

COMPETITION COMMISSION OF INDIA

M RTP Case No. DGIR/2007/IP/104-RTPE Case No. 33/2007

(Transferred from MRTPC)

Date: 07.06.2011

In Re: Charging of differential rate of interest by banks

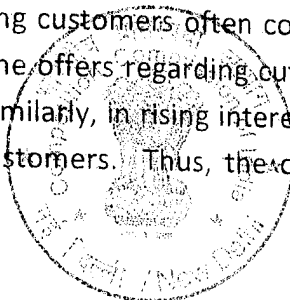
Order Under Section 26(2) of the Competition Act, 2002

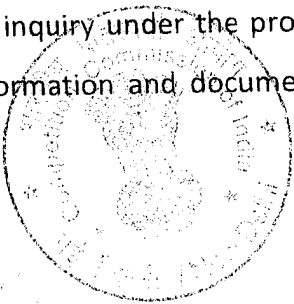
The present case was taken up *suo moto* by the Monopolies & Restrictive Trade Practices Commission (MRTPC) on the basis of a news report/article appeared in the "Economic Times" dated 18.10.2007. A preliminary investigation was ordered in the matter by the MRTPC to the Director General (Investigation and Registration), vide order dated 14.11.2007 in RTPE No. 33/2007. The case has been received by transfer under section 66 of the Competition Act, 2002 from MRTPC, vide their note dated 28.10.2009, to the Competition Commission of India (CCI).

2. The facts of the case, in brief, are as under:

2.1 According to the above referred news article in the "Economic Times" dated 18.10.2007, a person opting for floating rate of interest would assume that when the interest rate falls, the banks/HFCs would pass on the benefit to him. But that is not always the case. As per the article, bankers increase home loan rate by almost 0.5% when the cost of funds inch up by almost 0.25%, to protect their margins. However, the cost of funds would have to fall by 0.5% for the banks to reduce the home loan rates by at least 0.25%. It means the customer-borrower would be affected when the cost of funds inches up whereas the benefit would not be necessarily passed on to him in case cost of funds comes down.

2.2 According to the news article, existing customers often complain that they are always left out of the rate cuts as most of the offers regarding cut in the home loan rates are applicable only to new customers. Similarly, in rising interest rate scenario banks try to discount the rate to acquire new customers. Thus, the old customers lose out both ways, according to the news article.



- 2.3 As per the news article, home loan rate is linked to an internally computed reference rate such as prime lending rate (PLR) or mortgage reference rate (MRR). These are determined by the individual banks and are influenced by factors like Repo Rate. Whenever this reference rate increases, it pushes up the home loan rates as well. The news article stated that there remains a gap of a few basis points between the reference rate and effective rate of interest. The said gap varies in case of different borrowers, if the old and new customers are charged different rates.
- 2.4 According to the news article, in developed economies the benchmark rate that decides the effective rate on home loans is an external rate and banks do not have complete control over it. In India, the benchmark is the PLR, which is calculated by the bank itself. But the fact is that a bank does not lower the PLR unless the cost of funds falls considerably. The banks offering lower rate of interest to new customers offer a large discount on the benchmark but at the same time they do not lower the PLR or the benchmark rate and avoid passing on the benefit to the old customers.
- 2.5 The news article further states that there is always inertia for an existing customer to change the home loan provider when they are already repaying a loan with another bank/HFC. This intention is further deterred by slapping a prepayment penalty if a borrower decides to walk out on the service provider.
3. MRTPC, while considering the matter for investigation, had framed following issues—
- 3.1 The floating rate of interest is ideally linked to external benchmarks, but it appears that the floating rate of interest is linked to internal benchmarks, which goes against the borrowers.
- 3.2 The practice of not passing on the benefit of reduction in cost of the fund to the floating rate interest borrowers, charging two different floating rates of interest and the benchmark adopted in calculating the floating rate of interest, prima facie, appear to be unfair, discriminative and restrictive.
4. The DGIR, MRTPC, during his preliminary inquiry under the provisions of MRTP Act, asked following 12 banks several questions/information and documents for the purpose of the investigation:
1. Citi Bank
 2. Standard Chartered Bank
 3. ICICI Bank
 4. Axis Bank
 5. ABN Amro Bank
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6. HDFC Bank Limited
7. State Bank of India
8. Canara Bank
9. Punjab National Bank
10. Bank of India
11. Indian Bank
12. Bank of Maharashtra

5. Out of the most pertinent questions, the following question which identifies the questionable "practice carried on, or decision taken by" banks/HFCs is of vital importance for the purpose of examination of this matter:

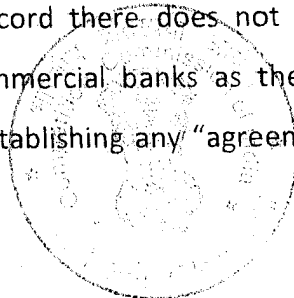
Whether the banks/HFCs are charging at a higher rate of interest to the old borrowers vis-à-vis new borrowers who are charged at lower rate of interest and if so, the banks were required to furnish the reasons of the same along with the details thereof.

6. In reply to the above query, the following 7 banks admitted charging different interests from new and old customers whereas rest of them have denied the allegations. The gist of replies of the banks is as under:

- 6.1 Citi Bank has admitted that different rate of interests is being charged from new and old customers and the difference is because of money market conditions, competitive offerings, borrowers fall and income methodology.
- 6.2 Standard Chartered Bank has also admitted charging of different rate of interests from new and old customers and submitted that the difference is because of calculated cost of funds and operation expenses.
- 6.3 ICICI Bank has also admitted charging different rate of interest from old and new customers and stated that the rate of interest offered to certain customers at a point of time may not remain the same with another set of similar customers availing the loan at a different time.
- 6.4 ABN Amro Bank admitted that it charges different rate of interest from old and new customers because of revision of money market conditions.
- 6.5 State Bank of India has also admitted charging different rate of interest from old and new customers; it justifies its decision on the basis of Prime Lending Rate (PLR)
- 6.6 Canara Bank also admitted charging different rate of interest from old and new customers. As per Canara Bank the charging of differential rate of interest is based on demands and volume of business, rates are determined for certain segments depending on the growth potential and evolving market conditions.
- 6.7 Bank of India has also admitted charging different rate of interest from old and new customers on home loan w.e.f. 01.01.2007 which was made applicable only for new

loans availed from that date. In respect of existing loans as on 31.12.2007 no revision was done by it.

- 6.8 Axis Bank, HDFC Bank, Punjab National Bank, Indian Bank and Bank of Maharashtra submitted that they are not charging differential rate of interest from old and new customers.
7. Before the DGIR could submit preliminary investigation report, MRTP Act was repealed and the matter was transferred to the Commission.
8. The Commission has carefully gone through the material available on record and has also considered the information available on public domain in its meetings held on 10.06.2010, 19.08.2010, 21.09.2010, 05.10.2010 & 20.10.2010.
9. For applicability of Section 3 of the Act there should be an agreement between existing or potential competitors or between enterprises upstream of downstream in any production chain. There could be a case of appreciable adverse effect on competition (AAEC) only if enterprises conspire either horizontally or vertically in form of some agreement/concerted action/understanding/joint decision etc., to gather undue market power. To assess any impact on competition what must be examined is whether banks are entering into some mala fide understanding amongst themselves to the detriment of the consumers or competing banks. Alternatively, whether any bank is imposing vertical restraints up or down the production chain of home loan that distorts upstream of downstream competition due to which consumer will eventually suffer. But in this case the banks are in a competitive market and all are offering their products at competitive rates. There is no evidence of any agreement between the banks/ financial institutions to control the interest rates in the market or any vertical restraint between enterprises or persons at different stages of the production chain of home loans.
10. From the material available on record there does not appear to exist any agreement between above mentioned 12 commercial banks as they are operating independently. Further, there is no evidence for establishing any "agreement" under Section 3(3). In fact,



out of the 12 banks questioned by DGIR, 5 said they are not charging different interests from old and new customers.

11. The practice of charging different rate of interest from new and existing customers and the practice of not passing on the benefit of decrease in cost of funds to customers are practices carried on by many of the banks investigated by DGIR but, for the application of Section 3(3) the above practices must have been adopted by an association of persons/enterprises. The word Association has not been defined under the Act or the Companies Act, 1956. In the instant case, the Indian Banking Association (IBA) can be said to be an association of banks but there is no evidence on record that IBA has adopted the practice or taken a decision in the matter.
12. Although there *is* empirical evidence of the practice of charging differential rate of interest by a few banks and the practice of not passing on the benefit of decrease in cost of funds to customers but *prima facie* it doesn't seem to result in consequences mentioned under Section 3(3), clauses (a) to (d). Similarly, there is no *prima facie* , evidence of any decision taken by any association of banks/HFCs that resulted in charging differential interests on home loans or not passing on benefits of decrease in cost of funds to customers. Therefore, in the instant case, the Commission finds no contravention of Section 3. Further, it is necessary that such agreements are proved to have AAEC in terms of Section 19(3). This is not the case in the instant matter.
13. *Prima facie*, the practice of charging differential interest and not passing benefits of lower cost of funds to consumers appear to be "unfair and discriminatory" and hence could be violative of Section 4(2)(a)(ii). But to establish violation there must be dominant position.
14. As can be seen that none of the 12 banks/HFCs are individually dominant in the relevant market, as per information available in public domain, as no bank/HFC has a market share of more than 16%. Both SBI and HDFC have 16% share each but while SBI is charging differential interest, HDFC is not. In the instant case, no single bank/HFC qualifies as

“dominant” in terms of parameters accepted by mature jurisdictions. None of them can be said to be capable of “operating independently of competitive forces” and/or “affecting its competitors or consumers or the relevant market in its favour” (in terms of definition in the Act) by the sheer fact that no bank/HFC has more than 16% market share. This is evident from different policies adopted by SBI and HDFC. Therefore there is no case of violation of Section 4 of the Act.

15. To determine if an enterprise enjoys dominant position, Section 19(4) provides some assessment tools. Market share of the enterprise should be one of the most decisive aspects for determining dominant position. In the instant case, market concentration is fairly dilute. Further, even other determinants do not point toward dominant position. There is also no obvious entry barrier for newer banks / HFCs to enter the home loan market. On the whole, considering the indicators provided by Section 19(4), no bank / HFC appears to enjoy dominant position.
16. In view of the above, the Commission is of the view that there is no *prima facie* case for making a reference to the Director General under section 26 (1) of the Act for conducting investigation into this matter and the proceedings are required to be closed forthwith.
17. Accordingly, the matter is hereby closed under section 26(2) of the Act.
18. Secretary is directed accordingly.

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