COMPETITION COMMISSION OF INDIA

2 December , 2010

Case No. 5 of 2009

Neeraj Malhotra Informant

Vs.

Deutsche Post Bank Home Finance Opposite Parties

ORDER

Per R. Prasad, Member (dissenting):

In this case, complaint was received from Neeraj Malhotra, Advocate against four banks, namely:

(i) Deutsche Post Bank Home
(ii) HDFC Ltd.
(iii) HDFC Bank Ltd.
(iv) LIC Housing Finance Ltd.

The allegations against the banks:-

2. In the present case it has been alleged by the Complainant that the above four respondent banks have indulged in the practice of imposing pre-payment penalty charges for the foreclosure of housing loans ranging from 1 – 4 % either the entire principal amount of the loan or on the outstanding balance of the loan, if the borrowers are pre-paying the loans for closing the loan account by raising a cheaper loan (also called refinancing the loan) from another bank. This practice prevents the borrowers from switching over from one bank to another which is offering a lower

rate of interest contravening thereby the provisions of Sec 3(1), 3(2), 3(3) (a) and 3(3) (b) and Sec 4(1), 4(2) (a) (i) of the Competition Act, 2002.

3. The Commission after hearing the informant, considering the information and on perusal of the documents reached on conclusion that prima facie case exists against the four banks as mentioned in the allegations. The Commission thereafter ordered investigation by the Director General, CCI vide its order dated 10.09.2009.

4. The Director General Investigation Report dated 16.12.2009 stated that though the allegations were against four banks, the scope of inquiry was to be enlarged to following 16 entities:

1. LIC Housing Finance Ltd.
2. HDFC Ltd.
3. HDFC Bank Ltd.
4. Deutsche Post Bank Finance Ltd.
5. Allahabad Bank
6. Canara Bank
7. Corporation Bank
8. ICICI Bank Ltd.
9. India Bank
10. Indian Overseas Bank
11. Oriental Bank of Commerce
12. Punjab & Sind Bank
13. Punjab National Bank
14. State Bank of Hyderabad
15. State Bank of India
16. Vijaya Bank

5. The allegations against these banks was that in the home loan or retail market if someone wanted to prepay his loans then he has to suffer a fine which is 2% of the outstanding amount and inclusive of interest as prepayment charges. This created an impediment to exit on the borrowers and did not allow a switchover to another bank even if the said bank offered a lower rate of interest. The whole issue before the DG was that whether this practice carried out by the bank was anti-competitive or not.

6. The history of the home loan market is not very old in India. HDFC started giving home loans from the year 1978. Some foreign banks were also given home loans to borrowers in India. HDFC did not levy any pre-payment penalty till 1993. Around 1993 LIC Housing Finance entered the home loan market and subsequently ICICI entered the same market. From 1993 after there was a competition in the home loan market in the form of LIC Housing Finance Ltd., HDFC started the practice of levying pre-payment penalty for the foreclosure of the loans. In 1995 LIC Housing Finance also started the same practice. The Public Sector Banks entered the business of the retail home loan market at a later date and initially they were not charging penalty on the pre-payment of home loans. In the year 2003 a meeting of Indian Banking Association (IBA) was held where the issue of the levy of fines for the foreclosure of the loans was discussed. After 2003 Public Sector Banks as a consequence of the said meeting started charging fines for the pre-payment of the home loans.

7. Director General (DG), CCI issued notices to the 16 entities named above as well as the Indian Banking Association (IBA) and the gist of the findings of the DG are reproduced as under:-

- Allegations regarding violation of section 3(1), (2) read with Section 4(1), (2) (a) (i) were found to be untrue.
- Allegation that the entities are levying pre-payment charges on the entire loan amount and on the outstanding loan amount was found to be untrue as all the

entities mentioned by the information provider are charging pre-payment penalty on the outstanding principal at the time of pre-payment and not on the entire loan amount.

- The allegation that the banks were imposing pre-payment penalty/charges was found to be true. Further, with regard to allegation for violation of Section 3(3) (a) & section 3(3)(b) of the Act made by the information provider, violation of Section 3(3) (b) of the Act was found to be true.
- In the context of Section 19(3) of the Act, levying of pre-payment penalty creates a barrier to a new entrant in the market in a way that if the new entrant is providing competitive/lower interest rates, better services etc. the borrower of the existing banks can only avail the services of the new entrant by incurring additional cost in the form of pre-payment charges. Levy of pre-payment penalty by banks makes the exit expensive and thus acts as a deterrent to the borrower.
- It is noted from the meeting of IBA that the group of banks had come together and taken a collective decision to limit market competition and to generate fee based income. The said collective decision of bank is beneficial to the banks and on the contrary is anti consumer and anti-competitive. In view of above, levy pre-payment charges by banks violate provision of Section 19(3) (a) (c) and (d).

8. Summary of Defence taken by the banks and other finance companies before the D.G. the business of home loan business is as follows:-

Sl. No.	Written arguments/objections submitted by banks	Name of the Banks
1	Asset Liability Management Mismatch	All the Banks
2.	Levying charges since 1993 and is not a member of IBA. Prepayment is an additional cost to the lender	HDFC Ltd.
3.	NHB also charges for prepayment if banks/HFCs want to prepay it.	HDFC Ltd., Corporation Bank, Deutsche Post Bank, Allahabad, SBH, Indian Bank, LIC HFC, Vijaya Bank
4.	Prepayment charges are only applicable if the loan is transferred to other bank	Corporation Bank, Allahabad Bank, Vijaya Bank, Canara Bank, SBH, SBI

5.	Foreclosure will generate reinvestment risk to the bank	OBC, ICICI Bank, LIC HFC, PSB, Vijaya Bank, HDFC Bank, HDFC Ltd.
6.	RBI has also endorsed that banks can generally levy charges for prepayment	HDFC Bank, Corporation Bank, Deutsche Post Bank, Allahabad Bank, HDFC Bank, SBH, Indian Bank, ICICI Bank, Vijaya Bank
7.	Allowed to be compensated under Section 73 & 74 of Indian Contract Act	Corporation Bank and Allahabad Bank
8.	Levying reasonable charges is not a barrier for new entrants	Corporation Bank, PNB, Canara Bank, OBC, ICICI Bank
9.	CCI is not to decide what is international practice	Corporation Bank, SBH
10.	Customer knows about the charges and enters into an agreement	Deutsche Post Bank, HDFC Bank, SBH, Canara Bank
11.	Violation of Sec 3(3) is not applicable and is not anti-competitive	OBC, SBI, ICICI Bank, Corporation Bank, PNB, HDFC Bank, Allahabad Bank, PSB, SBH, Canara Bank
12.	Levying charges to the customers governed by UTP not by Competition Act	Corporation Bank, SBI, ICICI
13.	Prepayment charges are not exorbitant or not usurious	ICICI Bank, OBC
14.	Additional cost on account of time lag in identifying new borrowers	ICICI Bank, IBA
15.	They started charging since IBA issued a letter to them	Indian Bank, PSB
16.	Banks have contractual obligation to pay it to their depositors but borrowers don't have	PSB
17.	Not levying Prepayment will increase the interest rates and will be borne by all the customers for the sake of few foreclosures	OBC and IBA
18.	Charging since 1995. No competition during that time and not a member of IBA	LIC HFC
19.	Reducing prepayment charges will affect depositors	SBI
20.	No prepayment charges	Axis Bank
21.	To inculcate a sense of discipline among the borrowers in availing the bank finance	IBA, Canara Bank, IOB
22.	To prevent migration to other banks the prepayment charges have been imposed	Deutsche Post Bank, Canara Bank, PNB, OBC
23.	The prepayment charges are intended to make exit expensive	Vijaya Bank
24.	Agenda of the meeting held on 10-9-2003 was on levying charges but not an agreement	PNB, SBH, Canara Bank

25.	Intense competition in market, no control over home loan market	Allahabad Bank, HDFC Bank, P&S Bank, Canara Bank
26.	No due regard to section 19 by DG	P&S bank, SBH, Canara Bank
27.	May not be beneficial for some person but beneficial for class	Allahabad bank, HDFC Ltd., SBH
28.	Admitted by DG that Section 3(1), 4(1) not applicable so the commission have jurisdiction under section 19(1)	PNB

9. The DG did not accept that prepayment charges are needed for asset liability management. In the opinion of the DG the banks loose money in a declining interest scenario but gain money in the interest increasing scenario. The DG was also of the view that such effects are generally factored while working out the cost of funds either on fixed interest loan or on a floating interest loan. The DG mainly relied on the meetings held by the IBA in 2003 and he has produced an extract which is reproduced as under:

"…At the meeting the need for a common approach in fixing prepayment charge on loans was also suggested by some of the members. After detailed discussion, the Committee, while fully appreciating the market dynamics decided that a suitable communication be sent to member banks bringing out the view points expressed by the members so that the member banks could take a decision on levy of commitment charges and prepayment charges…." (IBA Circular dated 10.09.2003)

10. The DG has also taken into account the submission of replies of banks whereas banks have stated that the reasons for levied prepayment charges were the following factors:-

(i) To prevent volatility and speculation in the home loan market.

(ii) To dissuade the borrowers from shifting to other banks

(iii) To strengthen Asset Management System

(iv) To prevent migration of borrower accounts from one bank to other

(v) The levy of prepayment was to make exit expensive.

11. The DG summarized the entire practices as under:

(i) The Practice has been elaborated in subsequent paras.

(ii) Origin of this practice is traced to the home finance companies somewhere around 1993 or so to discourage migration of customers to other lenders.

(iii) The justifications given by different lenders have been discussed in the body of this letter but these are not correct justifications. The correct justification is to kill competition, prevent migration of customer to other banks and enhance fee based income.

(iv) RBI is the regulatory body. It has issued general guidelines which discourage such practices. However, there is no enforcement of its direction and banks have been left free to charge different service charges within the broad parameters of regulatory guidelines issued by RBI. Thus, these are simply holy homilies without any impact.

(v) In once case where pre-payment penalty was charged, it has been upheld as wrong in the case of State Bank of India.

(vi) International practice is, broadly, in favour of not having any exit load on the borrower whether called by early redemption charge, pre-payment penalty or any other name.

(vii) As regards the violations under the Competition Act, 2002, it may be stated that the origin of this practice are rooted in preventing the customer from trying to get better bargain, disciplining the borrower and kill competition. In a way this practice limits/controls supply of funds in the loan market and, therefore, falls within the provisions of Section 3(3) of Competition Act, 2002.

12. After the report of the DG was received, notices were issued by the Commission to all the 16 Banks and finance companies and the IBA to give details of their objections against the findings of the DG that there was a contravention of the

Competition Act. A summary of arguments taken and issues raised are reproduced as under:

Replies/ Observations by respondents:-

(i) Indian Banks' Association

- RBI is the regulator of banking industry in India, and the practice of charging prepayment penalty is 'duly approved' by RBI
- The DG or CCI do not have jurisdiction in the matter.
- Prepayment penalty is charged under the terms of contract signed by the borrower. Any remedy lies with the Civil Court.
- The DG's report has tested the practice on rule of reason and found it reasonable
- The DG's report has not provided any evidence to suggest that prepayment penalty is anti competitive
- Prepayment penalty is ultimately in the interest of the consumers at large.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services.
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- Prepayment of loans is dependent on interest rates (cyclical factors) and rising income levels (structural factors). The DG's finding that prepayment penalty creates a demand side constraint is baseless.
- Banks apply upward interest rate changes to new customers only and not to existing customers. Therefore, prepayment penalty is welfare inducing and helps consumers.
- PPC is part of ALM exercise by lenders.
- 1-2% of PPC is not usurious, otherwise it would have been declared illegal by

Courts of Law.

- Reference to US and Taiwan markets is erroneous because of different market situations.
- If the practice of charging PPC by NHB is reasonable, it should be same if charged by other retail lenders.

(ii) State Bank of India

- PPC is not ex-facie anti-competitive but has useful economic purpose
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has not gathered any data to support the view that the practice of levying prepayment penalty limits or controls provision of financial services.
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- DG has not given due regard to Sec 19(3) of the Competition Act, before concluding that PPC has adverse effect on competition.
- There is no entry barrier in the loans market.
- Banks have to perform ALM function for which PPC is a tool.
- The Commission cannot side with one class of consumers who are benefitted by banning PPC.
- The Commission has no jurisdiction in the matter, because PPC at best can be termed at unfair trade practice.
- PPC may be harmful to borrowers but is beneficial to depositors.
- If some individuals pay PPC for their adventurism, it cannot be said that majority of the consumers is adversely affected.

(iii) Deutsche Postbank

- The bank loses interest for the remaining period when a borrower pre pays his loan
- The unexpected inflow of funds takes time to lend elsewhere

- Prepayment charge is collected to compensate opportunity loss due to prepayment of loan
- NHB also charges prepayment levy
- RBI guidelines permit levy of such charges
- Prepayment charges is levied to prevent volatility of customer
- 1-2% cannot be termed usurious
- Ths Supreme Court Case only says that transfer of loan amount cannot be termed as prepayment
- In US the law does not restrict prepayment penalty
- In UK mortgage companies may charge early settlement fee
- In Australia too, lenders impose early discharge fee

(iv) LIC Housing Finance

- Prepayment occurs mostly in falling interest rate scenario, whereby the lender is at loss due to pre payment of loan.
- PPC has not prevented new entry into the market.
- Growth of the industry proves that PPC has not acted against the industry.
- LIC housing and NHB, both are government owned and therefore should be treated in same fashion on the issue of PPC.
- LIC Housing borrows long term unlike retail banks and therefore has comparatively heavy ALM costs.
- Prepayment does not occur during increasing interest rate scenario.
- US and Taiwan may not be appropriate examples to follow for PPC.
- Removing PPC may lead to crisis in the loan market.

(v) Indian Bank

- There is no agreement among banks as per Sec 3 (3) of the Act
- Prepayment charges are levied to compensate for **likely** loss due to customer availing lower rate of interest from other lender
- If a term loan is repaid then bank cannot repay the term deposit
- Prepayment charge is taken only when borrowers shifts to another lender

''for his own gain''

- Borrowers enter into the loan agreement knowing all the charges ab initio, and therefore, expected to respect the agreement.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- Borrowers cannot be allowed to wriggle out of contract terms.
- Banks levy pre payment penalty to protect their business
- Prepayment charge is a business compulsion and charged for breach of contract
- Borrower cannot be allowed to walk away from a contract for his own gain and at a loss to the lender
- Prepayment penalty acts as a safeguard against unfair trade practices and ''competitions''
- No victim of pre payment charge has been cited in DG report
- No bank has been denied entry into the business or suffered from any adverse consequences of pre payment penalty being charged by existing lenders

(vi) HDFC Ltd.

- Prepayment penalty does not increase the effective interest rate in a loan
- Since HDFC is not a member of IBA nor attended their meeting, it cannot be said to be party to any agreement among the IBA members. Therefore, Sec 3(3) of the Competition Act does not apply to it.
- HDFC was the first to start housing finance in India and also to levy prepayment charge in 1993.
- Prepayment charges are welfare enhancing
- Prepayment charges are imposed to recover several costs like reinvestment cost, lower credit quality, administrative costs and reduced predictability of returns
- As per research, prepayment penalty reduces effective price to borrowers

- The DG- Competition Commission agrees in his report that prepayment is a cost to the lender
- The DG report does not have evidence or economic analysis to prove that imposition of prepayment charge limits or controls supply of home loans
- The home loans market is highly competitive.
- PPC has not deterred new players from entering the market.
- PPC stops unrestricted refinance by borrowers.
- Borrowers who prepay are net gainers even after paying PPC.
- PPC is the reasonable estimate of damages payable for breach of contract under the contract act.
- Borrowers who do not want to pay PPC can go to other lender like Axis Bank who do not charge PPC.
- PPC charged by HDFC is not anti competitive in the same manner that PPC charged by NHB is not anti competitive.
- RBI does not ban PPC.
- The DG report misses many housing finance companies.
- The DG has wrongly concluded that US authorities have recommended banning of PPC.
- The analogy with Taiwan market is erroneous.
- HDFC applies differential pricing of loan products.

(vii) HDFC Bank

- Prepayment penalty is like notice money charged by landlords
- Prepayment penalty is levied to cover expenses incurred on sanction, booking of loan, maintenance and ALM
- RBI is the regulator of banking industry as per Banking Regulations Act, 1949 and as such its policy is not subject to interference by a court or tribunal or by CCI. Only RBI can decide about foreclosure charges levied by banks. CCI has no jurisdiction in the matter.
- The banking market is competitive and no player can levy excessive charges.

- U/s 21A of the Banking Regulations Act, 1949, rates of interest charged by banking companies will not be subject to scrutiny by courts.
- RBI is aware of the practice of PPC being levied by banks.
- PPC is levied as per terms of contract signed by customers who are well aware of the implications.
- Internationally there is a practice of charging foreclosure charges.
- PPC is the compensation to the bank that is losing the customer to another lender.
- All other banks and FIs should also be issued notice by the CCI.

(viii) Oriental Bank of Commerce

- The DG has applied the rule of reason and then erroneously found the practice of charging PPC as anti competitive
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services.
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- There is no evidence to support the finding that PPC influences entry decision.
- Prepayment of loans is dependent on interest rates (cyclical factors) and rising income levels (structural factors). The DG's finding that prepayment penalty creates a demand side constraint is baseless.
- PPC enhances certaintly of cash flows from borrowers and therefore enhances consumer welfare.
- PPC is a tool for ALM by banks.
- 1-2% of PPC is not usurious, otherwise it would have been declared illegal by Courts of Law. Even if PPC is usurious, the Consumer fora are the right bodies to be approached.

- The DG has to keep in mind 'balance of interest' of all consumers.

(ix) State Bank of Hyderabad

- Banks are left with excess funds in case of prepayment of loans which may not be deployed profitably.
- If there is no PPC, there will be double benefit to the borrowers, because they anyway seek low rates of interest at the start.
- PPC is in interest of depositors.
- PPC is mentioned in the contract, therefore there is no effective increase in interest rate.
- SBH has some loan schemes where no PPC is charged.
- There is no question of abuse of dominance because SBH has 1.5% business of SCBs.
- There is no collective dominance in banking industry, otherwise the interest rates would have been higher than the current rates.
- As per law, transactions cannot be challenged for high interest rates being charged by banks.
- Banks have not formed any agreement to charge PPC.
- International practice appears to be in favour of PPC and World Bank etc levy PPC.
- Once a borrower has accepted a loan on certain terms, it is not open to him later to chose lower interest rate in the market.
- PPC cannot be termed illegal per se merely because it does not appeal to some borrowers.
- PPC is only restrictive or unfair trade practice and therefore beyond the jurisdiction of CCI.
- If PPC is to be prohibited for usury, then only consumer courts would have jurisdiction to do so.
- The Commission should refer the matter to RBI and Government of India for appropriate regulations.

- PPC is in the form of liquidated damages in a contract term.

(x) Canara Bank

- Section 3 (3) is not applicable because the agreement is not between persons in identical / similar trade.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- PPC does not influence new entrants and there is virtually no entry barrier in housing loan market.
- PPC may be against the interest of borrowers but keeping the balance of interest rule in mind it is beneficial to the depositors.
- PPC is only restrictive or unfair trade practice and therefore beyond the jurisdiction of CCI.

(xi) Indian Overseas Bank

- PPC creates healthy competition in the trade practices of banking industry.
- PPC has been tested on the rule of reasonableness by the DG and he has found the practice to be economically reasonable. The DG also found no dominance in the industry. Therefore there is no case made out against the banks.
- The DG has not given any evidence to establish that PPC is ex facie anti competitive.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has not gathered any data or evidence to establish that PPC is anti competitive practice.

- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- There are no entry barriers in the banking industry and also the market has been growing at a very high rate. This proves that PPC has not limited or controlled the availability of home loan products.
- The DG has not evaluated the practice of PPC on the factors mentioned u/s 19 of the Competition Act, 2002.
- Since there have been many new entrants in the market, it is not true that the practice of PPC has influenced the decision of new entry into the market.
- Prepayment of loans is dependent on interest rates (cyclical factors) and rising income levels (structural factors). The DG's finding that prepayment penalty creates a demand side constraint is baseless.
- When interest rate was rising in the market, existing borrowers were paying reasonably flat interest rates and were spared of rate shocks. Therefore PPC is welfare inducing.
- Since securitization is not common in Indian market, PPC is a tool employed by lenders to increase certainty of cash inflows.
- PPC is an ALM tool to manage reinvestment risk. That is the reason that RBI and the government did not frown upon PPC.
- 1-2% of PPC is not usurious, otherwise it would have been declared illegal by Courts of Law.
- PPC cannot be termed illegal per se merely because it does not appeal to some borrowers.
- The DG drawing analogy from US market is erroneous because the loan products in the Indian market, unlike US, are simple.
- The DG has erred to conclude that PPC is banned in the US.
- PPC is banned in UK because major chunk of the market is floating rate.
- Taiwanese example of banning PPC is of no relevance to the Indian scenario.
- IBA and economic thought across the world supports regulation of PPC rather

than complete ban.

- PPC is good for the depositors and the stake holders of banks. It may come under restrictive or unfair price terms and therefore beyond jurisdiction of CCI.
- If PPC is to be prohibited for usury, then only consumer courts would have jurisdiction to do so.
- Cases cited by the DG are irrelevant in the matter.

(xii) Vijaya Bank

- PPC allows banks to keep interest rates stable for existing borrowers and increase it to new customers; therefore the practice has given discernible benefits to the customers.
- PPC is an ALM tool to manage reinvestment risk. That is the reason that RBI and the government did not frown upon PPC.
- The DG has justified levy of PPC by NHB, but found it to be anti competitive in case of retail lenders.
- 1-2% PPC is not usurious.
- PPC charged by banks is within the directive and guidelines of RBI and the Government
- The DG's finding that there is collective dominance in the banking industry is incorrect because there is intense competition in the market.
- The market is well regulated by several agencies like RBI, Government and NHB whose mandate is protection of public interest.
- Since all banks are charging PPC, the Commission should not question it, but rather look into the implications. The RBI is the regulator for banking and it alone should decide policy about banks.
- PPC is good for the depositors and the stake holders of banks. It may come under restrictive or unfair price terms and therefore beyond jurisdiction of CCI.
- The DG has not gathered any data or evidence to establish that PPC is anti

competitive practice.

- The DG has not evaluated the practice of PPC on the factors mentioned u/s 19 of the Competition Act, 2002.
- All banks/HFCs are posting high profits so there is no question of adverse effect of PPC on competition.

(xiii) ICICI Bank

- PPC is required for Asset Liability Management of funds.
- PPC charged by ICICI Bank is not usurious.
- RBI directs that banks should be transparent in declaring the charges to the customer, and ICICI bank does that by taking acknowledgement of the customer for all terms and conditions in loan documents.
- Borrowers are deemed to be aware of all additional charges.
- Interest rates and charges of banks are not subject to judicial review.
- Only RBI can decide if any rate or charge is usurious or not
- The apex court has refrained from determining the legality of PPC.
- ICICI has been levying PPC since 2001 which is much before the IBA meeting.
- There is high growth and no entry barrier in the sector. This goes to prove that PPC has no correlation to market entry.
- PPC charged by banks is within the directive and guidelines of RBI and the Government
- The DG's finding that there is collective dominance in the banking industry is incorrect because there is intense competition in the market.

(xiv) Allahabad Bank

- PPC is levied as per contract terms and these terms are not against public policy.
- PPC is the damage payable by a party breaching a contract.
- PPC is levied to mitigate loss to lender due to prepayment of loan.
- PPC is nominal and does not restrict migration of borrowers. The DG has not quoted any instance for this.

- If NHB is justified in levying PPC, so are other banks.
- Cases cited by DG are of no assistance in this case.
- PPC has been tested on the rule of reasonableness by the DG and he has found the practice to be economically reasonable. The DG also found no dominance in the industry. Therefore there is no case made out against the banks.
- The DG has not given any evidence to establish that PPC is ex facie anti competitive.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services and is anti competitive.
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- Since there have been many new entrants in the market, it is not true that the practice of PPC has influenced the decision of new entry into the market.
- There are no entry barriers in the banking industry and also the market has been growing at a very high rate. This proves that PPC has not limited or controlled the availability of home loan products.
- The DG has not evaluated the practice of PPC on the factors mentioned u/s 19 of the Competition Act, 2002.
- Prepayment of loans is dependent on interest rates (cyclical factors) and rising income levels (structural factors). The DG's finding that prepayment penalty creates a demand side constraint is baseless.
- Banks are able to raise low cost funds by securitizing instruments that have certainty of cash flow (i.e. prepayment penalty). Therefore, PPC enhances consumer welfare. Banning PPC will have ***'appreciable adverse effect on consumers'*** (sic!)

- PPC is an ALM tool to manage reinvestment risk. That is the reason that RBI and the government did not frown upon PPC.
- 1-2% of PPC is not usurious, otherwise it would have been declared illegal by Courts of Law.
- The DG has to keep in mind 'balance of interest' of all consumers.
- Indian home loan market is diametrically opposite to the US market and therefore its example cannot be drawn. Anyway, US authorities have not favoured ban on PPC but rather to regulate the level of charges and fees.
- PPC is banned in UK because major chunk of the market is floating rate.
- Taiwanese example of banning PPC is of no relevance to the Indian scenario.
- IBA and economic thought across the world supports regulation of PPC rather than complete ban.
- PPC is good for the depositors and the stake holders of banks. It may come under restrictive or unfair price terms and therefore beyond jurisdiction of CCI.
- If PPC is to be prohibited for usury, then only consumer courts would have jurisdiction to do so.

(xv) Punjab National Bank

- RBI is the regulator of banking industry in India, and the practice of charging prepayment penalty is 'permitted' by RBI.
- Banks levy prepayment charges as per their genuine cost considerations.
- Letter of the IBA is not the basis of charging PPC and banks started levying the PPC at different times and different rates with different condidtions attached.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services.
- PPC is not ex-facie anti-competitive but has useful economic purpose
- Practice of charging PPC does not have predictable and pernicious anti competitive effect.

- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- DG has failed to give due regard to factors enumerated in 19 (3) to declare the practice as per se illegal.
- There is no entry barrier in the Housing Finance Market and PPC does not influence the decisions of potential new entrants to enter the market.
- Prepayment decisions are not influenced by the Prepayment penalties.
- Prepayment penalty is welfare inducing and benefits consumers
- Prepayment by the borrower generates reinvestment risk for the bank
- PPC is a tool for ALM by banks.
- The law in the united states does not ban charges and fees. Also there is no ban on the practice of payment penalty in EU.
- Competition act not applicable when practice is good for one class of consumer and not directly beneficial for another class.
- If PPC is to be prohibited for usury, then only consumer courts would have jurisdiction to do so.
- No concerted action by different banks / financial institutions

(xvi) Punjab and Sind Bank

- Since the DG report makes no reference to P&S bank specifically and because it charges a nominal PPC of 1%, it may be kept out of any enquiry by the CCI.
- Since PPC is part of sanction letter the borrower consciously accepts the terms.
- CCI has no jurisdiction in the matter as RBI is the regulator for banks.
- The DG's report gives no reason to establish that PPC is anti competitive practice.
- Banks do not decide fixing of their prices / interest rates or other charges under the umrella of IBA and there is no cartel.
- Practice of charging PPC does not have predictable and pernicious anti competitive effect.

- PPC is not anti competitive by the application of rule of reason and cannot be held as inherently anti competitive by the applying per se rule.
- PPC is not ex-facie anti-competitive but has useful economic purpose
- There is no evidence to prove market dominance and therefore not fit to be tried under MRTP Act.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services (home loan products).
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- DG has failed to give due regard to factors enumerated in 19 (3) to declare the practice as per se illegal.
- No evidence as to how the levy of PPC has in any way deterred the new entrants in the market and foreclosed the competition.
- Practice of levying prepayment penalty is welfare inducing and has discernible benefits. There is economic utility attached to the levy of PPC.
- Prepayment by the borrower generates reinvestment risk for the bank
- PPC is a tool for ALM by banks.
- Any practice cannot be termed illegal if it is beneficial to one class of consumers and not to other.
- PPC is beyond the jurisdiction of the CCI because it is beneficial to one class of consumers (i.e. depositors of banks) and accordingly subject of Consumer Courts.

(xvii) Corporation Bank

- The rationale for charging the PPC is to mitigate loss caused by such prepayment and ALM.
- Prepayment charges are nominal, does not discourage competition and

shifting of consumers from one bank to other.

- No consideration has been given to whether recommendation on financial regulatory reforms in USA and Taiwan were accepted or not.
- DG failed to assign any reason as to inapplicability of the policy adopted by National Housing Bank on Prepayment penalty to other banks.
- The case Dr. Usha Vaid vs. State Bank of India can not be basis of Investigation since prepayment charges were not part of the agreement.
- PPC is not exfacie anti competitive and serve useful economic purpose.
- So far as IBA circular dated 10/09/2003 is concerned, only economic consequences and not language and form of agreements can form basis of anti-competition investigation.
- Practice of charging PPC does not have predictable and pernicious anti competitive effect.
- The DG has failed to prove how the practice of levying prepayment penalty limits or controls provision of financial services (home loan products).
- Anti competitive effect of any practice can be presumed only if the relevant market is monopoly or oligopoly, which is not the case here.
- DG has failed to give due regard to factors enumerated in 19 (3) to declare the practice as per se illegal.
- PPC does not create entry barriers for the new entrants.
- PPC is levied to meet the reinvestment risk incurred by the bank and bank manages the risk through the process known as ALM.
- DG has failed to consider the totality of economic factors and interest of all classes of consumers
- If PPC is to be prohibited for usury, then only consumer courts would have jurisdiction to do so.
- PPC may be akin to restrictive or unfair trade practice and therefore beyond the jurisdiction of CCI.

13. The perusal of the above would show common issues raised in most of the replies which are as follows:-

i) Regulatory Purview

Since RBI is the banking regulator, CCI does not have jurisdiction in the matter.

(IBA, HDFC Bank, Vijaya Bank, ICICI Bank, PNB, P&S Bank)

ii) Legal Jurisdiction

PPC can be associated with unfair or restrictive trade practices and such practices can be challenged in Consumer Courts and are beyond the jurisdiction of CCI.

(SBI, SBH, Canara Bank, Vijaya Bank)

iii) IBA meeting has no consequence

The DG has wrongly relied on the language of the IBA circular dated 10 Sep 03 and internal circular of Banks to interpret that the intention has been to discipline the customer and to increase income. The DG concludes that the language of the said circular is monopolistic and that PPC is per se anti competitive. The DG should not have relied on the language and form of agreements but should have rather looked for economic consequences in has investigation.

(IBA, SBI, Indian Bank, OBC, IOB, Canara Bank, Allahabad Bank, Punjab & Sind Bank, Corporation Bank)

iv) PPC is a tool for asset liability management

When a borrower prepays a loan the Bank loses all future interest and also has to find new avenues to invest the fund received. This causes mismatch in the asset and liability tenure. Therefore, Banks charged PPC to compensate for the resultant loss.

(IBA, SBI, Deutsche Postbank , HDFC Bank, OBC, IOB, Vijaya Bank, Allahabad Bank, Punjab & Sind Bank, Corporation Bank, PNB)

v) DG has not gathered evidence to establish that PPC is anti-competitive practice

The DG has failed to produce evidence/data to establish that imposition of PPC limits or controls supply of home loans in any manner.

(IBA, SBI, HDFC Ltd, OBC, IOB, Vijaya Bank, Allahabad Bank, Punjab & Sind Bank, Corporation Bank, PNB)

vi) PPC has economic benefits

PPC enhances certainty of cash flow from borrowers and reduces volatility of interest rates, therefore, it enhances consumer welfare.

(IBA, SBI, HDFC Ltd, OBC, IOB, Vijaya Bank, Punjab & Sind Bank, Corporation Bank, PNB)

vii) PPC is a tool to manage reinvestment risk

Banks may suffer loss when a loan is paid before its tenure because they may not find equally profitable avenues to invest at the material time. To compensate for such probable loss they levy charge on the pre payment.

(PNB, Corporation Bank, Allahabad Bank, Punjab & Sind Bank)

viii) US, Taiwan and UK rules are irrelevant in the matter

US market has complex products and it has recently suffered crisis due to the profligacy of the players. On the other hand UK loans are mostly floating rate and therefore not comparable to the Indian situation. The example of Taiwan is also not relevant.

(IBA, LIC Housing, HDFC Ltd., IOB, Allahabad Bank)

ix) PPC is levied as per terms of the contract signed by the borrower; therefore CCI should not interfere in the Contract Act.

PPC is levied as per terms of the agreement between borrower and the lender and therefore any dispute under the Act is under the purview of Courts. CCI has no jurisdiction in the matter.

(IBA, LIC Housing, HDFC Ltd., IOB, Allahabad Bank)

x) The market is not monopoly/ oligopoly

In order to presume that a practice has anti competitive effects, the relevant market should be monopoly or oligopoly. Since there is no evidence in this regard, PPC cannot be presumed to be anti competitive.

(IBA, SBI, Canara Bank, OBC, PNB, Corporation Bank, IOB, Allahabad Bank)

xi) PPC does not cause demand constraints

Loans are prepaid due to cyclical factors (interest rates) or structural factors (rising income). DG's finding that PPC gives rise to demand constraints in the market, is baseless.

(IBA, OBC, IOB, Allahabad Bank)

xii) PPC is not usurious

PPC of 1-2% cannot be termed usurious, otherwise it would have been declared illegal by Courts.

(IBA, SBH, PNB, Corporation Bank, Deutsche Postbank, OBC, IOB, Vijaya Bank, Allahabad Bank)

xiii) If NHB is justified in charging PPC, so are other retail lenders

The DG has justified the practice of charging PPC by NHB. Other retail lenders are justified in similar manner to charge PPC.

(IBA, LIC Housing, Deutsche Postbank, HDFC Ltd., Vijaya Bank, Allahabad Bank)

xiv) The DG has not considered factors mentioned u/s 19 of Competition Act

The DG has failed to test the practice of levying PPC by lenders, with due regard to factors mentioned in section 19 of the Competition Act.

(SBI, Vijaya Bank, Allahabad Bank, PNB, Punjab & Sind Bank, IOB)

xv) PPC may be harmful to borrowers but it is beneficial to the depositors and other stake holders of the banks

(SBI, Canara Bank, Allahabad Bank, PNB, Punjab & Sind Bank)

xvi) The court cases cited by the DG are not relevant in the matter

The apex court has left the question of legality of PPC, open.

(Deutshce Postbank, Allahabad Bank, PNB, Punjab & Sind Bank)

xvii) The Commission has to keep balance of interest of all class of consumers

PPC may be harmful to borrowers but it is in the interest of depositors and CCI should not favour one class of consumers in the matter.
(SBI, OBC, Allahabad Bank)

xviii) The market has grown at very high rate which proves that PPC is no way detrimental to the industry. PPC has not deterred new entry in to the market.
(LIC Housing Finance, SBI, HDFC Ltd, IOB, ICICI Bank, Allahabad Bank)

xix) Miscellaneous

- Banks apply upward interest rate changes to new customers only and not to existing customers. Therefore, prepayment penalty is welfare inducing and helps consumers. – *(IBA)*
- Some individual pay PPC for their adventurism and it cannot be said that majority of consumer is adversely affected. – *(SBI)*
- PPC is levied to prevent volatility of customer. RBI permits levy of such charges. In Australia too lenders impose early discharge fee. – *(Deutsche Postbank)*
- Removing PPC may lead to crises in the market. Loans are prepaid mostly in falling interest rate scenario– *(LIC Housing Finance)*
- Borrower should not be allowed to wriggle out of contract terms. PPC is a safe guard against competition and unfair trade practices. Banks levy PPC to protect their business.– *(Indian Bank)*
- HDFC started levying the PPC much before the IBA meeting. PPC reduces effective price to borrowers. Borrowers who switch are net gainers even after paying PPC. Those who do not want to pay PPC can go to other lenders like Axis Bank. RBI does not ban PPC. DG report misses many finance companies. HDFC applies differential pricing of loan – *(HDFC Ltd)*
- PPC is the compensation to the bank that loses its customer to another lender. Under Banking Regulations Act 1949, interest rate charged by banks is not subject to scrutiny by courts– *(HDFC Bank)*

- There is no collective dominance in the banking industry otherwise interest rate would not have been so low. World Bank too charges PPC. Once a borrower has accepted a loan on certain terms it is not open to him to later choose lower interest rate in the market. The Commission should refer the matter to RBI or Government of India – *(SBH)*
- Section 3 (3) is not applicable in the case because there is no agreement between persons in identical/ similar trade– *(Canara Bank)*
- PPC creates healthy competition in the banking industry– *(IOB)*
- All banks and HFCs are posting high profits; therefore there is no question of PPC having adverse effect on competition– *(Vijaya Bank)*
- Borrowers are deemed to be aware of all additional charges. PPC is within the guidelines of RBI and Government of India.– *(ICICI Bank)*
- Banning PPC will have 'appreciable adverse effect on consumer' (sic!). – *(Allahabad Bank)*
- The decision to prepay is not influenced by the PPC. Competition Act is not applicable when the practice is good for one class of consumers and not directly beneficial for another class. – *(PNB)*
- Since P & S bank charges only 1% as PPC, it may be kept out of the purview of inquiry. – *(P & S Bank)*

14. After discussing the facts of the case, it is necessary to examine the provisions of the Competition Act. The preamble to the Act talks about:--

(i) Establishment of a Commission to prevent practices having adverse effect on competition.

(ii) To promote and sustain competition in markets.

(iii) To protect the interests of consumers.

(iv) To ensure freedom of trade carried on by the other participants in markets in India

(v) Matters connected therewith or incidental thereto.

15. Section 18 of the Competition Act defines the duty of the Commission which are:

(i) to eliminate practices having an adverse effect on competition.
(ii) Promote and sustain competition
(iii) Protect the interests of consumers
(iv) Ensure freedom of trade carried on by the other participants in markets in India

16. Competition itself has not been defined in the Act. The reason could be that by defining Competition the meaning of Competition is restricted. Therefore competition has to be given a wide meaning. The purpose of competition is the economic development of the country. Competition leads to higher productivity innovation, cheaper prices, freedom of choice and decreasing switching costs. Therefore practices which lead to decrease in productivity, innovation, higher prices, decrease of the freedom of choice and increasing switching costs may be classified as anti competitive or causing adverse effect on competition. It is the duty of the Commission to ensure freedom of trade, eliminate anticompetitive practices, promote and sustain competition and protect the interests of the consumers.

17. Section 3 of the Competition Act is reproduced and is as follows:-

Anti-competitive agreements

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

(2) Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void.

(3) 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 of goods or provision of services, which –

(a) directly or indirectly determines purchase or sale prices;

(b) limits or controls production, supply, markets, technical development, investment or provision of services;

(c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;

(d) directly or indirectly results in bid rigging or collusive bidding.

Shall be presumed to have an appreciable adverse effect on competition:

Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.

Explanation – For the purposes of this sub-section, "bid rigging" means any agreement, between enterprises or persons referred to in sub-section (3) engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

(4) Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply , distribution, storage, sale or price of , or trade in goods or provision of services, including -

(a) tie-in arrangement;

(b) exclusive supply agreement;

(c) exclusive distribution agreement;

(d) refusal to deal;

(e) resale price maintenance

shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.

Explanation – For the purposes of this sub-section –

(a) "tie-in arrangement" includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

(b) "exclusive supply agreement" includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

(c) "exclusive distribution agreement" includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods;

(d) "refusal to deal" includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought;

(e) "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

The section consists of various parts. Sub Section (1) of Section 3 has wide ramifications. An agreement which causes appreciable adverse effect on competition in India in respect of production, supply, acquisition, control of goods and services is void as stated in subsection (2) of section 3 of the Act. Sections 3(1) and 3(2) do not deal only with the supply side of the market. A market works on the principle of demand and supply. The assumption here is that a consumer would make a decision to purchase or sell in a rational manner so as to maximize gains to it. If an enterprise deals with an individual by entering into an agreement which causes an adverse effect to competition in India would be hit by Sections 3(1) and 3(2) of the Act. Any other view would be a narrow view and not authorised by the Act.

Section 3(3) of the Act is based on the concept of presumption. It is envisaged that if the factors as enumerated clauses (a), (b), (c) and (d) of Sections 3(3) exist then it would be presumed that there is an appreciable adverse effect on competition. No presumption is absolute as presumption can be rebutted. In the main section 3(3) of the Act, the behaviour of the persons or enterprises which are covered are agreements, practices carried on and decisions taken. Another aspect to be looked into is that the enterprises are engaged in similar trade of goods or provision of services.

Section 3(4) talks of an agreement between persons in a production chain in different markets in respect of production, supply, distribution, storage, sale or price of or trade in goods or provision of services. The Section has an inclusive definition which includes tie in arrangement, exclusive supply agreement, refusal to deal, exclusive distribution agreement and resale price maintenance. These five situations are not exhaustive and could include other situations. In any case exclusive supply agreement means an agreement which restricts the customer from buying goods or services from any other buyer. Only issue to be examined in Section 3(4) is whether on the facts and circumstances of the case there is an adverse effect on competition.

18. The next salient feature to be seen as to how the Act should operate. Under Section 16 of the Act, it is the duty of the Director General to assist the Commission to fulfill its obligation under Section 18 of the Act. It is not for the Commission to sit on judgement over the findings of the D.G. If the D.G. has not carried out proper investigation, the Commission can direct the D.G. to investigate the case on the issues to be directed by the D.G. It can inquire itself also. This is the scheme under Section 26(7) of the Act.

19. The procedure for inquiry has been laid down in Section 26 of the Competition Act. On the basis of own information or from any other source, the Commission can form an opinion that prima facie case exists it can direct the DG to carry out an investigation under the Competition Act [Section 26(1) of the Act]. If on the basis of information, the Commission forms a prima facie opinion that no case exists, it can close the case [Section 26(2)]. An appeal to the COMPAT lies against the Commission. Under Section 26(3) of the Act, the D.G. is required to submit his report to the Commission within the period specified. Under Section 26(4), the report of the D.G. is required to be forwarded to the parties concerned. Section 26(5) envisages a situation where the D.G. has not found a contravention of the Act. In such a case, the Commission is required to give a notice to all the parties and hear them. Under Section 26(6) of the Act, if the Commission agrees with the findings of the D.G. it can close the case by passing an order. This order under Section 26(6) is appealable. Section 26(8) talks of a situation where D.G. has found a contravention of the Act but the Commission finds that more enquiries are needed, it can carry out enquiries. No order dropping the case or penalizing the concerned parties can be passed under Section 26(8) of the Act because the section does not talk of an order as has been mentioned in sections 26(2) and 26(6) of the Act. It is impled in the Act when the

Commission has formed a prima facie opinion under Section 26(1) of the Act and the D.G. has confirmed this prima facie view by investigation, the Commission cannot drop the proceedings. If it drops the proceedings it amounts to a recall of its orders passed under Section 26(1) of the Act. Further the legislative intent is clear. As discussed earlier no order under section 26(8) can be passed. If the intention of the legislature was to drop proceeding under section 26(8) then it should have mentioned that an order was required to be passed and the said order would have been appealable. In such a case, the Commission has to accept the recommendations of the D.G. though it has discretion to levy penalty of different types under Section 27 of the Act.

20. We also have to examine the economic considerations for the levy of penalty charged by the banks for the foreclosure of loans. We have to examine the economies of treatment of this phenomena of penalty for the foreclosure of loans in other countries. We also have to examine the home loan market in India and its contribution to the Indian economy and vice versa. We also have to examine whether the banks/financial companies are losers or gainers if their customers prepay their loans.

21. In India, the shortage of homes for living is approximately 70 million. The economy in India was liberalized in 1991. Home loan concept was introduced in India and tax breaks were introduced for home loan takers. After the opening of the economy, the G.D.P. in India increased substantially and from 2003 to 2008, the G.D.P. growth was approx. 8.9%. Due to liberalization of the home loan market, increase in disposable income, the requirement for home loans increased and the home loan market grew by 43% between 2000 and 2005. Many new banks and finance companies entered the home loan market. The market is very big and demand is so high that many more enterprises want to enter the market.

25. An economy would grow in the short run if consumer spending increases. If consumer spending increases the savings rate would go down. Savings rate increase in the long run may be beneficial but consumption spending in the short run is beneficial for the economy. Thus it is necessary to put surplus cash in the hands of the consumers. But the banks by having a prepayment fine on the consumers is decreasing the cash availability. Further, a cap has been put on the banks and other companies as far as housing loan is concerned. If a filip is given to housing by having cheap property prices and cheap loans, the housing industry would receive a boost. This in turn would lead to higher employment, higher industrial growth, higher growth of person income and increase of G.D.P.

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

27. The European Commission carried out a study of retail banking. Even the EFTA Authority had carried out a study of retail banking in the EFTA countries. The European Commission found potential competition concerns and consumer harm in some of the areas such as list of coordinated behaviour in the banks to the detriment of customer mobility through a non-transparent treatment of certain products such as mortgages. There are some economists who consider that banks form a big cartel but most of the economists are not of this view. The European Commission observed that the mortgages generated largest share of income in retail banking in European banks. It has also been stated in the said report that before customers change banks he considers all the factors which help him in switching banks. This would include switching costs also. It was also observed by the Commission that switching costs in the retail bank industry has three significant effects (i) it increases the bank market power and this leads the bank to discriminate between new customers and old customers. The bank would charge low charges to attract new customers and once the customers are locked, the banks would charge higher prices which may be in the form of switching costs. (ii) Switching costs served as an entry barrier because it does not allow switching to consumer to bank with cheaper and better product. If the switching costs are high it was uneconomic for new entrants in the market to induce customer to switching. (iii) The third aspect was it discourages product innovation. When a new product is introduced in the market due to innovation and the switching costs are low the customer would like to switch to the new product. But if the switching costs are high there would be no reward and no customer would like to switch. In the EFTA report it has been stated that in order to have the benefits of the competition in the banking sector the customers should be able to choose their banks. Any obstacle that reduces consumers' ability to switch banks would reduce the competitive pressure on the banks. If closing charges are charged by bank this would reduce the mobility of the customers. High level of switching cost in the banking industry results in increasing the bank market power and enables banks to extract extra rent form the customers. High switching costs also constitute barriers

to entry as it makes harder for new entrants to attract new customers and hence it discourage new market entry. High switching costs also discourage product innovation as customers would be reluctant to switch to new products and services. The finding of the both European Commission and EFTA authority are similar.

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

29. An argument has been advanced that banks would suffer a loss if the customers prepay their loans. For this reason a prepayment penalty is levied. There is a fallacy in this reasoning. It is clear from the fact that the banks recover interest and then the principal. Let us take an example. Suppose a customer has taken a home loan of Rs.1,00,000/= for a period of ten years at an interest of 10%. Then the Balance, principal, interest and E.MI. would be as follows:-

At the end Year	Balance	Principal	EMI
1.	100000	6275	16275
2.	93725	6902	16275
3.	86823	7592	16275
4.	79231	8351	16275

5.	70880	9187	16275
6.	61693	10105	16275
7.	51588	11116	16275
8.	40472	12227	16275
9.	28245	13450	16275
10.	14795	14795	16275

If after five years the customer wants to prepay his loan, the balance principal amount payable is Rs.61,693/=. The customer has to prepay this amount as well as the prepayment penalty of 2%. Though the customer has not completed his tenure, it has paid most of the interest for a tenure equivalent to ten years. The bank is not a loser.

30. In banking, asset and liability management is the practice of managing risks that arise due to mismatches between the assets and liabilities (debt and assets) of the bank. A corporation that wishes to acquire an asset must decide whether to pay cash, thereby reducing an asset, or take out a loan, thereby increasing a liability. The banks contended that due to the prepayment of the loans banks will be in a situation in which it will be difficult to manage the liabilities (saving accounts/fixed deposits/borrowing, etc.) of the banks. Further, the concern is also related with the depositors with the banks as they are being provided fixed interest rates on their deposits.

31. Although, through the pre-payment of loan, the principal money is repaid well in advance to the banks through foreclosure. Even if it has been paid through switching banks or availing loan by the other competitor banks, the bank foreclosing the loan will get their principal money returned well before the tenure and will provide opportunity to further pump in the market.

32. Concept of time value for money is well recognized in the financial market. As the money received today has better value than the same amount of money received

in future. For example, Rs.100 of today's money invested for one year and earning 5 percent interest will be worth Rs.105 after one year. Therefore, Rs.100 paid now or Rs.105 paid exactly one year from now both have the same value to the recipient who assumes 5 percent interest; using time value of money terminology, Rs.100 invested for one year at 5 percent interest has a future value of Rs.105.

Accordingly a principal received 5 years earlier will have more value than received 5 years later, as the money will again in the process of generating interest through advances.

Further, the Equated Monthly Installments (EMI) is calculated in such a way that in the initial period of the payment, the component of the principal amount is very low and the interest portion is very high.

Suppose, if any customer wishes to foreclose the loan amount of 1 lakh in the 5^{th} year which has been taken for 10 years at the rate of 10% per annum. The EMI of this will be Rs.16275/Annual. The EMI contains an interest component as well as a principal component. The interest component is always 10% of the balance - because the interest rate is 10%. The remaining amount is the principal repayment.

33. In view of the calculation of EMI and the 'time value for money' it is 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. As this practice is fleecing the consumers and also it is not generating any economic value to the development and restricting the consumer to exercise the right of freedom to choose better financial options for the loan.

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

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

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

37. The housing loan market is a very secure market as the creditors which are banks/HFCs have the securities of the houses/flats to recover their loans. To spur economic activities and decrease the shortage of houses, the banks/HFCs have to increase the portfolio of the loans for homes. In India the home loan market constitutes a minuscule of the total loan given by the banks. The banks charge lower

interest on large loans given to large industrial houses but they do not do so in the home loan market. When an industrial house is in financial trouble, the banks restructure the loans by waiving interest but it is not done in the case of home loans. Home loans are given in India in two forms. There is a fixed interest home loan and there is a floating interest home loan. In the case of floating interest, home loan if the interest rate rises, the home loan interest is raised by the banks and if the interest rate goes down, the interest on the home loan interest goes down. But in practice it is found that even when the interest has gone down, the banks have not reduced the interest. Thus, the banks/HFCs have been not very honest with their home loan customers.

38. On the issue of pre-payment charges on housing loans, a reference was taken up by the Department of Financial Services, Ministry of Finance by a circular dated 05.05.2010 the Department issued a letter to all the CEOs of the Public Sector Banks which is reproduced as under:-

CEOs of
All Public Sector Banks

Sub: Pre-payment charges on Housing Loans

Sir,

On a reference made to this Department on the issue of Pre-payment charges on Housing Loans, the issues were examined after taking into account the views of RBI, IBA and select Public Sector Banks.

In the backdrop of examination, you are requested to kindly ensure, in letter and spirit that:-

(i) No pre-payment charges are levied when the loan amount is paid by the borrowers out their own sources; and

(ii) The pre-payment charges, if any to be imposed by your Bank on housing loans, the same need to be reasonable and not out of line with the average cost of providing these services.

You are requested to kindly acknowledge receipt of this letter.

Yours faithfully,

(Samir K. Sinha)
Director (BOA & IR)

39. Recently, the Bank Ombudsman received a complaint against a bank that the bank had levied pre-payment charges. When the issue came up before with the Ombudsman, he found that in the loan sanction letter there was no provision for levying pre-payment charges. The bank was, therefore not entitled to levy pre-payment charges. As a consequence of the order of the Ombudsman the bank had to refund 8.2% of the pre-payment charges taken for the foreclosure of the loan. It is thus clear that pre-payment charges are being levied in many cases wherein the sanction letter, no such penalty was required to be levied by the banks/financial institutions.

40. A similar case came up before the French Competition Authority. In the year 2000, Couseil de la concurrence (French Competition Commission) found that several banks and institutions had entered into anticompetitive agreement in the sector of home loans. According to this agreement, the banks/institutions 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. 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. The Competition Commission held that this agreement between the banks constitutes an anti competitive practice and that was viewed seriously by all the competition authorities. It also ruled that banking activities are subject to competition law and that the competitive workings of the market are based on the independence and autonomy of the players involved. The authority held that because the agreement between the banks acts as barriers the consumers were deprived of the option of significantly reducing their property cost. The authority also hold that property represents the most substantial investment by households and the repayment of loans required for this investment accounts for 30% of their disposable income. Thus, disposable incomes of the household were decreased. For this reason economic development suffered and the markets were deprived of large amount of funds. The authority thereafter levied a fine of one hundred & fifty million on the banks.

41. In the background of the legal position and the fact of the case, we have to examine each and every argument which has been raised by the banks and HFCs before the Director General and the Commission. The first argument is that the Commission had no jurisdiction over banks as RBI is the regulator. This argument is without any basis as the jurisdiction over the competition issues is with the Commission and the regulation of banks / HFCs on other matters is with the RBI.

42. The second argument is that prepayment fines are more in the nature of unfair or restrictive trade practices and should be dealt with by the Consumer Courts rather than by the Commission. It was, therefore, stated that the Commission had no legal jurisdiction. No basis has been given as to how the issues under consideration are unfair and restrictive trade practices. This argument is therefore, without any basis. In fact, the issues here are ones which show that the banks/HFCs have created an adverse effect on competition.

43. The third argument taken is that the decision taken in the IBA Circular of 10th Sep, 2003 should have been disregarded by the DG and that the economic consequences should have been seen by the DG. It has been conceded that the Circular had the intention of disciplining the customers and to increase the income of the banks. In fact the circular which was more in the form of recommendation was issued with the idea of retaining the captured customers by the banks and stop then from switching by levying charges at the time of foreclosure of loans.

44. The fourth argument taken was that when a borrower prepaid his loan, the bank lost future interest and also lost avenues to invest the funds received. It was stated that this created a mismatch in the asset and liability tenure. It was, therefore, argued that the banks charged penalty from the customers to compensate the losses. Though, most of the banks argued on these lines but none of them brought any data or material to establish this claim. No material has been brought on record to establish that the banks had suffered a loss which entitled them to levy penalty for the foreclosure of loans. On the contrary, as already worked out above, as the banks recover the interest first and the principal in later years, by the foreclosure of loans, applying the principles of discounting, the banks are gainers. Regarding the funds received as prepayment, as the home loan market is very huge, the funds can be redeployed and the banks would be gainers. Therefore, this argument of the banks/HFCs are without any basis and ought to be rejected.

45. The fifth argument raised is that the DG has not gathered any evidence to establish the penalty levied is an anti-competitive practice. The DG has invoked section 3(3)(b) of the Competition Act which is a case of rebuttal presumption. It is for the banks./HFCs to establish that the presumption is wrong by bringing material on record. This onus cast by the operation of the Act has not been discharged by the banks/HFCs.

46. The sixth argument is that PPC enhances cash flow from the borrowers and reduces the volatility of interest rates and therefore enhances consumer welfare. This is a fallacious agreement because the levy of penalty decreases the cash surplus of the borrowers and therefore is detrimental to the welfare of the consumers.

47. The seventh argument is that PPC is a tool to manage reinvestment risk. It has been argued that when prepayment of loans is made, the banks would have surplus cash which they may not be in a position to invest. To compensate for this loss the penalty is levied. It has been discussed that the home loan market in India is very large with an insatiable demand for home loans and therefore the surplus can cash can be lent to some other borrower. There may be a time lag for which a small compensation from the borrower in the form of one month's EMI may be collected.

48. The eighth argument was that the international treatment of PPC is not relevant in the Indian context. But no material was submitted to support this claim.

49. The ninth argument was that when a borrower takes a loan from a bank then he is hit by the provisions of the Contract Act. It was also agreed that the consumer was aware of the fact that he had to make payment of penalty when he prepaid the loan. It was therefore, argued that the consumer was aware of the fact that he had to make payment of penalty when he prepaid the loan. It was therefore argued that in such a case the competition Act is not applicable. This argument is correct to the extent that in any civilized society, priority of contract had to be maintained. But the legislature in its wisdom had also framed laws according to which whenever there is an anti-competitive behaviour the same is required are to be punished. Therefore, this argument of the banks/HFCs is without any basis.

50. The tenth argument is that the market should be governed by a monopolist or by an oligarchy and then only it could be said to be anti-competitive. It was argued

that in the absence of such a finding, Competition Act would not apply. The fact is that this argument is very simplistic. The provisions of the Competition Act would have to be examined as to whether they would be applicable in the Indian home loan market.

51. The eleventh argument is that the loans are prepaid due to cyclical factors and that PPC gives rise to demand constraints, as opined by the DG, is without any basis. The DG is to assist the commission and it is for the Commission to decide the anti-competitive behaviour of the participants in the market and not the DG.

52. The twelfth argument raised is that PPC is not usurious, otherwise it would have been declared so by the Courts. This argument is misplaced as the only issue before the Commission is whether the behaviour of the banks is anti-competitive in the home loan market.

53. The thirteenth argument is that the DG has recorded a finding that charging of PPC by National Housing Bank and other retail lenders is justified. As already discussed in the scheme of the Competition Act, DG is only an investigative branch of the Commission. If his findings are erroneous and without any basis, the Commission is not bound to perpetuate such erroneous findings. If PPC is found to be anti-competitive, the Commission is bound to take action against National Housing Bank and the other retail lenders.

54. The fourteenth argument is that the DG has not considered the factors of Section 19 of the Competition Act. The arguments are misplaced because it is the duty of the Commission to consider the factors of Section 19 of the Competition Act and not the DG.

55. In the fifteenth argument it has been conceded that PPC is harmful to the borrowers. But on the contrary it was stated to be beneficial to the depositors. This argument is without any basis because the gains from PPC have not been transferred to the depositors in the form of higher interest.

56. The sixteenth argument is that the court cases relied upon by the DG are not relevant. The argument raised here are correct because the court cases are with reference to the Consumer Act and not the Competition Act. Further, the Supreme Court has not opined on the legality of PPC and has left it open.

57. The seventeenth argument is that the home loan market has grown at a very high rate and that PPC has not deterred the entrance of new entrants to the market. This agreement is without any basis because the market in India has grown inspite of the anti-competitive behaviour of the banks. The reason for growth of the market is the pent up demand for houses, a very high GDP growth and cash surplus with the people in India.

58. The eighteenth argument is that banks apply upward interest rates to new consumers and not to existing consumers. It was therefore, argued that prepayment penalty is welfare inducing and helps consumers. This argument is totally incorrect. The banks in order to attract new customers charge lower rate of interest and after a year or two put the customers on a floating rate of interest which is substantially higher. But the rate of interest is not reduced even when the interest rate comes down. Thus, the banks are extorting rent from their old customers.

59. The nineteenth argument was that section 3(3) is not applicable to the banks/HFCs because there existed no agreement between the banks and that Section 3(3) would apply only in the case of agreements. A reading of Section 3(3) would show that the Section would apply when the following situations exist– (i) when

there is an agreement between the parties. (ii) Practice carried out by the parties. (iii) a decision taken by the enterprises as an association including a cartel. It is also stipulated in the Section that the parties/enterprises should be in the same line of business. Section 3(3) would apply if the conditions of clauses (a) to (d) are satisfied. The existence of an agreement is not necessary for the application of Section 3(3) of the Act. A practice carried out or a decision taken would also be hit by Section 3(3) of the Act provided the enterprises are in the same line of business.

60. It has also been argued that the levy of penalty for the foreclosure of loans creates a healthy competition in the market and the bank industry. Further with the existence of PPC the banks are showing very high profits and therefore PPC did not have any adverse effect on competition. It was also argued that banning PPC would have an adverse effect on competition. It has also been argued that the levy of penalty on the borrowers by the banks is beneficial to the consumers. Though these arguments were advanced no material was provided in support of these arguments. It could be possible that high profits of the banks/HFCs were due to the prepayment penalties of due to large home loan market. No bank furnished the details of their earnings through prepayment penalties. It is not clear how PPC leads to competition and how banning PPC would be anticompetitive. Even how PPC brings benefits to the consumers is not clear.

61. It was further argued that the PPC has been levied to stop the adventurism of the consumers, to stop volatility in the markets, to discipline the consumers and to stop the consumers from migrating to other home loan suppliers. It was further argued that PPC was a safeguard against competition and unfair trade practices and that PPC was levied to compensate for the losses suffered by the banks. It was also stated that World Bank also levied PPC. From these arguments it is clear that the main aim for the introduction of PPC was to hold on to customers and stop consumer choice. It has been conceded by some of the banks that PPC was introduced to

increase profits and reduce competition in the markets. It is not material whether the World Bank charges PPC or not. What is to be examined is as to how the levy of PPC affects the competition in the home loan market.

62. But before examining competition in the home loan market it is necessary to examine the behaviour pattern of consumers i.e. behaviour economics. Before a theory or hypothesis is formed, it is necessary to have certain axioms. In economics, the axiom is that in a perfect market, a consumer would make a rational choice which would increase his economic well being. The question is as to how this rational choice can be made. This choice depends on whether a person wants to improve his economic well being. It also depends on the information which is available to person in the market. This choice is dependent on the advertisements which flood any market, it depends on brand value, it depends on the services which are given in the market or it could depend on the perceived advantage to the consumer. The consumer can suffer from processing overload. Consumer biases can set in the processing of information. For a market to function properly a consumer should be able to assess access and process information. Because of the bulky information which the consumer has to go through before he enters in the agreement he can enter into an agreement which is anticompetitive. This can happen due to processing overload. The agreement may lead him to high switching costs. It there are high switching costs, mobility of the consumers would be affected. Thus, a new entrants would not get customers and innovation would suffer. Even the allocative efficiency of the markets would suffer. Competition Authorities such as the OFT and others thus realize that behaviour economies plays a major role in the competition in the market. It is recognized that agreements are not sacrosant as God's Ten Commandments. Even if a consumer has signed the agreement, it could be due to misinformation fed by the sellers of the products. Further, as discussed above, switching cost are being recovered even if there was no such factor in the agreement.

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

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

65. There are certain other factors which need to be considered. In the Indian home loan market, the only bank which does not charge penalties for prepayment is the Axis Bank. A rational choice for the home loan borrowers would have been this

bank. But Axis Bank is small new bank with few branches. Therefore, it remains an insignificant player in the home loan market. On the other hand, HDFC is the oldest and a major player. SBI being the largest bank with many branches is also a major player. Now if someone wants to shift from HDFC Bank or SBI to Axis Bank he cannot do so because he would have to suffer a penalty. Therefore a new bank with new and innovative product cannot enter the home loan market because the existing borrowers cannot shift to it.

66. In the year 2008, when the interest rates were falling due to the global economic slowdown, the SBI introduced home loans for new borrowers at 8%. The interest rates were to be raised after one year and after a number of years the interest rates were to be the same as the floating rate of interest. Incidentally, the home loans are given either at fixed rate or floating rate. Though the interest rates had fallen in 2009 none of the banks reduced the floating rate of interest. HDFC, ICICI and some other banks followed SBI. Thus for new borrowers and interest rate was 8% for the old borrowers the interest rate was above 12%. The old borrowers could not shift to other banks as they would suffer prepayment penalties.

67. During the course of hearing of the banks, it was conceded by some of the banks that the concept of penalties for the foreclosure of home loans was introduced because the banks did not want to lose customers who could have migrated to banks giving loans at a lower rate. They thus wanted to reduce the mobility of consumers and reduce their choice. The banks also wanted to discipline the consumers. The banks wanted to extract rent out of the consumers by charging the penalty as they perceived losses. But what losses they had incurred to would have incurred was not worked out. The banks were also not aware of how much they had earned out of the prepayment penalties. The data was not available because home loans constituted a very small percentage of their total loan portfolio. In fact even today S.B.I. which is the largest bank in the country, has a total home

loan portfolio of 13%. Most of the banks talked of asset liability mismatch when the consumers prepaid their loans. But no material to support this claim was furnished. On the contrary, as worked out above no loss is suffered by a bank if a consumer prepays his loan. In fact the prepayment enlarges and deepens the home loan market because there is an insatiable demand for home loans in India. I have already dealt with the arguments raised by the banks.

68. In view of the above noted factual position, the issues are to be examined with reference to the Competition Act, 2002. The question here is of switching charges which a consumer has to pay in the form of prepayment penalties. There is no doubt that by charging pre-payment penalty the banks reduced the choice of the customers. As a consequence of the prepayment penalty, a customer cannot shift from one bank to another. Further when a new bank enters the market it would not be able to get customers from the other banks because the customer would not like to shift in view of the penalties which he would have to pay if he shifts to a new bank. Thus by levying the pre-payment penalties banks are killing competition in the home loan market. This also leads to decrease in the allocative efficiency of the market and a reduction of innovation. Under the provisions of Section 3(1) of the Act, no supplier of goods and services can enter into an agreement which causes or is likely to cause an appreciable adverse effect on competition. In all the cases where the banks enter into an agreement with a consumer for home loans, the banks have envisaged penalties provided the consumer pre-pays his loans. As already discussed the levy of switching charges in the form of pre-payment penalties causes an appreciable adverse effect on competition. Therefore, under Section 3(2) of the Act of these agreements entered into by the banks are anti-competitive agreements and therefore void.

69. Before declaring an agreement to be void the provisions mentioned in Section 19(3) of the Act have to be looked into. An appreciable adverse effect on

competition under Section 3 cannot be determined without regard to the facts enumerated in Section 19(3) of the Act which are:

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

(ii) Driving existing competitors out of the market.

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

(iv) Accrual of benefits to consumers,.

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

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

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

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

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

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

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

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

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

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

(i) the agreements entered into between the entities of the class described therein, or
(ii) any practice carried on by them, or
(iii) any decision taken by them and

(iv) Containing the terms set out in clauses (a) to (d) which in substance are fixing prices, limiting or controlling supply of goods or services or technical development, sharing the market, and bid-rigging or collusive bidding.

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

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

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

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

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

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

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

f. Are these association of banks is in any way limiting or controlling this provision of services?

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

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

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

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

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

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

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

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

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

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

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

It has further been held in Commission vs. Bayer AG (2004) 4 CMLR 13, that it is sufficient that the parties to the agreement have expressed there joint intention to conduct themselves in the market in a specific manner. As regards the form in which the common intention is expressed, it is sufficient for a stipulation to be the expression of the parties' intention to behave on the market in accordance with its terms.

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

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

- Any formal or informal arrangement or understanding

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

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

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

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

72. Now, let us examine whether any or all elements of an anti-competitive agreements are present in the case under consideration. Is it not a fact that there was a meeting of IBA in September, 2003 where all members bank were present and the issue of pre-payment penalty issue was discussed? It is irrelevant whether there was an agreement, consensus or a decision to impose the PPC. Why this meeting was held in 2003? There is a background to that. When HDFC was the only player in the home loan financing market from 1978 to 1993, they never felt the need of imposing PPC nor they raised any issue such as ALM, but when LIC HFC entered into the market

in 1993 then they felt threatened and started charging PPC. Again when other players entered the Home Loan Market, the LIC HFC also started charging PPC to protect its market. Then other players also started advocating the imposition of PPC in order to hold their domain. That was the reason why this IBA meeting was held in 2003. Though, no consensus was reached due to opposition from some of minor players in HLF market, all major banks started this practice after this meeting.

So, what these signify?

- Was not there any tacit arrangement or understanding or a joint conspiracy and collaborative action which is pervasive in the initiation, execution and fulfillment of the plan i.e. the charging of Pre-payment penalty.
- Was not there meeting of minds or concurrence of wills?
- Have not they expressed there joint intention to conduct themselves in the market in a specific manner.
- Was any formal, explicit or written agreement is still required in this case.
- Is not there a concerted practice on the part of the banks to charge pre-payment penalty more or less at the same rate and terms & conditions.
- Is not there any coordination among the banks to charge pre-payment penalty to protect their market as held by the European Court of Justice in in Sugar Cartel Case (1969) 3 All ER 1065 that conceptually concerted practice is a form of coordination between the parties where they have not reached the stage of actual agreement but knowingly coordinate their actions and cooperate with one another instead of competing with each other.

73. Now, coming to the “Practice carried on” by these Banks“ which is limiting or controlling the provision of services”, it is a fact that the banks have adopted the practice of imposing prepayment penalty to Borrowers who wish to either repay their loan in advance or to the Borrowers who wish to migrate the said loan to another lender. The Banks are charging a rate of prepayment penalty varying from 1% to 4% on the outstanding loan amount. The banks have formed an association of

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

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

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

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

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

(a) creation of barriers to new entrants in the market;
(b) driving existing com[editors out of the market;
(c) foreclosure of competition by hindering entry into the market;
(d) accrual of benefits to consumers;
(e) improvements in production or distribution of goods provision of services;
(f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services,

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

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

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

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

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

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

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

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

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

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

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

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

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

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

76. Now, coming to the legal position, the Supreme Court, In Usha Vaid v Sate Bank of India [RP No.2466/2007] in a consumer grievance case has upheld the decision of the National Consumer Grievance Redressal Commission wherein it was held by them that there should be no pre payment charge on migration of loan to another lender and the levy of pre-payment penalty amounts to unfair and restrictive trade practice.

77. In another case, the French Competition Authority known as Conseil de la Concurrence, has dealt with the identical issue of giving property loans to individuals by different banks and charging pre-payment penalty. The gist of the decision is given below:-

Facts: In this decision, the Conseil de Ia Concurrence had, for the first time, to deal with anticompetitive practices in the banking sector. In 1993, the Conseil decided on its own initiative to investigate the property loans to individuals offered by the main French high-street and saving banks representing up to two-thirds of the relevant market.

The investigated period took place while the long-term property loans were fluctuating, peaking at 20 per cent in the early 1980s then falling gradually from 12 per cent in 1992 to less than 8.5 per cent in 1994. In such circumstances, any individual whose loan's maturity exceeded five—seven years, could have benefited from the fall. Loans holders were then interested in either renegotiating with their bank, or benefiting from the competitive situation by paying off their loan earlier and subscribing to a new one in a rival bank.

However, such a possibility allowing individuals to take full benefit of the market evolutions had been jeopardized by an "inter-bank non-aggression pact" which led to two main competition restrictions. First, the banks who signed the said agreement refrained from making offers to rival banks' customers who wanted to subscribe to a new loan. Secondly, the agreement enabled each of the banks to better resist requests by their own customers to renegotiate their loans, since these customers could not ask another bank in case their request was rejected.

The Conseil noted that, even if a cartel agreement between banks was not applied in a uniform manner, borrowers were prevented from significantly reducing their property debts, even though property represented the most substantial investment by households, and the repayment of loans required for this investment accounted for 30 per cent of their disposable income.

According to the banking establishments, the outstanding amounts likely to be affected by the renegotiation of property loans during the period in question amounted approximately to EUR 90 billion. However, households were only able to renegotiate around EUR 5.5 billion which represented for them an overall reduction in interest charges of about EUR 450 million over 10 years.

Given the seriousness of the practice and the national scope of the agreement implemented by the main property loans operators, the Conseil imposed fines to nine banks totaling more than EUR 150 million. This is one of the highest fines ever imposed by the Conseil de la Concurrence.

Comment: The Conseil de la Concurrence stated that, although banking activities are governed by specific regulations, they are still subject to competition law. The Conseil also indicated that any competitive market is based on the independence and autonomy of the players involved. It stated that when concerted practices lead to the removal of any uncertainty, they effectively distort competition; since each single actor is assured that the 0tber banking networks will apply the same commercial policy.

78. In view of the facts and circumstances stated above there is no doubt that there is a contravention of Section 3(3) (b) of the Competition Act, 2002 as these Banks have adopted a practice of imposing pre-payment penalty by way of a concerted action which in effect limits or controls provision of services which resulted into foreclosing of customers mobility and by hindering entry into the market and thereby no benefit is being accrued to the consumers.

79. In the consequences by having a system of pre-payment penalties for the foreclosure of the loans, the banks and the home loan companies have contravened the provisions of Section 3(1), 3(2), 3(3) and 3(4) of the Competition Act.

80. After all due considerations to the submissions and relevant case laws and oral submissions by different Banks and DG Report. I have found that the Banks/HFCs have contravened the scheme of the Act and are indulged into anti-competitive practices.

In accordance with the scheme of the Act, after finding of contravention of Section 3 or Section 4 of the Act, order under Section 27 has to be passed by the Commission.

Section 27 of the Act read as follows:

"Orders by Commission after inquiry into agreements or abuse of dominant position"

27. Where after inquiry the Commission finds that any agreement referred to in section 3 or action of an enterprise in a dominant position, is in contravention of section 3 or section 4, as the case may be, it may pass all or any of the following orders, namely:-

(a) direct any enterprise or association of enterprises or person or association of persons, as the case may be, involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case may be.

(b) impose such penalty, as it may deem fit which shall be not more than ten per cent of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse:

[Provided that in case any agreement referred to in section 3 has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or ten per cent of its turnover for each year of the continuance of such agreement, whichever is higher.]

(c) [Omitted by Competition (Amendment) Act, 2007]

(d) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;

(e) direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any;

(f) [Omitted by Competition (Amendment) Act, 2007]

(g) pass such other order or issue such directions as it may deem fit.

[Provided that while passing orders under this section, if the Commission comes to a finding, that an enterprise in contravention to section 3 or section 4 of the Act is a member of a group as defined in clause (b) of the Explanation to section 5 of the Act, and other members of such a group are also responsible for, or have contributed to, such a contravention, then it may pass orders, under this section, against such members of the group.]

The Competition Act is new Act and the enterprises operating in India re still unaware of the practices which can cause infringement of the Act. However, it has been concluded that the practices carried out by the Banks/HFCs were appreciably affecting the Competition in the Home loan market and perilously affecting the consumers. In view to restore better competition in the market and considering the plight of consumers, I pass following orders to all the Banks and HFCs:-

All the Banks and HFCs operating in India are directed-

(i) to stop all such agreements with the customers relating to charging of prepayment of penalty or foreclosure fees or any such switching cost which creates barriers to the customers to shift to avail finances from other cheaper sources, even if it is not paid through their own sources.

(ii) not to enter into an agreement with the customers relating to charging of prepayment of penalty or foreclosure fees or any such switching cost which creates barriers to the customers to switch to avail finances from other cheaper sources, even if it is not paid through their own sources.

(iii) to refund all the prepayment charges or foreclosure fees to the customers who have repaid the loans after 20th May, 2009 if collected by the Banks/HFCs as the provisions related with 'anti-competitive practices' and 'abuse of dominant position' became operational and law of the land on the said date.

(R. Prasad)
Member, CCI