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# Thinking out loud

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The Last Word

Banks are great. They take deposits and then find people who need the money and make them loans. They are called "financial intermediaries" and there is nothing else like them.

Well, not exactly. We now have exciting advances in Internet P2P lending, like Gofundme, Indiegogo and Kickstart.

They let you borrow directly by posting your money needs on their websites, along with the interest rate you are willing to pay. Then you sit back and wait for the money to roll in.

Or you can take the other side of the deal and make a loan to a project that seems like it might work and pays a good interest rate. It may pay 10 or 15 per cent, which beats a fixed deposit at a bank, although the risk is higher.

Having the borrower and lender find each other is called "peer to peer" or P2P lending and when I first heard about it, I thought, "What a wonderfully creative idea. Too bad it will never work."

To my shock and amazement, it has worked. The sites I mentioned are here to stay, and you can not only borrow and lend, you can also raise equity capital which you don't have to pay back, and make equity investments, which is like investing in an initial public offering.

Still, they won't replace banking and are presently less than one tenth of one per cent of all bank transactions.

Here are a couple more ideas that are not as inventive as crowdfunding, but still worth considering. They are not my ideas but are already "business as usual" overseas. The banks here may want to look into them.

QUICK QUOTE

**"The future ain't what it used to be."**

YOGI BERRA, 1925-2015, BASEBALL GREAT AND ALL-AROUND GURU

### 1. CEILING NOT FLOOR

Impose a credit card interest rate ceiling. At the moment, we don't have that, at least not one that is very low.

You may have thought the ceiling was 2 per cent per month, which comes to 24 per cent per year and 26.8 per cent with compounding, the effective rate.

I thought so too but it's not correct. We found this out last year when local banks surprised us by raising their interest rate on credit cards. The new rate is hard to calculate but it's easy to see it has taken rates in the wrong direction: Up.

Here's an idea: Why not impose an interest ceiling that holds down rates? Impossible? Guess what? They are doing it now just across the Causeway.

Malaysian banks have put a ceiling on credit card interest since 2008. All the cardholder has to do is pay their credit card debt on time for 12 months and their interest will be capped at 15 per cent.

If they are on time for 10 out of 12 months, the cap is 17 per cent. If they can't do that, the interest rate ceiling is 18 per cent, which is the highest but still less than the 26.8 per cent that our banks used to charge. I estimate it has now increased to around 28 per cent although, as I said, it can't be calculated precisely.

A cap is easy to justify since credit card default rates are only 0.2 per cent, as disclosed in a question in Parliament. So much for the bank's argument that they need to charge high interest because credit card debt is risky.

### 2. A BAN ON COMMISSION-BASED SELLING

Selling commission-based financial products is standard in Singapore. It includes most life insurance, health insurance, as well as funds, like unit trusts.

Some fee-based financial products are available here, but this is tricky because it sounds like the financial advisor asks you to pay a fee for a financial plan instead of him collecting a commission from products he sells you. That's wrong!

What really happens is you pay a fee for the financial plan and the advisor receives commissions, although he may not tell you that.

A typical arrangement is for the fund to kick back a fraction of the expense ratio to the advisor, called a "trailer fee". This goes directly into the advisor's pocket and may continue for years.

Of course, this presents an enormous conflict of interest, like with almost all commissions, since it pushes the salesman to sell the product with the highest commission instead of the one that is best for the client.

It is why advisors recommend expensive regular-premium investment-linked products (ILPs), instead of low-cost unit trusts which also permit regular payments at no additional charge. It is also why most advisors recommend unit trusts and ILPs instead of exchange-traded funds (ETFs) which give about the same thing but are much cheaper.

There are many examples but it all comes back to commissions pushing salesmen to sell you the expensive products and not low-cost ones. Here's an idea: Why not simply ban all incentive-based selling? Then we would rely less on sales staff. Or the sales staff could charge fees only and be free of conflicts.

The industry has 101 reasons why this would never work. Guess what? It works now. Where? Down Under. Australia has banned all forms of incentive-based selling since July 1, 2012 and it works fine.

Somehow, any Aussie who wants to learn about financial products is able to do so through the Internet, from the fund itself or from fee-only advisors. There is no shortage of financial information and the sky has not fallen.

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An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.

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