

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM



**Report to the Congress on the Use of Credit Cards
by Small Businesses and the Credit Card Market
for Small Businesses**

May 2010

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Submitted to the Congress pursuant to section 506 of
the Credit Card Accountability Responsibility and Disclosure Act of 2009

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Executive Summary

The Board of Governors of the Federal Reserve System (the Board) submits this report in accordance with section 506 of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act, or Act), Pub. L. No. 111-24, 123 Stat. 1734 (2009). Section 506(a) of the Credit CARD Act requires the Board to conduct a review of the use of credit cards by businesses with no more than 50 employees and of the credit card market for small businesses. Section 506(a) provides specific considerations for the Board's review.

In performing its review and preparing this report, the Board gathered data and other information from a number of sources. Board staff met with and gathered information from major issuers of small business credit cards, trade associations representing small business owners, and two consumer credit reporting agencies. Board staff also worked with a small business trade association to help develop some credit card-related questions for inclusion in their survey of small business owners, added special questions to a quarterly Board survey of banks' senior loan officers, and obtained from a vendor data regarding credit card direct mail offers to small businesses. Board staff reviewed the results of consumer testing that the Board conducted from 2006 to 2008 pertaining to disclosures given in connection with consumer credit card accounts, and considered customer complaint information maintained within the Board's own databases and provided by small business credit card issuers. Finally, Board staff reviewed existing surveys, studies, reports, and research related to small business use of credit cards.

This report summarizes the Board's review of the use of credit cards by small businesses and the market for small business credit cards that was conducted in accordance with the requirements of section 506 of the Credit CARD Act.

THE USE OF CREDIT CARDS BY SMALL BUSINESSES

The vast majority of small businesses use personal or small business credit cards. Most small businesses that use cards pay their balance in full each month, but some carry a balance, or borrow, on their credit cards. Small business credit cards differ from personal cards in that they are issued to firms, rather than individual consumers, and are intended to be used for business purposes only. Small business credit cards are also distinct from other types of card products designed for businesses, such as corporate cards, procurement cards, and fleet cards.

As of the end of 2009, 83 percent of small businesses used credit cards; 64 percent used small business cards, and 41 percent used personal cards. Despite the widespread *use* of credit cards, only a minority of small businesses—18 percent—reported *borrowing* on credit cards. About 12 percent of small businesses borrowed on small business cards, and about 12 percent

borrowed on personal cards.¹ In the aggregate, credit card debt represents a very small percentage of total debt held by small business owners to finance their business operations. In 2003, when 24 percent of small businesses reported borrowing on credit cards, credit card debt accounted for just 1.4 percent of all debt held by small businesses and the majority of credit card–borrowing firms reported borrowing less than \$5,000 in total on all their credit cards.²

Available evidence indicates that relatively high-risk firms, as measured by their business credit score from Dun & Bradstreet, are less likely than relatively low-risk firms to use small business credit cards. Nonetheless, higher-risk firms borrow more frequently on small business credit cards than lower-risk firms. Higher-risk firms also have a greater propensity to use and to borrow on personal credit cards compared with lower-risk firms. But again, total credit card debt accounted for less than 2 percent of higher-risk firms' total debt in 2003.

SMALL BUSINESS CREDIT CARDS

The small business credit card represents a fairly recent credit card product innovation, and the market for it has grown considerably since the mid- to late 1990s. Small business cards cater to business needs and require specialized management and underwriting techniques to help manage the particular risks that small businesses present. Issuers provide several services specifically for small businesses, such as employee cards with customizable spending limits and detailed spending statements each month or quarter. Also, small business cards often have higher credit limits than personal cards to facilitate the higher spending needs of small businesses.

At the same time, small business credit cards are similar to personal credit cards in many ways. The two types of credit cards offer many similar features, such as rewards programs, balance transfer programs, and introductory rate promotions. The fees and pricing structures, as well as other terms such as grace periods, also appear to be similar across the two products. Indeed, several card issuers told Board staff that they house their small business credit card function within the same business unit as their consumer credit card function because of the similarities between the two products.

Issuers use a variety of methods to market small business credit cards. One method, which is also commonly used for consumer cards, is targeted mail offers. In the case of small business cards, the issuers use small business mailing lists obtained from third parties such as Dun & Bradstreet and various trade organizations to identify potential customers. Evidence suggests that, as of the end of 2007, most small businesses were receiving unsolicited credit card offers in the mail on a monthly basis from issuers. Other marketing strategies employed by some

¹ The percentage of businesses using cards is less than the sum of the percentages using each type of card because some small businesses use both personal and business cards. Likewise, the percentage of businesses borrowing on cards is less than the sum of the percentages borrowing on each type of card because some small businesses borrow on both personal and business cards.

² More-recent information on the fraction of debt held on credit cards is not available.

issuers include Internet-based advertising, marketing to existing banking customers through bank branches, and attending trade conferences.

Small business credit cards are intended to be issued only to small business owners, not to consumers. Small business credit card contracts typically state that the card is to be used only for business purposes, and applicants must sign a statement attesting to the fact that they are applying for the card on behalf of their business.

At the same time, small business credit cards typically stipulate a personal guarantee, such that both the firm and the guarantor (either the business owner or an authorized officer) are responsible for balances accrued. Therefore, in the context of issuing small business credit cards, issuers examine the personal credit history of the guarantor in addition to the firm's characteristics (firm age, size, industry, and so on) and credit history, if such a history is available. When the firm has little or no credit history, issuers depend more heavily on the guarantor's personal credit history.

Issuers practice risk-based pricing on their small business cards, setting interest rates for card balances that vary with the firm's and the guarantor's riskiness. Similarly, issuers determine credit card line sizes based at least in part on an analysis of risk. The small businesses deemed most creditworthy may be offered relatively large lines and low interest rates. Little information exists on the actual rates small business cardholders currently face, but available evidence indicates that the range of potential annual percentage rates on small business cards is similar to that of consumer credit cards.

In Board staff's discussions with issuers, many stated that issuing and servicing costs are higher for small business cards than for consumer cards. In addition, several issuers indicated that, historically, small business card loss rates have been roughly 20 to 30 percent greater than for consumer cards.

SMALL BUSINESS ACCESS TO CREDIT CARDS IN 2009

During 2009, about 20 percent of small businesses attempted to obtain a new credit card. Among those small businesses applying for cards in 2009, four out of five reported that their most recent request was for a business card. Nearly three-fourths of all applicants were successful in getting a card. In contrast, the success rates for small businesses applying for lines of credit or bank loans in 2009 were about one-third and one-half, respectively.

DISCLOSURES AND PROTECTIONS FOR SMALL BUSINESS CARDS

As a general matter, the substantive protections and disclosure requirements for credit cards under the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.*, do not apply to business credit card accounts. The Congress has excluded business credit cards from coverage under

TILA, with the exception of the 1974 amendments providing business cards with certain protections against unsolicited issuance and unauthorized or fraudulent use.

TILA's disclosure requirements for credit cards generally do not apply to business credit card accounts. Nevertheless, based on its review, the Board understands that many card issuers provide small business cardholders with key disclosures similar to the disclosures that are required by TILA for consumer credit card accounts. However, some issuers have stated that they do not intend to modify their small business credit card disclosures for conformity with the new disclosure rules in Regulation Z, which become effective for consumer credit card accounts on July 1, 2010.

The Board believes that standardizing and improving disclosures for small business credit cards would benefit small businesses by enhancing their ability to compare the cost of the credit card plans available to them. There would be costs associated with requiring all small business card issuers to provide TILA disclosures, although those costs may be limited because small business card issuers may already provide some of these disclosures. However, to the extent that TILA's disclosure provisions also contain related substantive requirements, application of those provisions could adversely affect the cost and availability of small business credit cards. Overall, it is not clear whether the benefits of applying TILA's disclosure requirements to small business cards outweigh the costs.

Although some small business credit card issuers have elected to voluntarily comply with certain of the substantive restrictions contained in TILA (as amended by the Credit CARD Act), the Board understands that other issuers of small business cards do not intend to do so. Applying many of TILA's substantive credit card protections to small business credit cards would protect small businesses from practices that the Congress and the Board have found to be harmful in the context of consumer credit cards (such as restrictions on applying increased rates to existing balances). If, however, the Congress were to consider the application of these provisions to small business cards, it would be important to recognize the potential for adverse effects on the cost and availability of small business credit cards. For example, because credit card issuers have more difficulty assessing the creditworthiness of small businesses than of consumers, restricting issuers' ability to adjust interest rates may lead to higher initial interest rates, which would harm those firms that borrow on small business credit cards. In addition, if credit card issuers were to reduce credit limits in response to such restrictions, even those businesses that use credit cards for transactions and cash management would be harmed. Thus, it is not apparent that the potential benefits of applying substantive restrictions similar to those in TILA to small business cards outweigh the potential risk of increased cost and reduced credit card availability for small businesses.

Introduction

The Board of Governors of the Federal Reserve System (the Board) submits this report in accordance with section 506 of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act, or the Act), Pub. L. No. 111-24, 123 Stat. 1734 (2009). Section 506(a) of the Credit CARD Act requires the Board to conduct a review of the use of credit cards by businesses with no more than 50 employees and the credit card market for small businesses. Section 506(a) provides the following specific considerations for the Board’s review:

(a) Required Review. – Not later than 9 months after the date of enactment of this Act, the Board shall conduct a review of the use of credit cards by businesses with not more than 50 employees (in this section referred to as “small businesses”) and the credit card market for small businesses, including—

- (1) the terms of credit card agreements for small businesses and the practices of credit card issuers relating to small businesses;
- (2) the adequacy of disclosures of terms, fees, and other expenses of credit card plans for small businesses;
- (3) the adequacy of protections against unfair or deceptive acts or practices relating to credit card plans for small businesses;
- (4) the cost and availability of credit for small businesses, particularly with respect to non-prime borrowers;
- (5) the use of risk-based pricing for small businesses;
- (6) credit card product innovation relating to small businesses; and
- (7) the extent to which small business owners use personal credit cards to fund their business operations.

Section 506(b) of the Act also directs the Board to provide a report to the Congress that summarizes the review and other evidence gathered by the Board. Section 506(b) requires the Board to include in its report any recommendations that it determines to be appropriate for administrative or legislative initiatives to provide protections for credit card plans for small businesses.

In performing its review and preparing this report, the Board gathered data and other information regarding small business credit cards from a number of sources.³ Board staff met

³ For purposes of this report, “small business credit cards” refers to credit card plans which issuers offer to small businesses, as defined by issuers.

with and gathered information from major issuers of small business credit cards, trade associations representing small business owners, and consumer credit reporting agencies. Board staff also assisted a small business trade association with the development of a questionnaire for a survey of small business owners that included information relevant to this report, added special questions to a quarterly Board survey of banks' senior loan officers, and obtained from a vendor data regarding credit card direct mail offers to small businesses. Board staff reviewed the results of consumer testing that the Board conducted from 2006 to 2008 pertaining to disclosures given in connection with consumer credit card accounts. Board staff also considered customer complaint information maintained within the Board's own databases and provided by small business credit card issuers. Finally, Board staff reviewed existing surveys, studies, reports, and research related to small business use of credit cards.

The Congress specified that, for purposes of this review, the term "small businesses" should be interpreted to mean businesses with not more than 50 employees. The various information sources used by the Board in conducting its review do not employ a single, consistent definition of the term "small businesses." Indeed, there is no generally accepted definition available. Definitions may be based on the number of employees (with the maximum to qualify as a small business ranging from as low as 10 to as high as 500) or annual revenue (with the maximum ranging from \$1 million to \$50 million). Wherever possible, Board staff has focused its analysis on employer firms with 50 or fewer employees; however, in some cases (for example, reporting findings from interviews with card issuers), the definition employed by the source was used.⁴

This report summarizes the Board's review of the use of credit cards by small businesses and the credit card market for small businesses that was conducted in accordance with the requirements of section 506 of the Credit CARD Act. The first part of the report, "Background Regarding the Truth in Lending Act and Existing Protections for Credit Card Accounts," discusses the extent to which existing protections in the Truth in Lending Act are applicable or otherwise relevant to small business credit cards. The second part, "The Small Business Credit Card Market," describes the credit card market with a focus on small business credit cards. The third part, "Small Business Credit Card Programs," focuses on card features and issuer practices such as marketing and the use of risk based pricing. The fourth part, "Credit Card Use among Small Businesses," includes a discussion of the extent to which small businesses use personal credit cards to fund their business operations. The fifth part, "Credit Card Access, Terms, and Conditions," assesses the cost and availability of credit cards for small businesses. The sixth part, "Adequacy of Disclosures of Terms, Fees, and Other Expenses and Protections against Unfair or Deceptive Acts or Practices," assesses the adequacy of disclosures of terms, fees, and other expenses, as well as the adequacy of protections against unfair and deceptive acts or practices relating to small business credit card plans. Finally, the report ends with "Conclusion and Recommendations."

⁴ Note that the definition of small businesses as firms with 50 or fewer employees does not include businesses that have no employees.

Background Regarding the Truth in Lending Act and Existing Protections for Credit Card Accounts

In 1968, the Congress adopted the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.* The original purpose of TILA is to promote the informed use of consumer credit by requiring disclosures about its terms and costs. Generally, TILA covers only credit extended to consumers.⁵ Section 103(h) of TILA provides that the term “consumer,” used with reference to a credit transaction, characterizes the transaction as one in which the party to whom the credit is extended is a natural person, and that the money, property, or services that are the subject of the transaction are “primarily for personal, family, or household purposes.”⁶ Generally, TILA does not apply to business or commercial credit. Indeed, in section 104(1), TILA specifically exempts credit transactions involving “extensions of credit primarily for a business, commercial or agricultural purpose.”⁷ Therefore, unless otherwise expressly provided, credit cards issued to small businesses are generally not covered by TILA.

The declaration of purpose set forth in section 102(a) of TILA indicates that the Congress intended TILA in 1968 to require uniform and meaningful disclosures about credit in order to protect consumers: “It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.”⁸

Congressional records indicate that the Congress considered whether to include business and commercial credit within the scope of TILA, but instead focused on consumer credit. The legislative history suggests that the Congress believed disclosure requirements were needed for consumers, but that businesses were better able to evaluate the credit plans available to them:

By limiting the bill to the field of consumer credit, the committee believes it is providing disclosure requirements in the area where it is most essential. Most businesses and corporations are in a good position to judge the relative worth of alternative credit plans and by and large do not require the special disclosure protections provided by the bill.⁹

As a result, early versions of the bill that became TILA were revised to clarify that the law should apply to consumer credit only, and not to all forms of credit or all users of credit. In formulating TILA’s exemption of business credit under section 104(1), the Senate clarified

⁵ 15 U.S.C. 1601(a); see also 12 C.F.R. 226.1(c)(1). The Board’s regulations implementing TILA are set forth in Regulation Z, 12 C.F.R. part 226.

⁶ 15 U.S.C. 1602(h). See also 12 C.F.R. 226.2(a)(12) for a definition of consumer credit (“credit offered or extended to a consumer primarily for personal, family, or household purposes”); and 12 C.F.R. 226.2(b)(2) (“Where the word credit is used in the regulation, it means consumer credit unless the context clearly indicates otherwise”).

⁷ 15 U.S.C. 1603(1); see also 12 C.F.R. 226.3(a).

⁸ 15 U.S.C. 1601(a).

⁹ 113 Cong. Rec. 18401 (1967).

TILA's "purpose test" and defined credit as "primarily for personal, family, household, or agricultural purposes."¹⁰

Since TILA's initial enactment in 1968, the Congress has amended the statute to include additional disclosure requirements as well as substantive restrictions on credit card activity in order "to protect the consumer against inaccurate and unfair credit billing and credit card practices."¹¹ In certain cases, the Congress expanded TILA's coverage by applying specific provisions to both business and consumer credit card accounts. However, the Congress has not amended TILA to apply to business credit cards as a general matter.

On October 28, 1974, the Congress amended TILA to add section 135 to clarify that certain provisions of TILA are excluded from the business credit exemption in section 104(1).¹² Section 135 of TILA provides:

Section 135—Business Credit Cards

The exemption provided by section 104(1) does not apply to the provisions of sections 132, 133, and 134, except that a card issuer and a business or other organization which provides credit cards issued by the same card issuer to ten or more of its employees may by contract agree as to liability of the business or other organization with respect to unauthorized use of such credit cards without regard to the provisions of section 133, but in no case may such business or other organization or card issuer impose liability upon any employee with respect to unauthorized use of such a credit card except in accordance with and subject to the limitations of section 133.

As a result of the addition of section 135, the protections provided by sections 132 (issuance of credit cards), section 133 (liability of holder of credit card), and section 134 (fraudulent use of credit card) apply to all credit cards, including business cards.¹³ These provisions generally prohibit the sending of unsolicited credit cards and limit a cardholder's liability for unauthorized use.¹⁴ Notably, section 135 provides an exception for businesses with credit cards issued to ten or more employees. Section 135 permits a card issuer and a business that provide credit cards to ten or more employees to agree by contract to the liability of the business with respect to unauthorized use of such credit cards.

¹⁰ 113 Cong. Rec. 18406 (1967). In 1980, the Congress subsequently amended section 104(1) of TILA to exclude credit for agricultural purposes from TILA.

¹¹ 15 U.S.C. 1601(a).

¹² Pub. L. No. 93-495, 88 Stat. 1517-21 (1974). See also U. S. Congress, Senate (1973), *Report of the Committee on Banking, Housing and Urban Affairs*, June 28 ("This section [Section 210—Business use of credit cards] clarifies the authority of the Board to apply the provisions of Sections 132, 133 and 134 to credit cards used for business purposes.").

¹³ TILA was amended on October 26, 1970, to include sections 132, 133, and 134. These provisions applied to all credit cards.

¹⁴ Section 134 imposes criminal penalties for fraudulent use of a credit card.

On May 22, 2009, the Credit CARD Act was signed into law (Pub. L. No. 111-24, 123 Stat. 1734 (2009)). The Act amended TILA and created a number of new substantive and disclosure requirements to establish fair and transparent practices pertaining to open-end consumer credit plans. The Act addresses, among other things: advance notice of interest rate increases and significant changes in terms (new TILA section 127(i)), the amount of time that consumers have to make payments (revised TILA section 163), interest rate increases (revised TILA section 171), over-the-limit transactions (new TILA section 127(k)), student cards (new TILA sections 127(c)(8), 127(p), and 140(f)), the reasonableness and proportionality of penalty fees and charges (new TILA section 149), and the reevaluation by creditors of rate increases (new TILA section 148). It is notable that the provisions of the Act that establish new substantive protections and disclosure requirements for credit card accounts apply to “credit card account[s] under an open end *consumer* credit plan,” and accordingly do not apply to business credit cards. However, as discussed previously, section 506 of the Credit CARD Act requires the Board to review of the use of credit cards by small businesses and the credit card market for small businesses and to provide this report to the Congress no later than 12 months after enactment.

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The Small Business Credit Card Market

Many small businesses use credit cards as a convenient method to pay for goods and services and to track expenses. Some small businesses also use credit cards for borrowing purposes (in other words, carry a balance from month to month). This report focuses on the use of both personal and business credit cards by small businesses as well as on the market for small business credit cards.

Small business credit cards differ from consumer cards in that they are issued to firms, rather than individual consumers, and are intended to be used for business purposes only. Small business credit cards are also distinct from other types of card products designed for businesses, such as corporate cards, procurement cards and fleet cards. Corporate credit cards are issued to large companies for use by employees when traveling or entertaining clients. Procurement cards facilitate large-dollar purchases managed by corporate procurement departments. Fleet cards cater to trucking and transportation companies; employees use these cards for fuel and auto-related charges.¹⁵

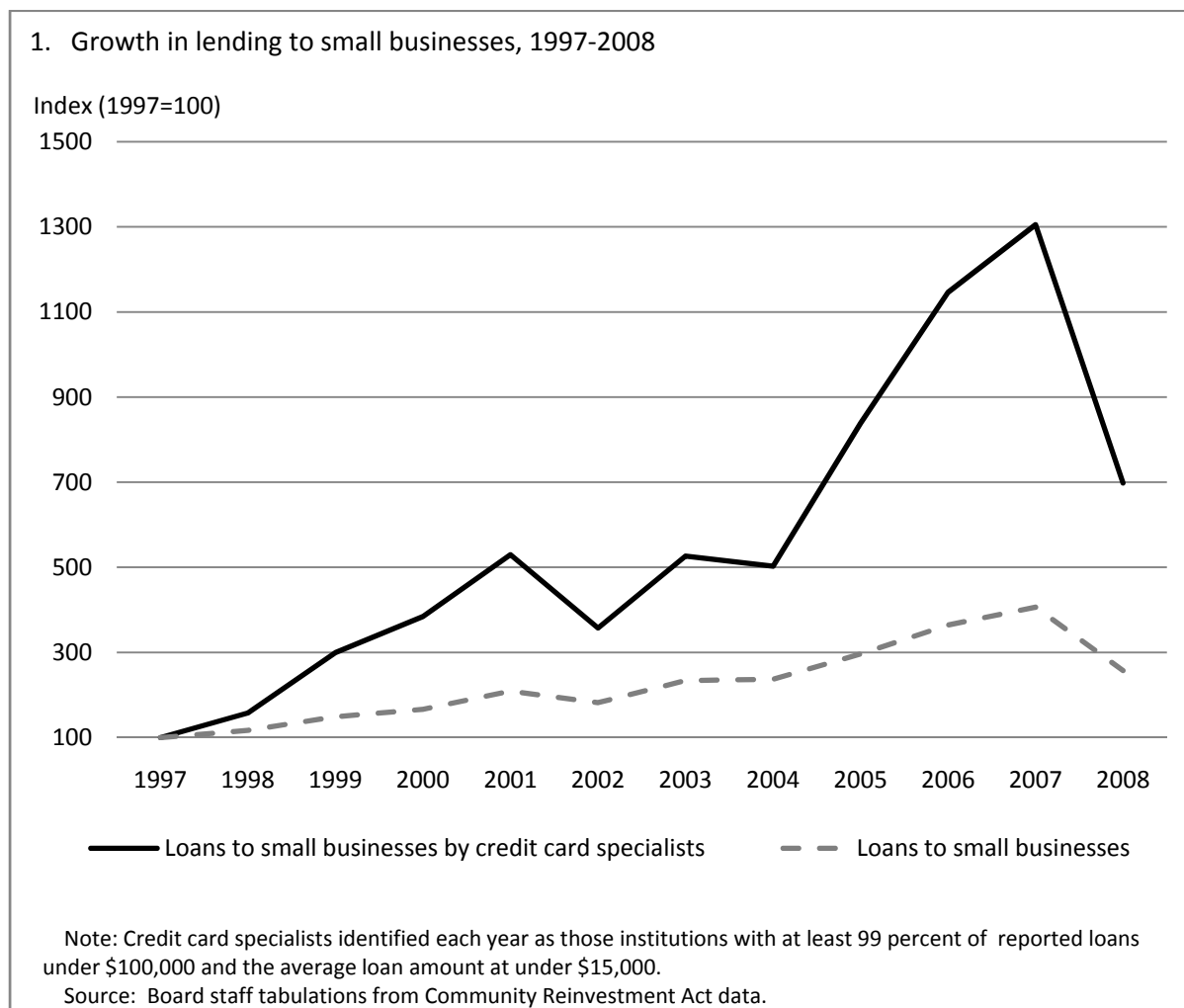
The small business credit card market has grown considerably since the late 1990s. According to *Nilson Reports* (2003 through 2008), a payments industry newsletter, spending on small business Visa and MasterCard credit cards more than tripled between 2002 and 2007, to about \$150 billion in 2007, and held steady at that level in 2008. Despite this rapid growth, the small business credit card market is still quite small in terms of annual spending compared with the consumer credit card market. Indeed, spending on Visa and MasterCard consumer credit cards exceeded \$2 trillion in 2008.

Data collected under the Community Reinvestment Act (CRA) provides information on the extension of credit via small business credit cards. The solid line in figure 1 illustrates the growth from 1997 to 2007 in the number of loans and lines of credit (the data are indexed so that 1997 equals 100) extended to small businesses by institutions identified as credit card specialists (for example, American Express, Advanta, Discover, and so on). Each year, the CRA requires that federally insured depository institutions report on the number and dollar volume of small loans and credit lines (“small” is defined as under \$1 million) to businesses. Lenders also report on the number of small loans and lines to small businesses (businesses with annual revenue of less than \$1 million).¹⁶ Under the assumption that the loans and lines of credit originated to small businesses by credit card specialists largely represent small business credit cards, the black

¹⁵ In addition, a professional card, another type of credit card, is often issued to consumers rather than business owners. And as an alternative to credit cards, small businesses may use business debit cards to help access funds on deposit either through point-of-sale charges or cash withdrawals via an automated teller machine. For a more extensive review of the various types of commercial payment cards, see Susan Herbst-Murphy, “Getting Down to Business: Commercial Cards in Business to Business Payments,” Federal Reserve Bank of Philadelphia, forthcoming.

¹⁶ Lending institutions must report on the volume of small loans and lines to small businesses only to the extent that they collect information on business revenues from borrowers. For more on the CRA data, see Federal Financial Institutions Examinations Council, “Community Reinvestment Act,” webpage, www.ffiec.gov/cra/default.htm.

line in figure 1 hints at robust growth in small business credit card issuance from 1997 to 2007, followed by a sharp drop off in 2008.¹⁷



¹⁷ Board staff identified credit card specialists each year as those institutions where at least 99 percent of the institution's loans/lines were for amounts under \$100,000, and where the average loan/line size was less than \$15,000. It is important to note that lenders can report an increase in the credit limit of an existing credit card account as a new loan origination. Thus, the growth shown in figure 1 includes both new credit card accounts and credit line increases.

For comparison, the dashed line in figure 1 displays the number of loans and lines of credit (again, the data are indexed so that 1997 equals 100) extended to small businesses by *all* reporting institutions.¹⁸ These data indicate that between 1997 and 2007, the number of loans and lines to small businesses by all reporting lenders grew far less dramatically than that by lenders identified as credit card specialists.

Finally, data from the Board's 1998 and 2003 Surveys of Small Business Finances (SSBF) and the 2009 Credit Access Poll conducted by the National Federation of Independent Business (2009 NFIB survey) indicate that the use of business credit cards by small businesses has been rising steadily.¹⁹ An estimated 37 percent of small firms (those with 1 to 50 employees) used business credit cards either for borrowing or transacting in 1998, and this proportion grew considerably to 52 percent by 2003, and 64 percent by 2009. That said, according to the 2003 survey, for employer firms with 50 or fewer employees, less than 5 percent of total small business expenditures occurred on business cards. Other findings from these business surveys will be discussed in more detail in later sections of this report.

¹⁸ Prior to 2005, independent institutions with assets over \$250 million were required to report data under the CRA. In 2005, this asset size threshold increased to approximately \$1 billion. Consequently, a large fraction of institutions (about 800 of 1906) that reported data in 2004 did not report data in 2005 while continuing to operate under the same organizational structure in 2005 (note that some smaller institutions voluntarily report data). However, these 800 institutions only accounted for about 7 percent of the number of loans to small businesses reported in the 2004 CRA data. Therefore, the change in reporting requirements in 2004 most likely does not substantially bias downward the trend after 2004 shown by the dashed line in figure 1. More importantly, the change in reporting requirements is virtually irrelevant with respect to lending by credit card specialists (solid line).

The Call and Thrift Financial Reports, an alternative source of data on commercial lending, does not suffer from such reporting changes. However, one major disadvantage of these data is that they do not distinguish between loans made to smaller versus larger businesses and therefore may reflect corporate cards to a much greater extent than the CRA data used to create figure 1.

¹⁹ Data from the 2009 NFIB survey were graciously provided to the Board by the National Federation of Independent Business (NFIB). The 2009 NFIB survey data are generally representative of U.S. small employer firms with 250 or fewer employees. Results from that survey are described in William J. Dennis, Jr. (2010), *Small Business Credit in a Deep Recession* (Washington: NFIB, February). The 2003 SSBF data are generally representative of all U.S. small firms with fewer than 500 employees and are described in more detail in Traci L. Mach and John D. Wolken (2006), "Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances," *Federal Reserve Bulletin*, vol. 92 (October), pp. 167–95.

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Small Business Credit Card Programs

Board staff held discussions with representatives of several of the largest issuers of small business credit cards to help gain a deeper understanding of this market from the suppliers' perspective. Each issuer was asked detailed questions within the following broad areas:

- organization and basic characteristics of small business credit card program
- marketing of small business credit cards
- product features of small business credit cards
- underwriting, pricing and costs of small business credit card programs

The following discussion is based on (1) information obtained from card issuers through conversations, e-mail communications, and review of their public websites; (2) data obtained from Mintel Comperemedia (Mintel) on credit card direct mail offers to small businesses; and (3) special questions regarding small business credit cards that Board staff included in the Board's April 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS).

Mintel collects direct mail credit card offers from a "panel" of about 1,000 small businesses each month (in other words, the same businesses remain in the sample from month to month indefinitely).²⁰ Mintel asks the businesses participating in the survey to submit all credit card mail received, and Mintel then records a variety of information from these mail pieces, including details on the terms and conditions of credit card offers. The Board also has access to Mintel's data on consumer credit card mail offers from a similar survey of households. This report draws on these data, as well, where appropriate.

It is important to note that Mintel's small-business sample is not necessarily representative of the population of small businesses in the United States.²¹ Nonetheless, these data give a sense of the terms and conditions offered in a large sample of small business card offers in recent years. By virtue of being a panel, these data may be particularly informative about *changes* over time in terms and conditions, as well as changes in business credit card marketing volume. The data that the Board acquired from Mintel cover the period from 2005 to 2009.

The SLOOS is a quarterly survey, conducted by the Board, of a senior loan officer at each of approximately 60 domestic banks.²² The purpose of the survey is to provide qualitative and limited quantitative information on credit availability and demand, as well as evolving developments and lending practices in the U.S. loan markets. Each survey typically includes a

²⁰ Businesses may exit the sample at any point because of, for example, business failure. As businesses exit, Mintel replenishes the sample with new businesses.

²¹ Information provided by Mintel regarding the general characteristics of the businesses in the survey (number of employees, the industry, and revenues) indicates that the survey covers a reasonable variety of small businesses.

²² The SLOOS also includes selected branches and agencies of foreign banks operating in the United States. These institutions were not asked the special questions regarding small business credit cards. For more information about the survey, see Board of Governors of the Federal Reserve System, "Senior Loan Officer Opinion Survey on Bank Lending Practices," webpage, www.federalreserve.gov/boarddocs/SnLoanSurvey.

small number of questions covering special topics of timely interest. The April 2010 survey included special questions on small business credit cards to help provide information for this report to the Congress.²³ More specifically, questions were asked regarding banks' current standards for approving small business credit card applications relative to historical norms and recent changes in terms for new and existing small business card accounts.

ORGANIZATION AND CHARACTERISTICS OF SMALL BUSINESS CREDIT CARD PROGRAMS

Small business cards are a relatively new product. Among the issuers that Board staff interviewed, the first companies to offer credit cards specifically targeted at small businesses began doing so only a little over 20 years ago. Some of the issuers that the staff spoke with did not enter this business until the mid- to late 1990s.

Issuers generally indicated fairly close ties between the issuance of small business credit cards and consumer credit cards. Some companies issue small business credit cards through their consumer credit card unit, while others have a separate business card unit that works closely with the consumer card unit. Although the small business card is distinct in many ways from the consumer card, economies of scale and scope may nevertheless be gained by linking the two businesses. For example, because small business cards generally involve a personal guarantee by the business owner, an issuer's experience in the consumer lending business may be helpful in assessing the value of that personal guarantee. That said, one issuer noted that its small business card division uses separate, specialized resources to market and underwrite these cards, and to manage credit risk and debt collections. Issuers reported uniformly that other types of business cards, such as procurement and corporate cards, are an entirely separate product from small business cards and often are issued through a different business unit.

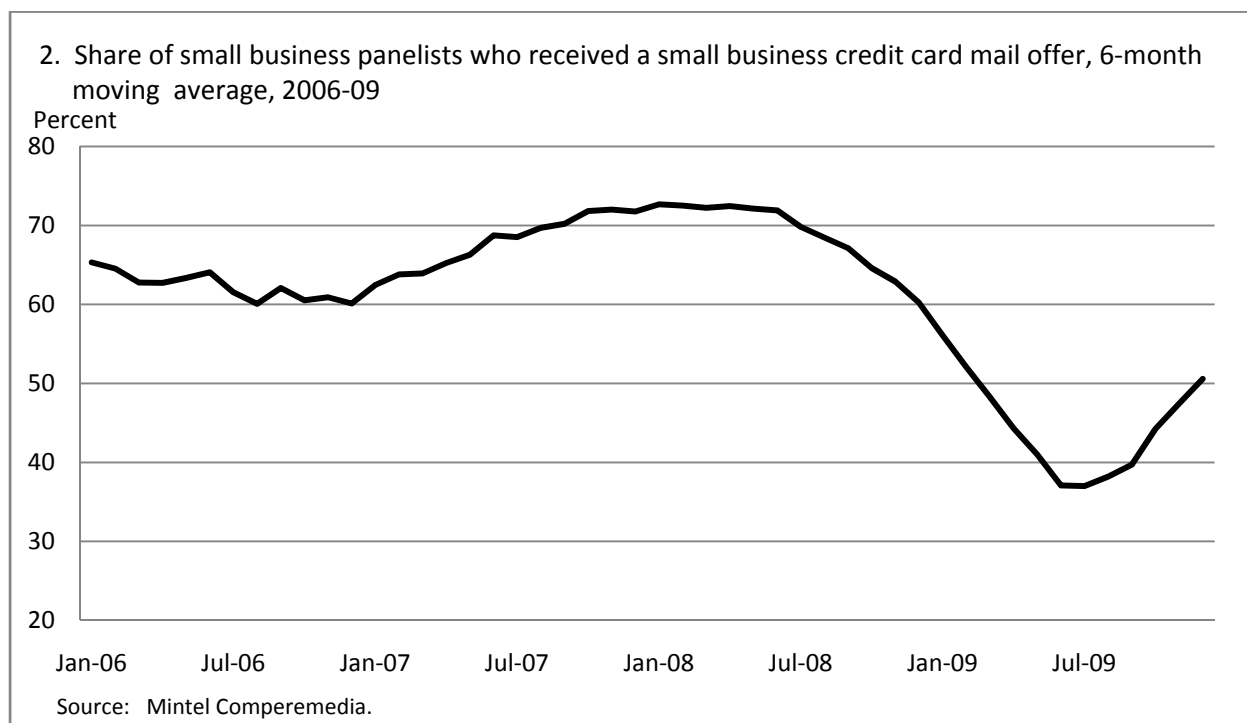
All of the issuers that Board staff interviewed indicated that their consumer card portfolios are much larger than their small business card portfolios, in terms of both the number of accounts and total dollars outstanding. Indeed, for some of these issuers, consumer card portfolios are 15 to 20 times greater in size than small business card portfolios, despite the fact that they are among the largest issuers of small business credit cards. However, credit lines and spending *per card* tend to be considerably larger among small business cards for all of these issuers.

MARKETING SMALL BUSINESS CREDIT CARDS

Each issuer that Board staff spoke with had a unique definition of the term "small business." Definitions were based on annual revenue and the number of employees. The maximum revenue to be considered a small business ranged from \$5 million to \$20 million, and the employee limit ranged from 10 to 100.

²³ Note that in the SLOOS, small businesses are defined as those with less than \$50 million in revenues.

Issuers use a variety of methods to market their products to small businesses. One method cited by several issuers is targeted mail offers, using small business mailing lists obtained from third parties such as Dun & Bradstreet and various trade organizations. Data from Mintel suggest that at the end of 2007, more than 70 percent of small businesses were receiving unsolicited mail on a monthly basis from credit card issuers advertising their business credit card products and inviting recipients to apply. After 2007, this number fell sharply to about 35 percent by the second quarter of 2009 (figure 2). The latter observation is consistent with issuers' reports that they had curtailed their mail marketing campaigns during 2009 in response to economic conditions.



Another marketing strategy employed by some issuers is Internet-based advertising. Some issuers rely heavily on the Internet, while others expressed an aversion toward Internet-based marketing and account acquisition, saying that such accounts often performed relatively poorly. Some issuers prefer to take advantage of their “footprint” (brick-and-mortar branch network) and customer relationships to market small business cards. These issuers require potential customers to apply for a small business card either in person at a branch or online after logging into an existing account. One issuer also mentioned marketing its products at trade conferences.

All of the issuers indicated to Board staff that they have no reliable way to identify which of their consumer cardholders may be using their consumer cards for business purchases. Therefore, they do not rely on internal consumer card use data to identify small business owners for marketing purposes. The issuers also indicated that small business credit cards are designed to meet business needs and are intended to be issued only to small business owners, not to

consumers. To that end, small business credit card contracts typically state that the card is to be used only for business purposes, and applicants must sign a statement attesting to the fact that they are applying for the card on behalf of their business.²⁴

FEATURES OF SMALL BUSINESS CREDIT CARDS

Similar to consumer credit cards, many small business credit cards have rewards programs and issuers appear to promote these programs heavily. According to Mintel data, from 2005 to 2009, about 85 percent of credit card mail offers to small businesses were for cards with some type of rewards program.

Discussions with issuers and information on their websites indicate that many small business cards offer cash back or are “co-branded,” offering extra rewards points with particular airlines, hotels or car rental companies. Some small business cards may also provide travel benefits, such as access to airport clubs. Credit card companies may also offer cards for exclusive use at one major business-supply store, such as Staples or Home Depot. Finally, general purpose cards without rewards are also available.

When asked about recent product innovations, issuers mainly mentioned new rewards programs. Of course, small business cards in general are a relatively new product and might be considered an innovation in and of themselves. Issuers reported that small business cards cater to business needs, and require innovative management and underwriting techniques to help manage the particular risks that small businesses present. For example, issuers provide employee cards with customizable spending limits and detailed spending statements each month or quarter. These additional cards and spending statements are generally provided free of charge.

To facilitate the higher spending needs of small businesses, issuers reported that small business cards also tend to have higher credit limits than consumer cards. While each issuer indicated that spending on small business cards is higher, on average, than on consumer cards, the magnitude of the difference varied considerably among issuers. Some issuers indicated that average spending on small business accounts relative to consumer accounts is 20 to 30 percent higher, while some other issuers said that it is 100 to 200 percent higher.

UNDERWRITING SMALL BUSINESS CREDIT CARDS

Small business credit card applications typically require applicants to disclose detailed information about the business, such as industry, annual revenue, age of the business, number of employees, and tax identification number. The answers to these questions help to both verify that the applicant owns a business and gauge the creditworthiness of the business.

²⁴ Board staff reviewed the card contracts of several issuers online and found that each stated that the card was to be used for business purposes only.

Card issuers may use business credit bureaus such as Dun & Bradstreet to help verify the identity of the business and check its credit record. In the absence of such a record, card issuers may check other business listings on the Internet or the yellow pages, or draw on knowledge about the owner gained through an existing consumer relationship.

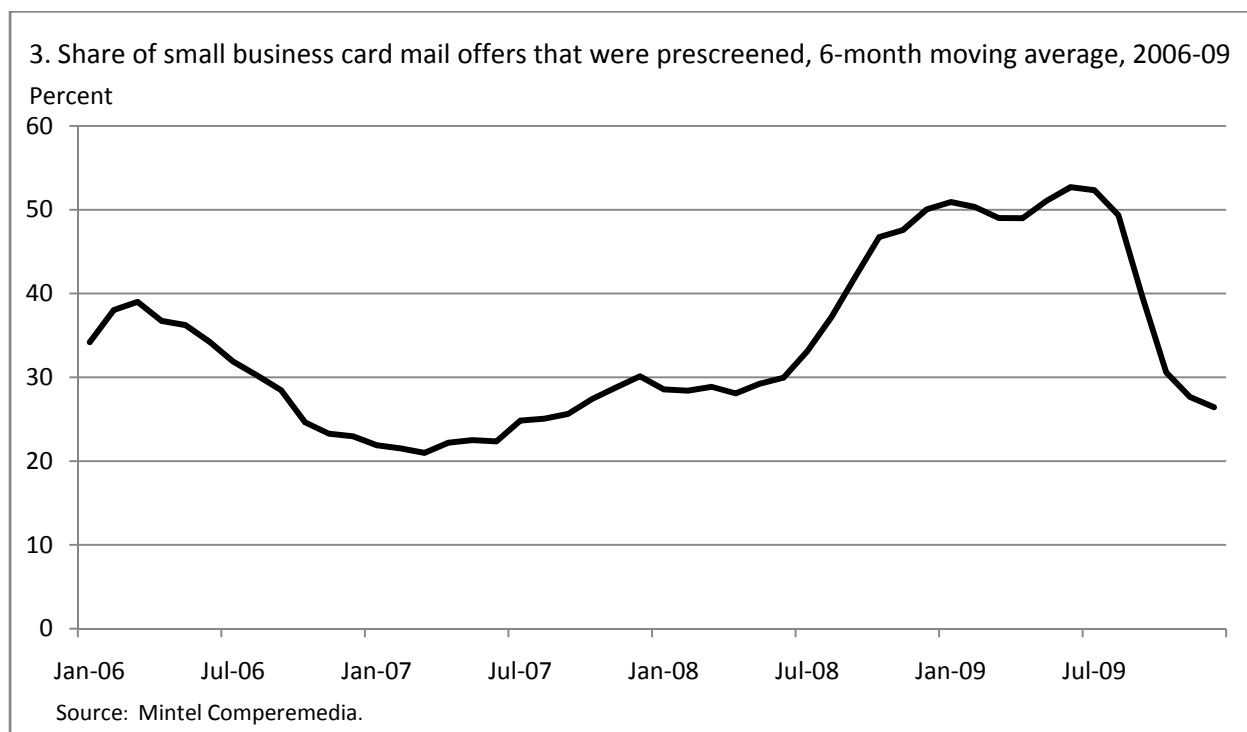
Issuers assess creditworthiness via automated processes as well as manual or judgmental processes, which may require additional information from the business such as a detailed balance sheet or net income statement. Some issuers indicated that they rely more heavily on judgmental review when they do not have an existing relationship with the business or its owner. Judgmental review can also be important when a business requests a relatively large credit line.

Small business credit cards carry a personal guarantee, so both the firm and the guarantor (either the business owner or an authorized officer) are liable for payments due. Issuers therefore examine the personal credit history of the guarantor in addition to the firm's characteristics and credit history. When the firm has little or no credit history, issuers depend more heavily on the guarantor's personal credit history. As such, consumer account experience with the guarantor can provide valuable information about the guarantor's creditworthiness.²⁵

Almost one-third of the mail offers to small businesses for small business credit cards from the middle of 2005 to the end of 2009 involved "prescreening," implying that the small business owner was preapproved or prequalified for the credit card based on information from the owner's *consumer* credit file.²⁶ Figure 3 shows that as the recession took hold in 2008, prescreening became much more prevalent. Figures 2 and 3 together suggest that from 2008 to the beginning of 2009, credit card issuers reduced their marketing efforts considerably and relied more heavily on prescreening in their marketing campaigns. But by the end of 2009, business credit card marketing was increasing and prescreening less frequent.

²⁵ Issuers do not consider the credit history of authorized *users* on the account, only that of the principal guarantor.

²⁶ Mintel data on consumer card marketing campaigns indicates that, in general, more than 70 percent of consumer card offers are prescreened.



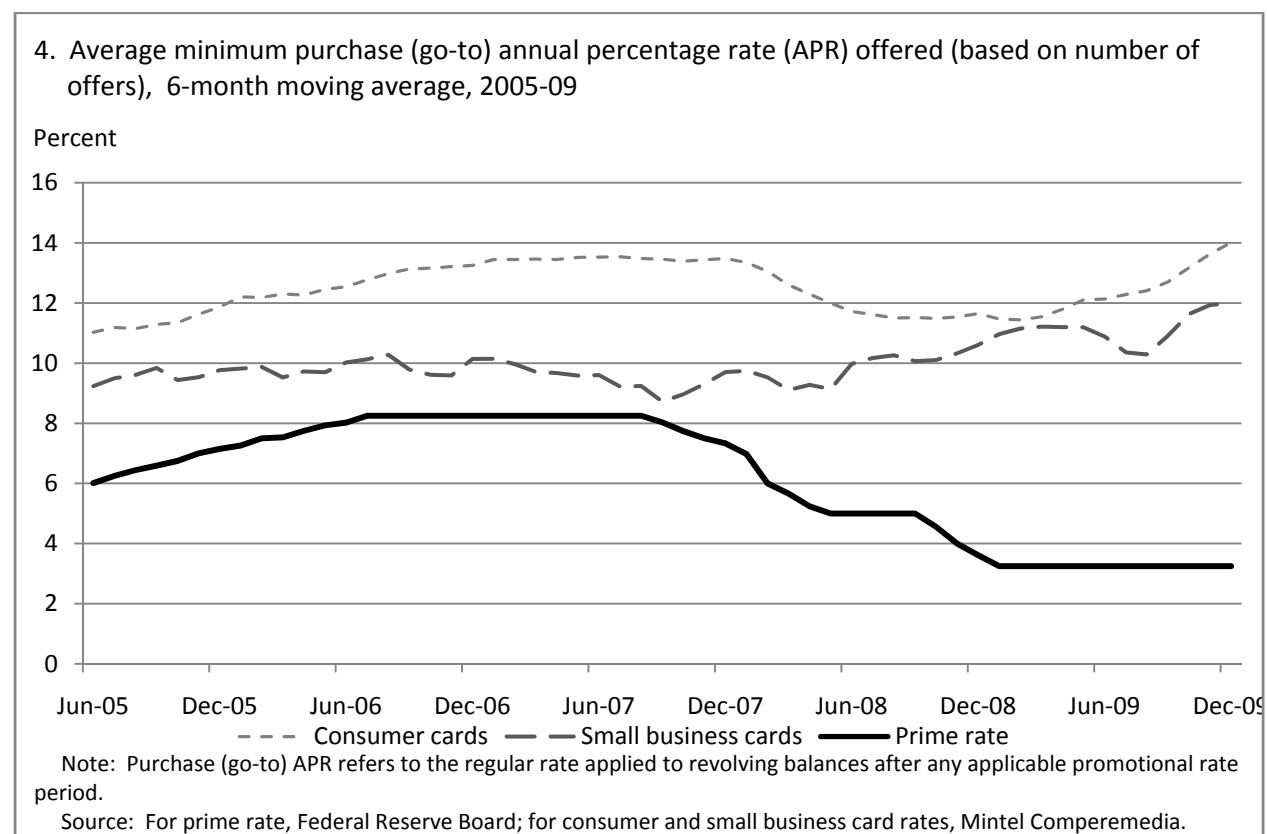
Still, other evidence suggests that the standards for approving small business credit card applications are currently tighter than historical norms. As noted previously, Board staff added special questions regarding small business credit cards to the April 2010 SLOOS. Two-thirds of respondents said that current approval standards are tighter than their “long-run” average, defined as the standards typically applied between 1998 and 2007. Among large banks, 15 of 20 respondents (75 percent) said that current approval standards are tighter than their “long-run” average.²⁷ Moreover, banks reported, on net, continuing to tighten standards for approval of new credit card accounts during the six months prior to the survey. For example, 14 of 34 banks responding to the special business credit card questions indicated that they had raised the minimum required credit score needed to obtain a business credit card over that period, while none said that they had lowered the minimum required score.

INTEREST RATES AND FEES ASSOCIATED WITH SMALL BUSINESS CREDIT CARDS

Data from Mintel indicate that the average *minimum* annual percentage rate (APR) applied to new purchases (as opposed to transferred balances or cash advances) in both business and consumer direct mail credit card offers has risen substantially since late 2007 relative to the

²⁷ Large banks are defined as those with total domestic assets of \$20 billion or more as of December 31, 2009. A total of 31 large banks were in the April SLOOS. The 11 that did not answer the questions about business credit cards likely do not offer them. Twenty-five smaller banks, with total combined assets of about \$300 billion, were surveyed and 14 answered the business credit card questions.

average prime rate (figure 4).²⁸ These data also indicate that the minimum APR for new purchases tends to be slightly lower for business cards than for personal cards. It is important to keep in mind that these data only refer to the lowest possible APR for which a consumer or small business may qualify.²⁹ Discussions with issuers indicated that the ultimate pricing decision depends on a risk assessment of the firm and the card's principal guarantor. In other words, issuers practice risk-based pricing on their small business cards. Similarly, issuers determine credit card line sizes based at least in part on an analysis of risk. The small businesses deemed most creditworthy may be offered relatively large lines and low APRs.



²⁸ Credit card mail often discloses an APR range (for example, 11.99 to 19.99 percent) for purchases following any applicable introductory rate period. The data in figure 5 refer to the lower bound of these ranges, or the specific rate disclosed in cases where there is no range. Issuers determine the actual APR for an account after fully evaluating the applicant.

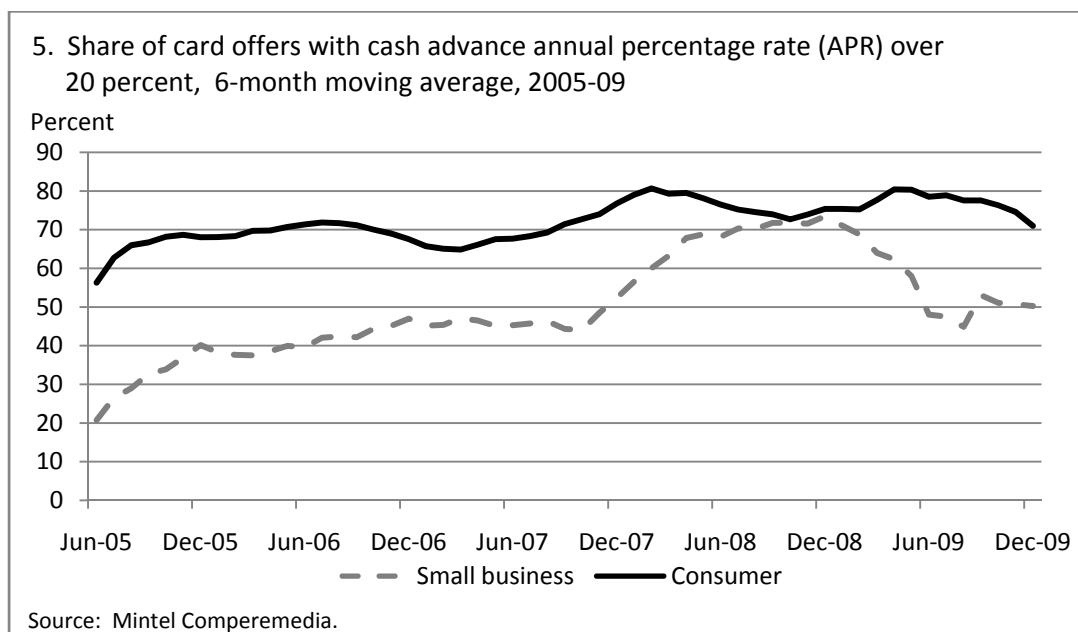
The prime rate series shown in figure 5 is the rate posted by a majority of top 25 (by assets in domestic offices) insured U.S.-chartered commercial banks. The prime rate is one of several base rates used by banks to price short-term business loans. See Board of Governors of the Federal Reserve System, Statistical Release H.15, "Selected Interest Rates," www.federalreserve.gov/releases/h15/data.htm.

²⁹ The differences between the consumer and small business rates shown in figure 4 may stem from direct mail and prescreening being more prevalent in the consumer card space than in the small business card space. At the same time, however, as discussed in more detail later, data from the 2003 Survey of Small Business Finances also indicates that business card rates are somewhat lower than personal card rates in 2003.

Although the *maximum* possible APR for new purchases is not available in the data acquired by the Board from Mintel, disclosures found on major issuers' websites as of early April 2010 suggest that there can be large differences in pricing by risk. Among several different small business card disclosures that advertised a range of potential APRs for which an applicant might qualify, the most narrow range Board staff observed was 6 percentage points (that is, the lowest possible APR was close to 11 percent and the highest possible APR was close to 17 percent). Several other disclosures had wider ranges; the largest range observed was 13 percentage points.

Nearly one-third of SLOOS respondents and nearly 50 percent of large bank respondents said that their bank had increased spreads on new small business credit card accounts during the six months prior to the survey. No banks answered that they had reduced spreads.

Based on a review of small business credit card disclosures available on a few of the largest issuers' websites, cash advance APRs currently tend to exceed the maximum possible APR for purchases and may be set according to firm or cardholder risk. According to data from Mintel, nearly 50 percent of small business credit card offers between 2005 and 2009 advertised a cash advance APR of at least 20 percent. The likelihood of a small business card offer posting a cash advance APR in excess of 20 percent increased sharply at the beginning of 2008 and then declined in 2009, as shown in figure 5. Figure 5 also suggests that small business card offers are generally less likely than consumer card offers to advertise a cash advance APR over 20 percent.³⁰



Disclosures from issuers' websites indicated that penalty APRs on business cards could be well over 20 percent. Some card disclosures indicate that the penalty APR is capped at just

³⁰ Note that the credit limit for cash advances may differ from the purchase credit limit.

under 30 percent. Penalty APRs may be applied to existing or future balances when the cardholder violates the terms of the credit card agreement, as discussed in more detail below. In at least one case, the penalty APR varies according to the type or severity of the cardholder's violation.

Fees, such as those for a late payment or cash advances, do not typically vary across accounts based on firm or cardholder risk. Lenders do not heavily market cards with annual fees to small businesses; Mintel data indicate that only about 20 percent of direct mail offers to small businesses in 2008 and 2009 were for credit cards with an annual fee.

Lenders do, however, heavily market cards with introductory promotional pricing such as an introductory purchase or balance transfer APR. More than three-quarters of small business card offers during this period included introductory promotional pricing.

MANAGEMENT OF SMALL BUSINESS CREDIT CARD ACCOUNTS

Because of the open-ended nature of credit card accounts, issuers conduct ongoing reviews of accounts and customers to reassess risk. Business credit card contracts typically stipulate that the issuer has the right to close accounts or alter many of the terms and conditions on existing accounts at any time. Credit line reductions or pricing changes may be triggered by a number of events, including missing a payment, taking cash advances, adverse information acquired about the firm or personal guarantor, or certain changes in payment patterns such as paying only the minimum due after a long history of paying the balance in full each month.³¹

Issuers often disclose on their websites the conditions under which the penalty APR may be assessed on existing or future business credit card balances. These conditions can differ considerably from one issuer or card product to the next; the following list describes some of the types of conditions Board staff observed when looking at small business card disclosures available on major issuers' websites or in discussions with issuers:

- multiple instances of failure to make the minimum payment by the due date
- exceeding the credit limit one or multiple times
- making a payment that is returned
- defaulting on any other account with the issuer of the credit card
- defaulting on any other account with another creditor
- a large increase in the firm's overall debt level relative to its financial resources

Deterioration in general economic conditions or in the issuing bank's balance sheet may also trigger broad-based account actions. In our discussions with issuers, most said that they had closed a substantial fraction of inactive small business card accounts during 2008 and 2009.

³¹ Off-account adverse information about the business may come from consumer or business credit bureaus or an issuing bank's internal records (for instance, if the business has become delinquent on other credit accounts with the institution).

Some also mentioned closing or reducing lines on relatively risky accounts. And some issuers said that they had raised interest rates across much or all of their portfolio.

Responses to the April SLOOS suggest that, on net, issuers continue to tighten terms and conditions on existing credit card accounts. Of large banks surveyed, 35 percent (7 out of 20) said that their bank had, over the previous six months, raised spreads of interest rates charged on existing small business credit card accounts over their costs of funds; none said they had lowered spreads. Six large banks out of 20 said that over the past six months they had increased the frequency with which active accounts were closed, compared with one large bank saying it had reduced the frequency of such closures. In terms of the frequency of inactive account closures, the responses were the same as for active account closures. Smaller banks reported taking such adverse actions much less often.

THE COSTS AND PROFITABILITY OF SMALL BUSINESS CREDIT CARD PROGRAMS

In Board staff's discussions with issuers, many indicated that issuing and servicing costs are higher for small business cards relative to consumer cards. They gave several reasons for the higher costs, as listed below:

- Judgmental review, in addition to automated review, is used more often in assessments of business credit card applications and management of business credit card accounts.
- Obtaining data from business credit bureaus is expensive relative to consumer credit bureaus.
- Administrative costs are higher, stemming from detailed spending reports and managing multiple card holders per account with (potentially) different spending limits.
- Banks provide more customer service personnel for small business accounts.
- Fraud is more difficult to anticipate and detect for small business cards.
- The small business card market is smaller, with fewer opportunities to gain economies of scale.
- Losses on delinquent small business card accounts tend to be larger than on delinquent consumer card accounts because average spending on small business cards is higher.
- Collecting overdue balances from small businesses can be more difficult than collecting from individuals.

Several issuers indicated that, historically, small business card loss rates have been roughly 20 to 30 percent greater than for consumer cards. In an economic downturn, issuers expect loss rates to rise more quickly for small business cards relative to consumer cards since the typical small business is more susceptible to economic downturns than the typical consumer cardholder. Consistent with that expectation, business bankruptcy filings rose by 114 percent between 2007 and 2009, compared with about a 70 percent rise in consumer filings, according to

data from the Administrative Office of the U.S. Courts and compiled by the American Bankruptcy Institute.³²

One issuer indicated that despite higher costs associated with small business cards, profitability, on average, has been similar to that of consumer cards. Another issuer, however, reported that net income from small business cards has generally been about 20 percent lower than for their consumer cards.

³² See the American Bankruptcy Institute website at <http://www.abiworld.org>.

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Credit Card Use among Small Businesses

This part of the report discusses the use of credit cards by small businesses. The first section describes the evolution over the past decade of the use of credit cards (both business cards and personal cards) by small businesses and quantifies the extent to which small businesses currently rely on credit cards as a source of finance. The second section compares firms that use cards with those that do not use cards and firms that borrow on cards with those that do not borrow on cards. Characteristics examined include firm size, age, creditworthiness, and the use of traditional sources of credit such as lines of credit and loans from financial institutions. The third section focuses on differences in card use between more-risky firms and less-risky firms, including a discussion of the intensity with which cards are used for both transactions and borrowing. Finally, the fourth section examines access to credit cards and presents some information on card terms (interest rates) and changes in terms and conditions experienced by card-using firms during 2009.

The analysis that follows is based largely on data obtained from the 2003 SSBF and the 2009 NFIB survey and focuses on employer firms with 50 or fewer employees.³³ In the text that follows, “small businesses” and “small firms” both refer to employer firms with 50 or fewer employees.

³³ The statistics discussed in this section are primarily special tabulations of data from the 2009 NFIB survey and the 1998 and 2003 SSBF. Other sources of information on small business credit card use include the Kauffman Firm Survey (<http://sites.kauffman.org/kfs>), which focuses on new and emerging firms that started operations in 2004; the National Small Business Association, which periodically surveys its membership (in particular, see 2009 Small Business Credit Card Survey available at www.nsba.biz/docs/09CCSurvey.pdf) and earlier surveys conducted by the NFIB, including William J. Dennis, Jr. (2008), National Small Business Poll: Access to Credit, National Federation of Independent Businesses, NFIB, Washington, vol. 8 (7); and William J. Dennis, Jr. (2008), National Small Business Poll: Credit Cards, National Federation of Independent Businesses, NFIB, Washington, vol. 8 (3). These sources represent either subsets of small businesses (for example, the Kauffman firm data survey represents new and emerging firms starting in 2004, and the NSBA surveys represent its membership) or do not contain all of the information on credit card use contained in the recent NFIB and SSBF surveys such as information on personal versus business cards and information on the creditworthiness of the business.

Section 506 of the Credit CARD Act specifies that this report examine small firms with 50 or fewer employees. Although the 2009 NFIB survey and the 2003 SSBF define small businesses more broadly, they each include subsets of firms that are nationally representative of employer firms with fewer than 50 employees. Both surveys utilized the Dun & Bradstreet sampling frame and asked similar questions about credit card use. Appendix table 1.A presents credit card use information for 2003 for all businesses with fewer than 500 employees and subsets of nonemployer firms, employer firms with 50 or fewer employees, and employer firms with more than 50 employees. Nonemployer firms tend to be smaller and younger than employer firms, are less apt to use cards of any type, and are less apt to borrow on cards than are employer small businesses.

TRENDS IN SMALL BUSINESS CREDIT CARD USE AND CREDIT CARD BORROWING, 1998–2009

Among small businesses, credit cards are the second most commonly used financial product. Only checking accounts are used by more small businesses.³⁴ Credit cards can serve as a convenient alternative to paying expenses by cash or check if a business pays balances on time and in full each month. They can also serve as a source of credit when balances are carried from month to month. In this report, using credit cards as a source of credit, or borrowing on credit cards, means carrying balances after monthly payments are made.

In 2009, 83 percent of small firms used credit cards for either transaction or borrowing purposes, up from 70 percent in 1998 (table 1). Both personal and business cards are used by small businesses for business purposes. The growth in card use over the past decade has been primarily from the business card segment. In 1998, personal cards were used more commonly than business cards among small firms. By 2003, the percentage of small businesses using business cards had become larger than the percentage using personal cards. Between 1998 and 2009, the percentage of small firms using business cards increased substantially, from 37 percent of firms to 64 percent. At the same time, the share of firms using personal cards appears to have declined somewhat, from 47 percent in 1998 to 41 percent in 2009.

Table 1 also presents evidence that only a minority of small firms *borrowed* using either personal or business credit cards in 1998, 2003, and 2009. In 1998, 17 percent of small firms (24 percent of small firms using cards) borrowed using either business or personal cards. At the end of 2003, 24 percent of small firms (30 percent of card users) borrowed, but by the end of 2009, only 18 percent of small firms (22 percent of card users) reported borrowing on cards. While the proportion of firms borrowing using personal cards stayed roughly constant from 1998 to 2009, the proportion of small firms borrowing on business cards more than doubled, increasing from 5.9 percent to 12.3 percent.³⁵ With nearly 80 percent of card users in 2009 paying off their balances every month, small firms use credit cards primarily for transactions purposes.

To help further characterize the importance of credit card borrowing, it is useful to consider other sources of credit, such as lines of credit, or loans from financial institutions for equipment, vehicles, term loans, and leases. Among small firms at the end of 2009, 46 percent had a line of credit and 36 percent had a business loan (not a line of credit or credit card) with a financial institution.³⁶

³⁴ See Mach and Wolken, “Financial Services Used by Small Businesses,” table 6, pp. 174–77, note 19.

³⁵ Some of this growth is associated with the large increase in small business credit card use.

³⁶ The statistics in this paragraph were calculated from the 2009 NFIB survey for small employer firms with 50 or fewer employees.

Table 1. Credit card use and borrowing, by employer firms with 50 or fewer employees, 1998, 2003, and 2009¹

Percent of population unless otherwise noted

	1998	2003	2009
Used credit card	70.3%	79.2%	83.1%
Used business credit card	37.2%	51.9%	63.7%
Used personal credit card	46.6%	46.5%	41.2%
Borrowed on credit card	17.0%	23.6%	17.9%
Borrowed on credit card (percent of card users)	24.2%	29.7%	21.5%
Borrowed on business credit card	5.9%	14.9%	12.3%
Borrowed on business credit card (percent of business card users)	15.9%	28.7%	19.2%
Borrowed on personal credit card	12.7%	13.3%	11.5%
Borrowed on personal credit card (percent of personal card users)	27.3%	28.6%	27.8%

1. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: Survey of Small Business Finances, 1998 and 2003, tabulated for employer firms with 50 or fewer employees; and the 2009 National Federation of Independent Business (NFIB) survey, tabulated for employer firms with 50 or fewer employees. See William J. Dennis, Jr. (2010), *Small Business Credit in a Deep Recession* (Washington: NFIB, February). Employer firms have at least one employee other than principal owner working in firm.

In sum, credit card use by small businesses has increased since the early 1990s. At the end of 2009, more than 83 percent of small firms used cards. Most card-using firms—nearly 80 percent—used cards for transactions purposes or convenience. Only 18 percent of small firms used cards as a source of credit. Finally, businesses use both personal and business cards in their businesses. Over the decade, the percentage of firms using personal cards declined from 47 percent to 41 percent, whereas the percentage using business cards increased from 37 percent to 64 percent.

CHARACTERISTICS OF SMALL BUSINESSES THAT USE CREDIT CARDS

This section compares small firms that use credit cards with those that do not use credit cards and small firms that borrow on cards with those that do not borrow on cards. The firm characteristics examined are firm size (number of employees), firm age, firm credit score, and indicators for having lines of credit, having business loans (other than cards, lines, or mortgages), and having a mortgage used for business purposes. Small and young firms and firms with low credit scores are likely to have more difficulty than other firms obtaining loans and lines of credit from financial institutions. If credit cards serve primarily as a substitute for these other types of

credit, the likelihood of having these other types of credit would be expected to be lower among card users (or, alternatively, card borrowers) than among firms that do not use (borrow on) cards.

Credit Scores

The Congress specified that this report should address the cost and availability of credit for nonprime borrowers. Classification as a nonprime borrower is typically based on having a consumer credit score below some critical value. Lenders often use a business owner's personal credit score, obtained from one or more of the three major national consumer credit reporting agencies (Equifax, Experian and TransUnion), to assess the creditworthiness of the business. Lenders may also consider a business credit score, obtained from Dun & Bradstreet Corporation (D&B) or FICO, or produced by running their own business score models.

Information regarding the consumer credit scores of the small business owners participating in the 2009 NFIB survey and the 2003 SSBF are not available. However, the most recent value of D&B's PAYDEX score for the firm is available for both surveys. This score is developed from firm-specific data, such as prior repayment history, and forecasts the amount of time from a due date that it will take a business customer to complete the payment terms of a credit contract.³⁷ The higher the score, the shorter the time a customer typically takes to complete payment terms, and the more likely the credit supplier is to extend credit. These scores range from 1 to 100, with an 80 meaning that the creditor can expect payment in line with terms of the credit agreement. In 2009, 34 percent of small firms scored 80 or above. In the analysis that follows, we use a PAYDEX score below 80 as a proxy for a nonprime borrower; such firms are referred to as risky firms or low-score firms.

Characteristics Associated with Card Use

In previous studies that looked at firms with fewer than 500 employees, firm size, firm age, and credit score are some of the variables that have been found to be important in explaining credit card use among all small businesses.³⁸

Table 2 shows the means for number of employees, firm age, and credit score for firms that use cards, firms that do not use cards, firms that borrow using cards, and those that do not borrow using cards, for employer firms with 50 or fewer employees. In addition, the table includes the proportion of small firms that had a line of credit, had a business loan other than a line of credit, had either a line of credit or a business loan, and had a mortgage used for business purposes. Panel A presents data from 2009, and panel B presents data for 2003. The discussion that follows focuses on the 2009 data.

³⁷ See Dun & Bradstreet, "D&B Rating, PAYDEX, and Score Tables—United States," webpage, www.dnb.com/us/customer_service/paydex_tables.html.

³⁸ See Board of Governors of the Federal Reserve System (2002), *Report to the Congress on the Availability of Credit to Small Businesses* (Washington: Board of Governors, September); and Board of Governors of the Federal Reserve System (2007), *Report to the Congress on the Availability of Credit to Small Businesses* (Washington: Board of Governors, October).

Table 2. Credit card use and characteristics of employer firms with 50 or fewer employees, 2009 and 2003

A. 2009

Population means except as noted

	Number of employees	Firm credit score ¹	Firm age (years)	Have a line of credit ²	Have business loan from financial institution ²	Have line of credit or business loan ²	Have mortgage used for business purposes ²
Any employer firm with 50 or fewer employees	6.27	62.91	17.00	45.6%	35.5%	61.2%	34.1%
Do not use cards	5.26	55.61	15.49	47.1%	40.3%	70.6%	31.0%
Use cards	6.47	64.42	17.31	45.3%	34.5%	59.2%	34.7%
Do not borrow using cards	6.21	64.54	17.15	45.8%	31.4%	58.9%	32.3%
Borrow using cards ³	6.56	55.29	16.30	44.5%	54.4%	71.4%	42.4%

B. 2003

	Number of employees	Firm credit score ¹	Firm age (years)	Have a line of credit ²	Have business loan from financial institution ²	Have line of credit or business loan ²	Have mortgage used for business purposes ²
Any employer firm with 50 or fewer employees	6.32	53.43	14.65	37.0%	45.1%	60.9%	15.0%
Do not use cards	5.50	46.37	15.24	22.3%	34.5%	45.9%	13.7%
Use cards	6.54	55.30	14.49	40.8%	47.9%	64.8%	15.3%
Do not borrow using cards	6.78	56.31	15.23	36.4%	42.0%	57.8%	13.4%
Borrow using cards ³	4.83	44.02	12.77	38.7%	55.0%	70.9%	20.3%

1. Dun and Bradstreet PAYDEX score; values range from 1 to

2. Variable equal to one if firm has the loan type and zero otherwise. Cell value is the percent of firms having loan type listed in column.

3. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: 2009 data are tabulated from the 2009 National Federation of Independent Business survey; 2003 data are tabulated from the 2003 Survey of Small Business Finances.

As mentioned previously, 83 percent of small firms in 2009 used credit cards and 17 percent did not. On average, credit card–using firms were slightly larger (6.5 employees versus 5.3 employees), somewhat older (17.3 years versus 15.5 years), and had higher (better) credit scores (64.4 versus 55.6) than firms that did not use cards. In addition, credit card–using firms were less likely to have a line of credit or a loan from a financial institution and more likely to have a mortgage used for business purposes than were non-card-using firms.

Compared with firms that did not borrow using credit cards, firms that borrowed on credit cards in 2009 had lower credit scores (55 versus 65) and were somewhat younger. Firms borrowing with cards were slightly less likely to have a line of credit but quite a bit more likely to have a business loan or mortgage, suggesting that overall credit needs for credit card–borrowing firms may be greater than for nonborrowing card users, and that credit cards may provide a source of credit that is not strictly a substitute for other types of business credit.

INTENSITY OF CREDIT CARD USE AND BORROWING: LOW VERSUS HIGH CREDIT SCORE FIRMS

This section compares credit card use of small firms that had low credit scores with those that had high credit scores. Included in this section is an examination of the intensity of credit card use and borrowing—that is, the amounts charged and borrowed by the business using credit cards. In table 3, panels A, B, and C contain information discussed in this section.³⁹

A firm’s credit score should indicate the creditworthiness of the firm. In table 3, credit card use is tabulated for small firms with scores less than 80 (more-risky firms) and for small firms with scores above 80 (less-risky firms). While more-risky firms do not *use* credit cards as often as less-risky firms (81 percent versus 88 percent), they nevertheless have a substantially higher incidence of borrowing on credit cards than less-risky firms (20 percent versus nearly 14 percent).

Small firms with low credit scores are substantially less apt to use business credit cards and slightly more likely to use personal credit cards than firms with high credit scores (table 3, panel A). Still, low-score firms are more likely than high-score firms to borrow using business cards (14 percent of low-score firms and 10 percent for high-score firms). Low-score firms are also more likely than high-score firms to borrow using personal cards (13 percent of low-score firms versus 9 percent of high-score firms).

³⁹ Table 1.A in the appendix contains credit card use information from 2003 for all businesses with fewer than 500 employees, nonemployer firms, employer firms with 50 or fewer employees, and employer firms with more than 50 but fewer than 500 employees. These data are not available for later years. Credit card use among nonemployer firms, which by definition are smaller than employer firms, was similar to credit card use by employer firms with 50 or fewer employees (smaller employer firms). Nonemployer firms were less likely to use cards, especially business cards. They were about as likely to borrow on cards as were smaller employer firms. However, among card users, nonemployer firms were more likely to borrow on business cards and somewhat less likely to borrow on personal cards than the smaller employer firms.

Table 3, panel B, contains information on levels of card charges and card borrowings from the 2003 SSBF. The 2009 data, shown in table 3, panel A, are somewhat limited because questions in the 2009 NFIB survey regarding charges and borrowings (balances remaining after payments) required respondents to answer within ranges (for example, \$500 to \$1,000) rather than provide specific dollar amounts. These data do not provide enough information to calculate average values. Moreover, without additional information regarding the scale of the firm's operation (such as sales), it is difficult to know the relative importance of the levels of charges and outstanding balances. It is reasonable to expect charges and outstanding balances to increase with firm size, but the only firm-size indicator available in the 2009 data is employment. The 2003 SSBF, in contrast, contains information on the dollar value of charges and borrowing on credit cards. Consequently, this section will begin by examining the dollar value of charges and outstanding balances using data from the 2003 SSBF shown in table 3, panel B. Comparisons will also be made between risky firms (credit scores less than 80) and less-risky firms (credit scores 80 or larger). The dollar values from the 2003 SSBF are then converted to ranges (table 3, panel C) to facilitate comparison with the 2009 data.

Table 3. Credit card use details for employer firms with 50 or fewer employees,
by firm credit score

A. 2009 amounts charged and borrowed, by type of card

	Percent of employer firms with 50 or fewer employees	Percent of risky firms (Credit score <80) ¹	Percent of less risky firms (Credit score >=80) ¹
Used credit cards	83.1%	80.8%	87.6%
Borrowed on credit cards	17.9%	20.0%	13.7%
Used business credit cards	63.7%	58.9%	73.1%
Charged <\$1,000	22.5%	23.1%	21.7%
Charged \$1,000-<\$5,000	26.9%	24.7%	31.2%
Charged \$5,000 or more	14.4%	11.1%	20.2%
Borrowed on business credit cards ²	12.3%	13.5%	9.9%
Borrowed <\$1,000	2.4%	2.6%	n/a
Borrowed \$1,000-<\$5,000	4.6%	6.1%	n/a
Borrowed \$5,000 or more	5.3%	4.9%	n/a
Used personal credit cards	41.2%	42.7%	38.4%
Charged <\$1,000	18.5%	17.8%	20.0%
Charged \$1,000-<\$5,000	13.7%	14.0%	13.4%
Charged \$5,000 or more	8.9%	10.9%	5.1%
Borrowed on personal credit cards ²	11.5%	12.9%	8.6%
Borrowed <\$1,000	2.0%	2.8%	n/a
Borrowed \$1,000-<\$5,000	4.1%	5.0%	n/a
Borrowed \$5,000 or more	5.5%	5.2%	n/a
Memo: Percent of employer firms with 50 or fewer employees	100.0%	65.9%	34.1%

Note: n/a indicates too few observations to be statistically reliable.

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

2. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: 2009 National Federation of Independent Business (NFIB) survey, tabulated for employer firms with 50 or fewer employees. See William J. Dennis, Jr. (2010), *Small Business Credit in a Deep Recession* (Washington: NFIB, February).

Table 3. Credit card use details for employer firms with 50 or fewer employees, by firm credit score

B. 2003 means and medians of charges and amounts borrowed

	Employer firms with 50 or fewer employees	Risky firms (Credit score <80) ¹	Less risky firms (Credit score ≥80) ¹
Any credit card			
Mean amount charged	\$3,224	\$3,163	\$3,390
Median amount charged	\$1,000	\$1,000	\$1,200
Mean amount borrowed ²	\$9,328	\$9,013	\$11,166
Median amount borrowed ²	\$3,500	\$3,348	\$4,000
Business credit card			
Mean amount charged	\$2,983	\$2,908	\$3,179
Median amount charged	\$1,000	\$1,000	\$1,500
Mean amount borrowed ²	\$6,402	\$6,164	\$7,808
Median amount borrowed ²	\$3,000	\$3,000	\$3,000
Personal credit cards			
Mean amount charged	\$2,161	\$2,080	\$2,429
Median amount charged	\$650	\$600	\$1,000
Mean amount borrowed ²	\$9,353	\$8,972	\$11,717
Median amount borrowed ²	\$3,000	\$3,000	\$3,000
Memo: Percent of employer firms with 50 or fewer employees	100.0%	74.8%	25.2%

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

2. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: 2003 Survey of Small Business Finances.

Table 3. Credit card use details for employer firms with 50 or fewer employees,
by firm credit score

C. 2003 amounts charged and borrowed, by type of card

	Percent of employer firms with 50 or fewer employees	Percent of risky firms (Credit score <80) ¹	Percent of less risky firms (Credit score ≥80) ¹
Used credit cards	79.2%	77.5%	84.4%
Charged <\$1,000	33.8%	34.1%	32.5%
Charged \$1,000-<\$5,000	30.9%	29.6%	34.7%
Charged \$5,000 or more	14.6%	13.7%	17.3%
Borrowed on credit cards ²	23.6%	26.9%	13.7%
Borrowed <\$1,000	4.8%	5.1%	3.8%
Borrowed \$1,000-<\$5,000	9.7%	10.6%	4.6%
Borrowed \$5,000 or more	10.0%	11.2%	6.4%
Used business credit cards	51.9%	50.1%	57.1%
Charged <\$1,000	21.7%	22.3%	20.0%
Charged \$1,000-<\$5,000	21.1%	19.4%	25.9%
Charged \$5,000 or more	9.1%	8.4%	11.1%
Borrowed on business credit cards ²	14.9%	17.0%	8.6%
Borrowed <\$1,000	3.2%	3.5%	2.4%
Borrowed \$1,000-<\$5,000	6.3%	7.6%	2.6%
Borrowed \$5,000 or more	5.4%	6.1%	3.6%
Used personal credit cards	46.5%	47.7%	43.1%
Charged <\$1,000	25.1%	26.5%	21.1%
Charged \$1,000-<\$5,000	15.8%	15.8%	15.6%
Charged \$5,000 or more	5.8%	5.5%	6.4%
Borrowed on personal credit cards ²	13.3%	15.3%	7.3%
Borrowed <\$1,000	3.4%	3.8%	2.2%
Borrowed \$1,000-<\$5,000	4.3%	5.2%	1.8%
Borrowed \$5,000 or more	5.5%	6.3%	3.3%
Memo: Percent of employer firms with 50 or fewer employees	100.0%	74.8%	25.2%

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

2. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: 2003 Survey of Small Business Finances.

Intensity of Card Use

As shown in table 3, panel B, in 2003, small firms that used credit cards, on average, charged \$3,224 of new business expenses each month.⁴⁰ Users of business cards charged an average of \$2,983, and users of personal cards on average charged \$2,161 a month. Overall, risky firms were somewhat less likely to use cards than less-risky firms in 2003. Risky firms (column 2 of table 3, panel B) charged somewhat less than the less-risky firms (column 3)—\$3,163 versus \$3,390—in total, and also charged somewhat less on business and on personal cards.

In order to provide some perspective on the importance of credit card charges, credit card charges as a percentage of total expenses are calculated for each card-using firm for 2003. Charges on cards averaged about 18 percent of total expenses, with more than half of all card charges being made on business cards. Charges ranged from zero to \$150,000 per month. Although monthly charges tended to increase with firm size, charges as a percentage of expenses generally declined with firm size. Card charges as a percentage of expenses were higher for risky firms than for less-risky firms—20.3 percent compared with 14.2 percent. Similar differences were found for charges on business cards or charges on personal cards separately. Even though the nominal level of charges was similar between risky and less-risky firms, relative to total expenses, cards were used more intensively by riskier firms.

Another way to gauge the importance of credit card charges is to compare total aggregate charges across all small firms with total small firm aggregate expenses. The total charges to credit cards by small firms in 2003 were 4.4 percent of total expenses recorded by these firms. For small risky firms, such charges equaled 4.8 percent of their total expenses, whereas for small less-risky firms, charges equaled 3.7 percent.

Data from 2009 provides only ranges of values for credit card charges and borrowings (table 3, panel A). Comparable data for 2003 are presented in table 3, panel C. In 2003, 9.1 percent of firms charged \$5,000 or more on business cards and 5.8 percent charged \$5,000 or more on personal cards. In 2009, 14.4 percent of firms charged \$5,000 or more on business cards and 9 percent of firms charged \$5,000 or more on personal cards. Among risky firms, a smaller proportion charged \$5,000 or more on business cards than less-risky firms, and this result holds in both years. In 2003, the percentage of risky firms charging \$5,000 or more to personal cards is smaller than the percentage of less-risky firms charging \$5,000 or more (5.5 percent versus 6.4 percent). By 2009, the percentage of risky firms charging \$5,000 or more to personal cards is more than twice the percentage of less-risky firms charging \$5,000 or more (10.9 percent versus 5.1 percent). Regardless of risk level or type of card used, only a small fraction of small businesses charged more than \$5,000 per month on credit cards.

⁴⁰Statistics shown in table 3, panels B and C, as well as other statistics discussed in this section, were calculated for employer firms with 50 or fewer employees from the 2003 SSBF data by Board staff.

Intensity of Borrowing on Cards

As stated above, a substantial majority of card users do not carry balances month to month. In 2003, 24 percent of the population of small firms and 30 percent of small-firm card users carried balances after monthly payments. As shown in table 3, panel B, in 2003 credit card borrowings averaged \$9,328. It is worth noting that the median amount of borrowing was considerably lower at \$3,500; in other words, half of firms reported borrowing no more than \$3,500. As noted earlier, riskier firms were more likely to borrow using cards than less-risky firms, but on average, riskier firms carried lower balances than less-risky firms (\$9,013 compared with \$11,166).

While in 2003, 24 percent of all small businesses borrowed using credit cards, in the aggregate, only 1.4 percent of the outstanding debt of small firms was credit card borrowing. Business card borrowings accounted for 0.6 percent of outstanding small firm loans, whereas personal card borrowing accounted for 0.8 percent. Credit card debt accounted for 1.5 percent of risky firms' outstanding loans, and it accounted for 0.9 percent of less-risky firms' outstanding loans.⁴¹

Comparisons between 2009 and 2003 are limited to an examination of the distribution of borrowings (table 3, panels A and C, respectively). In 2003, 10 percent of firms borrowed \$5,000 or more on business cards and 6 percent borrowed \$5,000 or more on personal cards. In 2009, these percentages were 5 percent and 6 percent, respectively. In 2003, a larger percentage of risky firms borrowed \$5,000 or more on business cards and on personal cards than did less-risky firms. Data on the distribution of borrowings for less-risky firms is not available for 2009 due to limited sample sizes. However, comparisons for the riskier firms between 2003 and 2009 are available. In 2003, 6 percent of the riskier firms borrowed \$5,000 or more on business cards and 6 percent borrowed \$5,000 or more on personal cards. In 2009, these percentages were both 5 percent. In sum, in both 2003 and 2009 relatively few small businesses borrowed more than \$5,000 on either business or personal credit cards.

⁴¹ Comparable data for 2009 is unavailable.

Credit Card Access, Terms, and Conditions

This section focuses on small businesses' access to new credit cards in 2009, interest rates paid by small credit card borrowing firms in 2003, and changes in terms and conditions that small businesses have recently experienced on their existing credit cards. To help assess credit access, we look at the frequency with which firms seeking new credit cards are able to obtain them. With the exception of information on card interest rates from the 2003 SSBF, data for this section, which is presented in table 4, is drawn from the 2009 NFIB survey and profiles the experiences of small firms during 2009.⁴²

CREDIT CARD ACCESS: APPLICATIONS FOR NEW CARDS

Table 4 presents information drawn from the 2009 NFIB survey, including the percentage of firms applying for cards, the outcome of those applications, and whether the recent application was for a business or a personal card. The table includes data for three categories of firms: small businesses, riskier small businesses (credit score less than 80), and less-risky small businesses (credit score 80 or greater). For each of these categories, there are two columns: The first column titled "Percent of firms" presents the percentage of that category of firms having the characteristic identified by the row of the table, and the second column titled "Percent of applicants" presents the percentages defined over the firms in that category that applied for credit cards during 2009. For example, as shown in row 2, "Applied for business card," 15.7 percent of employer firms with 50 or fewer employees applied for a business card (column 1), whereas 80 percent of employer firms with 50 or fewer employees that applied for a card applied for a business card (column 2).

During 2009, 19.6 percent of small firms attempted to obtain a new credit card. Among those applying for cards, four out of five firms applied for a business card on their most recent request. Nearly three-fourths of all firms that applied for a new credit card were successful in getting a card (rows A and B), although 15 percent of those applying for a card obtained the card with an unsatisfactory limit or terms. More than 20 percent of firms applying for a credit card were not able to get a card, and another 5.6 percent did not accept the card because of unfavorable terms. Although the sample of firms that applied for cards and received unfavorable terms is quite small, among those firms the most prevalent unfavorable terms were either inadequate credit limits (80 percent) or unfavorable interest rates (56 percent).⁴³

⁴² Questions on applications for new credit cards and changes in terms of existing cards were not asked on any of the SSBF surveys. The NFIB conducted two credit access polls (see Dennis, *Small Business Credit in a Deep Recession*, note 19; and Dennis, National Small Business Poll: Access to Credit, note 33), as well as a survey on credit cards conducted in July 2008 (see Dennis, National Small Business Poll: Credit Cards, note 33).

⁴³ The small samples do not permit comparisons between risky and less-risky firms regarding what was unfavorable about the terms.

Table 4. Most recent attempt to obtain new credit card during 2009 for employer firms with 50 or fewer employees

	Employer firms with 50 or fewer employees		Risky firms (Credit score <80) ¹		Less risky firms (Credit score ≥80) ¹	
	Percent of firms	Percent of applicants	Percent of firms	Percent of applicants	Percent of firms	Percent of applicants
Applied for business or personal card	19.6%	100.0%	18.5%	100.0%	21.6%	100.0%
Applied for business card	15.7%	80.0%	14.8%	79.9%	17.3%	80.1%
Applied for personal card	3.9%	20.0%	3.7%	20.1%	4.3%	19.9%
<i>Outcome:</i>						
A. Obtained card with acceptable terms/conditions	11.5%	58.7%	9.8%	53.0%	14.6%	67.6%
B. Obtained card, but with unsatisfactory terms/conditions	2.9%	15.0%	3.6%	19.4%	1.8%	8.2%
C. Turned down card because terms/conditions unsatisfactory	1.1%	5.6%	1.4%	7.6%	0.5%	2.5%
D. Was unable to get the card	4.1%	20.7%	3.7%	20.0%	4.7%	21.7%

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

Source: 2009 National Federation of Independent Business (NFIB) survey, tabulated for employer firms with 50 or fewer employees. See William J. Dennis, Jr. (2010), *Small Business Credit in a Deep Recession* (Washington: NFIB, February).

Riskier firms were somewhat less likely to apply than less-risky firms. About 72 percent of riskier firms that applied obtained a card, compared with about 76 percent of the less-risky firms. A slightly greater percentage of less-risky firms applying for a card (21.7 percent) were unable to get a card than riskier firms (20.0 percent); but 7.6 percent of riskier firms, compared with only 2.5 percent of less-risky firms, turned down a card because of unfavorable terms.

Small businesses were relatively more successful in obtaining credit cards than other forms of credit during 2009. Although roughly similar percentages of small firms applied for lines of credit (21 percent) or applied for bank loans (16 percent), the success rate for such applicants was only about half the success rate of applicants for credit cards.

INTEREST RATES ON CREDIT CARDS IN 2003

Little systematic information exists on the credit card interest rates that small businesses face.⁴⁴ As discussed in detail earlier, data from Mintel provides information on the minimum possible APR advertised for small business credit cards. The 2003 SSBF collected data on card interest rates by type of card—business or personal. Comparable data for 2009 are unavailable; however, the data from 2003 do provide some information on the level of interest rates by type of card and type of firm—risky or less risky. Table 5 summarizes these data. There are two main findings. First, average interest rates on personal cards used by businesses were about 40 basis points higher than business card rates (13.0 versus 12.6 percent). Similar differences existed between personal and business rates for risky firms (13.1 versus 12.8 percent) and less-risky firms (12.3 versus 11.8 percent). Second, in 2003, more-risky firms, on average, paid higher interest rates than less-risky firms on both business and personal cards. Interest rates on personal cards used in businesses were about 80 basis points higher for risky firms than for less-risky firms, whereas rates on business cards were 100 basis points higher for the riskier firms.

Table 5. 2003 average credit card interest rates for employer firms with 50 or fewer employees

	Personal card	Business card
Employer firms with 50 or fewer employees	13.0%	12.6%
Risky firms (Credit score <80) ¹	13.1%	12.8%
Less risky firms (Credit score ≥80) ¹	12.3%	11.8%

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

Source: Calculated from the 2003 Survey of Small Business Finances.

⁴⁴ Data on card interest rates for personal and business cards is available from the 2003 SSBF. Similar information was not collected in the recent 2009 NFIB survey, nor is similar data available for other public sources of which we are aware. Some information on offer rates and other terms was described earlier in this report.

TERMS AND CONDITIONS DURING 2009

As shown in the first two columns of table 6, during 2009, 23 percent of small firms had the terms or conditions of their most important card changed by the issuer.⁴⁵ The most frequent change reported (by 60 percent of those firms reporting changes) was higher interest rates, followed by lowered credit limits (reported by 23 percent). Among all card users, the percentage reporting higher interest rates was about 14 percent, whereas the percentage reporting lowered credit limits was about 6 percent. About 4 percent of card users indicated that their card was canceled. These data are consistent with data from the SLOOS in that, as discussed earlier, a substantial fraction of senior loan officers indicated having raised interest rates on small business credit card accounts during the last quarter of 2009 and first quarter of 2010.

More than 25 percent of risky firms reported changes in terms and conditions compared with 18.5 percent of less-risky firms. For both risky and less-risky firms, the most frequent change reported was an increase in interest rates, although such changes were less common among the less-risky firms. Among card holders, decreases in credit limits were more likely for the risky firms (6.9 percent) than for the less-risky firms (3.1 percent). Card cancellations were also more frequent among risky firms (4.7 percent) than among less-risky firms (3.6 percent of card users).

When asked about the effects of the unilateral changes to their most important credit card during 2009, 40 percent of small firms experiencing changes indicated that the changes were either very harmful or harmful. Risky firms experiencing changes were more likely to have found the changes either very harmful or harmful than were less-risky firms. Finally, 1.2 percent of risky firms experiencing changes indicated the changes were positive. Those firms reported that interest rates were lowered. There did not appear to be any relationship between those indicating the changes were harmful and the type of change.⁴⁶

⁴⁵ Data are from the 2009 NFIB survey. The sample for this section is restricted to employer firms with fewer than 50 employees where the respondent was an owner and to the 458 sampled firms that completed both the personal card and the business card sections of the survey. Of the 751 firms surveyed, 193 firms did not complete the personal card section of the questionnaire.

⁴⁶ See Dennis, *Small Business Credit in a Deep Recession*, note 19.

Table 6. Changes in terms and conditions for most important credit card during 2009 for employer firms with 50 or fewer employees

	Employer firms with 50 or fewer employees		Risky firms (Credit score <80) ¹		Less risky firms (Credit score ≥80) ¹	
	Percent of card users	Percent of card users who reported changes	Percent of card users	Percent of card users who reported changes	Percent of card users	Percent of card users who reported changes
Issuer changed terms or conditions	23.0%	100.0%	25.7%	100.0%	18.5%	100.0%
Increased minimum payment	0.7%	3.0%	1.0%	3.9%	0.2%	1.2%
Increased interest rate	13.8%	60.1%	16.1%	62.8%	9.8%	53.1%
Decreased interest rate	0.5%	2.2%	0.8%	3.3%	0.0%	0.0%
Increased credit limit	0.1%	0.4%	0.2%	0.6%	0.0%	0.0%
Decreased credit limit	5.3%	23.1%	6.9%	26.7%	3.1%	16.9%
Canceled card	4.1%	17.7%	4.7%	18.2%	3.6%	19.2%
Shortened grace period	0.6%	2.7%	1.0%	4.0%	0.0%	0.0%
Changed charges/fees	1.1%	4.8%	1.7%	6.7%	0.2%	1.2%
Card company went out of business/changed hands	0.2%	0.9%	0.4%	1.4%	0.0%	0.0%
Other	2.5%	11.0%	2.4%	9.3%	2.2%	11.7%
<i>Effect on business from changed terms or conditions</i>						
Very harmful	3.3%	14.5%	3.6%	13.9%	2.9%	15.9%
Harmful	5.8%	25.4%	8.0%	31.2%	2.1%	11.6%
More irritating than harmful	11.5%	49.9%	11.9%	46.4%	10.8%	58.2%
No effect	2.2%	9.5%	1.9%	7.5%	2.6%	14.2%
Helpful	0.2%	0.9%	0.3%	1.2%	0.0%	0.0%

1. Dun & Bradstreet PAYDEX score; values range from 1 to 100.

Source: 2009 National Federation of Independent Business (NFIB) survey, tabulated for employer firms with 50 or fewer employees. See William J. Dennis, Jr. (2010), *Small Business Credit in a Deep Recession* (Washington: NFIB, February).

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Adequacy of Disclosures of Terms, Fees, and Other Expenses and Protections against Unfair or Deceptive Acts or Practices

Section 506 of the Credit CARD Act requires the Board to review the adequacy of disclosures of terms, fees, and other expenses of credit card plans for small businesses. Similarly, section 506 of the Act also requires the Board to review the adequacy of protections against unfair or deceptive acts or practices relating to credit card plans for small businesses.⁴⁷

CURRENT PRACTICES REGARDING DISCLOSURES OF TERMS, FEES, AND OTHER EXPENSES

As discussed in “Background Regarding the Truth in Lending Act and Existing Protections for Credit Card Accounts” of this report, TILA’s substantive protections and disclosure requirements for credit cards generally do not apply to business credit card accounts. However, based on meetings with card issuers and a review of small business credit card disclosures, the Board understands that many card issuers nonetheless provide small business cardholders with disclosures similar to the disclosures that are required by TILA for consumer credit card accounts. For example, many issuers of small business credit cards provide disclosures of key terms such as APRs, other finance charges, and penalty fees. Although it is not mandated by TILA or Regulation Z, some business card issuers provide these disclosures in a format similar to the format required under TILA and Regulation Z for consumer credit card accounts.⁴⁸ For example, some small business card issuers provide important disclosures of terms and fees in a table that is similar to the tabular format required in connection with consumer credit card accounts. The Board notes that issuers of small business credit cards often also provide additional disclosures specific to business credit plans, such as disclosures regarding the costs associated with obtaining additional employee cards.

For consumer credit card accounts, the disclosures required under TILA and Regulation Z (as amended effective July 1, 2010) have proven in testing to be effective in communicating key information to consumers regarding their accounts. During the period from 2006 to 2008,

⁴⁷ For consistency with section 506, this report generally refers to provisions of TILA as either “disclosure” or “substantive” provisions. In particular, the Board uses “disclosure” generally to refer to provisions which require “disclosures of terms, fees, and other expenses of credit card plans.” Credit CARD Act § 506(a)(2). In addition, the Board uses “substantive” generally to refer to provisions which provide “protections against unfair or deceptive acts or practices relating to credit card plans” or otherwise prohibit or require certain acts or practices other than disclosure of information. Credit CARD Act § 506(a)(3). The Board notes, however, that certain provisions of TILA that pertain to disclosures may have related substantive limitations or requirements.

⁴⁸ 12 C.F.R. part 226.

the Board conducted extensive consumer testing on consumer credit card disclosures.⁴⁹ The Board used this testing to develop amendments to Regulation Z and model disclosure forms. The Board's consumer testing focused on: summary table disclosures provided in solicitations and applications; disclosures provided at account opening; periodic statement disclosures; and subsequent disclosures, such as notices when key account terms are changed. Based on the results of its testing, the Board adopted several amendments to the formatting and content of notices required by Regulation Z where the testing indicated those changes were helpful for consumers and effective in improving understanding of the terms of a credit card agreement. For example, the Board's consumer testing indicated that providing a table at account opening that summarizes the key terms of an account was more effective than presenting those disclosures in a narrative format that might include dense prose and small print. The Board's amendments to Regulation Z's disclosure requirements generally become effective on July 1, 2010.⁵⁰

Some major issuers of small business cards have indicated to Board staff that they intend to revise certain disclosures for their small business card accounts to conform with the new requirements of Regulation Z for consumer cards. However, other issuers have stated that they do not intend to modify their small business credit card disclosures for conformity with the new disclosure rules for consumer credit card accounts.

Furthermore, Board staff understands that many small business card issuers do not comply with all aspects of certain disclosure provisions in TILA. For example, section 127(i) of TILA generally requires a card issuer to provide a consumer with a written notice of any increase in an annual percentage rate; however, section 127(i) also prohibits the card issuer from applying the increased rate to the account for 45 days after provision of the notice. Board staff understands that, while small business card issuers generally provide a written notice of rate increases, most do not provide 45 days advance notice.

CURRENT PRACTICES REGARDING SUBSTANTIVE PROTECTIONS

The Board understands that few business card issuers have elected to voluntarily comply with the substantive restrictions contained in TILA as amended by the Credit CARD Act. Many card issuers maintain that this distinction is appropriate because their small business credit card portfolios are separate and distinct from their consumer card portfolios, with different underwriting requirements, pricing, and risk factors. These issuers do not intend to apply the pricing restrictions of the Credit CARD Act to their small business credit cards because they consider small business credit and charge cards different products than consumer credit cards. In particular, these issuers have stated that applying restrictions on the ability to raise interest rates

⁴⁹ For more information on the Board's consumer testing, see two reports submitted to the Board on December 15, 2008, and available on the Board's website: *Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research*, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a7.pdf; and *Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study*, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf.

⁵⁰ See 75 FR 7658 (Feb. 22, 2010).

in order to account for changes in risk to small business cards would significantly reduce the number of accounts and the amount of credit availability for small business cards. These issuers also indicated that there could be unintended consequences such as lower credit limits. Recently, however, one major small business card issuer has announced a number of changes to its small business card accounts that mirror certain substantive provisions for consumer cards in the Credit CARD Act. These changes include: no rate increases on existing balances, 45 days' advance notice of any rate changes for new transactions, no over-the-limit fees, and a minimum of 25 days from statement closing to payment due date.⁵¹ Furthermore, the Board understands that other issuers are applying certain substantive provisions of the Credit CARD Act to small business card accounts. For example, one issuer is applying the Act's requirement that amounts paid above the minimum generally be applied to the balance with the highest rate to its small business card accounts. Another small business card issuer is complying with the Act's requirement that, when the rate on an existing balance is increased because the account is more than 60 days delinquent, the rate on that balance must be lowered to the preexisting rate if the issuer receives six consecutive timely minimum payments. In addition, the Board identified at least one card issuer that indicated it intends to consider the Act's limitations on pricing terms in the context of its small business cards and to assess the costs of voluntarily complying with the Credit CARD Act. At this time, the Board cannot determine the extent to which small business card issuers may voluntarily comply with certain substantive provisions of the Credit CARD Act and believes that further monitoring of small business credit card practices would be required.

ADEQUACY OF EXISTING DISCLOSURES AND SUBSTANTIVE PROTECTIONS— COMPLAINT INFORMATION

As noted above, TILA applies certain substantive protections to all credit cards. Specifically, the provisions prohibiting unsolicited issuance of credit cards (section 132) and limiting liability of cardholders for unauthorized use (section 133) apply to small business credit cards. The Board notes that other consumer protection statutes and regulations address business credit card activity, such as the Equal Credit Opportunity Act, 15 U.S.C. 1691 *et seq.*, and section 5 of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1), which prohibits unfair and deceptive acts and practices.⁵²

Although the Board does not have direct data regarding the adequacy of protections for small business cardholders against unfair and deceptive acts and practices, the volume and nature of credit card complaints raised by small businesses may provide some indication regarding potential areas of concern. The Board receives and responds to consumer inquiries and

⁵¹ Bank of America (2010), "Bank of America Commits to Clarity for Small Business Customers," press release, April 1, <http://newsroom.bankofamerica.com/index.php?s=43&item=8669>.

⁵² See, for example, "In the Matter of Advanta Bank Corp., Draper, Utah," FDIC-08-259b, FDIC-08-403k, June 30, 2009 (a cease and desist order prohibiting deceptive solicitations and rate increases on accounts in an unfair manner), available at Federal Deposit Insurance Corporation (2009), "FDIC Announces Settlement with Advanta Bank Corporation for Deceptive and Unfair Practices," press release, July 1, www.fdic.gov/news/news/press/2009/pr09109.html.

complaints on a broad range of banking topics, including questions regarding credit cards.⁵³ In preparing this report, the Board reviewed complaint information maintained on the Board's consumer complaint system, CAESAR. Specifically, the Board reviewed complaints about credit cards received from businesses and from individual consumers.⁵⁴ From 2007 through 2009, 3,886 complaints concerning credit card activity were processed, of which 2 percent (69) were from businesses and 98 percent (3,817) were from consumers. These complaints are summarized in table 7.

Table 7. Summary of personal card user and business card user complaints during 2007–09, from CAESAR complaint data files

Complaint category	Percent of personal card complaints	Percent of business card complaints
Account opening	11.9%	11.6%
Account terms	23.5%	10.1%
Application	7.8%	8.7%
Billing	18.3%	21.7%
Collection	10.9%	2.9%
Disclosure	1.2%	1.5%
Fees	5.7%	11.6%
Fraud, forgery, embezzlement, or theft	5.9%	17.4%
Other	14.7%	14.5%
Total	100.0%	100.0%
Number of complaints	3817	69

Source: Complaint Analysis Evaluation System and Reports (CAESAR), Washington: Board of Governors of the Federal Reserve System.

The relative scarcity of credit card complaints by small businesses may reflect a true lack of complaints on the part of small businesses. However, it is important to keep in mind that there are many more consumers and consumer credit card accounts from which consumer complaints may be generated, compared to small businesses and small business credit card accounts. Nevertheless, one large issuer of consumer and small business credit cards reported that, *on a per account basis*, they receive about 20 percent fewer small business credit card complaints compared to consumer card complaints. This issuer also indicated that the top categories of complaints from small businesses are: (1) changes in terms; (2) collections; and (3) billing

⁵³ In addition, the Board investigates complaints against state member banks and forwards complaints against other creditors and businesses to the appropriate enforcement agency.

⁵⁴ Note that, when processing complaints, the Board generally does not distinguish between businesses based on size or number of employees.

disputes. The top categories of complaints from the card issuer's consumers are: (1) collections; (2) fees; and (3) changes in terms.

Based on the Board's review of complaints the Board has received, the nature of the complaints raised by businesses and individual consumers have some similarities, as well as some notable differences.⁵⁵ Billing and account-opening problems were among the top three sources of complaints for both consumers and businesses. Billing problems (including, among other things, payment errors or delays, errors in finance charge calculations, and problems with billing error resolution) accounted for roughly one-fifth of the complaints from each group, and account-opening problems (including delays in application decisions, unsolicited cards, and concerns about preapproved solicitations) comprised about one-eighth of complaints from each group. However, complaints involving account terms or fraud, forgery, embezzlement, or theft show notable differences between consumer and business complaints. Nearly one-fourth of consumer complaints, but only about one-tenth of business complaints, involved account terms. Complaints about fraud, forgery, embezzlement, and theft were the second most-common category for businesses (comprising about one-sixth of complaints) but were relatively infrequent for consumers. Other notable differences include complaints about collections (including, among other things, debt collection tactics, judgments, liens and garnishments), which ranked higher among consumers than among businesses, and complaints about fees (primarily late fees and over-the-limit fees), which ranked higher among businesses than among consumers.

⁵⁵ It is important to keep in mind that any statements made in this paragraph regarding complaints from businesses are based on an extremely small number of observations.

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Conclusion and Recommendations

The Board has considered whether small business credit cards may benefit from being subject to disclosure and substantive requirements similar to those in TILA (as amended by the Credit CARD Act). The Board notes that the Congress has excluded business credit cards from coverage under TILA, with the exception of the 1974 amendments providing business cards with certain protections against unsolicited issuance and unauthorized or fraudulent use. If the Congress were to consider establishing new disclosure requirements and substantive protections for small business credit cards, it should consider the similarities and differences between consumers and small businesses and the two different types of credit cards, as well as the differences between TILA's disclosure requirements and its substantive protections.⁵⁶

COMPARISON OF CONSUMER AND SMALL BUSINESS CARDS

Consumer and small business cards are similar in many respects. As discussed earlier in the report, consumer credit cards and small business credit cards offer many similar features, such as rewards programs, balance transfer programs, and introductory rate promotions. The fees and pricing structures, as well as other terms such as grace periods, also appear to be similar across the two products. Several card issuers told Board staff that they house their small business credit card function within the same business unit as their consumer credit card function because of the similarities between the two products.

However, significant differences exist between consumers and small businesses and the ways in which each group uses credit cards, leading to some important differences between consumer and small business credit card programs. First, small businesses and consumers differ markedly in their propensity to use credit cards for borrowing purposes (in other words, to carry a balance from month to month). Whereas only 18 percent of small businesses report borrowing each month on credit cards, about 46 percent of households report having credit card debt.⁵⁷

Second, small businesses tend to spend more in a given month than consumers and therefore small businesses demand relatively large credit lines. But granting larger lines increases card issuers' risk exposure. At the same time assessing the risk of a small business at the time of application can be more difficult for credit card issuers than assessing the risk of a personal card applicant. When evaluating a consumer credit card application, issuers can utilize the three national consumer credit bureaus, which provide detailed information on consumers' historical performance in repaying debts. Moreover, consumer credit scoring methods using these credit bureau data are well-developed. In contrast, small business credit reporting and scoring is not as well established and virtually non-existent for newer firms. Many small

⁵⁶ Of course, some of TILA's credit card provisions would have little or no application in the context of small business cards, such as restrictions on the extension of credit cards to consumers under the age of 21.

⁵⁷ See Brian Bucks, Arthur Kennickell, Traci Mach, and Kevin Moore (2009), "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 95 (February), table 13.

business credit card applicants may have little or no credit history, making small business risk assessments difficult and imprecise.

POTENTIAL EFFECTS OF APPLYING TILA’S DISCLOSURE REQUIREMENTS TO SMALL BUSINESS CARDS

As mentioned before, the disclosures required under TILA and Regulation Z (as amended effective July 1, 2010) for consumer credit card accounts have proven in testing to be effective in communicating key information to consumers regarding their accounts. Given the similarities between consumer and small business cards as noted above and earlier in this report, small business owners may benefit from many of the same disclosures. The Board believes that standardizing and improving disclosures for small business credit cards would promote the informed use of credit by enhancing small businesses’ ability to compare the cost of the credit card plans available to them. However, many small businesses may not benefit from TILA’s disclosure requirements to the same extent as consumers. For example, disclosures aimed at improving users’ understanding of the costs associated with making only the required minimum payment may be less beneficial for small businesses than for consumers because, as discussed above, most small businesses pay the balance in full each month and use credit cards for transaction and cash-flow management purposes. In addition, the Congress has previously stated that business owners may, on average, be in a better position than consumers to assess credit plans available to them.⁵⁸ Moreover, many of the small businesses that borrow on credit cards use personal cards, which are subject to the disclosure requirements in TILA and Regulation Z.⁵⁹

Requiring TILA and Regulation Z disclosures for small business cards would impose costs related to revising marketing materials, application and solicitation disclosures, account-opening disclosures, and periodic statements. Such costs could be passed on to small businesses in the form of higher fees or interest rates. However, card issuers’ existing systems for providing TILA and Regulation Z disclosures for their consumer credit cards may mitigate some of the burden of providing such disclosures for small business cards. As noted earlier, some issuers have chosen to provide disclosures of key terms such as annual percentage rates, other charges, and penalty fees in a table that is similar to the required format for consumer credit cards. However, these issuers generally do not comply with related substantive requirements, such as the requirement in section 127(i) of TILA that card issuers provide 45 days advance notice before an increase in rate.

For the reasons discussed above, applying TILA’s disclosure requirements to small business cards would produce benefits for small businesses, but the extent of those benefits is unclear. In addition, there would be costs associated with requiring all small business card issuers to provide TILA disclosures, although those costs may be limited because small business

⁵⁸ The Board, however, is not aware of any studies that compare the level of financial sophistication between consumers and small business owners.

⁵⁹ The Board notes, however, that credit cards used primarily for a “business, commercial or agricultural purpose” would generally not be covered by TILA and Regulation Z.

card issuers may already provide some of these disclosures. As discussed below, however, to the extent that TILA's disclosure provisions also contain related substantive requirements, application of those provisions could adversely affect the cost and availability of small business credit cards. Overall, it is not clear whether the benefits of applying TILA's disclosure requirements to small business cards outweigh the costs.

POTENTIAL EFFECTS OF APPLYING TILA'S SUBSTANTIVE PROVISIONS TO SMALL BUSINESS CARDS

Applying many of TILA's substantive credit card protections to small business credit cards would protect small businesses from practices that the Congress and the Board have found to be harmful in the context of consumer credit cards. For example, application of TILA's requirement that cut-off times for payments be no earlier than 5 p.m. on the payment due date would assist small businesses in making timely payments and avoiding penalty fees. Furthermore, TILA's restrictions on applying increased rates to existing balances and on allocating payments in a manner that maximizes interest charges would assist small businesses that borrow on their credit cards by limiting or reducing interest charges.

However, if the Congress were to consider the application of TILA's substantive provisions to small business cards, it would be important to recognize the potential for adverse effects on the cost and availability of small business credit cards. For example, applying TILA's restrictions on the ability of creditors to adjust interest rates on small business credit cards could have negative consequences for small businesses. As noted earlier, credit card issuers have more difficulty assessing the creditworthiness of small businesses than consumers. Therefore, the willingness of issuers to extend the relatively large credit card lines that small businesses require may depend importantly on issuers' ability to adjust prices in the future, as they learn through experience about businesses' ability and willingness to pay. Restricting the ability of card issuers to adjust interest rates may lead to higher initial interest rates, which would harm those firms that borrow on small business credit cards. In addition, if credit card issuers were to reduce credit limits in response to the imposition of TILA's substantive requirements, even those businesses that use credit cards for transactions and cash management would be harmed. However, the Board notes that at least one major issuer of small business cards has chosen to voluntarily comply with TILA's rate increase restrictions with respect to its small business card accounts. The Board also notes that the extent to which the Credit CARD Act's substantive provisions have affected or will affect the cost and availability of consumer credit cards is not yet clear.

Based on this review, it is not apparent, for the reasons discussed above, that the potential benefits of applying substantive restrictions similar to those in TILA to small business cards outweigh the potential risk of increased cost and reduced credit card availability for small businesses.

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Appendix

Appendix Table A.1. Small business credit card use and borrowing, by firm employment status, 2003¹

Percent of population unless otherwise noted

	All small businesses	Non-employer firms	Employer firms with 50 or fewer employees	Employer firms with 51 to 499 employees
Used credit card	77.3%	69.5%	79.2%	82.3%
Used business credit card	48.1%	31.9%	51.9%	66.4%
Used personal credit card	46.7%	48.9%	46.5%	33.8%
Borrowed on credit card	22.6%	21.2%	23.6%	5.3%
Borrowed on credit card (percent of card users)	29.3%	30.5%	29.7%	6.5%
Borrowed on business credit card	14.1%	12.4%	14.9%	3.6%
Borrowed on business credit card (percent of business card users)	29.3%	38.7%	28.7%	5.4%
Borrowed on personal credit card	12.7%	11.6%	13.3%	2.4%
Borrowed on personal credit card (percent of personal card users)	27.1%	23.7%	28.6%	7.2%
Memo: Percent of population of firms with fewer than 500 employees	100.0%	20.5%	77.1%	2.4%

1. Borrowing on credit cards means carrying balances after monthly payments are made.

Source: 2003 Survey of Small Business Finances, tabulated by Board staff. Small businesses consist of all firms with fewer than 500 employees.