NSBA
National Small Business Association

ISSUE BRIEF

Credit Card Reform

Egregious credit card practices are harming small businesses and the US economy

Hindering both aspiring and thriving entrepreneurs, access to capital is a perennial concern for America's small businesses, as they face unique challenges when obtaining financing Bank consolidation and changes in the lending market have only exacerbated the problem. In turn, many entrepreneurs have been forced to finance their start-up or growing firms with credit cards.

In a nationwide survey commissioned by NSBA, 44 percent of small- and mid- sized business owners identified credit cards as a source of financing they had used in the previous 12 months—more than any other source, including business earnings. In 1993, only 16 percent of small-businesses owners identified credit cards as a source of funding they had used in the preceding 12 months. This dramatic increase represents more than just emergency or short-term usage.

The survey also showed that nearly three-quarters (71 percent) of the small-business owners who use credit cards as a source of funding are carrying a balance month-to-month. This is up from 64 percent in 2000. Thirteen percent of small-business owners are carrying a balance of more than $25,000, and 36 percent are carrying a balance of more than $10,000.

Although they are increasingly turning to credit cards to finance their business ventures, more than half of small-business owners report that the terms of their cards are worsening. This is not good news for America's economy, which is heavily reliant on a robust and thriving small-business community.

Small businesses comprise 99.7 percent of all U.S. employer firms and more than half of all private-sector employees. Over the last decade, they have generated 60 to 80 percent of all net, new U.S. jobs. The billions of dollars generated from outlandish retroactive interest rates hikes, the escalating imposition of undisclosed fees, and unilateral and unforeseen interest-rate increases is money diverted from economic development. A third of small- and mid-sized businesses say that they would hire additional employees if more capital were available to them.

America's small-business owners are not in the habit of advocating the passage of increased federal regulations, preferring free enterprise and market solutions, but the current practices of the credit-card industry defy the principles of a free market.

One of the basic tenets of free-market capitalism is the sanctity and insolubility of contracts, but somehow the credit-card industry has managed to insulate itself from adherence to this principle, retaining the right to unilaterally change the conditions of their contracts at any time. For instance, the retroactive application of penalty interest rates effectively increases the purchase price of products and services for which consumers are already committed. This *ex post facto* application undermines business plans.

A free-market system also relies on actual competition, but there is no longer real competition in the credit-card industry. In 2004, the top 10 issuers controlled 88.1 percent of the market (understood as their proportion of outstanding credit-card debt) and by 2006, the top three card issuers alone controlled more than 61.8 percent.

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Free market competition also is based on informed consumers, but the business practices of the credit-card industry appear geared more toward obfuscation than illumination. A recent Government Accountability Office report found that the required disclosures of credit cards "often were poorly organized, burying important information in text or scattering information about a single topic in numerous places. The design of the disclosures often made them hard to read, with large amounts of text in small, condensed typefaces and poor, ineffective headings to distinguish important topics from the surrounding text."

Improved disclosure—which must not be construed as simply *more* disclosure—is of paramount importance to the small-business community and NSBA supports the enactment of the new credit card disclosure regulations recently proposed by the Federal Reserve Board. America's small-business owners are capable of following the rules governing their credit cards but the rules must be clearly established, and they must be consistent and predictable.

Improved disclosure is not enough, however. America's entrepreneurs are not naïve or uniformed consumers. They are accustomed to dealing with myriad complex financial and regulatory frameworks. The current rules governing the credit-card industry are simply stacked against them.

While welcoming the recent voluntary discontinuation of certain practices by individual card issuers, NSBA believes that stronger safeguards are necessary to help ensure that America's small businesses can continue to serve as the engine of the U.S. economy. Accordingly, NSBA supports the following credit-card reforms:

1. Prohibit the practice of universal default,
2. Prohibit the practice of double-cycle billing,
3. Prohibit the retroactive application of interest rate hikes—interest rate increases only should be applied to future card usage,
4. Limit the interest rate percentage increases that card issuers can impose on holders,
5. Require card issuers to apply a customer's payments to the card balance with the highest interest rate first,
6. Prohibit extra interest charges on card debt that the cardholder already paid in full,
7. Prohibit interest charges on transaction fees,
8. Prohibit late fees if an issuer's action caused a delay in crediting a payment, and
9. Establish an industry-wide practice regarding the time on which a payment must be received or sent to be considered on time.

The small-business community is not opposed to the credit-card industry. On the contrary, small businesses are increasingly reliant on credit cards for their very existence. To this end, Congress must remain vigilant of any unintended consequences arising from the enactment of credit-card reform legislation. If such legislation had the affect of greatly restricting the availability of essential credit-card capital to America's small business, the effects on the economy could be highly adverse and the effects on individual entrepreneurs and communities could be devastating.

NSBA strongly encourages Congress and the administration to fully support small businesses as the true centers of growth in the U.S. economy and take the lead in ensuring that egregious credit-card practices are not restricting small-business growth and harming America's economy.