, RBI has stressed that while fixing service charges, banks should ensure that the charges are reasonable and not out of line with the average cost of providing these services. In the light of above discussion, it is manifest that the opposite parties have made no such effort to justify the levy of PPP and accordingly, it is held that the said charge is in violation of the Fair Practices Code for Lenders issued by the RBI.

153. At this stage, I may also refer to the letter dated 04/05.05.2010 issued by the Department of Financial Services, Ministry of Finance, Government of India to the CEOs of all public sector banks, it appears that after examining the issue of pre-payment charges on housing loans, the Government requested the banks to ensure, in letter and spirit, that no pre-payment charges are levied when the loan amount is paid by the borrowers out of their own sources and the pre-payment charges, if any, to be imposed by the Banks on housing loans, the same need to be reasonable and not out of line with the average cost of providing these services.

154. In the light of replies given by the opposite parties it is not possible to reach any definite conclusion that PPP levied by them is reasonable and is not out of line with the average cost of providing services as no details have been provided by the opposite parties and accordingly, it is held that the levy of a PPP by the opposite parties is also in contravention of the directions issued by the Ministry of Finance on the issue.

155. Before concluding my discussion on this issue, I may again refer to the approach of the RBI which while giving freedom to the banks to levy service charges requires transparency in providing information regarding such charges. As can be seen from the following, no such transparency has been maintained by the banks in levying the PPP.

156. Now, I may refer to illustratively some home loan agreements entered into by the opposite parties with the customers to highlight the complete lack of

transparency therein in as much as some of the banks have not even indicated the rate of PPP leave alone the basis to arrive thereat.

(i) *HDFC Ltd.*

157. Clause 2.8 headed as 'Pre-payment' of home loan agreement of HDFC is quoted below:

> *'2.8 Pre-payment*
>
> *The borrower shall be entitled to prepay the loan, either partly or fully, as per rules of HDFC, including as to the pre-payment charges, for the time being in force in that behalf.'*

(ii) *Deutsche Postbank Home Finance Limited*

158. Clause 2.7 headed as 'Pre-payment' of home loan agreement of Deutsche Postbank Home Finance Limited is quoted below:

> *'2.7 Pre-payment*
>
> *(i) The Lender may, in its sole discretion and on such terms as to pre-payment charges etc., as it may prescribe, permit acceleration of EMIs on pre-payment at the request of the Borrower.*
>
> *(ii) If permitted by the Lender, the Borrower shall give written notice of his intention to prepay the full amount of the loan and pay to the Lender such pre-payment charges which is subject to change by the Lender from time to time.*
>
> *(iii) The Borrower agrees that no pre-payment can be made during the first 6 months from the date of execution of this agreement of till the loan is fully disbursed, whichever is later.'*

(iii) *LIC Housing Finance Ltd.*

159. Proposed clause 7 (b) of the Terms and Conditions of the Loan Offer Letter reads as follows:

> *"7(b) You will be at liberty to make either full payment or part payments towards the principal in multiples of Rs.2000/- (Rupees Two Thousand Only), at any time after the expiry of 6 months from the date of disbursement of the loan or the first instalment thereof, provided, however, that no instalment of interest/EMI is in arrears on the date of*

payment and provided further that such payment will not interfere with, or affect the payment in due course of the subsequent monthly instalments of Interest/Additional Interest or EMIs, if any. ***Such pre-payment shall carry Levy Charge of 2% of the amount pre-paid. Further, Interest for the full month, calculated on the amount of loan outstanding at the beginning of the month will be playable, irrespective of the date of payment of part/full Principal****. Also, where the lump sump offered in repayment is 25% of the loan outstanding or Rs .10,000/- whichever is less, the subsequent EMIs may be rescheduled at the discretion of the Company. In such an event, EMI will be re-calculated on the amount of loan outstanding as at the end of the month in which the payment is made for the remaining period of the loan."*

(iv) ***Indian Bank***

160. Clause 20 of the Term Loan Agreement for Housing Finance reads as follows:

> *'In the event of pre-payment of the loan by the borrower(s) before the stipulated repayment schedule, the bank is entitled to levy a pre-payment charge of …….% or at such rates as per the Bank's rules in force on the applicable drawing limit or on the balance outstanding, whichever is higher.'*

161. Thus, it can be seen that the pre-payment charges have not been indicated in clear terms in the agreement. Rather the same are stated to be *as per rules for the time being in force* which clearly reflects complete lack of transparency, reasonableness and justifiability.

Concluding Remarks

162. In view of the foregoing discussion and observations made while dealing with the points formulated for determination as above, for the sake of clarity and at the cost of repetition the following concluding remarks are being noted:

i) Before the meeting of the IBA on 28.8.2003, the HFCs and some banks were charging a PPP on the basis of their individual policy which was motivated for augmenting their profits. These institutions, however, adopted different objectives and yardsticks for doing so. For example, as found from the circular of HDFC dated

12.9.2004, this financing company decided not to levy any early redemption charges on loans granted to non-resident Indians. It may be noted that the ground of asset liability mis-match was not the basis for early redemption charges.

ii) The LIC Housing Finance Ltd. also started charging a PPP to meet the challenge from its competitors, i.e., HDFC and also from later entrants such as ICICI Ltd., etc. The obvious objective of these companies was to deter competition and to prevent the flight of loan from the existing banks/ HFCs to the other entrants offering a lower rate of interest on housing loans. It is also obvious that the practice of charging a PPP was neither widespread or uniform nor based upon working of any cost factors or economic methodology or sound financial strategy.

iii) In the meeting of the IBA, a concerted action in the shape of a policy decision was taken and for adopting a concerted practice, circular letter dated 10.9.2003 was issued, which clearly reflected the collective/common decision of the members that levy of a PPP in the range of 0.5% to 1.00% would be reasonable. Thus, the meeting on 28.08.2003 was a meeting of minds of banks in which a definite decision was taken on the subject of charging PPP. The banks generally followed the decision and thereafter, started adopting the practice for charging a PPP.

iv) The analysis of the follow up actions by banks/HFCs demonstrates that out of fifteen opposite parties, twelve opposite parties started adopting the practice of charging PPP at a rate of 2%. The other three opposite parties namely Indian Overseas Bank, Corporation Bank and Punjab & Sind Bank which were not earlier charging any PPP started charging the same at a rate of 1 to 2% after 2003. These findings are gathered and reflected in the table *supra.* This practice as adopted by the opposite parties is in the nature of a cartel like behaviour and anti-competitive practice.

v) On examination of the circular letters, it is clear that the same were issued as pursuant to the policy decision taken by the banks at the IBA meeting on

28.08.2003. The letter dated 20.10.2009 of Punjab & Sind Bank clearly states as under:

> *'Further, in a meeting under the aegis of IBA on 10.9.2003, the levying of prepayment charges was agreed to by the member banks.'*

vi) The circular letters of some of the opposite parties like Vijaya Bank, Canara Bank clearly indicate that the PPP was intended to make exit expensive for the borrowers. In case of SBI, its circular dated 13.4.2004, similarly, states that no PPP will be applicable up to pre-payment of Rs.10 lakhs except in cases where the loan is prepaid for reasons of takeover by another bank. The circular of Canara Bank categorically states that the object of charging a PPP of 2% on the outstanding liability was to prevent migration of borrowers' accounts from one bank to another bank. Same appears to be the intention of Oriental Bank of Commerce as reflected in its circular dated 15.1.2004.

vii) These banks started charging a PPP at a rate of 2% or around 2% on all outstanding loans and no distinction was made whether the amount prepaid came from the borrower's own sources or from takeover of the loan by another bank/financial institution except in the case of SBI.

viii) In view of these aspects, it may be inferred that the ground of asset liability mis-match of as taken now before the Commission for justifying pre-payment charges was never the basis for charging a pre-payment penalty; rather the objective was to prevent the switch over or exit by the consumers to other banks. It may be noticed that the opposite parties have failed to explain the pre-payment charges on the basis of the submissions relating to asset liability mis-match. No details or data have been supplied to link or justify such levy/fee by the banks. Moreover, it can be seen that no transparency has been maintained by the answering opposite parties either in displaying or in levying pre-payment charges. Besides, it may be noted that the banks have not been reasonable in levying the said charges as is mandated by the Ministry of Finance, as discussed earlier. It may

also not be out of place that some banks in their circulars have stated that pre-payment charges are import to dissuade the customers from shifting to other banks. Thus, the plea of asset liability mis-match seems to be merely an after thought and is not tenable.

ix) The practice of charging PPP has not been justified by the banks on any economic working or financial data. Despite repeated queries by the DG and by the Commission, no opposite party has come forward to demonstrate the working of its cost of funds, cost of services or the working of asset liability mis-match. The replies in this regard and on this point are vague, non-specific, evasive, general and have been presented in a roundabout way.

x) The RBI which is a regulatory body for banks has insisted on 'reasonableness of such charges' and that the charging banks show that these charges are not unreasonable. Therefore, a solid, scientific and concrete material and methodology along with a rationale is needed to justify the requisite reasonableness. Thus if the rate of PPP has no nexus with the transactions and is not reasonable the same cannot be justified. The opposite parties have not satisfactorily explained that there is a reasonable basis for fixing the rate of 2% or around for charging prepayment penalty on all transactions uniformly for so many years, despite fluctuation in the rate of interest, changes in banking set up and infrastructure, shifting trends in economic policies and the changes in the banking services from time to time. In my view, while fixing the rates for charging prepayment penalty, as per the prevalent practice, the guidelines of RBI have not been adhered to.

xi) The Government of India as per its letter dated 04/05.05.2010 and thereafter, NHB in its letter of 18.10.2010 have specifically prohibited banks from charging prepayment penalty if the amount of loan is prepaid out of borrowers' own sources. This by itself suggests that charging of PPP is not justified at least in cases where the amount is prepaid out of borrower's own sources of funds. If this approach is

adopted then the justification that there would be an asset liability mismatch will collapse, because irrespective of the source, the colour and tenor of money will not change and in either case the prepayments are bound to have the same effect on asset liability management or fund management.

xii) It is found that although the Finance Department of the Govt. of India and the National Housing Bank and even some of the banks like SBI have recently prohibited/stopped the practice for charging PPP if the home loan is pre-paid out of the borrower's own resources. However, these authorities have neither specifically approved charging of PPP if the loan is pre-paid out of other sources nor have they laid down any standards or specific parameters for approving such practice. These authorities have also not assigned any grounds for making a distinction between the cases where the pre-payment is made out of own resources by the borrower or from other sources. Such distinction, if made, cannot be justified by any logic. The management of liability of borrowed funds, the payment of interest and the repayment of the loan is done by the borrower. For discharging this liability and for arranging the funds for repayment, the borrower may sell his property or assets or borrow from friends or relatives or from any other source including other banks. The banks should not and cannot make any distinction between the source of pre-payment funds because, in any case, their money i.e. the loan amount comes back to the banks with the prescribed rate of interest. The source of the pre-payment funds is immaterial. The liability in arranging the funds falls on the borrower. The PPP, if levied, in either case, shall be the additional burden on this liability which is bound to cause adverse effect on the borrower. Similarly, the distinction on account of source of pre-payment or repayment will not have a different impact on the management of funds and liability of the lender banks. Thus the practice of charging PPP, in view of the totality of facts and circumstances and observations made in this order cannot be even partly justified. The entire practice, is anti-competitive and violative of the provisions of section 3(1), 3(3)(a) and 3(3)(b) of the Act. For promoting and sustaining better competition in the market and for serving and

protecting the interest of the consumers, the same needs to be stopped and restrained forthwith.

xiii) There is no provision in any Act, rules & regulations or guidelines of any regulator or bank to prescribe the rate of PPP based on any sound approach. The banks are left to decide it for themselves. The banks also have adopted the uniform practice without showing a basis to justify the percentage or the rate. The French Commission in Case No. 00-D-287 September 19, 2000 on the state of competition has observed that the pre payment can be charged as laid down in the Consumer Code and any excessive charge is violation of the law. On that basis, heavy fines were imposed on the banks. The OECD in its policy guidelines of 2006 on *"Competition and Regulation in Retail Banking"* has said that the policy of charging switching cost should be transparent. The impugned practice of levying PPP and rates for charging the same are not as per any code, rules or regulations or based on any economic rationale. Hence, the same are anti-competitive.

xiv) The agreements entered into by the banks with the consumers are neither transparent nor specific on the issue. The consumers are not made aware of the basis for charging prepayment penalty.

xv) The main objective for charging PPP, therefore, is to check and prevent a switchover by the borrowers which in consequence, leads to preventing the new entrant banks from entering into market, debarring the consumers from availing the facility of lower rate of interest loans offered by other banks. Hence the practice of PPP as adopted by the opposite parties and as is prevalent today, is against the interests of the consumers and hinders their free mobility. It has an appreciable adverse effect on competition in the market because it is creating barriers on entry for the new entrants which offer lower rate of interest on home loans. This certainly is to the detriment of consumers and is violative of the provisions contained under section 3(1), 3(3)(a) and 3(3)(b) of the Act.

xvi) This practice of levying a PPP by banks/ HFCs cannot be held to be justified in view of the factors laid down in section 19(3) of the Act. Rather, it is against consumer interests and therefore, directly against the guiding factors laid down in section 19(3) of the Act.

xvii) It is for the RBI and NHB to consider all the relevant aspects and then to lay down proper, specific and detailed guidelines on the subject. The levy of PPP, if at all, is to be permitted then it has to be transaction based and the customers have to be informed in advance about the manner and method of calculating and working PPP in their transactions. Until, such exercise is undertaken and unless the required guidelines are prescribed, the practice of levying a PPP has to be stopped and the banks/ HFCs have to be restrained from following or adopting this anti-competitive practice.

xviii) As has been noted elsewhere, the protection of the interest of the consumer pervades the entire scheme of the Act and the Commission cannot remain oblivious and aloof of the difficulties and plight faced by the consumers of home loans.

xix) Hence, in view of the above discussion and in view of the approach of the other domestic and foreign regulators, competition authorities, forums and courts I derive additional strength to support my findings on point nos. (ii), (iii) and (iv) and accordingly hold that the common practice of charging a PPP by the opposite parties is anti-competitive being violative of section 3(1), 3(3)(a) and 3(3)(b) of the Act and the same is not justifiable in terms of the guidelines of RBI, NHB and Government of India.

Point No.(v)

What order(s), if any, may be passed under the Act?

163. For committing the breach, in my view, the banks/HFCs should not be penalized by imposing monetary penalty under section 27(b) of the Act because the

parties have acted upon the agreements and have carried the practice since the year 2003 and although these anti-competitive practices are being perpetrated and breach of sections 3(1), 3 (3)(a) and 3(3)(b) of the Act is continuing but it is neither possible nor desirable to quantify the monetary penalty against them in terms of section 27 (b) of the Act and to impose the same upon them. The proper remedy , in my opinion, would be to restrain them by issuing directions under section 27 (a) of the Act.

164. In view of the above, I am of the considered opinion that the practice of levying PPP as adopted by the opposite parties is violative of sections 3 (1), 3(3)(a) and 3(3)(b) of the Act and hence the same is void in view of the provisions contained in of section 3(2) of the Act. I am further of the opinion that the anti-competitive practices which have an appreciable adverse affect on competition in the market and are seriously jeopardizing the interests of consumers and are causing serious damage and detriment to them should be discontinued forthwith.

165. Before parting with this order, I may observe that, if in view of banking regulators like RBI and NHB, it is found to be absolutely necessary to permit the financial institutions/ banks to levy a PPP for justifiable reasons, the policy guidelines for the same may be framed based upon sound parameters of economic considerations reasonableness and transparency and by duly taking into consideration the interest of consumers.

166. In the result and in view of the above, the following order is passed:

> *'The practice/decision of the opposite parties of levying a PPP on foreclosure of home loans is anti-competitive and is squarely covered within the mischief of section 3(1), 3(3)(a) and 3(3)(b) of the Act and accordingly, I direct the opposite parties to discontinue such practice forthwith and further direct them not to re-enter, directly or indirectly, into such understanding, arrangement, agreement, decision or practice in future.'*

167. With the aforesaid observations and directions, this information stands disposed of accordingly.

Member (P)

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