at a rate permitted by the law of the state in which the bank is located.[41] In 1978, the U.S. Supreme Court ruled that a national bank is "located" in the state in which it is chartered, and, therefore, the amount of the interest rates charged by a national bank are subject only to the laws of the state in which it is chartered, even if its lending activities occur elsewhere.[42] As a result, the largest credit card issuing banks are chartered in states that either lacked interest rate caps or had very high caps from which they would offer credit cards to customers in other states. This ability to "export" their chartered states' interest rates effectively removed any caps applicable to interest rates on the cards from these banks. In 1996, the U.S. Supreme Court determined that fees charged on credit extended by national banks are a form of interest, allowing issuers to also export the level of fees allowable in their state of charter to their customers nationwide, which effectively removed any caps on the level of fees that these banks could charge.[43]

In the absence of federal regulatory limitations on the rates and fees that card issuers can assess, the primary means that U.S. banking regulators have for influencing the level of such charges is by facilitating competition among issuers, which, in turn, is highly dependent on informed consumers. The Truth in Lending Act of 1968 (TILA) mandates certain disclosures aimed at informing consumers about the cost of credit. In approving TILA, Congress intended that the required disclosures would foster price competition among card issuers by enabling consumers to discern differences among cards while shopping for credit. TILA also states that its purpose is to assure that the consumer will be able to compare more readily the various credit terms available to him or her and avoid the uninformed use of credit. As authorized under TILA, the Federal Reserve has promulgated Regulation Z to carry out the purposes of TILA. The Federal Reserve, along with the other federal banking agencies, enforces compliance with Regulation Z with respect to the depository institutions under their respective supervision.

In general, TILA and the accompanying provisions of Regulation Z require credit card issuers to inform potential and existing customers about specific pricing terms at specific times. For example, card issuers are

[41] 12 U.S.C. § 85.

[42] *Marquette National Bank v First of Omaha Service Corp. et. al*, 439 U.S. 299 (1978).

[43] *Smiley v. Citibank*, 517 U.S. 735 (1996).

required to make various disclosures when soliciting potential customers, as well as on the actual applications for credit. On or with card applications and solicitations, issuers generally are required to present pricing terms, including the interest rates and various fees that apply to a card, as well as information about how finance charges are calculated, among other things. Issuers also are required to provide cardholders with specified disclosures prior to the cardholder's first transaction, periodically in billing statements, upon changes to terms and conditions pertaining to the account, and upon account renewal. For example, in periodic statements, which issuers typically provide monthly to active cardholders, issuers are required to provide detailed information about the transactions on the account during the billing cycle, including purchases and payments, and are to disclose the amount of finance charges that accrued on the cardholder's outstanding balance and detail the type and amount of fees assessed on the account, among other things.

In addition to the required timing and content of disclosures, issuers also must adhere to various formatting requirements. For example, since 1989, certain pricing terms must be disclosed in direct mail, telephone, and other applications and solicitations and presented in a tabular format on mailed applications or solicitations.[44] This table, generally referred to as the Schumer box, must contain information about the interest rates and fees that could be assessed to the cardholder, as well as information about how finance charges are calculated, among other things.[45] According to a Federal Reserve representative, the Schumer box is designed to be easy for consumers to read and use for comparing credit cards. According to a consumer group representative, an effective regulatory disclosure is one that stimulates competition among issuers; the introduction of the Schumer box in the late 1980s preceded the increased price competition in the credit card market in the early 1990s and the movement away from uniform credit card products.

Not all fees that are charged by card issuers must be disclosed in the Schumer box. Regulation Z does not require that issuers disclose fees unrelated to the opening of an account. For example, according to the Official Staff Interpretations of Regulation Z (staff interpretations), nonperiodic fees, such as fees charged for reproducing billing statements

[44]See generally 12 C.F.R. § 226.5a.

[45]See supra note 21.

or reissuing a lost or stolen card, are not required to be disclosed. Staff interpretations, which are compiled and published in a supplement to Regulation Z, are a means of guiding issuers on the requirements of Regulation Z.[46] Staff interpretations also explain that various fees are not required in initial disclosure statements, such as a fee to expedite the delivery of a credit card or, under certain circumstances, a fee for arranging a single payment by telephone. However, issuers we surveyed told us they inform cardholders about these other fees at the time the cardholders request the service, rather than in a disclosure document.

Although Congress authorized solely the Federal Reserve to adopt regulations to implement the purposes of TILA, other federal banking regulators, under their authority to ensure the safety and soundness of depository institutions, have undertaken initiatives to improve the credit card disclosures made by the institutions under their supervision. For example, the regulator of national banks, OCC, issued an advisory letter in 2004 alerting banks of its concerns regarding certain credit card marketing and account management practices that may expose a bank to compliance and reputation risks. One such practice involved the marketing of promotional interest rates and conditions under which issuers reprice accounts to higher interest rates.[47] In its advisory letter, OCC recommended that issuers disclose any limits on the applicability of promotional interest rates, such as the duration of the rates and the circumstances that could shorten the promotional rate period or cause rates to increase. Additionally, OCC advised issuers to disclose the circumstances under which they could increase a consumer's interest rate or fees, such as for failure to make timely payments to another creditor.

Credit Card Disclosures Typically Provided to Many Consumers Have Various Weaknesses

The disclosures that credit card issuers typically provide to potential and new cardholders had various weaknesses that reduced their usefulness to consumers. These weaknesses affecting the disclosure materials included the typical grade level required to comprehend them, their poor organization and formatting of information, and their excessive detail and length.

[46]Compliance with these official staff interpretations afford issuers protection from liability under Section 130(f) of TILA, which protects issuers from civil liability for any act done or omitted in good faith compliance with any official staff interpretation. 12 C.F.R. Part 226, Supp. I.

[47]Credit Card Practices, OCC Advisory Letter AL 2004-10 (Sept. 14, 2004).

Disclosures Written at Too High a Level

The typical credit card disclosure documents contained content that was written at a level above that likely to be understandable by many consumers. To assess the readability of typical credit card disclosures, we contracted with a private usability consultant to evaluate the two primary disclosure documents for four popular, widely-held cards (one each from four large credit card issuers). The two documents were (1) a direct mail solicitation letter and application, which must include information about the costs and fees associated with the card; and (2) the cardmember agreement that contains the full range of terms and conditions applicable to the card.[48] Through visual inspection, we determined that this set of disclosures appeared representative of the disclosures for the 28 cards we reviewed from the six largest issuers that accounted for the majority of cardholders in the United States. To determine the level of education likely needed for someone to understand these disclosures, the usability consultant used computer software programs that applied three widely used readability formulas to the entire text of the disclosures. These formulas determined the readability of written material based on quantitative measures, such as average number of syllables in words or numbers of words in sentences. For more information about the usability consultant's analyses, see appendix I.

On the basis of the usability consultant's analysis, the disclosure documents provided to many cardholders likely were written at a level too high for the average individual to understand. The consultant found that the disclosures on average were written at a reading level commensurate with about a tenth- to twelfth-grade education. According to the consultant's analysis, understanding the disclosures in the solicitation letters would require an eleventh-grade level of reading comprehension, while understanding the cardmember agreements would require about a twelfth-grade education. A consumer advocacy group that tested the reading level needed to understand credit card disclosures arrived at a similar conclusion. In a comment letter to the Federal Reserve, this consumer group noted it had measured a typical passage from a change-in-terms notice on how issuers calculate finance charges using one of the readability formulas and that this passage required a twelfth-grade reading level.

[48]We did not evaluate disclosures that issuers are required to provide at other times—such as in periodic billing statements or change in terms notices

These disclosure documents were written such that understanding them required a higher reading level than that attained by many U.S. cardholders. For example, a nationwide assessment of the reading level of the U.S. population cited by the usability consultant indicated that nearly half of the adult population in the United States reads at or below the eighth-grade level.[49] Similarly, to ensure that the information that public companies are required to disclose to prospective investors is adequately understandable, the Securities and Exchange Commission (SEC) recommends that such disclosure materials be written at a sixth- to eighth-grade level.[50]

In addition to the average reading level, certain portions of the typical disclosure documents provided by the large issuers required even higher reading levels to be understandable. For example, the information that appeared in cardmember agreements about annual percentage rates, grace periods, balance computation, and payment allocation methods required a minimum of a fifteenth-grade education, which is the equivalent of 3 years of college education. Similarly, text in the documents describing the interest rates applicable to one issuer's card were written at a twenty-seventh-grade level. However, not all text in the disclosures required such high levels. For example, the consultant found that the information about fees that generally appeared in solicitation letters required only a seventh- and eighth-grade reading level to be understandable. Solicitation letters likely required lower reading levels to be understandable because they generally included more information in a tabular format than cardmember agreements.

Poor Organization and Formatting

The disclosure documents the consultant evaluated did not use designs, including effective organizational structures and formatting, that would have made them more useful to consumers. To assess the adequacy of the design of the typical large issuer credit card solicitation letters and cardmember agreements, the consultant evaluated the extent to which these disclosures adhered to generally accepted industry standards for

[49]1992 National Adult Literacy Survey. The 2003 National Assessment of Adult Literacy (renamed from 1992) found that reading comprehension levels did not significantly change between 1992 and 2003 and that there was little change in adults' ability to read and understand sentences and paragraphs

[50]U. S. Securities and Exchange Commission, *Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: 1998). The Securities and Exchange Commission regulates the issuance of securities to the public, including the information that companies provide to their investors.

effective organizational structures and designs intended to make documents easy to read. In the absence of best practices and guidelines specifically for credit card disclosures, the consultant used knowledge of plain language, publications design guidelines, and industry best practices and also compared the credit card disclosure documents to the guidelines in the Securities and Exchange Commission's plain English handbook. The usability consultant used these standards to identify aspects of the design of the typical card disclosure documents that could cause consumers using them to encounter problems.

On the basis of this analysis, the usability consultant concluded that the typical credit card disclosures lacked effective organization. For example, the disclosure documents frequently placed pertinent information toward the end of sentences. Figure 7 illustrates an example taken from the cardmember agreement of one of the large issuers that shows that a consumer would need to read through considerable amounts of text before reaching the important information, in this case the amount of the annual percentage rate (APR) for purchases. Best practices would dictate that important information—the amount of the APR—be presented first, with the less important information—the explanation of how the APR is determined—placed last.

Figure 7: Example of Important Information Not Prominently Presented in Typical Credit Card Disclosure Documents

Usability consultant's comments: Placing pertinent information, in this case the APR for purchases, near the end of sentences requires readers to wade through considerable amounts of text before reaching important information

3.3.1.a: Purchases. The Annual Percentage Rate for Purchases, a variable rate is the Index plus a Margin of 4.99% Based on this formula the APR as of May 4, 2005 is 10.99% (0.03011% corresponding Daily Periodic Rate)

Sources: UserWorks, Inc., Information International Associates

In addition, the disclosure documents often failed to group relevant information together. Although one of the disclosure formats mandated by law—the Schumer box—has been praised as having simplified the presentation of complex information, our consultant observed that the amount of information that issuers typically presented in the box compromised the benefits of using a tabular format. Specifically, the typical credit card solicitation letter, which includes a Schumer box, may be

causing difficulties for consumers because related information generally is not grouped appropriately, as shown in figure 8.

Figure 8: Example of How Related Information Was Not Being Grouped Together in Typical Credit Card Disclosure Documents

Annual Percentage Rate (APR) for Purchases[3]	0.0% fixed introductory rate until October 1, 2006;[1] thereafter, a variable APR, currently 13.49%. Current rate for purchases
Other APRs[3]	**Non-Check Balance Transfers:** 0.0% fixed introductory APR until October 1, 2006;[1] thereafter, together with all other Balance Transfers, a variable APR, currently 13.49%. **Cash Advances and Convenience Checks:** A variable APR, currently 22.49%. **Penalty APR:** A variable APR, currently up to 30.49%.[3]
Variable Rate Information[2]	All APRs (other than your introductory APRs) may vary. They are determined by adding the following margin to the Prime Rate: 6.99% for Purchases and Non-Check Balance Transfers; 15.99% for Cash Advances and Convenience Checks; and up to 23.99% for Penalty APRs. How the rate is determined
Balance Calculation Method for Purchases	Average Daily Balance (including new purchases)
Annual Fee	None
Grace Period for Purchases	At least 20 days
Minimum Finance Charge for Purchases	$1.50 (unless purchase Average Daily Balance is zero)

†The terms of your Account, including any APR (or how an APR is Calculated) are subject to change. Any changes will be made in accordance with the Cardholder Agreement.

[1]If an introductory rate is applicable to this product and we do not receive at least the Minimum Payment Due during any billing cycle, you exceed your credit limit or you close your account, any introductory rate on Purchases and Balance Transfers will terminate

[2]The Prime Rate used in your APR calculations is determined on the last day of each month by taking the highest prime rate published in the Money Rates section of The Wall Street Journal in effect within the prior three months (the "Index Date(s)"). All Prime Rate changes will take effect on the first day of your Billing Cycle that ends in the calendar month following the Index Date. All variable rate disclosures are based on the Prime Rate of 6.50% in effect on August 10, 2005

How the prime rate is determined

Usability consultant's comments:
Related information, in this case the APR for purchases, is not grouped together, potentially causing difficulties for readers.

Sources: GAO analysis of data from UserWorks, Inc., Information International Associates

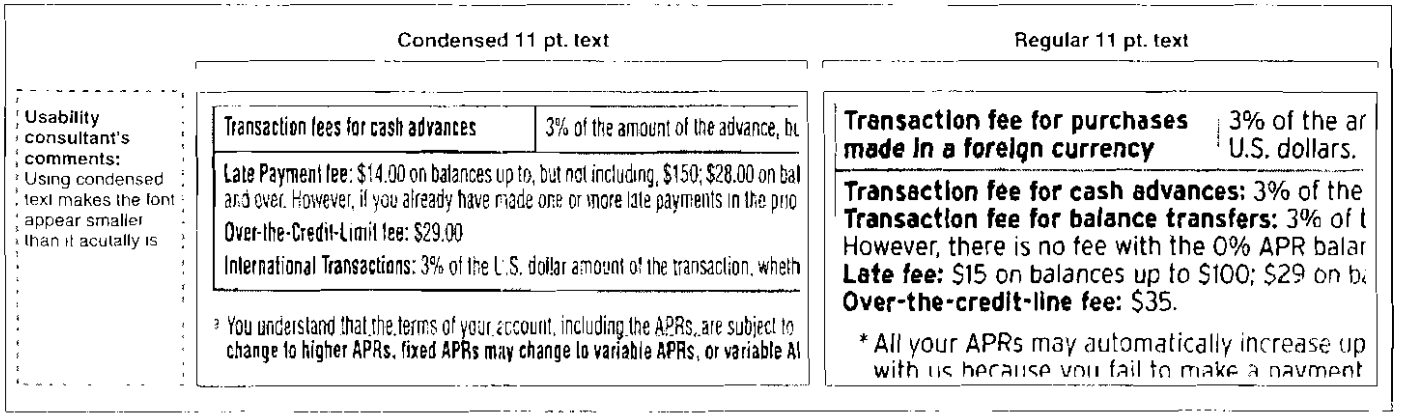
As shown in figure 8, information about the APR that would apply to purchases made with the card appeared in three different locations. The first row includes the current prevailing rate of the purchase APR; text that describes how the level of the purchase APR could vary according to an underlying rate, such as the prime rate, is included in the third row; and text describing how the issuer determines the level of this underlying rate is included in the footnotes. According to the consultant, grouping such related information together likely would help readers to more easily understand the material.

In addition, of the four issuers whose materials were analyzed, three provided a single document with all relevant information in a single cardmember agreement, but one issuer provided the information in separate documents. For example, this issuer disclosed specific information about the actual amount of rates and fees in one document and presented information about how such rates were determined in another document. According to the readability consultant, disclosures in multiple documents can be more difficult for the reader to use because they may require more work to find information.

Formatting weaknesses also likely reduced the usefulness of typical credit card disclosure documents. The specific formatting issues were as follows:

- *Font sizes.* According to the usability consultant's analysis, many of the disclosure documents used font sizes that were difficult to read and could hinder consumers' ability to find information. For example, the consultant found extensive use of small and condensed typeface in cardmember agreements and in footnotes in solicitation materials when best practices would suggest using a larger, more legible font size. Figure 9 contains an illustration of how the disclosures used condensed text that makes the font appear smaller than it actually is. Multiple consumers and consumer groups who provided comments to the Federal Reserve noted that credit card disclosures were written in a small print that reduces a consumer's ability to read or understand the document. For example, a consumer who provided comments to the Federal Reserve referred to the text in card disclosures as "mice type." This example also illustrates how notes to the text, which should be less important, were the same size and thus given the same visual emphasis as the text inside the box. Consumers attempting to read such disclosures may have difficulty determining which information is more important.

Figure 9: Example of How Use of Small Font Sizes Reduces Readability in Typical Credit Card Disclosure Documents



Sources: UserWorks, Inc., Information International Associates

Note: Graphic shown is the actual size it appears in issuer disclosure documents. Graphic is intentionally portioned off to focus attention to headings.

- *Ineffective font placements.* According to the usability consultant, some issuers' efforts to distinguish text using different font types sometimes had the opposite effect. The consultant found that the disclosures from all four issuers emphasized large amounts of text with all capital letters and sometimes boldface. According to the consultant, formatting large blocks of text in capitals makes it harder to read because the shapes of the words disappear, forcing the reader to slow down and study each letter (see figure 10). In a comment letter to the Federal Reserve, an industry group recommended that boldfaced or capitalized text should be used discriminately, because in its experience, excessive use of such font types caused disclosures to lose all effectiveness. SEC's guidelines for producing clear disclosures contain similar suggestions.

Figure 10: Example of How Use of Ineffective Font Types Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments: By emphasizing all the text in a paragraph, nothing is emphasized

7.14: AMENDMENT OF THIS AGREEMENT. WE MAY AMEND THIS AGREEMENT BY CHANGING, ADDING OR DELETING ANY TERM, CONDITION, SERVICE OR FEATURE ("NEW TERM") OF YOUR ACCOUNT OR OF THIS AGREEMENT AT ANY TIME. WE WILL PROVIDE YOU WITH NOTICE OF THE AMENDMENT TO THE EXTENT REQUIRED BY LAW. UNLESS WE STATE OTHERWISE, ANY NEW TERM WILL APPLY TO YOUR

ARBITRATION: PLEASE READ THIS PROVISION CAREFULLY IT PROVIDES THAT ANY DISPUTE MAY BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT. YOU WILL NOT BE ABLE TO BRING A CLASS ACTION OR SIMILAR PROCEEDING IN COURT NOR WILL YOU BE ABLE TO BRING ANY CLAIM IN

Sources: UserWorks, Inc., Information International Associates

- *Selecting text for emphasis.* According to the usability consultant, most of the disclosure documents unnecessarily emphasized specific terms. Inappropriate emphasis of such material could distract readers from more important messages. Figure 11 contains a passage from one cardmember agreement that the readability consultant singled out for its emphasis of the term "periodic finance charge," which is repeated six times in this example. According to the consultant, the use of boldface and capitalized text calls attention to the word, potentially requiring readers to work harder to understand the entire passage's message.

Figure 11: Example of How Use of Inappropriate Emphasis Reduces Readability in Typical Credit Card Disclosure Documents

Usability consultant's comments: Repeated use of boldface and caps calls attention to a word, potentially requiring readers to work harder to understand the passage's message

zero. We multiply the daily balance by the applicable Daily Periodic Rate, as stated in the Table of Interest Charges, to get your **Periodic FINANCE CHARGES** for that day. We then add those **Periodic FINANCE CHARGES** to your daily balance to get the beginning balance for the next day. For Purchases, we do the same thing for each day of the previous cycle to get the daily balance of Purchases for the previous billing cycle. However, the daily balance for previous billing cycle Purchases is considered to be zero for each day of the previous billing cycle if a **Periodic FINANCE CHARGE** was already imposed on Purchases itemized on your previous statement or you paid your New Balance on your previous statement in full by the payment due date.

To get your total **Periodic FINANCE CHARGE** for a billing cycle, we add all of the daily **Periodic FINANCE CHARGES** for all features. If you multiply the Average Daily Balance for each feature by the applicable Daily Periodic Rate and the number of days in the applicable billing cycle(s) and add the results together, the total will equal the **Periodic FINANCE CHARGES** for the billing cycle except for minor variations due to rounding. To determine an Average Daily Balance, we add your daily balances and divide by the number of the days in the applicable billing cycle(s).

Sources: UserWorks, Inc., Information International Associates

- *Use of headings.* According to the usability consultant, disclosure documents from three of the four issuers analyzed contained headings that were difficult to distinguish from surrounding text. Headings, according to the consultant, provide a visual hierarchy to help readers quickly identify information in a lengthy document. Good headers are easy to identify and use meaningful labels. Figure 12 illustrates two examples of how the credit card disclosure documents failed to use headings effectively.

Figure 12: Example of Ineffective and Effective Use of Headings in Typical Credit Card Disclosure Documents

Ineffective heading use (shading added by GAO)

Section 2: USE OF YOUR ACCOUNT
2.1: Types of Transactions. You may use your Account for the following types of consumer transactions
2.1.1: Purchases. Purchase goods or services with your Card
2.1.2: Cash Advances. Obtain cash from a participating financial institution or merchant ("Cash Disbursement") or from an ATM ("ATM Advance"), write a Convenience Check for any legal purpose ("Convenience Check Advance") or purchase money orders, travelers checks, foreign currency, lottery tickets, casino chips, racetrack wagers, vouchers redeemable for cash or other items readily convertible into cash ("Quasi Cash"), or transfer funds from your Account to your personal checking account for overdraft protection ("Overdraft Protection")
2.1.3: Balance Transfers. Transferred balances to your Account from other creditors, except those made using a Convenience Check
2.2: Limitations on Use

Payment Allocation: You agree that we are authorized to allocate your payments and credits in a way that is most favorable to or convenient for us. For example, you authorize us to apply your payments and credits to balances with lower **Annual Percentage Rates** ("APRs") (such as promotional APRs) before balances with higher APRs for all balances except promotional balances for Disney vacation packages
Credit Line/Authorized Usage: Your credit line is shown on the folder containing your Card. Since we may change your credit line from time to time, your latest credit line will appear on your monthly statement. You agree not to make a Purchase or obtain a Cash Advance that would cause the unpaid balance of your Account to exceed your

Usability consultant's comments:

Headings are easy to identify, but are preceded by an unnecessary string of numbers that do not correspond to anything useful like a table of contents

Headings are not substantially different from the text

Effective heading use (shading added by GAO)

How We Determine the Balance:
The total outstanding balance (the amount you owe us) appears as the "New Balance" on the billing statement. To determine the New Balance, we begin with the outstanding balance on your account at the beginning of each billing period, called the "Previous Balance" on the billing statement. We add any purchases or cash advances and subtract any credits or payments credited as of that billing period. We then add the appropriate finance charges and fees and make other applicable adjustments.

Annual Percentage Rates for Purchases and Cash Advances:
Your annual percentage rates and the corresponding daily periodic rates appear on the card carrier. A daily periodic rate is the appli-

Usability consultant's comments:

Headings are easy to distinguish from the surrounding text

Sources: UserWorks, Inc., Information International Associates

In the first example, the headings contained an unnecessary string of numbers that the consultant found would make locating a specific topic in the text more difficult. As a result, readers would need to actively ignore the string of numbers until the middle of the line to find what they wanted. The consultant noted that such numbers might be useful if this document had a table of contents that referred to the numbers, but it did not. In the second example, the consultant noted that a reader's ability to locate information using the headings in this document was hindered because the headings were not made more visually distinct, but instead were aligned with other text and printed in the same type size as the text that followed. As a result, these headings blended in with the text. Furthermore, the consultant noted that because the term "Annual Percentage Rates" was given the same visual treatment as the two headings in the example, finding headings quickly was made even more difficult. In contrast, figure 12 also shows an example that the consultant identified in one of the disclosure documents that was an effective use of headings.

- *Presentation techniques.* According to the usability consultant, the disclosure documents analyzed did not use presentation techniques, such as tables, bulleted lists, and graphics, that could help to simplify the presentation of complicated concepts, especially in the cardmember agreements. Best practices for document design suggest using tables and bulleted lists to simplify the presentation of complex information. Instead, the usability consultant noted that all the cardmember agreements reviewed almost exclusively employed undifferentiated blocks of text, potentially hindering clear communication of complex information, such as the multiple-step procedures issuers use for calculating a cardholder's minimum required payment. Figure 13 below presents two samples of text from different cardmember agreements describing how minimum payments are calculated. According to the consultant, the sample that used a bulleted list was easier to read than the one formatted as a paragraph. Also, an issuer stated in a letter to the Federal Reserve that their consumers have welcomed the issuer's use of bullets to format information, emphasizing the concept that the visual layout of information either facilitates or hinders consumer understanding.

Figure 13: Example of How Presentation Techniques Can Affect Readability in Typical Credit Card Disclosure Documents

MINIMUM MONTHLY PAYMENT The Minimum Payment Due each month will be the sum of any amount past due and the minimum monthly payment. The minimum monthly payment each month will be the greater of $10 or 1/50th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is greater than 22.99%, but less than 26.00%, your minimum monthly payment will be the greater of $10 or 1/45th of the New Balance, rounded to the next higher whole dollar amount. If any ANNUAL PERCENTAGE RATE applicable to your Account is 26.00% or greater, your minimum monthly payment will be the greater of $10 or 1/40th of the New Balance. Regardless of the Annual Percentage Rates on your Account, if the New Balance is less than $10.00, the minimum monthly payment will be the amount of the New Balance. We may also include in your minimum monthly payment all or a portion of the amount by which your outstanding balance exceeds your Account credit limit as of the last day of the billing period. Paying the Minimum Payment Due may be insufficient to bring

Usability consultant's comments:
Expressing a complicated, multistep process as prose makes it difficult to understand the relationships between steps

Minimum Amount Due:
Each month you must pay a minimum amount that is calculated as follows. First, we begin with any amount that is past due and add to it any amount in excess of your credit line. Second, we add the largest of the following.

- The New Balance on the billing statement if it is less than $20;
- $20 if the New Balance is at least $20;
- 1% of the New Balance (which calculation is rounded down to the nearest dollar) plus the amount of your billed finance charges and any applicable late fee; or
- 1.5% of the New Balance (which calculation is rounded down to the nearest dollar).

However, the Minimum Amount Due will never exceed your New Balance. In calculating the Minimum Amount Due, we may subtract from the New Balance certain fees added to your account during the billing period.

Usability consultant's comments:
By using bullet points, it is much easier to see multiple steps broken out into individual steps and when they are applied

Sources: UserWorks, Inc.; Information International Associates

Excessive Complexity and Volume of Information

The content of typical credit card disclosure documents generally was overly complex and presented in too much detail, such as by using unfamiliar or complex terms to describe simple concepts. For example, the usability consultant identified one cardmember agreement that used the term "rolling consecutive twelve billing cycle period" instead of saying "over the course of the next 12 billing statements" or "next 12 months"—if that was appropriate. Further, a number of consumers, consumer advocacy groups, and government and private entities that have provided comments to the Federal Reserve agreed that typical credit card disclosures are written in complex language that hinders consumers' understanding. For example, a consumer wrote that disclosure documents were "loaded with booby traps designed to trip consumers, and written in intentionally impenetrable and confusing language." One of the consumer advocacy groups stated the disclosures were "full of dense, impenetrable legal jargon that even lawyers and seasoned consumer advocates have difficulty understanding." In addition, the consultant noted that many of the disclosures, including solicitation letters and cardmember agreements, contained overly long and complex sentences that increase the effort a reader must devote to understanding the text. Figure 14 contains two

examples of instances in which the disclosure documents used uncommon words and phrases to express simple concepts.

Figure 14: Examples of How Removing Overly Complex Language Can Improve Readability in Typical Credit Card Disclosure Documents

101 words

If at any time during any rolling consecutive twelve billing cycle period you fail to make two Minimum Payments on a timely basis or exceed your Credit Limit twice we may elect to increase your Purchase, Cash Advance and/or Balance Transfer APRs to the Penalty APRs. All Penalty APRs will remain in effect until, in a subsequent rolling consecutive six billing cycle period, you do not exceed your Credit Limit at any time and you make all of your required Minimum Payments on a timely basis when, in your next billing cycle, all Penalty APRs will no longer apply

50 words

Usability consultant's rewrite:
If you pay late or go over your credit limit twice in a year, the interest rate you pay on most things goes up to the default rate, currently 30.49%. It will go back down when you pay on time and do not go over your credit limit for six months.

69 words

Using Your Account: You may use your Card or Account to purchase or lease goods or services, or pay amounts you owe, wherever the Card is honored, transfer balances from other accounts or, if applicable, to obtain advances to cover an overdraft on your checking account with a affiliate under the terms of this Agreement and your Overdraft Protection Agreement, ("Overdraft Advances"), (Purchases, Balance Transfers and Overdraft Advances are collectively called "Purchases")

20 words

Usability consultant's rewrite:
You can use this card to buy things, pay off other accounts, transfer balances, or keep from bouncing a check.

Sources: UserWorks, Inc., Information International Associates

In addition, the disclosure documents regularly presented too much or irrelevant detail. According to the usability consultant's analysis, the credit card disclosures often contained superfluous information. For example, figure 15 presents an example of text from one cardmember agreement that described the actions the issuer would take if its normal source for the rate information used to set its variable rates—*The Wall Street Journal*—were to cease publication. Including such an arguably unimportant detail lengthens and makes this disclosure more complex. According to SEC best practices for creating clear disclosures, disclosure documents are more effective when they adhere to the rule that less is more. By omitting unnecessary details from disclosure documents, the usability consultant indicated that consumers would be more likely to read and understand the information they contain.

Figure 15: Example of Superfluous Detail in Typical Credit Card Disclosure Documents

Usability consultant's comments: This section provides superfluous information on how the prime rate is determined. For example, the explanation of the actions if the Wall Street Journal was to cease publication

If any annual percentage rate is based on the U.S. Prime Rate plus a margin, we will calculate the rate for each billing period by adding the applicable margin that appears on the card carrier to the U.S. Prime Rate. For each billing period we will use the U.S. Prime Rate published in *The Wall Street Journal* two business days prior to your Statement/Closing Date for that billing period. Any increase or decrease in a variable annual percentage rate due to a change in the U.S. Prime Rate takes effect as of the first day of the billing period for which we calculate the variable annual percentage rate. If more than one U.S. Prime Rate is published, we may choose the highest rate. If *The Wall Street Journal* ceases publication or to publish the U.S. Prime Rate, we may use the U.S. Prime Rate published in any other newspaper of general circulation, or we may substitute a similar reference rate at our sole discretion. When a change in an applicable variable annual percentage rate takes effect we will apply it to any existing balances, subject to any promotional rate that may apply.

Sources: UserWorks, Inc.; Information International Associates

Consumer Confusion Indicated That Disclosures Were Not Communicating Credit Card Cost Information Clearly

Many of the credit cardholders that were tested and interviewed as part of our review exhibited confusion over various fees, practices, and other terms that could affect the cost of using their credit cards. To understand how well consumers could use typical credit card disclosure documents to locate and understand information about card fees and other practices, the usability consultant with whom we contracted used a sample of cardholders to perform a usability assessment of the disclosure documents from the four large issuers. As part of this assessment, the consultant conducted one-on-one sessions with a total of 12 cardholders so that each set of disclosures, which included a solicitation letter and a cardmember agreement, was reviewed by 3 cardholders.[51] Each of these cardholders were asked to locate information about fee levels and rates, the circumstances in which they would be imposed, and information about changes in card terms. The consultant also tested the cardholders' ability to explain various practices used by the issuer, such as the process for determining the amount of the minimum monthly payment, by reading the disclosure documents. Although the results of the usability testing cannot

[51]According to the consultant, testing with small numbers of individuals can generally identify many of the problems that can affect the readability and usability of materials.

be used to make generalizations about all cardholders, the consultant selected cardholders based on the demographics of the U.S. adult population, according to age, education level, and income, to ensure that the cardholders tested were representative of the general population. In addition, as part of this review, we conducted one-on-one interviews with 112 cardholders to learn about consumer behavior and knowledge about various credit card terms and practices.[52] Although we also selected these cardholders to reflect the demographics of the U.S. adult population, with respect to age, education level, and income, the results of these interviews cannot be generalized to the population of all U.S. cardholders.[53]

Based on the work with consumers, specific aspects of credit card terms that apparently were not well understood included:

- *Default interest rates.* Although issuers can penalize cardholders for violating the terms of the card, such as by making late payments or by increasing the interest rates in effect on the cardholder's account to rates as high as 30 percent or more, only about half of the cardholders that the usability consultant tested were able to use the typical credit card disclosure documents to successfully identify the default rate and the circumstances that would trigger rate increases for these cards. In addition, the usability consultant observed the cardholders could not identify this information easily. Many also were unsure of their answers, especially when rates were expressed as a "prime plus" number, indicating the rate varied based on the prime rate. Locating information in the typical cardmemher agreement was especially difficult for cardholders, as only 3 of 12 cardholders were able to use such documents to identify the default interest rate applicahle to the card. More importantly, only about half of the cardholders tested using solicitation letters were able to accurately determine what actions could potentially cause the default rate to be imposed on these cards.

- *Other penalty rate increases.* Although card issuers generally reserve the right to seek to raise a cardholder's rate in other situations, such as when a cardholder makes a late payment to another issuer's credit card, (even if the cardholder has not defaulted on the cardmember

[52]We also used this data in a previous report to show cardholder preferences for customized information in their monthly billing statements about the consequences of making minimum payments on their outstanding balance. GAO-06-434.

[53]For more information about our scope and methodology, see appendix I.

agreement), about 71 percent of the 112 cardholders we interviewed were unsure or did not believe that issuers could increase their rates in such a case. In addition, about two-thirds of cardholders we interviewed were unaware or did not believe that a drop in their credit score could cause an issuer to seek to assess higher interest rates on their account.[54]

- *Late payment fees.* According to the usability assessment, many of the cardholders had trouble using the disclosure documents to correctly identify what would occur if a payment were to be received after the due date printed in the billing statement. For example, nearly half of the cardholders were unable to use the cardmember agreement to determine whether a payment would be considered late based on the date the issuer receives the payment or the date the payment was mailed or postmarked. Additionally, the majority of the 112 cardholders we interviewed also exhibited confusion over late fees: 52 percent indicated that they have been surprised when their card company applied a fee or penalty to their account.

- *Using a credit card to obtain cash.* Although the cardholders tested by the consultant generally were able to use the disclosures to identify how a transaction fee for a cash advance would be calculated, most were unable to accurately use this information to determine the transaction fee for withdrawing funds, usually because they neglected to consider the minimum dollar amount, such as $5 or $10, that would be assessed.

- *Grace periods.* Almost all 12 cardholders in the usability assessment had trouble using the solicitation letters to locate and define the grace period, the period during which the a cardholder is not charged interest on a balance. Instead, many cardholders incorrectly indicated that the grace period was instead when their lower, promotional interest rates would expire. Others incorrectly indicated that it was the amount of time after the monthly bill's due date that a cardholder could submit a payment without being charged a late fee.

- *Balance computation method.* Issuers use various methods to calculate interest charges on outstanding balances, but only 1 of the 12 cardholders the usability consultant tested correctly described average

[54]A credit score is a number, roughly between 300 and 800, that reflects the credit history detailed by a person's credit report. Lenders use borrowers' credit scores in the process of assigning rates and terms to the loans they make

daily balance, and none of the cardholders were able to describe two-cycle average daily balance accurately. At least nine letters submitted to the Federal Reserve in connection with its review of credit card disclosures noted that few consumers understand balance computation methods as stated in disclosure documents.

Perhaps as a result of weaknesses previously described, cardholders generally avoid using the documents issuers provide with a new card to improve their understanding of fees and practices. For example, many of the cardholders interviewed as part of this report noted that the length, format, and complexity of disclosures led them to generally disregard the information contained in them. More than half (54 percent) of the 112 cardholders we interviewed indicated they read the disclosures provided with a new card either not very closely or not at all. Instead, many cardholders said they would call the issuer's customer service representatives for information about their card's terms and conditions. Cardholders also noted that the ability of issuers to change the terms and conditions of a card at any time led them to generally disregard the information contained in card disclosures. Regulation Z allows card issuers to change the terms of credit cards provided that issuers notify cardholders in writing within 15 days of the change. As a result, the usability consultant observed some participants were dismissive of the information in the disclosure documents because they were aware that issuers could change anything.

Federal Reserve Effort to Revise Regulations Presents Opportunity to Improve Disclosures

With liability concerns and outdated regulatory requirements seemingly explaining the weaknesses in card disclosures, the Federal Reserve has begun efforts to review its requirements for credit card disclosures. Industry participants have advocated various ways in which the Federal Reserve can act to improve these disclosures and otherwise assist cardholders.

Regulations and Guidance May Contribute to Weaknesses in Current Disclosures

Several factors may help explain why typical credit card disclosures exhibit weaknesses that reduce their usefulness to cardholders. First, issuers make decisions about the content and format of their disclosures to limit potential legal liability. Issuer representatives told us that the disclosures made in credit card solicitations and cardmember agreements are written for legal purposes and in language that consumers generally could not understand. For example, representatives for one large issuer told us they cannot always state information in disclosures clearly because the increased potential that simpler statements would be misinterpreted would

expose them to litigation. Similarly, a participant of a symposium on credit card disclosures said that disclosures typically became lengthier after the issuance of court rulings on consumer credit issues. Issuers can attempt to reduce the risk of civil liability based on their disclosures by closely following the formats that the Federal Reserve has provided in its model forms and other guidance. According to the regulations that govern card disclosures, issuers acting in good faith compliance with any interpretation issued by a duly authorized official or employee of the Federal Reserve are afforded protection from liability.[55]

Second, the regulations governing credit card disclosures have become outdated. As noted earlier in this report, TILA and Regulation Z that implements the act's provisions are intended to ensure that consumers have adequate information about potential costs and other applicable terms and conditions to make appropriate choices among competing credit cards. The most recent comprehensive revisions to Regulation Z's open-end credit rules occurred in 1989 to implement the provisions of the Fair Credit and Charge Card Act. As we have found, the features and cost structures of credit cards have changed considerably since then. An issuer representative told us that current Schumer box requirements are not as useful in presenting the more complicated structures of many current cards. For example, they noted that it does not easily accommodate information about the various cardholder actions that could trigger rate increases, which they argued is now important information for consumers to know when shopping for credit. As a result, some of the specific requirements of Regulation Z that are intended to ensure that consumers have accurate information instead may be diminishing the usefulness of these disclosures.

Third, the guidance that the Federal Reserve provides issuers may not be consistent with guidelines for producing clear, written documents. Based on our analysis, many issuers appear to adhere to the formats and model forms that the Federal Reserve staff included in the Official Staff Interpretations of Regulation Z, which are prepared to help issuers comply with the regulations. For example, the model forms present text about how rates are determined in footnotes. However, as discussed previously, not grouping related information undermines the usability of documents. The

[55]Under Section 130(f) of the TILA, creditors are protected from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System. 15 U.S.C. § 1640.

Schumer box format requires a cardholder to look in several places, such as in multiple rows in the table and in notes to the table, for information about related aspects of the card. Similarly, the Federal Reserve's model form for the Schumer box recommends that the information about the transaction fee and interest rate for cash advances be disclosed in different areas.

Finally, the way that issuers have implemented regulatory guidance may have contributed to the weaknesses typical disclosure materials exhibited. For example, in certain required disclosures, the terms "annual percentage rate" and "finance charge," when used with a corresponding amount or percentage rate, are required to be more conspicuous than any other required disclosures.[56] Staff guidance suggests that such terms may be made more conspicuous by, for example, capitalizing these terms when other disclosures are printed in lower case or by displaying these terms in larger type relative to other disclosures, putting them in boldface print or underlining them.[57] Our usability consultant's analysis found that card disclosure documents that followed this guidance were less effective because they placed an inappropriate emphasis on terms. As shown previously in figure 11, the use of bold and capital letters to emphasize the term "finance charge" in the paragraph unnecessarily calls attention to that term, potentially distracting readers from information that is more important. The excerpt shown in figure 11 is from an initial disclosure document which, according to Regulation Z, is subject to the "more conspicuous" rule requiring emphasis of the terms "finance charge" and "annual percentage rate."

Suggestions for Improving Disclosures Included Obtaining Input from Consumers

With the intention of improving credit card disclosures, the Federal Reserve has begun efforts to develop new regulations. According to its 2004 notice seeking public comments on Regulation Z, the Federal Reserve hopes to address the length, complexity, and superfluous information of disclosures and produce new disclosures that will be more useful in helping consumers compare credit products.[58] After the passage of the

[56]See generally 12 C.F.R. 225.5(a)(3) and the corresponding staff commentary.

[57]Notwithstanding the more conspicuous rule, Regulation Z expressly provides that the annual percentage rate for purchases required to be disclosed in the Schumer box must be in at least 18-point type. 12 C.F.R. § 226.5a(b)(1).

[58]Truth in Lending, 69 Fed. Reg. 70925 (advanced notice of proposed rulemaking, published Dec. 8, 2004).

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Bankruptcy Act) in October of that year, which included amendments to TILA, the Federal Reserve sought additional comments from the public to prepare to implement new disclosure requirements including disclosures intended to advise consumers of the consequences of making only minimum payments on credit cards.[59] According to Federal Reserve staff, new credit card disclosure regulations may not be in effect until sometime in 2007 or 2008 because of the time required to conduct consumer testing, modify the existing regulations, and then seek comment on the revised regulation.

Industry participants and others have provided input to assist the Federal Reserve in this effort. Based on the interviews we conducted, documents we reviewed, and our analysis of the more than 280 comment letters submitted to the Federal Reserve, issuers, consumer groups, and others provided various suggestions to improve the content and format of credit card disclosures, including:

- *Reduce the amount of information disclosed.* Some industry participants said that some of the information currently presented in the Schumer box could be removed because it is too complicated to disclose meaningfully or otherwise lacks importance compared to other credit terms that are arguably more important when choosing among cards. Such information included the method for computing balances and the amount of the minimum finance charge (the latter because it is typically so small, about 50 cents in 2005).

- *Provide a shorter document that summarizes key information.* Some industry participants advocated that all key information that could significantly affect a cardholder's costs be presented in a short document that consumers could use to readily compare across cards, with all other details included in a longer document. For example, although the Schumer box includes several key pieces of information, it does not include other information that could be as important for consumer decisions, such as what actions could cause the issuer to raise the interest rate to the defanlt rate.

[59]Truth in Lending, 70 Fed. Reg. 60235 (request for comments; extension of comment period, published October 17, 2005).

- *Revise disclosure formats to improve readability.* Various suggestions were made to improve the readability of card disclosures, including making more use of tables of contents, making labels and headings more prominent, and presenting more information in tables instead of in text. Disclosure documents also could use consistent wording that could allow for better comparison of terms across cards.

Some issuers and others also told us that the new regulations should allow for more flexibility in card disclosure formats. Regulations mandating formats and font sizes were seen as precluding issuers from presenting information in more effective ways. For example, one issuer already has conducted market research and developed new formats for the Schumer box that it says are more readable and contain new information important to choosing cards in today's credit card environment, such as cardholder actions that would trigger late fees or penalty interest rate increases.

In addition to suggestions about content, obtaining the input of consumers, and possibly other professionals, was also seen as an important way to make any new disclosures more useful. For example, participants in a Federal Reserve Bank symposium on credit card disclosures recommended that the Federal Reserve obtain the input of marketers, researchers, and consumers as part of developing new disclosures. OCC staff suggested that the Federal Reserve also employ qualitative research methods such as in-depth interviews with consumers and others and that it conduct usability testing.

Consumer testing can validate the effectiveness or measure the comprehension of messages and information, and detect document design problems. Many issuers are using some form of market research to test their disclosure materials and have advocated improving disclosures by seeking the input of marketers, researchers, and consumers.[60] SEC also has recently used consumer focus groups to test the format of new disclosures related to mutual funds. According to an SEC staff member who participated in this effort, their testing provided them with valuable information on what consumers liked and disliked about some of the initial forms that the regulator had drafted. In some cases, they learned that

[60]Consumer testing can be conducted in several ways, such as focus groups, where consumers analyze products in a group setting, and conjoint analysis, which helps companies understand the extent to which consumers prefer certain product attributes over others.

information that SEC staff had considered necessary to include was not seen as important by consumers. As a result, they revised the formats for these disclosures substantially to make them simpler and may use graphics to present more information rather than text.[61] According to Federal Reserve staff, they have begun to involve consumers in the development of new credit card disclosures. According to Federal Reserve staff, they have already conducted some consumer focus groups. In addition, they have contracted with a design consultant and a market research firm to help them develop some disclosure formats that they can then use in one-on-one testing with consumers. However, the Federal Reserve staff told us they recognize the challenge of designing disclosures that include all key information in a clear manner, given the complexity of credit card products and the different ways in which consumers use credit cards.

Although Credit Card Penalty Fees and Interest Could Increase Indebtedness, the Extent to Which They Have Contributed to Bankruptcies Was Unclear

The number of consumers filing for bankruptcy has risen more than six-fold over the past 25 years, and various factors have been cited as possible explanations. While some researchers have pointed to increases in total debt or credit card debt in particular, others found that debt burdens and other measures of financial distress had not increased and thus cite other factors, such as a general decline in the stigma of going bankrupt or the potentially increased costs of major life events such as health problems or divorce. Some critics of the credit card industry have cited penalty interest and fees as leading to increased financial distress; however, no comprehensive data existed to determine the extent to which these charges were contributing to consumer bankruptcies. Data provided by the six largest card issuers indicated that unpaid interest and fees represented a small portion of the amounts owed by cardholders that filed for bankruptcy; however, these data alone were not sufficient to determine any relationship between the charges and bankruptcies filed by cardholders.

Researchers Cited Various Factors as Explanations for Rise in Consumer Bankruptcies

According to U.S. Department of Justice statistics, consumer bankruptcy filings generally rose steadily from about 287,000 in 1980 to more than 2 million as of December 31, 2005, which represents about a 609 percent

[61]Securities Exchange Act Release No. 33-8544 (Feb. 28, 2005).

increase over the last 25 years.[62] Researchers have cited a number of factors as possible explanations for the long-term trend.

Increase in Household Indebtedness

The total debt of American households is composed of mortgages on real estate, which accounts for about 80 percent of the total, and consumer credit debt, which includes revolving credit, such as balances owed on credit cards, and nonrevolving credit, primarily consisting of auto loans. According to Federal Reserve statistics, consumers' use of debt has expanded over the last 25 years, increasing more than sevenfold from $1.4 trillion in 1980 to about $11.5 trillion in 2005. Some researchers pointed to this rise in overall indebtedness as contributing to the rise in bankruptcies. For example, a 2000 Congressional Budget Office summary of bankruptcy research noted that various academic studies have argued that consumer bankruptcies are either directly or indirectly caused by heavy consumer indebtedness.

Rather than total debt, some researchers and others argue that the rise in bankruptcies is related to the rise in credit card debt in particular. According to the Federal Reserve's survey of consumer debt, the amount of credit card debt reported as outstanding rose from about $237 billion to more than $802 billion—a 238 percent increase between 1990 and 2005.[63] One academic researcher noted that the rise in bankruptcies and charge-offs by banks in credit card accounts grew along with the increase in credit card debt during the 1973 to 1996 period he examined.[64] According to some consumer groups, the growth of credit card debt is one of the primary explanations of the increased prevalence of bankruptcies in the United States. For example, one group noted in a 2005 testimony before Congress that growth of credit card debt—particularly among lower and moderate income households, consumers with poor credit scores, college students,

[62]Bankruptcy filings sharply increased recently, with filings in 2005 30 percent higher than in 2004. This increase likely resulted from the accelerated rate of filing that occurred in the months before the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which tightened eligibility for filing, became effective on October 17, 2005.

[63]In addition to capturing amounts outstanding on credit cards, the number reported in the Federal Reserve's survey of consumer debt for revolving debt also includes other types of revolving debt. However, Federal Reserve staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

[64]L. Ausubel, "Credit Card Defaults, Credit Card Profits, and Bankruptcy," *The American Bankruptcy Law Journal*, 71 (Spring 1997)

older Americans, and minorities—was contributing to the rise in bankruptcies.[65]

However, other evidence indicates that increased indebtedness has not severely affected the financial condition of U.S. households in general. For example:

- Some researchers note that the ability of households to make payments on debt appears to be keeping pace. For example, total household debt levels as a percentage of income has remained relatively constant since the 1980s. According to the Federal Reserve, the aggregate debt burden ratio—which covers monthly aggregate required payments of all households on mortgage debt and both revolving and non-revolving consumer loans relative to the aggregate monthly disposable income of all households—for U.S. households has been above 13 percent in the last few years but generally fluctuated between 11 percent and 14 percent from 1990 to 2005, similar to the levels observed during the 1980s. According to one researcher, although the debt burden ratio has risen since the 1980s, the increase has been gradual and therefore cannot explain the six-fold increase in consumer bankruptcy filings over the same period.

- Credit card debt remains a small portion of overall household debt, even among households with the lowest income levels. According to the Federal Reserve, credit card balances as a percentage of total household debt have declined from 3.9 percent of total household debt in 1995 to just 3.0 percent as of 2004.

- The proportion of households that could be considered to be in financial distress does not appear to be increasing significantly. According to the Federal Reserve Board's Survey of Consumer Finances, the proportion of households that could be considered to be in financial distress—those that report debt-to-income ratios exceeding 40 percent and that have had at least one delinquent payment within the last 60 days—was relatively stable between 1995 and 2004. Further, the proportion of the

[65]Consumer Federation of America testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, "*Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers with Respect to Consumer Disclosures and Marketing Efforts*," 109th Congress, 2nd sess., May 17, 2005. We reported on issues relating to college students and credits in 2001. See GAO, *Consumer Finance: College Students and Credit Cards*, GAO-01-773 (Washington, D.C.; June 20, 2001).