

July 1, 2008

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington DC 20551

Re: Regulation AA - Unfair or Deceptive Acts or Practices [R-1314]

Dear Ms. Johnson:

The National Small Business Association (NSBA) is pleased to file comments in support of “Regulation AA - Unfair or Deceptive Acts or Practices [R-1314],” the recent proposal to address unfair and deceptive credit card practices. NSBA appreciates and supports the credit-card aspects of the rule, but believes that additional protections are needed to prohibit or curtail various credit-card practices not covered by the proposed rule.

Established in 1937, NSBA is the nation’s oldest small-business advocacy organization. Reaching 150,000 small businesses across the country, NSBA represents small-businesses in every facet of the economy—from self-employed, sole-proprietors to federal contractors with 450 employees. NSBA is proudly nonpartisan, advocating only in the general interest of America’s small-business community.

Starting in the early years of this decade—when a multitude of banks tightened their lending standards—many small-business owners have been forced to turn to credit cards as their primary source of working capital. Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan requests. Rapidly growing businesses that are not traditional brick and mortar have neither. They are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit-card accounts.

Rapidly-growing service and technology companies do not want to rely on credit card debt—they are forced to. According to a nationwide survey of small and midsized business owners, recently commissioned by the National Small Business Association, credit cards are a primary source of financing for America’s small businesses. In fact, 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.

In 1993, only 16 percent of small-business owners identified credit cards as a source of funding they had used in the preceding 12 months. This dramatic increase does not only represent emergency or short-term usage. Of the small-business owners who use credit cards as a source of funding, 71 percent report carrying a balance month-to-month. This is up from 64 percent in 2000. Twelve percent of small-business owners are carrying a balance of more than \$25,000, and 33 percent are carrying a balance of more than \$10,000.

It is important to note that small-business owners are not turning to credit cards to finance their businesses because they think they are getting a good deal. In fact, among those using credit cards, 57 percent think that the terms of their cards have worsened over the last five years. This perception only appears to be growing. Two-thirds of the respondents to a recent NSBA quick poll reported noticing an increase in the fees associated with their credit cards in the last three months. The same quick poll revealed that 56

percent of respondents had experienced an increase in their credit-card interest rates in the last three months or had received notice that their issuer planned to increase them in the near future.

Why should the small-business community's increased reliance on credit cards and their sense of worsening credit-card terms be of interest to federal regulators? Put simply, small businesses are the engine of the U.S. economy. 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 jobs in the country. They are responsible for more than 50 percent of nonfarm private gross domestic product. In short, what harms America's small businesses harms America's economy.

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. For small businesses, it means less money to advertise or invest in new equipment or hire new employees. A third of small- and mid-sized businesses say that they would hire additional employees if more capital were available to them. More capital might be available if so much of it was not being siphoned off by the unacceptable business practices of the credit-card industry.

Accordingly, NSBA supports the following provisions from the proposed rule:

• ***Ensuring a reasonable time to make a payment***

Credit-card companies should be prohibited from treating payments as late unless consumers have been provided a reasonable amount of time to make their payments. To be sure, the 21 day time period in the proposal is an improvement, but a longer period (perhaps 30 days) would be an even larger improvement.

It is important to note that nearly a fifth (18 percent) of the small-business respondents to a 2006 NSBA survey reported that they did not conduct business via the Internet. The vagaries of the U.S. Postal System and the inconsistent mailing cycles and changing due dates of the credit-card companies create havoc for the small businesses in America that rely on credit cards to finance their operations. This inconsistency makes running a business more challenging and perilous. NSBA also supports prohibiting credit-card companies from treating payments as late if the issuer's action caused a delay in crediting a payment.

• ***Ensuring fair application of payments***

Although a more aggressive approach is preferred, NSBA would be willing to accept the proposed rule requiring credit-card companies to more fairly apply the payments that cardholders make to balances with different interest rates as an acceptable compromise. NSBA supports requiring card issuers to apply customers' payments to the card balance with the highest interest rate first. NSBA also supports the proposal prohibiting credit-card companies from denying consumers a grace period on purchases solely because they have not paid off a balance at a promotional rate.

• ***Restricting increases in APR***

Viewing the proposed rule that would restrict credit-card companies from increasing the interest rate on outstanding balances unless consumers were more than 30 days late with their payment as, again, an acceptable—but less than ideal—compromise, NSBA is willing to support it. Ideally, NSBA would like to see *all* retroactive interest rate hikes prohibited, believing that interest rate increases only should be applied to future card usage.

One of the basic tenets of free-market capitalism is the sanctity and insolvency 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.

To this end, NSBA supports the proposed requirement that when a credit card company raises the rate for a category of new charges, consumers who carry a balance at the old interest rate would now be protected from a fee for carrying a balance and would be given five years to pay off the balance at the old interest rate.

NSBA also supports the restriction that when a low promotional interest rate, such as a balance transfer rate, is lost, then the new rate would be only the regular interest rate instead of a much higher penalty interest rate.

- ***Restraining unfair over-limit fees***

NSBA supports prohibiting credit-card company from assessing fees if consumers exceed their credit limits solely due to holds placed on the available credit by the card issuers. Card holders should not be liable for over-limit fees due to the manipulatable processing methods of their credit-card companies.

- ***Eliminating double-cycle billing***

NSBA enthusiastically endorses the proposed provision that would prohibit a credit-card company from reaching back to an earlier billing cycle when calculating the amount of interest charged in the current cycle.

- ***Improving firm offers of credit***

NSBA appreciates and supports the acknowledgement of the Federal Reserve Board and its partner agencies that it is an unfair practice for a credit card company to advertise and ostensibly promise interest rates far below the interest rates most consumers actually will qualify for and receive. It is not clear that improved disclosure—if the inclusion of another standard form disclosure even can be considered “improved” disclosure—is a sufficient remedy to this practice. NSBA contends that if a card issuer can use consumers’ credit scores or records to screen for potential credit-card consumers then the offer should describe only those interest rates and credit limits that the consumers are likely to receive and not merely the whole spectrum of only-theoretically-possible offers. Having small-business owners apply for cards that they only later learn will not carry the interest rate they anticipated also serves to damage the entrepreneurs’ credit ratings and greatly impedes their ability to qualify for other cards.

Additional Reforms Needed

In addition to the aforementioned provisions, NSBA contends that the following credit-card reforms also should be included in the proposed rule:

- ***Prohibiting the practice of universal default***

While many card issuers voluntarily have suspended this practice, a voluntary suspension is an insufficient response to this grossly unfair practice and its prohibition needs to be codified

- ***Limiting the interest-rate percentage increases that card issuers can impose on holders***

It is unacceptable and patently unfair for small-business owners to have their interest rates jump to the average default rate of 27.3 percent because of one late payment or because they slightly exceeded their credit limit; small firms reliant on credit cards already pay more than twice the interest rate that large firms pay when borrowing at the prime rate

- ***Prohibiting the ability of card issuers to unilaterally alter the terms of consumers' credit-card contracts at "any time for any reason"***

One of the basic tenets of free-market capitalism is the sanctity and insolvency of contracts, but somehow the credit-card industry has managed to insulate itself from adherence to this principle; this must change

- ***Prohibiting interest charges on transaction fees***

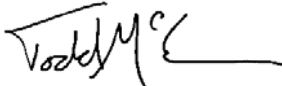
Credit-card transaction fees do not represent a line of credit. They are surcharges incurred for partaking of particular products and services offered by the credit-card companies. It is, therefore, unclear to NSBA why consumers are charged interest on these fees.

- ***Prohibiting extra interest charges on card debt that the cardholder already paid in full***

NSBA appreciates the Federal Reserve Board and its partner agencies' acknowledgement that systematic failures exist in the country's credit-card industry and applauds its efforts to address them. Although NSBA believes that a number of additional measures are necessary to successfully and sufficiently curb the most egregious practices of the industry, it enthusiastically welcomes these proposed rules as a welcome first step in the reform process. NSBA also encourages the Federal Reserve Board and its partner agencies to refrain from weakening the proposed rules.

Thank you again for the opportunity to comment on the proposed rule. NSBA looks forward to the continuing work of the Board and its partner agencies to address the deficiencies of the credit-card industry.

Sincerely,



Todd McCracken
President