

**COMPETITION COMMISSION OF INDIA**

**CASE Reference DGIR/2007/IP/104-RTPE Case No. 33/2007**

Date: 07.06.11

**In the matter of charging differential Floating Rate of Interest from old and new borrowers**

**As per R. Prasad, Member (dissenting):**

**Order Under Section 26(1) of the Competition Act, 2002**

The present case had been taken up 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 DGIR, MRTPC vide order dated 14.11.2007 in RTPE No. 33/2007. The case has been received on 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 dated 18.10.2007 in the Economic Times, a person opting for floating rate of interest would assume that when the interest rate falls, the banks/HFCs pass on the benefit to him. But that is not always the case. 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 will have to fall by 0.5% to reduce the home loan rates by at least 0.25%. It means the customer borrower shall be affected when the cost of funds inches up whereas the benefit shall 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 the banks try to discount the rate to acquire new customers. Thus, the old customers lose out both ways.

2.3 A 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. 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 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 Moreover, 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 lined to external benchmarks, but it appears that the floating rate of interest is linked to internal benchmarks, which goes against the borrowers.

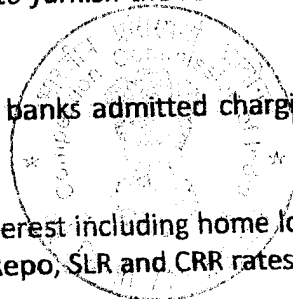
3.2 The practice of not passing on the benefit of reduction in cost of the fund to the floating rate interest borrowers, charging two different floating rates of interest and the benchmark adopted in calculating the floating rate of interest, prima facie, appear to be unfair, discriminative and restrictive.

4. The DGIR, MRTPC, in its preliminary inquiry under the provisions of MRTP Act, asked 12 banks several questions/information and documents for the purpose of the investigation. Out of the most pertinent questions the following 1 question is of vital importance for the purpose of examination of this matter. This question identifies the questionable "practice carried on, or decision taken by" banks/HFCs :

*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.*

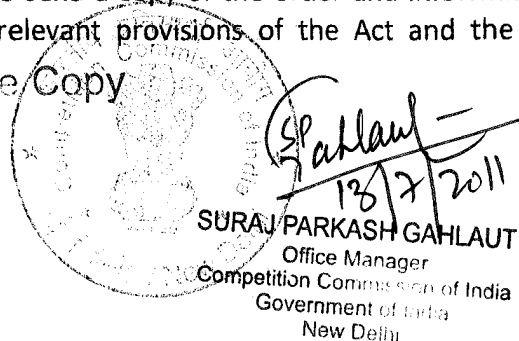
5. In reply to the above query, the 7 banks admitted charging different interests from new and old customers.

6. Banks increase/decrease rate of interest including home loan interest in line with the trend of prevailing Repo, Reverse Repo, SLR and CRR rates.



7. The Competition Act 2002 defines "agreement" in Section 2(b) to include "arrangement", "understanding" or "action in concert". This implies active complicity. Therefore, to include "practices carried on or decision taken by" as "any agreement" in terms of Section 3(1) there is need to establish it as an arrangement / understanding / action in concert. There has to be collective and active complicity. As can be seen from the replies of the banks, 7 out of the 12 banks are following the practice of charging differential rate of interest from the old and new borrowers. Though the banks offer their own arguments for the same, it cannot be a mere coincidence that the majority of the banks follow the same practice which is detrimental to the interest of the borrowers at large. This, indicates that *prima facie* there is some sort of understanding between the banks to exploit the borrowers – consumers, in monetary terms.
8. In view of the above, it can be observed that the practice of charging differential rate of interest carried on by the banks, *prima facie* violates section 3 (3) of the Act.
9. The Commission has carefully gone through the facts of the case and the replies of the respective banks submitted to the DGIR, MRTPC as well as the relevant information available on public domain. On thorough perusal of the entire material, the Commission finds that the practice of charging differential Rate of Interest from new and old customers and not passing on the benefit of lower cost of funds to the consumers are *prima facie* "unfair and discriminatory". This gives reasons to believe there is *prima facie* possibility of contravention of Section 4 of the Act.
10. In view of the above, the Commission, at this stage, is of the opinion that there exists a *prima facie* case to order the Director General to investigate into the matter. DG may also inquire into the role of IBA (as an association of banks) in the adoption of practices being followed by different banks.
11. The Commission, however, makes it quite clear that the observations made in this order are not final and shall not, in any manner, influence the investigating authority.
12. Accordingly, the Commission directs the Director General to conduct an investigation into the matter and to submit the report within a period of 60 days from the date of communication of this order.
13. The Secretary is directed to send a copy of the order and information to the Director General in terms of the relevant provisions of the Act and the Regulations made thereunder.

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(R. Prasad)  
Member