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 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.

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.

<u>Additional Reforms Needed</u>

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 insolubility 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

NSBA
National Small Business Association®

TESTIMONY OF MARILYN LANDIS

OWNER,
BASIC BUSINESS CONCEPTS, INC.

CHAIR,
NATIONAL SMALL BUSINESS ASSOCIATION

"The Impact of the Credit Crunch on Small Business"

Before the U.S. Senate Committee on Small Business and Entrepreneurship

April 16, 2008

Good morning, Chairman Kerry and Ranking Member Snowe; thank you for inviting me here today to discuss the impact of the credit crunch on America's small businesses. My name is Marilyn Landis and I am chair of the National Small Business Association (NSBA), America's oldest small-business advocacy organization. I also am the owner of Basic Business Concepts, a consulting and financial management company that provides temporary chief financial officer (CFO) assistance to other small businesses, primarily in Pennsylvania and Ohio—but I am expanding, or at least trying to expand.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country and have continued working with my clients on securing SBA loans and myriad other sources of capital. After 37 years of working with small businesses, the one thing I can tell you without hesitation is that it is not easy to start or develop a business. Entrepreneurs must overcome a host of obstacles to create and expand their businesses.

The credit crunch currently is among the most daunting of these obstacles.

SMALL-BUSINESS CHALLENGES IN FINANCING

Even in the best of times, access to capital is one of the largest impediments facing America's small businesses, hindering both aspiring and thriving entrepreneurs. In fact, the small-business members of NSBA consistently identify access to capital as one of the top-10 issues impacting their firms.

This perennial problem is exacerbated during troubled economic periods, such as those we are experiencing now. According to a nationwide survey of small- and mid- sized small business owners, recently commissioned by the NSBA and unveiled today (henceforth: NSBA Survey), 55 percent of small- and mid- sized small business owners have had difficulty securing credit in the last six months—and this finding is consistent across firm size and revenue.

One of the biggest barriers to small-business financing is requiring debt be secured by equity in fixed assets. Many small and startup businesses lack the kind of equity necessary for traditional bank loans. This gap in debt-equity financing especially hinders startup and growing businesses, as these entrepreneurs typically do not have the assets necessary to acquire sizeable loans.

It is important to note that home ownership rarely meets the equity requirements necessary to acquire a larger commercial loan. Only ten percent of small-business owners leveraged their business loans through a second mortgage, according to the NSBA Survey—yet this represents the third most popular avenue of business financing after credit cards and business earnings. Of course, many of the small-business owners who were lucky enough to leverage their business financing with their home equity are regretting it now. With home prices plummeting, many are discovering that they owe more than their homes are worth.

Another barrier to capital for small businesses is that banks too often shy away from the small-business community. Smaller loans generally are less-profitable for banks and typically have higher default rates. Additionally, the proper valuation and credit worthiness of small businesses are notoriously difficult to determine. Ongoing bank consolidation has lead to fewer community banks and fewer character-based loans as well.

Aggravating this state of affairs is the recent tightening of lending standards by banks. According to the Federal Reserve Board's January Senior Loan Officer Opinion Survey, one-third of domestic banks have tightened their standards on commercial loans over the last three months. Even for those small-business owners fortunate enough to qualify under the tightened standards there is bad news, as banks are raising the costs of their credit lines and the premiums they charge for higher-risk loans.

In addition to tightening their lending standards, more and more banks simply are dropping out of the lending programs offered by the U.S. Small Business Administration (SBA). In fact, 368 banks have quit the programs in the last two years, and there has been a 47-percent decrease since 2001 in the number of banks making at least one 7(a) loan. Much of this withdrawal is due to the SBA's increased fees, which are at their statutory limit for the 7(a) program. Furthermore, although the SBA likes to tout that the number of 7(a) loans is rising, the dollar volume of those loans is shrinking, decreasing by 14 percent compared to last year. Government guaranteed loans overall have shriveled by as much as 23 percent compared to last year.

SMALL BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

While insufficient access to capital has long been a lament in the small-business community, the current capital vacuum has created a new predicament for small-business owners: Use credit cards or bust. According to the NSBA Survey, 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 businesses owners identified credit cards as a source of funding they had used in the preceding 12 months.

It is important to note that this dramatic increase does not represent only 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. This suggests that credit cards have replaced term loans to fund expansion needs. This hardly is surprising when one considers that the "credit card industry is typically the most profitable in the banking sector, earning a return on assets since 1995 that is more than three times greater than that for commercial banks overall," according to Travis Plunkett, legislative director at the Consumer Federation of America.

Many small-business owners first turned to credit cards as their primary source of working capital in the early years of this decade—when a multitude of banks last tightened their lending standards. Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan requests. Rapidly-growing service or technology companies that are not traditional brick and mortar, like mine, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit-card accounts. I can personally attest to this phenomenon, as not long ago I applied for a "line of credit" with Wells Fargo and instead received a new credit card. The same was true more recently when National City Bank offered a credit line and sent a credit card.

THE TROUBLE WITH SMALL-BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

Under current law, credit cards are permitted to have significantly higher and more volatile rates and payment structures than traditional bank loans. According to Professor David Walker, of the McDonough School of Business at Georgetown University, "Small firms that rely on debt secured by credit cards usually pay more than twice the interest rate that large firms pay when borrowing at the prime rate."

This fact is not lost on most small-business owners. Although increasingly reliant on credit cards for financing, most small-business owners do not think they are getting a good deal. In fact, among those using credit cards for financing, 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 very 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.

I, personally, can speak to another problem: The credit-card industry's underwriting practices and their reliance on "risk analysis" are an imperfect answer for small businesses' access to capital needs; and I would like to illustrate this point with an example from my own experience. I have been an American Express customer since 1989. In January 2007, American Express increased my credit limit, based on my "responsible credit history." The letter I received announcing this increase stated, "Effective immediately, your new credit line is $7,000.00 and it will appear on your next statement. This new line will be valid on your account as long as your credit is in good standing." Later in the year, this line of credit was further increased—to $11,400.00.

This increase was helpful, as I spent most of 2007 trying to expand my business. I hired 2 more people and opened 2 more offices. I also began expanding the zone of business into New England. Having primarily focused on Pennsylvania and Ohio in the past, I began traveling regularly (I would say, exhaustively) to the northeast region. As a result of my increased traveling and efforts to expand my business, I began to run much higher monthly balances on the Bank of America credit card I use for business. I still paid on time, mind you; I just gradually acquired more debt.

Despite being told that this line would "be valid … as long as your credit is in good standing," I received a letter early this year—dated January 2, 2008—informing me that as a result of a review of my account, American Express was changing my Line of Credit. My $11,400.00 line of credit was reduced back to $4,200.00. I was informed that this action was being taken for the following reasons:

- "Information received from a consumer reporting agency."
- "Our analysis of the credit risk associated with customers who have residential loans from the creditor(s) indicated in your credit report."

The letter elaborated that the consumer reporting agency factors that affected their decision were:

- "Too many accounts with balances."
- "Too many inquires last 12 months."
- "Too many accounts recently opened."
- "Proportion of balances to credit limits on bank/national or other revolving accounts is too high."

There was no mention—as there was no history—of slow or non-payment.

In December 2007, I received a similar letter from Bank of America for an unrelated card, informing me that effective January 2008, my annual interest rate was skyrocketing from a "promotional rate" of 3.99 percent to 27.99 percent. Thankfully, this interest hike only applied to future charges and was not retroactively applied to my outstanding balance. This increase was attributed to "information we [Bank of America] obtained from your account, as well as from information reported by a major credit reporting agency." Keep in mind, I had no record of slow or non-payment.

In other words, as a small-business owner trying to expand a service company that lacks sufficient equity to secure a traditional bank loan, I am forced to use credit cards to finance my firm's growth. If I actually use the credit cards that I am forced to turn to, however, the issuers are liable to ratchet back the credit previously promised to me. If I seek out additional capital from a different credit card, the result is likely the same.

Let me detail another personal incident that demonstrates the inconsistent and unpredictable nature of current credit card practices. I have an Advanta credit card for which I carried an average daily balance of $5,506.22, at 2.99 percent. In November 2006, I received a cash advance—for which I paid a $50 fee, interest on the fee, and 11.49 percent interest on the advance—from the card in the amount of $14,317.77, at 11.49 percent. There was no other activity and when my $455 bill arrived, I paid it on time. Therefore, I was surprised to see my cash advance interest rate swell from 11.49 percent to 20.01 percent in my December bill. Equally surprising was that my average daily balance, for which I was paying 2.99 percent, had dropped to $1,779.86, while the rest of my outstanding balance, for which I was paying 19.99 percent, jumped up to $17,333.50 with no explanation. One can imagine how difficult it is to adhere to a business plan with this sort of unpredictability lurking in every expenditure.

This unpredictability does not end with unexpected interest-rate hikes. Let me share with you another story—this one dealing with a Bank of America credit card I opened in November 2006. For this card, Bank of America promised a zero-percent interest rate until September 2007. Unfortunately, it did not quite make it. I received my December bill on Jan. 3, 2007. It was dated Dec. 26, 2006—the day after Christmas—and due on Jan. 20, 2007, which was only 17 days away. I mailed my payment on Jan. 5. Bank of America said they received my payment on Jan. 22 so I was charged a $49 late fee. Oh, and my zero-interest rate credit card suddenly sported a new and improved 22.24 percent interest rate. Thankfully, I am only being charged $1 a month on my existing balance for this card, but any new expenditure is being charged at the new interest rate and any remaining balance would be charged at that rate come September. In the meantime, I am stuck with a card that I cannot and will not use, while the mere existence of the card hinders my ability to garner additional capital.

There is one predictable aspect of my Bank of America card: the monthly payment due dates are never the same, fluctuating by several days in the last seven months, from 12/19/06 to 1/20/07 to 2/20/07 to 3/23/07 to 4/20/07 to 5/21/07 to 6/19/07. The statement cut-off has remained the same during this time. The same can be said of my MBNA card, since it was sold to Bank of America. Previously, the due date was the 27th of the month. Between December 2006 and April 2007, the due dates for this card fluctuated greatly, from 12/28/06 to 1/27/07 to 2/24/07 to 3/22/07 to 4/22/07. Again, the statement cut-off has remained the same during this time.

This inconsistency makes running a business more challenging and perilous. I practice and I instruct my clients to use debt wisely, plan carefully for that repayment, and stick faithfully to that plan. Without a consistent, predictable debt instrument small businesses like mine without home equity based loans are often caught in financial turmoil. Now, with the recent mortgage crisis, even the previously fortunate entrepreneurs who had home equity based loans are facing turbulence.

RECOMMENDATIONS

America's small-business owners recognize that the current credit crunch cannot be legislated away—as much as we, and the Congress, might wish the opposite. There are, however, a number of steps that we think Congress can take to help alleviate its effects.

Strengthen the SBA's lending programs and other federally-backed loan programs for entrepreneurs. The fees the SBA charges both lenders and borrowers must be reduced; and the Microloan program must be funded. *S. 2612, the Small Business Lending Stimulus Act of 2008*, recently introduced by Sen. Kerry, is a good starting point. The lending process itself must be streamlined as well. While securing a new credit card no doubt will remain regrettably easier than securing a 7(a) loan, the disparity can be reduced.

Reform the practices of the credit-card industry. 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. Almost 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. In order to address the practices that are making running a small business increasingly difficult and hindering the economic development of the nation's small businesses, NSBA supports the following credit-card reforms:

- Prohibit the practice of universal default,
- Prohibit the practice of double-cycle billing,
- Prohibit the retroactive application of interest rate hikes—interest rate increases only should be applied to future card usage,
- Limit the interest rate percentage increases that card issuers can impose on holders,
- Require card issuers to apply a customer's payments to the card balance with the highest interest rate first,
- Prohibit extra interest charges on card debt that the cardholder already paid in full,

- Prohibit interest charges on transaction fees,
- Prohibit late fees if an issuer's action caused a delay in crediting a payment, and
- Establish an industry-wide practice regarding the time on which a payment must be received or sent to be considered on time.

NSBA also urges Congress to remain vigilant of any unintended consequences arising from the enactment of credit-card reform legislation. Provisions such as those in section 6 of the recently introduced *S. 2753, the Credit Card Reform Act of 2008*, would be highly detrimental to America's small businesses and economy. This highly problematic section requires credit-card companies, before issuing a credit card, to verify an applicant's ability to pay. The ability to pay would be based on an applicant's current and expected income, current obligations, and employment status, using a formula provided by the Federal Reserve Board.

While such a provision may make sense when applied to a student or senior, it would wreak havoc on 44 percent of entrepreneurs in this country that rely on credit cards to finance their businesses. How can a small business owner verify her employment status? How will the Fed's formula project a fledgling business's "expected income?" How will an entrepreneur's potential lack of income affect her ability to finance her business? Such questions are too important to remain unanswered.

CONCLUSION

NSBA appreciates the Federal Reserve Board's recent efforts to boost the nation's sagging economy. America's small-business owners are convinced, however, that the effort to ward off financial ruin on Wall Street should be equaled by the effort to stave off economic disaster on Main Street. Slowing or reversing the impact of the credit crunch on America's small businesses will stimulate job creation and fuel the nation's sputtering economy. As this Committee well knows, small businesses are the engine of the U.S. economy. They comprise 99.7 percent of all U.S. employer firms and more than half of all private-sector employees. Perhaps most importantly, they have created 93.5 percent of all net new jobs since 1989. Spit-polishing the chrome of America's economy, while ignoring its engine, isn't going to win us any races.

I thank you for your time and welcome any questions.

TESTIMONY OF
MARILYN LANDIS
OWNER, BASIC BUSINESS CONCEPTS, INC.
ON BEHALF OF THE
NATIONAL SMALL BUSINESS ASSOCIATION
AT A HEARING BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
U.S. HOUSE OF REPRESENTATIVES
ENTITLED
"IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES"
JUNE 7, 2007

Good morning. Chairwoman Maloney and Ranking Member Gillmor, thank you inviting me here today to discuss the impact that various credit-card practices are having on America's small-business community. My name is Marilyn Landis and I am representing the National Small Business Association. I am proud to serve as NSBA's first vice chair as we celebrate our 70th year of small-business advocacy, and continue our long-standing tradition of working in a nonpartisan manner to promote pro-small-business policies. In addition to my leadership role within NSBA, I am the owner of Basic Business Concepts, a consulting and financial management company serving small businesses primarily in Pennsylvania and Ohio.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country and have continued working with my clients on securing SBA loans and myriad other sources of capital. After 36 years of working with small businesses, the one thing I can tell you without hesitation is that it is not easy to start or develop a business in America. Entrepreneurs must overcome a host of obstacles to create and expand their businesses—and the practices of the credit card industry are not the least among them.

Small-Business Challenges in Financing

Access to capital is one of the largest obstacles facing America's small businesses, hindering both aspiring and thriving entrepreneurs. In fact, the small-business members of the National Small

Business Association recently identified access to capital as one of the top-10 issues impacting their companies. Many small and startup businesses lack the assets necessary for traditional bank loans. Smaller loans are generally less-profitable for banks, and typically have a higher default rate. The increased usage of personal credit ratings for business owners has further exacerbated the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks and fewer character-based loans.

One of the biggest barriers to small-business financing is debt secured by equity in fixed assets. Many small-business owners do not have the kind of equity required by banks to acquire a sizeable loan. This gap in debt-equity financing primarily hinders both startup businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership (if the entrepreneur owns a home) rarely meets the equity requirements for receiving a larger commercial loan. The small-business owner seeking to expand his or her business or hire additional employees faces the same challenges.

Small-Business Reliance on Credit-Card Financing

Into this access to capital vacuum, a new capital issue has sprung to the forefront: an increased reliance on credit cards. 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, like mine, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit card accounts. As such, these loans are subject to credit card regulations, which permit significantly higher and more volatile rates and payment structures. I can personally attest to this phenomenon, as not long ago I applied for a "line of credit" with Wells Fargo and instead received a new credit card.

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 mid- sized small 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 businesses 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. Thirteen percent of small-business owners are carrying a balance of more than $25,000, and 36 percent are carrying a balance 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, 53 percent say that the terms of their cards have gotten worse over the last five years.

Why should the small-business community's increased reliance on credit cards and their sense of worsening credit-card terms be of interest to this subcommittee? Put simply, small businesses are the engine of the U.S. economy and the backbone of the communities you represent. 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. In order to address the practices that are making running a small business increasingly difficult and hindering the economic development of the nation's small businesses, NSBA supports credit-card reform.

Recommendations

NSBA supports the enactment of the new credit card regulations recently proposed by the Federal Reserve Board. Improved disclosure—which must not be construed as simply *more* disclosure—

is of paramount importance to the small-business community. We are businesspeople, more than capable of playing by the rules—but the rules must be made known, and they must be consistent and predictable.

Let me detail a personal incident that demonstrates the inconsistent and unpredictable nature of current credit card practices. I have an Advanta credit card for which I carried an average daily balance of $5,506.22, at 2.99 percent. In November 2006, I received a cash advance—a cash advance, incidentally, for which I paid a $50 fee, interest on the fee, and 11.49 percent interest on the advance—from the card in the amount of $14,317.77, at 11.49 percent. There was no other activity and when my $455 bill arrived, I paid it on time. Therefore, I was surprised to see my cash advance interest rate swell from 11.49 percent to 20.01 percent in my December bill. Equally surprising was that my average daily balance, for which I was paying 2.99 percent, had dropped to $1,779.86, while the rest of my outstanding balance, for which I was paying 19.99 percent, jumped up to $17,333.50 with no explanation. One can imagine how difficult it is to adhere to a business plan with this sort of unpredictability lurking in every expenditure.

This unpredictability does not end with unexpected interest-rate hikes. Let me share with you another story—this one dealing with a Bank of America credit card I opened in November 2006. For this card, Bank of America promised a zero-percent interest rate until September 2007. Unfortunately, it did not quite make it. I received my December bill on Jan. 3, 2007. It was dated Dec. 26, 2006—the day after Christmas—and due on Jan. 20, 2007, which was only 17 days away. I mailed my payment on Jan. 5. Bank of America said they received my payment on Jan. 22 so I was charged a $49 late fee. Oh, and my zero-interest rate credit card suddenly sported a new and improved 22.24 percent interest rate. Thankfully, I am only being charged $1 a month on my existing balance for this card, but any new expenditure is being charged at the new interest rate and any remaining balance will charged at this rate come September. In the meantime, I am stuck with a card that I cannot and will not use, while the mere existence of the card hinders my ability to garner additional capital.

There is one predictable aspect of my Bank of America card: the due dates are never the same, fluctuating by five days in the last seven months, from 12/19/06 to 1/20/07 to 2/20/07 to 3/23/07 to 4/20/07 to 5/21/07 to 6/19/07. The statement cut-off has remained the same during this time. The same can be said of my MBNA card, since it was sold to Bank of America. Previously, the due date was the 27th of the month. Between December 2006 and April 2007, the due dates for this card fluctuated greatly, from 12/28/06 to 1/27/07 to 2/24/07 to 3/22/07 to 4/22/07. Again, the statement cut-off has remained the same during this time. While I will stop short of calling this willful inconsistency, however it is characterized it makes running a business more challenging and perilous.

As welcome and necessary as the improved disclosure practices at the heart of the Fed's proposal are, they are not enough. Adding more pages to the typical encyclopedic credit card contract (which, on average, is now longer than 30 pages, according to the *Wall Street Journal*) will do little to assist most small business. America's entrepreneurs are not naïve or uniformed consumers. They are accustomed to dealing with myriad complex financial and regulatory frameworks. The current rules—such as they are—governing the credit-card industry are simply stacked against them.

Eliminate Universal Default

Starting in 2000, credit card issuers began increasing a credit card holder's interest rate if the cardholder was late on an unrelated payment to a different credit card, a utility company, or a mortgage lender, to name a few. This practice, known as "universal default," is particularly injurious to small-business owners, who have intermingled personal and professional finances as they increasingly rely on personal credit cards to finance their businesses. In practice, universal default meant small-business owners that were a day late paying their power bill might see the interest rate on their business credit card soar to nearly 30 percent.

In 2004, the Office of the Comptroller of the Currency issued a guidance to banks urging them to disclose this practice in promotional materials. This guidance, which included language warning of the risks of using a universal default policy, was fairly successful in motivating U.S. credit-card issuers to cease the practice. According to a September 2006 report by the Government Accountability Office (GAO), however, three of the 28 most popular cards still employ a universal default policy. This GAO report also found that four other of the most-popular 28 cards are seeking to reinstate universal default, but are trying to do so under the auspices of a "change-in-terms," which unlike the automatic increase previously done with universal default can require prior notification.

While Regulation Z of the *Truth in Lending Act* requires that affected cardholders be notified in writing of any proposed changes in rate terms at least 15 days before such change becomes effective—and the Federal Reserve proposed increasing this notification period to 45 days—this "opt-out" option does little to help small businesses who are carrying large month-to-month balances. Most small-business owners forced to turn to credit cards to finance a capital expenditure or an expansion of their business would be hard pressed to immediately pay off their balance with a 15, or even a 45, day notice. NSBA urges Congress to codify language preventing banks and credit-card issuers from using universal default increases on credit cards unrelated to a particular late payment.

Eliminate Double-Cycle Billing

The aforementioned GAO report found that two of the six largest credit-card issuers employ a billing technique known as double-cycle billing, wherein the issuers consider two billing cycles when assessing interest on custumers that move from non-revolving to revolving status. In other words, a consumer who begins with no balance and pays off some but not all of his or her new expenditures is forced to pay interest on the entirety of the original bill, even that which previously had been subject to an interest-free period.

Eliminate Retroactive Application of Interest Rate Increases

As exorbitant as the penalty rates most credit-card issues charge may appear, the small-business members of NSBA are not advocating a cap—although America's small-business community certainly would welcome a voluntary reduction in penalty rates or an enlarged threshold for their application. Jumping to the average default rate of 27.3 percent because of one late payment or slightly exceeding one's credit limit seems an awfully stiff penalty. Having said this, NSBA does support eliminating the retroactive application of penalty rates. This effectively increases the purchase price of products and services for which consumers are already committed. This *ex post facto* application is contrary to basic market principles and undermines business plans. As Travis Plunkett, legislative director of the Consumer Federation of America, recently testified before this committee, "There is no other industry in the country that is allowed to increase the price of a product once it is purchased."

Conclusion

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 there is no functionally-free credit-card market. One of the basic tenets of the 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 basic principle, retaining the right to unilaterally change the conditions of their contracts.

Free market competition also is based on informed consumers, but the business practices of the credit card industry appear geared more towards obfuscation than illumination. The aforementioned GAO report found that credit-card disclosure statements were written at too-high a level, displayed poor organization and formatting, and were filled with extraneous, non-pertinent information. As Professor Elizabeth Warren recently testified before the full committee, "In a perfectly competitive market, both firms and consumers have the information they need to make sound economic decisions. Because these tricks and traps are effectively hidden from customers—invisible until they bite, that is—credit card issuers face no economic penalty in the marketplace for including them in card agreements."

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

The small-business community is not opposed to the credit-card industry nor does it begrudge it the $109 billion in revenue it made in 2005. In fact, as I previously outlined, the small-business community is increasing reliant on credit cards for its very existence. This is why Congress must act to protect the interests of America's small businesses, while still allowing the credit-card industry ample opportunity to turn a profit. NSBA strongly encourages both the administration and Congress 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.

I thank you for your time and welcome any questions.

SMALL BUSINESS FINANCING

Roles of Consumer Credit, Credit Card Financing and Mortgage Credit

Testimony
in the front of the
House Committee on Small Business

April 3, 2008

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INTRODUCTION

Madam Chairwoman, Committee members, fellow panel members, and guests. Thank you for the opportunity to testify in front of the House Committee on Small Business.

Background

My interest in small business originates from experience from my family owning and operating a retail store in York, PA for 93 years; working with the U.S. Small Business Administration, which this Committee overseas; and extensive small business research and policy analysis since beginning my Ph.d. dissertation in 1966. Appendix A for this testimony lists my small business experience that I believe is relevant to this hearing. My summary bio and complete resume are provided in Appendix C.

As you may have noticed from my bio, until 2005 I chaired the governing board of the Credit Research Center (CRC) at Georgetown. I did not receive any compensation whatsoever for this service and in no way will that experience influence my testimony.
The CRC is funded by a variety of research grants from many sources as well as contributions from the credit card industry. This Center moved from Georgetown two years ago.

Assistance

I would like to acknowledge the assistance I have received with this testimony from my friend and co-author Dr. Thomas Durkin, formerly senior economist with the Board of Governors of the Federal Reserve for 22 years, and my former student, Mr. Jay Tuli, vice president of commercial lending for Leader Bank, a $212 million nationally chartered commercial bank established in 2002 in Arlington, MA. Dr. Durkin's specialty is consumer credit. We have co-authored a paper on consumer and mortgage credit, and he is the lead author of a forthcoming book on *Consumer Credit and the American Economy*, being published by the Oxford University Press later this year. Mr. Tuli is a specialist in lending to small firms.

SMALL BUSINESS AND CONSUMER CREDIT IN THE U.S. ECONOMY

Consumer Credit and Business Borrowing

Small business and consumer credit are often indistinguishable in the U.S. economy. Much of the credit available to small firms is based on the entrepreneurs' personal resources, credit card loans and lines of credit, and mortgage loans and potential home equity loans and lines. Costs and the supply of consumer credit and mortgage debt are within the subject of these hearings.

In our study on "Long Run Growth in Consumer and Mortgage Credit," which I am submitting with this testimony, Dr. Durkin and I show that aggregate real consumer credit (adjusted for price changes and excluding mortgage credit) has increased at virtually the same rate as real disposable income in the U.S. over the past 60 years. The level of consumer credit is inversely related to interest rates. A one percent increase in the corporate double A bond rate, for example, has reduced the level of consumer credit outstanding by 10 percent over the past 60 years.

In that same study, Dr. Durkin and I argue that much of consumer credit is revolving credit, without a fixed payment schedule, that is often in the form of credit card loans from financial service firms to small business. In the next section you will see the magnitude of credit card lending to the business sector.

Table 1 delineates the trends in various components of American Consumers' assets, debt, and income over the past 60 years, using the Federal Reserve's Flow of Funds Accounts. These accounts clearly show that the consumer sector of the U.S. economy is actually a net lender in financial markets (usually through financial intermediaries), households still borrow substantial amounts for housing, durable goods, education, and other purposes. Continuing a long term trend toward higher nominal debt levels, borrowing by households grew sharply in the cyclical expansions of the past few decades. For example, total non mortgage consumer credit outstanding, which is an important component of household liabilities, increased more than ten fold over the period 1975-2006 and approximately tripled in real terms (see Table 1), thereby providing financing for a significant portion of major consumer outlays during those years. Many other household economic factors have risen sharply over this period and generally in the years since World War II, however, including employment, income, assets, and wealth.

Despite the obvious cyclical contribution of credit availability to support the expansion of consumer spending (and economic growth), the increase of consumer debt levels in cyclical upswings inevitably leads to expressions of concern.[1] Because the periods of most rapid growth in consumer credit usually occur early in the business cycle, later cyclic stages are perennially subject to the contention that consumer debt has risen "too fast" or that the level has become "too high." Doomsayers assert that high and increasing debt levels lead inevitably to overindebtedness and are likely to cause delinquencies, a spending slowdown, recession, and rising unemployment. Some of this concern is directed towards housing-related debt, especially recently in the subprime area, but much concern aims also at consumer credit, in the recent past decades particularly at credit card debt. Certainly, communications media pronouncements about consumer credit growth have generally been dismal (see Durkin and Jonasson, 2002). It is difficult to estimate how influential such statements have been, if at all, but even the casual empiricism of asking one's neighbors for their views of the domestic credit picture reveals the widespread notion that consumers' credit use has grown too fast for too long.

One possible cause for credit growth among consumers is the hypothesis of consumer profligacy and some sort of inexorable desire to live beyond one's means. But there are other possible explanations for credit growth, ranging from statistical artifacts associated with how the data are collected to changing population demographics and greater macro-economic stability over time that have produced a greater willingness to take on the risks sometimes associated with increased leverage. There is also the possibility that leverage, or at least the asset accumulation that greater leverage permits, is a luxury good where an income elasticity greater than one might reasonably be expected. This paper does not explicitly attempt to model the behavioral foundations of such a possibility, but rather presents an empirical approach to exploring correlates of postwar credit growth and explaining empirically the trends it exhibits." (Durkin and Walker, 2008, pages 5-6).

<u>Subprime Lending</u>

[1]See, for example, front-page articles in the <u>Wall Street Journal</u> for June 17, 1964, January 29, 1970, March 26, 1973, June 28, 1977, December 2, 1985, and February 2, 1987, among others. [XXX STEPH: CAN YOU HELP DESIGNATE SOME NEWER FRONT PAGE ARTICLES?]

Much of today's credit crunch has been caused by what I consider to be irresponsible mortgage lending and the unreasonable assumption that there would be no finite limit to which housing prices would rise during the current decade.

Consider for example a 2/28 subprime mortgage where the loan equaled virtually 100 percent of the 2005 property appraisal. When the mortgage resets at new rates for years 3 through 30 in 2008, they may reset at an interest rate that is generally above the market rate that you would find on an adjustable rate mortgage. For example, the rate in 2006 might have been 5% for two years and the reset might be 7% for 2008-2035 even though the market adjustable rate mortgages in 2008 might be 5.5%. If the borrower has negative equity in 2008, the borrower will not be able to refinance at the 5.5% market adjustable rate. According to an experienced mortgage lender whom I contacted for this testimony, "the offered rate is not normally the same as the fully indexed rate, sometimes the one-year Libor rate plus a margin or spread."

Adjustable rate mortgages have allowed many legitimate borrowers to purchase a home. They are not the blame for the current credit crisis, as has sometimes been claimed. The problem is the high reset rate, often above market rates, when the reset is required and the borrower has no equity in the property and no alternative, except to accept a high reset rate.

FUNDING THE SMALL FIRM IN AMERICA

<u>Cost of Small Business Credit</u>

Costs of credit to small business are often very high compared to rates available to other sectors, and this is especially true during a credit crunch. Small firms that rely on debt secured by credit cards usually pay more than twice the interest rate that large firms pay when borrowing at the prime rate.

The following national data for April 3, 2008 are typical, except that many small firms would already have too much debt to qualify for this "low" credit card rate.

30 yr. fixed mortgage rate	prime rate	credit card rate
5.75%	5.25%	13.42%

In the Chairwoman's home district of Brooklyn, New York, if the borrower had a FICO score of 750 and could offer a down payment of 20 percent, the interest rate on a conforming mortgage (below $417,000 for a single family dwelling) would be approximately 6 percent and the same loan with a FICO score of 650 would be 25 basis points higher.
(Approximately 30 percent of the FICO scores are above 750 and 80 percent of the FICO scores are above 650.)

<u>Financing the Small Firm</u>

Total business borrowing in the US increased by 34 percent, from $562 billion in 2005 to $753 billion in 2006 (*The Small Business Economy,* December 2007, U.S. Small Business Administration, page 29), while U.S. GDP grew by 6 percent and total employment increased by 2 percent (*Economic Report of the President, 2008).* Over the same period, consumer credit outstanding increased by 4.6 percent, mortgage credit outstanding increased 8.9 percent, and revolving credit outstanding increased 6.6 percent. The large increase in business borrowing far exceeded the other increments.

The Office of Advocacy of the Small Business Administration reports that small businesses employ 51 percent of the domestic work force, small firms produce 51 percent of the non farm private gross product, and small firms created "all of the net new jobs" in 2004, (*The Small Business Economy,* December 2007, U.S. Small Business Administration, page 9). Any disruption in credit card markets is not likely an inconsequential occurrence, either for these important businesses or for the economy as a whole.

The most recent period for which employment growth is available by firm size is 2004. Between 2003 and 2004, employment by firms with more than 500 employees decreased by 2.7 percent, while employment at firms with fewer than 20 employees increased by 59.8 percent and employment at firms with fewer than 500 employees increased by 27.1 percent. (*The Small Business Economy*, page 311). Obviously, small business in the United States is critical to employ the growing population.

To support continued employment and economic growth, small firms must have access to credit and external resources, and the funds must be available at costs that allow small firms to earn a fair rate of return on equity. Data for 2003 from the Federal Reserve small business finance survey show that 47 percent of small business owners used a personal credit card to pay business expenses in 2003, and 48 percent used a business credit card to pay business expenses in that year. Looking at both of these groups together, over 77 percent of small businesses used credit cards in 2003, an increase from 68 percent determined from a similar survey in 1998 (*The Small Business Economy*, December 2007, U.S. Small Business Administration, Table 2.5). Using the 2003 percentage and multiplying it by the 26.8 million small businesses in the United States in 2006, according to SBA statistics, implies that more than 20 million small businesses were using credit card users in 2006.

Among small business credit card users, almost 30 percent used revolving business balances (without a fixed payment schedule) in 2003, indicating they were using the credit cards for business financing purposes, an increase of 6 percentage points from 1998. Employing the same multiplication approach, this would mean more than 8 million small business used this form of financing in 2006. The Office of Advocacy of the Small Business Administration has reported in its "frequently asked questions" that "Credit cards account for much of the growth in small business lending over the past few years."

Alpha Omega Jewelers

The unfortunate experience of Alpha Omega Jewelers in Boston exemplifies the circumstances that many small firms have faced during the past decade. In order to maintain the firm, the owner, Mr. Raman Handa remortgaged and refinanced his home approximately a dozen times between 1997 and 2007.

Finally Mr. Handa reached the point where he had negative equity in his $2 million home and was adding to his principal balance each month. Alpha Omega Jewelers went bankrupt in January of this year, after operating for more than 20 years, and Mr. Handa felt such shame that he left the United States. He could not continue to serve his customers, which included President Clinton, Boston Celtics star Paul Pierce, and film star Ben Affleck. Much of the experience for Alpha Omega Jewelers is described in articles from the *Boston Globe,* some of which are provided in Appendix B of this testimony. Unfortunately the Alpha Omega experience is not unique for small businesses in the United States in 2008.

Costs of Credit for Large and Small Firms
The difference between the costs of credit for large and small American firms is illustrated by the difference between the prime interest rate and the rate of interest on credit card balances (available from see Federal Reserve, www.federalreserve.gov). The interest rate on outstanding balances on credit cards is not a perfect measure of the cost of credit for the small firm because the small firm is financed by many means besides credit card loans. The prime rate is not a perfect measure of the cost of funds for large firms because these firms are financed by various forms of debt, equity, and retained earnings.
However, since credit cards are used so often for some of the financing for small firms and borrowing at the prime rate is possible for many large firms, the difference between the credit card rate and the prime rate surely reflects much of the difference of costs of debt for small and large firms.

Figure 1 shows the substantial difference in the credit card rate and the prime rate between 1994 and 2007. According to the National Bureau of Economic Research (http://www.nber.org.cycles.html), between 1994 and 2006, only the period of March 2001 to November 2001 should be considered a recession period. Some economists are suggesting that the United States economy is either in or entering a recession at the current time.

According to Figure 1, these are the only two times (2000-2001 and currently) when the differences between the credit card rate and the prime rate have declined between 1994 and 2007. Yet throughout the period 1994 -2007, the difference between the credit card borrowing rate and the prime rate is substantial. Thus it can be argued that small firms have incurred a much higher cost for external resources than large firms over the past 13 years.

POSSIBLE IMPACTS FROM REGULATORY REFORM

The U.S. Treasury has recently issued a “Blueprint for a New Regulatory Order” for American financial service firms. The Blueprint includes short-term recommendations, intermediate recommendations, and a Long Term Goal for a New Regulatory Structure. The short-term recommendations and intermediate recommendations would not appear, on the surface, to have much effect on the supply, the demand, or the cost of credit for small business. The Long Term Goal for a New Regulatory Structure could have an effect because it calls for greater attention to “disclosures, business practices, and licensing of certain types of financial firms.” The House Committee on Small Business will surely play an integral role in implementing the aspects of the Blueprint that improve the economic and regulatory climate for small business.

THANK YOU

Thank you for this opportunity to meet and speak with you. I would be pleased to attempt to answer any of your questions and to provide further information to the Committee on matters that are of particular interest to you. As my students can tell you, I am a strong believer in answering “I don’t know” to many of the complex economic questions we are facing in our current volatile, uncertain economic environment.

Table 1. Selected Measures of Assets, Debts, and Income of American Consumers, Selected Years, 1945-2006

	1945	1955	1965	1975	1985	1995	2005	2006
					Current Dollars (billions)			
Disposable Personal Income[1]	161	283	498	1187	3109	5408	9036	9523
Total Assets	742	1569	2868	5902	16,572	32,612	64,014	68,920
Financial assets	560	1015	1954	3665	9938	21,386	38,886	42,116
Deposits	104	172	373	908	2506	3332	6049	6870
Other financial	456	843	1581	2757	7432	18,054	32,837	35,446
Total Liabilities	30	144	352	761	2360	5052	12,220	13,293
Home mortgages	19	88	219	459	1442	3325	8883	9676
Consumer credit	7	43	98	207	611	1169	2327	2438
Other liabilities	4	13	35	95	307	558	1011	1179
Net Worth	711	1425	2516	5142	14,211	27,560	51,795	53,626
					2006 Dollars (billions)			
Disposable Personal Income[a]	1803	2129	3187	4448	5825	7153	9327	9523
Total Assets	8310	11,803	18,355	22,116	31,049	43,140	66,079	68,920
Financial assets	6272	7635	12,506	13,734	18,619	28,290	40,140	42,116
Deposits	1165	1294	2387	3402	4695	4408	6244	6870
Other financial	5107	6341	10,118	10,331	13,925	23,882	33,896	35,446
Total Liabilities	336	1083	2253	2852	4422	6683	12,614	13,293
Home mortgages	213	662	1402	1720	2701	4398	9170	9676
Consumer credit	78	323	627	776	1145	1546	2402	2438
Other liabilities	45	98	218	356	575	738	1044	1179
Net Worth	7963	10,719	16,102	19,268	26,626	36,457	53,465	53,626

Source: Federal Reserve Statistical Release Z1, "Flow of Funds Accounts of the United States," various issues. Figures shown are year end, not seasonally adjusted. Some lines include assets and debts of nonprofit organizations.

[1]Measured as annual rate; figure in 1945 column is for 1946.

Figure 1. Credit Card Rate – Prime Rate

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APPENDIX A

David A. Walker

SMALL BUSINESS CREDENTIALS

David A. Walker
Small Business Finance Credentials

director emeritus of the Georgetown University Capital Markets Research Center, 1988 – 2005.

chaired the Governing Board for the Credit Research Center(sponsored by the credit card industry), 1997 - 2005

chaired Board of Trustees and past president of Financial Management Association International, representing 4700 finance academicians and practitioners

Executive Editor: *Journal of Financial Research;* Co-editor: *Journal of Small Business Finance;* editorial board member for seven finance journals.

Director of Research for the Office of the Comptroller of the Currency and Financial Economist for the Federal Deposit Insurance Corporation (total of 10 years)

teaches courses on global financial markets and institutions, business economics, and applied macro-economics

advising a chain of several hundred medium sized retail stores and economic analysis for Dunkin' Donuts

U.S. Small Business Administration: visiting scholar, analyzed trade credit availability and demand; advised in creating the SBA proposal for a small business loan guarantee program with a secondary capital market.

topics for scholar publications include financing small firms, trade credit demand and supply, financial institutions decisions and performance; consumer and mortgage credit

APPENDIX B

ALPHA OMEGA’S EXPERIENCE

Pages 14-19 are the Alpha Omega Story

APPENDIX C

David A. Walker

SUMMARY BIO

and

COMPLETE RESUME

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Background

Dr. David A. Walker is the John A. Largay Professor and director emeritus of the Capital Markets Research Center, which he directed for 17 years at Georgetown University. The Israel Council on Higher Education has appointed him to their business school quality assessment team for the Israel Council on Higher Education. Dr. Walker is currently a board member for the George Town Club and the Georgetown University Student Credit Union. He chaired the Governing Board for the Credit Research Center for eight years. His biography appears in recent and many previous editions of *Who's Who in America, Who's Who in the East,* and *Who's Who in Finance and Industry*.

Dr. Walker recently completed two terms as chair of the Board of Trustees and is past president of Financial Management Association International, representing 4700 academics and practitioners. He has served as Executive Editor of the *Journal of Financial Research*, Co-editor of the *Journal of Small Business Finance*, and an editorial board member for seven finance journals.

Dr. Walker joined the Georgetown faculty in 1980, after serving as Director of Research for the Office of the Comptroller of the Currency and Financial Economist for the Federal Deposit Insurance Corporation. He served as Associate Dean for the Georgetown Graduate MBA and MS Tax Programs during their initial accreditation, and he has chaired many search committees and academic committees during his 28 years at Georgetown. Previously he taught at Northwestern University, the Pennsylvania State University, the George Washington University, and Iowa State University, where he earned his Ph.D. and Master's degrees in quantitative economics.

Dr. Walker's special expertise is developing quantitative analyses to represent financial and economic situations using sample and population data. He has applied this expertise to a variety of consulting opportunities, legal issues, and research questions.

Research

Dr. Walker has published seven books and monographs, 55 scholarly, peer-reviewed articles, and presented many research and policy studies at professional meetings. The topics include financing and operations of global and domestic financial service firms, financing small companies, mutual fund performance, trade credit demand and supply, and monetary and fiscal policies for emerging markets. His recent published papers are: "Impacts of Bank Acquisitions on Shareholder Returns," in *Bank Accounting & Finance,* "Predicting Presidential Election Results" in *Applied Economics,* "Performance Persistence in Fixed Income Mutual Funds," in the *Journal of Economics and Finance*, and "Emerging Markets' Deficits, Privatization, and Interest Rates," *Economia Internazionale*.

Teaching and Lectures

Professor Walker teaches a variety of courses on global financial markets and institutions, applied macro-economics, and managerial economics. At various times he has taught courses in management science, micro-economics, mathematical economics, and statistics. He has also lectured and conducted courses in Australia, China, Estonia, Hungary, India, Japan, Poland, Singapore, and Thailand and was previously selected for a Fulbright Award in India.

Consulting

Dr. Walker is currently a consultant to the Promontory Financial Group and Nathan Associates. He has served as consultant to the World Bank, the U.S. Department of the Treasury, the U.S. Small Business Administration, and numerous companies. For the World Bank, Dr. Walker and several colleagues developed models to identify factors that would lead to successful ventures for new firms in emerging markets. Dr. Walker was a member of a blue ribbon commission to review the Treasury's efforts to implement of electronic processing and payments options for Treasury Bill accounting and to reduce paper processing and bookkeeping.

Dr. Walker has analyzed trade credit availability and demand for the U.S. Small Business Administration (SBA). He also developed cases for state and local governments' delineating their experiences contracting services with the private sector. Dr. Walker created the SBA proposal for a small business loan guarantee program with a secondary capital market. He has published studies on financing small firms through venture capital, informal investment, trade credit, and bank credit.

Dr. Walker's consulting work with Nathan Associates has involved price fixing cases, studies of long-term debt and equity levels and their impacts on Federal revenues and expenditures, and review of numerous other projects. He serves on the academic Advisory Board for the firm, with which he has had an affiliation for 25 years.

Case Experience

Dr. Walker has been qualified as an expert economist by seven Federal, state and local courts and for the Federal Energy Regulatory Commission. He has never been rejected by a court as an expert.
Dr. Walker has completed legal, case-oriented economic analyses for a variety of clients. His clients have included: prestigious and smaller law firms, the U. S. House of Representatives, Nathan Associates, Memphis Gas & Light Company, the District of Columbia, and Dunkin' Donuts, Inc. The issues on which he has qualified or been retained to provide expert reports include: lost income, valuation of financial assets, bank management and financial practices, financial institutions' asset portfolio management, costs of capital, bank share valuations, profit projections for privately held firms and franchises, business profits and sales and personal income projections, and valuation of professional medical, legal, and business services.