



Highlights of [GAO-06-929](#), a report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

With credit card penalty rates and fees now common, the Federal Reserve has begun efforts to revise disclosures to better inform consumers of these costs. Questions have also been raised about the relationship among penalty charges, consumer bankruptcies, and issuer profits. GAO examined (1) how card fees and other practices have evolved and how cardholders have been affected, (2) how effectively these pricing practices are disclosed to cardholders, (3) the extent to which penalty charges contribute to cardholder bankruptcies, and (4) card issuers' revenues and profitability. Among other things, GAO analyzed disclosures from popular cards; obtained data on rates and fees paid on cardholder accounts from 6 large issuers; employed a usability consultant to analyze and test disclosures; interviewed a sample of consumers selected to represent a range of education and income levels; and analyzed academic and regulatory studies on bankruptcy and card issuer revenues.

What GAO Recommends

As part of revising card disclosures, the Federal Reserve should ensure that such disclosure materials more clearly emphasize those terms that can significantly affect cardholder costs, such as the actions that can cause default or other penalty pricing rates to be imposed. The Federal Reserve generally concurred with the report.

www.gao.gov/cgi-bin/getrpt?GAO-06-929.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-8678 or woodd@gao.gov.

CREDIT CARDS

Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers

What GAO Found

Originally having fixed interest rates around 20 percent and few fees, popular credit cards now feature a variety of interest rates and other fees, including penalties for making late payments that have increased to as high as \$39 per occurrence and interest rates of over 30 percent for cardholders who pay late or exceed a credit limit. Issuers explained that these practices represent risk-based pricing that allows them to offer cards with lower costs to less risky cardholders while providing cards to riskier consumers who might otherwise be unable to obtain such credit. Although costs can vary significantly, many cardholders now appear to have cards with lower interest rates than those offered in the past; data from the top six issuers reported to GAO indicate that, in 2005, about 80 percent of their accounts were assessed interest rates of less than 20 percent, with over 40 percent having rates below 15 percent. The issuers also reported that 35 percent of their active U.S. accounts were assessed late fees and 13 percent were assessed over-limit fees in 2005.

Although issuers must disclose information intended to help consumers compare card costs, disclosures by the largest issuers have various weaknesses that reduced consumers' ability to use and understand them. According to a usability expert's review, disclosures from the largest credit card issuers were often written well above the eighth-grade level at which about half of U.S. adults read. Contrary to usability and readability best practices, the disclosures buried important information in text, failed to group and label related material, and used small typefaces. Perhaps as a result, cardholders that the expert tested often had difficulty using the disclosures to find and understand key rates or terms applicable to the cards. Similarly, GAO's interviews with 112 cardholders indicated that many failed to understand key aspects of their cards, including when they would be charged for late payments or what actions could cause issuers to raise rates. These weaknesses may arise from issuers drafting disclosures to avoid lawsuits, and from federal regulations that highlight less relevant information and are not well suited for presenting the complex rates or terms that cards currently feature. Although the Federal Reserve has started to obtain consumer input, its staff recognizes the challenge of designing disclosures that include all key information in a clear manner.

Although penalty charges reduce the funds available to repay cardholders' debts, their role in contributing to bankruptcies was not clear. The six largest issuers reported that unpaid interest and fees represented about 10 percent of the balances owed by bankrupt cardholders, but were unable to provide data on penalty charges these cardholders paid prior to filing for bankruptcy. Although revenues from penalty interest and fees have increased, profits of the largest issuers have been stable in recent years. GAO analysis indicates that while the majority of issuer revenues came from interest charges, the portion attributable to penalty rates has grown.