

# Police in probe of business funding

## Moneylenders' law called into question

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Updated on Dec 13, 2010

The police are investigating a business set up by three former senior bankers to provide short-term, high-cost cash advances to restaurants, bars and retailers who could not otherwise raise funds from banks.

Global Merchant Funding, whose founders include former Barclays Capital senior director Richard Grainger and whose backers have included high-profile Asian hedge fund Artradis Fund Management, is being scrutinised by police on grounds that it may be acting as an unlicensed moneylender.

The police have confirmed their investigations are continuing. No arrests have been made. Global Merchant says it is not a lender and does not need to be licensed.

The company gives businesses money up front and then collects a percentage of the credit card sales daily until it is repaid.

Global Merchant states clearly on its website and in its literature that its transactions are purchases - in this case they are purchases of future credit card receivables - and not loans.

The Moneylenders' Ordinance outlaws loans carrying effective annual interest rates of more than 60 per cent. It carries maximum penalties of a HK\$5 million fine and 10 years' jail.

Companies taking Global Merchant's cash advances are sometimes charged more than the equivalent of a 60 per cent annual interest rate on a loan, according to analysis of figures found in documents Global Merchant has shown to potential customers.

The *Post* asked the Department of Justice whether advances against future receivables such as credit card payments could be considered a loan under Hong Kong law. Department officials have referred the inquiry to the Financial Services Bureau, which has yet to respond.

Retailers and bankers say the situation appears to be a test case that could transform the lending industry, particularly as it relates to hard-up clients, if unlicensed lenders using similar models were allowed.

Global Merchant co-founder and managing director Avery Stone, who previously worked as a senior business leader for MasterCard Worldwide, confirmed that the company's cash advances could cost more than 60 per cent on an annual basis, depending on how quickly the advances were repaid.

Asked whether police were investigating Global Merchant Funding, a spokesman said on Friday: "Wan Chai Police District have received a complaint against a company for lending money without a licence issued under the Moneylenders' Ordinance. Active police inquiries are continuing and it is not appropriate for us to further comment at this stage."

When asked about the police investigation, Grainger said: "GMF is, and always has been, operating lawfully and with the full knowledge of the police, the regulatory authorities and the Hong Kong government. This is also the case in each of the other markets where GMF operates."

Companies like Global Merchant are common in North America, where they are not regulated as moneylenders. According to Global Merchant's website, the company is the first of its kind in Asia.

Grainger, who headed a Barclays Capital group selling debt capital products to Asian financial institutions, founded Global Merchant in late 2008 with Stone and Simon Zoen, who previously ran Citi's commercial cards business in Hong Kong.

"The merchant cash advance industry is well established in other countries, including the US, UK and Canada," Grainger said.

"Hong Kong has always had a strong reputation for being at the forefront of financial innovation and being willing to embrace new products. However, despite being one of the most entrepreneurial cities in the world, it is actually very difficult for small businesses in Hong Kong to obtain bank loans. GMF was established precisely for this reason and has helped to provide funding to hundreds of businesses in Hong Kong and many more across Asia."

Global Merchant's cash advances can be more expensive for its customers than a loan from a licensed moneylender that charges the maximum 60 per cent annual interest because it has no set term for customers to repay.

Global Merchant takes a set percentage of a business' credit card income, typically 25 to 30 per cent a day, until the cash advance and the money it has charged the customer to access the cash is repaid.

In one pitch to a customer, Global Merchant referred to an advance worth HK\$100,000, where the business would eventually repay HK\$120,000.

If the company repaid within six months, the annual effective rate would be 40 per cent. If it repaid within three months, the annual effective rate would be 80 per cent.

Grainger said the company would typically target a transaction time of five to six months.

The moneylending laws stipulate a maximum "effective annual interest" rate to guard against licensed lenders giving short-term loans with daily or monthly interest rates, which could be much higher if the loan existed for a year. They are also geared to outlawing loan-sharking, a common triad money-earner.

Grainger said the company was operating lawfully because it was not a lender.

During the same interview, when asked to confirm that Global Merchant's advances would always cost less than an equivalent loan charging 60 per cent annual interest, Stone said: "We cannot guarantee it."

Stone said a typical transaction would involve a company being advanced HK\$100,000 and repaying HK\$116,000 within six months - that would be a 32 per cent effective annual rate of interest if the product were a loan with a six-month term.

When asked to confirm the annual effective rate would rise to 64 per cent if the customer repaid in three months, Stone said: "Yes, hypothetically." GMF said this scenario was extremely unlikely to occur. Stone added there were no hidden charges in Global Merchant's advances and that the company did not charge compound interest - when interest is charged on accrued interest, as happens with a mortgage.

Grainger said Global Merchant gave rebates to companies that repaid cash advances early, but would not specify how the rebate was calculated. When asked if the rebate was set to take the annual effective rate below 60 per cent, Grainger said: "The bonus is completely independent of [the] 60pc [figure]."

Grainger said Global Merchant's customers were not comparing his cash-advance product to high-interest loans.

"They are not looking at this as: 'Oh, what's my interest rate?' They are thinking: 'I want money to expand my business.' A lot of the local guys, they are going to pawnbrokers, they are going to loan sharks. We are giving a cash advance."

He said that Global Merchant's borrowers were higher risk than companies who borrow from banks and would come to his firm because they had been turned away by banks. "We are looking at short-dated transactions that are for businesses that provide access to capital. Nobody we are dealing with is sitting there comparing multiple loan products," he said.

"If our customers are getting bank loans, there is no way they would be dealing with us, no way at all. Our experience has always been that customers are not rejecting our business based on price. They are not refusing to use us again, the satisfaction is very high."

Several prominent bar and restaurant managers said they had been approached by GMF salesmen.

Grainger said: "Let's be clear, this is not a loan." He added that Global Merchant, which is not listed on the stock market, was backed by a range of highly sophisticated investors. "We have a very quality, diverse investor base. We have a lot of guys who are very smart, in banking, private equity, a lot of financial guys."

He said such people, who he did not name because the arrangements were private, would not have invested in Global Merchant if there was any chance the company was operating illegally. "They have asked all the right questions," he said.

Global Merchant has secured a US\$10 million credit facility from Singapore-based hedge fund Artradis, a highly respected investment manager founded by former star Lehman Brothers trader Stephen Diggle.

According to Hong Kong company registry documents filed in May, Artradis has lent cash to Global Merchant through a vehicle named the Tetsudo Fund.

Artradis has been a top performing hedge fund manager in Asia. In 2008, two of its funds, named Barracuda and AB2, were the first- and second-best performers in the Asia Pacific region.

The Hong Kong Moneylenders' Ordinance says: "Any person (whether a moneylender or not) who lends or offers to lend money at an effective rate of interest which exceeds 60 per cent per annum commits an offence."

#### **Case study**

The annualised cost of a HK\$100,000 cash advance from Global Merchant Funding, assuming that the amount a merchant must repay from credit card income is HK\$120,000, is as follows:

**Annual effective interest rate if paid over one year:** 20 per cent

**If paid over six months:** 40 per cent

**If paid over three months:** 80 per cent

**If paid over two months:** 120 per cent

- In this case the annual effective rate is the interest rate a borrower would need to pay if charged 20 per cent on a loan of the same amount that was rolled over for the same period continually for a year.
- The company pays a bonus to clients who repay early but did not disclose the formula for calculating it.

Source: GMF pitch to customers/investors and SCMP Research