



**TESTIMONY OF TODD MCCRACKEN, PRESIDENT
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*“H.R. 2382, Credit Card Interchange Fees Act of 2009 and
H.R. 3639, Expedited CARD Reform for Consumers Act of 2009”*

Before the U.S. House Committee on Financial Services

October 8, 2009

Good morning Chairman Frank, Ranking Member Bachus, Congresswoman Maloney, and members of the committee; thank you for inviting me here today to discuss the *Expedited CARD Reform for Consumers Act (H.R. 3639)* and small businesses' immediate need for credit-card reform. My name is Todd McCracken and I am the president of the National Small Business Association (NSBA), America's oldest small-business advocacy organization.

SMALL-BUSINESS CREDIT CRUNCH CONTINUES

When I testified before this committee's Subcommittee on Financial Institutions and Consumer Credit in March, I spoke at some length to the difficulties America's small-business owners were encountering in their attempts to access credit. Unfortunately, the situation is little improved.

In its July 2009 quarterly Senior Loan Officer Opinion Survey, the U.S. Federal Reserve reported that, over the previous three months, domestic banks continued to tighten standards and terms on all major types of loans to businesses and households. Banks also reported that they expected their lending standards across all loan categories to remain tighter than their average levels over the past decade until at least the second half of 2010.

While Congress should be pleased that the small-business provisions of the *American Recovery and Reinvestment Act*, specifically the temporary elimination of the upfront borrower fees and the increased guarantee, have had a positive effect on the lending programs at the U.S. Small Business Administration (SBA), they hardly were a panacea. In Fiscal Year 2009, the SBA approved 44,221 7(a) loans. This represents 36 percent fewer loans than in FY 2008 and 56 percent fewer loans than in FY 2007. The total dollar amount of these loans also plummeted—by about \$3.4 billion—to \$9.3 billion.

SMALL BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

Credit cards are now the most common source of financing for America's small-business owners. According to NSBA's 2008 nationwide survey of small- and mid- sized business owners (henceforth: NSBA Survey), 44 percent of small-business owners identified credit cards as a source of financing that their company had used in the previous 12 months—more than any other source of financing, including business earnings. The results of more recent internal surveys have been even more dramatic.

When asked what types of financing their firm used in the previous 12 months, 59 percent of the small-business respondents to NSBA's 2009 Small Business Credit Card Survey (henceforth: credit-card survey), identified credit cards. 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. Over a third of the respondents to the credit-card survey also reported that a quarter or more of their overall debt/financing was comprised of credit-card debt.

DETERIORATING CREDIT-CARD TERMS AND “UNFAIR” AND “DECEPTIVE” PRACTICES

When I testified in March, I said: “As the small-business owners who serve as the engine of America’s economy and the backbone of its communities suffer, along with the rest of the country, through an economic crisis not witnessed in seventy years, it is unconscionable that Congress would allow issuers to perpetuate—with impunity—practices recognized as “unfair” and “deceptive” against them for 16 more months.”

The 16 months became, for the most part, nine months but the sentiment remains unchanged: the small-business members of NSBA believe that the rules codified by the *Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009* need to be implemented prior to February 22, 2010.

In 2009, small-business owners have experienced a litany of abuses and deteriorating credit terms unrelated to their past performances. Nearly 80 percent (79) of the small-business respondents to the credit-card survey said that the terms of their credit cards had gotten worse in the last five years. Almost half (48 percent) of the respondents reported that they had encountered a credit-card due date that seemed to change randomly; and 57 percent reported that they had received a bill too close to the due date to mail their payment in on time.

Furthermore, a quarter of the respondents reported that their interest rates increased between February and April 2009; while a third reported that their credit limit had been reduced in the previous six months. According to a recent article in the *Wall Street Journal*, credit-card lines have been cut by over \$1.25 trillion in the last two years and 10 percent of all credit-card accounts have been cancelled. The same article asserts that lenders began reducing available credit by zip code in the fourth quarter of 2007 and have been cutting “‘inactive’ accounts (whether or not the customer viewed the account as a liquidity vehicle)” for the last four quarters.

ADDITIONAL CREDIT-CARD REFORMS MEASURES NEEDED

While NSBA supports the expedited enactment of the protections contained in the *Credit CARD Act*, it also urges Congress and this committee to address two additional aspects of the credit-card industry

that urgently need reform: (1) the absence of explicit protections for small-business cards, and (2) the secretive and unfair interchange system.

The Small Business Credit Card Act of 2009 (H.R. 3457)

The largest loophole in the *Credit CARD Act* was the absence of explicit protection for small-business owners who use their card(s) for business purposes. Since the legislation amended the *Truth in Lending Act (TILA)*—which, except for a few provisions, does not apply to business cards—its protections were limited to consumer credit cards. Although the credit cards of many—if not most—small-business owners are based on the individual owner’s personal credit history, it is conceivable that issuers could legally consider them exempt from the law’s vital protections.

TILA defines a “consumer” as a “natural person who seeks or acquires goods, services, or money for personal, family, household use other than for the purchase of real property.” While a small-business owner who opens a personal credit-card account and uses it occasionally for business should be covered under *TILA*, it is far from clear that this legislation would protect a small-business owner who used his card exclusively or even primarily for business purposes. Eighty-six percent of the respondents to NSBA’s credit-card survey reported using their consumer or business credit-cards primarily or exclusively for business purposes.

Although in the past, issuers appear largely to have kept most of their cards in compliance with *TILA*, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small-business cards. An unintended consequence the *Credit CARD Act* is that it could provide just such an incentive.

Thankfully, legislation has been introduced that would correct this oversight and extend equal protection to the cards used by small-business owners with 50 or fewer employees. The *Small Business Credit Card Act of 2009 (H.R. 3457)*—introduced by Reps. Neil Abercrombie (D-Hawaii), Nita Lowey (D-N.Y.), Michael Michaud (D-Maine), Thomas Perriello (D-Va.), and Don Young (R-Alaska)—also contains an “opt-out” provision, so that small-business owners who did not want their cards protected in such a manner can choose to keep any current agreements.

H.R. 3457 is supported by a diverse range of small-business organizations and consumer groups—from U.S. PIRG to the Consumer Federation of America to the Associated General Contractors of America to

the Hispanic, Black, and Women's Chambers of Commerce—and I respectfully request that this committee consider this bipartisan, common-sense legislation as soon as possible.

The Credit Card Interchange Fees Act (H.R. 2382)

Interchange is the fee paid by a merchant's bank every time a credit or debit card is used to pay for a good or service to the bank that issued the consumer's credit card. The fees—which vary depending on the type and size of the merchant's business, the way the transaction is processed, and the specific kind of card used—are set by Visa and MasterCard and the issuing banks and are not subject to negotiation. As much as \$2 of every \$100 in credit or debit card receipts goes to the card issuers, which inflates the cost of nearly everything consumers buy—since merchants are prohibited from surcharging the customers who use the most high-fee cards. It is important to note, especially as states across the U.S. raise their state sales taxes to meet budgetary shortfalls, that these interchange fees are based on the *total* transaction amount, including taxes.

Interchange fees originated in the 1960s as a way to cover the real cost of a credit-card transaction. Despite vast technological advancements, which have led to greatly diminished processing times and manpower requirements, interchange fees have more than tripled since 2001 alone. As Professor Adam Levitin, of Georgetown University Law Center, has noted, since “interchange is transaction-based revenue; the issuer doesn't incur the consumer's credit risk. That means that issuers can risk greater credit losses because they've already made a nice bit of money via interchange with virtually no risk. Not surprisingly, interchange has increased over the last decade from being about 13 percent of card issuer revenue to being 20 percent.” In total, Americans paid more than \$48 billion in interchange fees in 2008.

Visa and MasterCard force merchants to sign a contract when they decide to accept credit cards, agreeing to all current and future operating rules. Merchants rarely have seen these rules and are prohibited from disclosing their terms to consumers, preventing merchants from alerting their customers to the true cost of accepting credit and debit cards. Many argue that Visa and MasterCard, which control roughly 80 percent of the credit-card market, and their card network function like “price-fixing cartels,” operating in collusion and in violation of federal antitrust laws by using their market power to impose non-negotiable rates and terms on merchants.

The *Credit Card Interchange Fees Act (H.R. 2382)*—introduced by Reps. Peter Welch (D-Vt.) and Bill Shuster (R-Pa.)—directs the Federal Trade Commission (FTC) to fulfill a regulatory void and review the credit-card industry's interchange practices and rules. The bill also grants the FTC the authority to

prohibit any practices that it deems unfair, deceptive, or anticompetitive; and prohibits a number of practices that NSBA believes clearly meet this definition.

In an attempt to provide transparency to the system, *H.R. 2382* also would require the Federal Reserve to collect and disseminate information on interchange fees and the rules that currently govern the system. It also requires the Visa, MasterCard, and the rest of the credit-card industry to make their operating rules available to participating merchants and the public.

Believing that *H.R. 2382* provides critical transparency to the currently shrouded interchange rules and addresses some of the most egregiously unfair, deceptive, or anticompetitive practices of the industry, the small-business members of NSBA join Americans for Financial Reform and more than 20 national trade associations in urging Congress to adopt it.

CONCLUSION

With the unemployment rate at a 26-year high and America's entrepreneurs—existent and, importantly, aspiring—suffering through a crippling credit crunch, it is high time that Congress provide U.S. small businesses with the credit-card protection they so desperately deserve—protection against practices already identified as “unfair” and “deceptive” by the U.S. Federal Reserve Board, the Office of Thrift Supervision at the U.S. Department of the Treasury, the National Credit Union Administration, and an overwhelming majority of the Congress.

If millions of new, small firms are going to be created during this recession—as they have been in previous recessions and economic downturns—then they largely are going to be financed through credit-cards, given the current lending environment. Although credit cards are an inherently expensive and volatile source of financing for entrepreneurs, they also are indispensable. Congress can and must ensure, however, that they are not allowed to function simply as a mechanism with which to siphon capital—through “unfair” and “deceptive” practices—from the backbone of the economy to the top 10 U.S. banks, which controlled 83 percent of the small business credit-card market (understood as their proportion of outstanding credit-card debt) in 2005.

NSBA is pleased to support the *Expedited CARD Reform for Consumers Act (H.R. 3639)* and urges the members of this committee to do the same.

I thank you for your time and welcome any questions.