population and therefore cannot be generalized to the population of all U.S. cardholders. Cardholders had to speak English, have owned at least one general-purpose credit card for a minimum of 12 months, and have not participated in more than one focus group or similar in-person study in the 12 months prior to the interview. We gathered information about the cardholders' knowledge of credit card terms and conditions, and assessed cardholders' use of card disclosure materials by asking them a number of open- and closed-ended questions.

Methodology for Determining How Penalty Charges Contribute to Bankruptcy

To determine whether credit card debt and penalty interest and fees contribute to cardholder bankruptcies, we interviewed Department of Justice staff responsible for overseeing bankruptcy courts and trustees about the availability of data on credit card penalty charges in materials submitted by consumers or issuers as part of bankruptcy filings or collections cases. We also interviewed two attorneys that assist consumers with bankruptcy filings. In addition, we reviewed studies that analyzed credit card and bankruptcy issues published by various academic researchers, the Congressional Research Service, and the Congressional Budget Office. We did not attempt to assess the reliability of all of these studies to the same, full extent. However, because of the prominence of some of these data sources, and frequency of use of this data by other researchers, as well as the fact that much of the evidence is corroborated by other evidence, we determined that citing these studies was appropriate.

We also analyzed aggregated card account data provided by the six largest issuers (as previously discussed) to measure the amount of credit card interest charges and fees owed at the time these accounts were charged off as a result of becoming subject to bankruptcy filing. We also spoke with representatives of the largest U.S. credit card issuers, as well as representatives of consumer groups and industry associations, and with academic researchers that conduct analysis on the credit card industry.

Methodology for Determining How Penalty Charges Contribute to Issuer Revenues

To determine the extent to which penalty interest and fees contributed to the revenues and profitability of issuers' credit card operations, we reviewed the extent to which penalty charges are disclosed in bank regulatory reports—the call reports—and in public disclosures—such as annual reports (10-Ks) and quarterly reports (10-Qs) made by publicly traded card issuers. We analyzed data reported by the Federal Reserve on the profitability of commercial bank card issuers with at least $200 million in yearly average assets (loans to individuals plus securitizations) and at least 50 percent of assets in consumer lending, of which 90 percent must be in the form of revolving credit. In 2004, the Federal Reserve reported that 17 banks had card operations with at least this level of activity in 2004. We also analyzed information from the Federal Deposit Insurance Corporation, which analyzes data for all federally insured banks and savings institutions and publishes aggregated data on those with various lending activity concentrations, including a group of 33 banks that, as of December 2005, had credit card operations that exceeded 50 percent of their total assets and securitized receivables.

We also analyzed data reported to us by the six largest card issuers on their revenues and profitability of their credit card operations for 2003, 2004, and 2005. We also reviewed data on revenues compiled by industry analysis firms, including *Card Industry Directory* published by Sourcemedia, and R.K. Hammer. Because of the proprietary nature of their data, representatives for Sourcemedia and R.K. Hammer were not able to provide us with information sufficient for us to assess the reliability of their data. However, we analyzed and presented some information from these sources because we were able to corroborate their information with each other and with data from sources of known reliability, such as regulatory data, and we attribute their data to them.

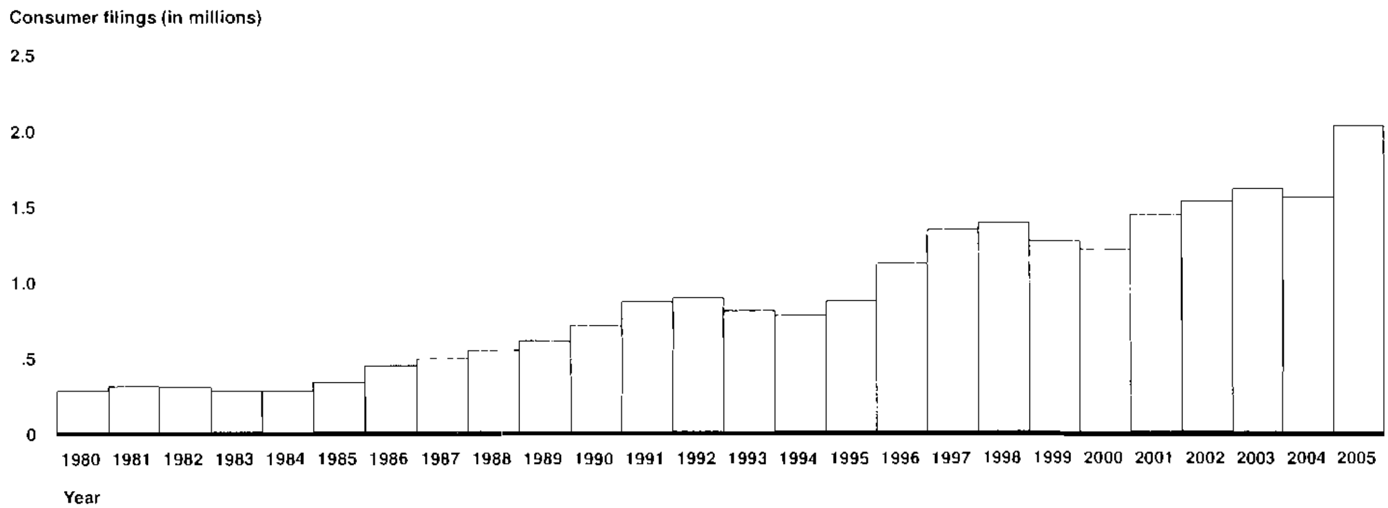
We also interviewed broker-dealer financial analysts who monitor activities by credit card issuers to identify the extent to which various sources of income contribute to card issuers' revenues and profitability. We attempted to obtain the latest in a series of studies of card issuer profitability that Visa, Inc. traditionally has compiled. However, staff from this organization said that this report is no longer being made publicly available.

We discussed issues relevant to this report with various organizations, including representatives of 13 U.S. credit card issuers and card networks, 2 trade associations, 4 academics, 4 federal bank agencies, 4 national consumer interest groups, 2 broker dealer analysts that study credit card issuers for large investors, and a commercial credit-rating agency. We also obtained technical comments on a draft of this report from representatives of the issuers that supplied data for this study.

Consumer Bankruptcies Have Risen Along with Debt

Consumer bankruptcies have increased significantly over the past 25 years. As shown in figure 21 below, consumer bankruptcy filings rose from about 287,000 in 1980 to more than 2 million as of December 31, 2005, about a 609 percent increase over the last 25 years.[1]

Figure 21: U.S. Consumer Bankruptcy Filings, 1980-2005



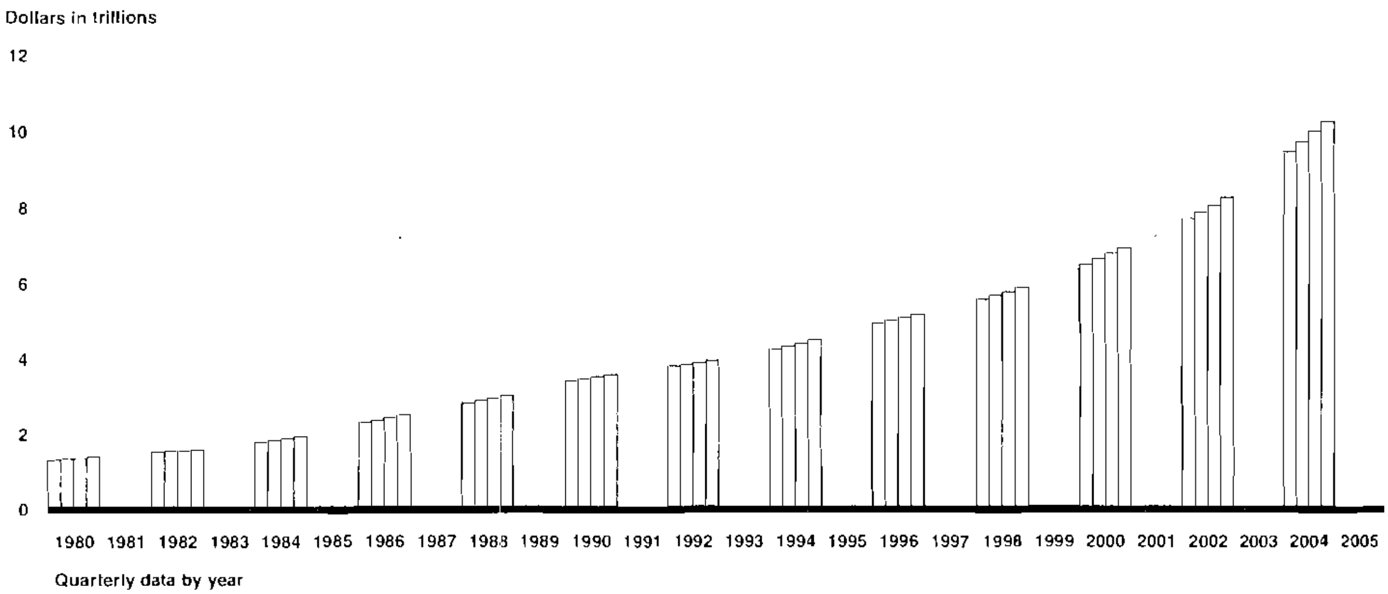
Source: GAO analysis of Congressional Research Service report and Administrative Office of the United States Courts data

Debt Levels Have Also Risen

The expansion of consumers' overall indebtedness is one of the explanations cited for the significant increase in bankruptcy filings. As shown in figure 22, consumers' use of debt has expanded over the last 25 years, increasing more than 720 percent from about $1.4 trillion in 1980 to about $11.5 trillion in 2005.

[1] Of the filings in 2005, approximately 80 percent were Chapter 7 cases and the other 20 percent were Chapter 13 cases.

Figure 22: U.S. Household Debt, 1980-2005



Source: Board of Governors of the Federal Reserve System

Some researchers have been commenting on the rise in overall indebtedness as a contributor to the rise in bankruptcies for some time. For example, in a 1997 congressional testimony, a Congressional Budget Office official noted that the increase in consumer bankruptcy filings and the increase in household indebtedness appeared to be correlated.[2] Also, an academic paper that summarized existing literature on bankruptcy found that some consumer bankruptcies were either directly or indirectly caused by heavy consumer indebtedness, specifically pointing to the high correlation between consumer bankruptcies and consumer debt-to-income ratios.[3]

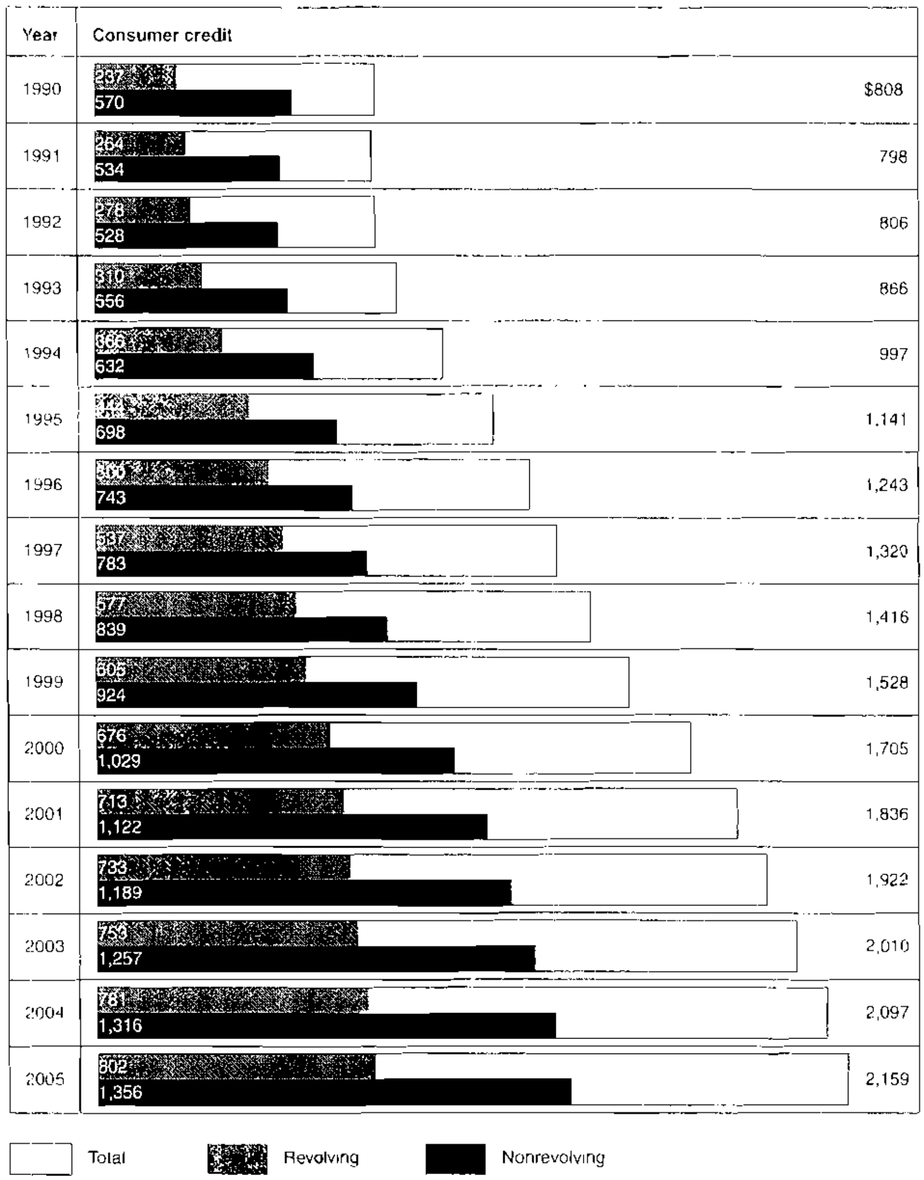
[2] Kim Kowalewski, "Consumer Debt and Bankruptcy," Congressional Budget Office testimony before the United States Senate Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, 105th Congress, 1st sess., Apr. 11, 1997.

[3] Todd J. Zywicki, "An Economic Analysis of the Consumer Bankruptcy Crisis," *Northwestern University Law Review*, 99, no.4, (2005).

Beyond total debt, some researchers and others argue that the rise in bankruptcies also was related to the rise in credit debt, in particular. As shown in figure 23, the amount of credit card debt reported also has risen from $237 billion to about $802 billion—a 238 percent increase between 1990 and 2005.[4]

[4]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, Congressional Research Service staff familiar with the survey's results indicated that the vast majority of the amount reported as revolving debt is from credit cards.

Figure 23: Credit Card and Other Revolving and Nonrevolving Debt Outstanding, 1990 to 2005



Source: GAO analysis of Congressional Research Service report data

Increased Access to Credit Cards by Lower-income Households Raised Concerns

Rather than total credit card debt alone, some researchers argued that growth in credit card use and indebtedness by lower-income households has contributed to the rise in bankruptcies. In the survey of consumer finances conducted every 3 years, the Federal Reserve reports on the use and indebtedness on credit cards by households overall and also by income percentiles. As shown in figure 24 below, the latest Federal Reserve survey results indicated the greatest increase of families reporting credit card debt occurred among those in the lowest 20 percent of household income between 1998 and 2001.

Figure 24: Percent of Households Holding Credit Card Debt by Household Income, 1998, 2001, and 2004

Percentile of income	1998	2001	2004
Less than 20	24.5	30.3	28.8
20-39.9	40.9	44.5	42.9
40-59.9	50.1	52.8	55.1
60-79.9	57.4	52.6	56.0
80-89.9	53.1	50.3	57.6
90-100	42.1	33.1	38.5
All	44.1	44.4	46.2

Source: Federal Reserve Board's Survey of Consumer Finances

In the last 15 years, credit card companies have greatly expanded the marketing of credit cards, including to households with lower incomes than previously had been offered cards. An effort by credit card issuers to expand its customer base in an increasingly competitive market dramatically increased credit card solicitations. According to one study, more than half of credit cards held by consumers are the result of receiving mail solicitations.[5] According to another academic research paper, credit card issuers have increased the number of mail solicitations they send to consumers by more than five times since 1990, from 1.1 billion to 5.23 billion in 2004, or a little over 47 solicitations per household. The research paper also found that wealthier families receive the highest number of solicitations but that low-income families were more likely to open them.[6] As shown in figure 25 above, the Federal Reserve's survey results indicated that the number of lower income households with credit cards has also grown the most during 1998 to 2001, reflecting issuers' willingness to grant greater access to credit cards to such households than in the past.

Levels of Financial Distress Have Remained Stable among Households

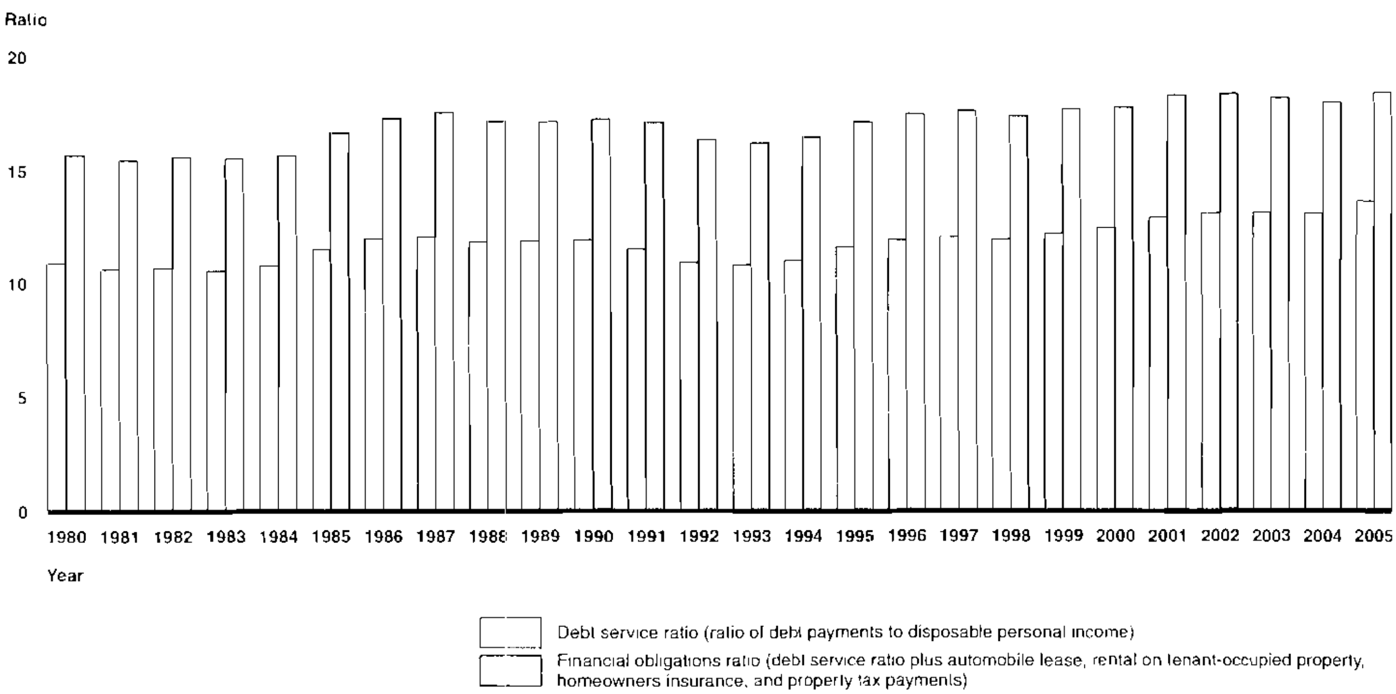
The ability of households to make the payments on their debt appeared to be keeping pace with their incomes as their total household debt burden levels—which measure their payments required on their debts as percentage of household incomes—have remained relatively constant since the 1980s. As shown below in figure 25, Federal Reserve statistics show that the aggregate debt burden ratio for U.S. households has generally fluctuated between 10.77 percent to 13.89 percent between 1990 to 2005, which are similar to the levels for this ratio that were observed during the 1980s. Also shown in figure 25 are the Federal Reserve's statistics on the household financial obligations ratio, which compares the total payments that a household must make for mortgages, consumer debt, auto leases, rent, homeowners insurance, and real estate taxes to its after-tax income. Although this ratio has risen from around 16 percent in 1980 to over 18 percent in 2005—representing an approximately 13 percent increase—Federal Reserve staff researchers indicated that it does not necessarily indicate an increase in household financial stress because

[5]Vertis, "*Financial Direct Mail Readers Interested in Credit Card Offers*," (Jan. 25, 2005), cited in the 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.

[6]Amdetsion Kidane and Sandip Mukerji, "Characteristics of Consumers Targeted and Neglected by Credit Card Companies," *Financial Services Review*, 13, no. 3, (2004), cited in the 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.

much of this increase appeared to be the result of increased use of credit cards for transactions and more households with cards.[7]

Figure 25: U.S. Household Debt Burden and Financial Obligations Ratios, 1980 to 2005



Source: Federal Reserve

In addition, credit card debt remains a small portion of overall household debt, including those with the lowest income levels. As shown in table 2, credit card balances as a percentage of total household debt actually have been declining since the 1990s.

[7]Board of Governors of the Federal Reserve System, *Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency* (Washington, D.C. June 2006)

Table 2: Portion of Credit Card Debt Held by Households

Type of debt	1995	1998	2001	2004
Amount of debt of all families, distributed by type of debt				
Secured home loan	80.7	78.9	81.4	83.7
Lines of credit not secured by residential property	0.6	0.3	0.5	0.7
Installment loans	12.0	13.1	12.3	11.0
Credit card balances	3.9	3.9	3.4	3.0
Other	2.9	3.7	2.3	1.6
Total	**100**	**100**	**100**	**100**

Source: Federal Reserve

Also, as shown in table 3, median credit card balances for the lowest-income households has remained stable from 1998 through 2004.

Table 3: Credit Card Debt Balances Held by Household Income[a]

	1998	2001	2004
Median value of holdings for families holding credit card debt			
All families	$1,900	$2,000	$2,200
Percentile of income			
Less than 20	$1,000	$1,100	$1,000
20-39.9	$1,300	$1,300	$1,900
40-59.9	$2,100	$2,100	$2,200
60-79.9	$2,400	$2,400	$3,000
80-89.9	$2,200	$4,000	$2,700
90-100	$3,300	$3,000	$4,000

Source: Federal Reserve

As shown in figure 26 below, the number of households in the twentieth percentile of income or less that reportedly were in financial distress has remained relatively stable.

[a]The 1998 median credit card balance in 2001 dollars; 2001 and 2004 median credit card balances in 2004 dollars.

Figure 26: Households Reporting Financial Distress by Household Income, 1995 through 2004

Percentile of income	1995	1998	2001	2004
All	11.7	13.6	11.8	12.2
Less than 20	27.5	29.9	29.3	27.0
20-39.9	18.0	18.3	16.6	18.6
40-59.9	9.9	15.8	12.3	13.7
60-79.9	7.7	9.8	6.5	7.10
80-89.9	4.7	3.5	3.5	2.4
90-100	2.3	2.8	2.0	1.8

Source: Federal Reserve Survey of Consumer Finances

As shown in figure 26 above, more lower-income households generally reported being in financial distress than did other households in most of the other higher-income groups. In addition, the lowest-income households in the aggregate generally did not exhibit greater levels of distress over the last 20 years, as the proportion of households that reported distress was higher in the 1990s than in 2004.

Some Researchers Find Other Factors May Trigger Consumer Bankruptcies and that Credit Cards Role Varied

Some academics, consumer advocacy groups, and others have indicated that the rise in consumer bankruptcy filings has occurred because the normal life events that reduce incomes or increase expenses for households have more serious effects today. Events that can reduce household incomes include job losses, pay cuts, or conversion of full-time positions to part-time work. Medical emergencies can result in increased household expenses and debts. Divorces can both reduce income and increase expenses. One researcher explained that, while households have faced the same kinds of risks for generations, the likelihood of these types of life events occurring has increased. This researcher's studies noted that the likelihood of job loss or financial distress arising from medical problems and the risk of divorce have all increased. Furthermore, more households send all adults into the workforce, and, while this increases their income, it also doubles their total risk exposure, which increases their likelihood of having to file for bankruptcy. According to this researcher, about 94 percent of families who filed for bankruptcy would qualify as middle class.[9]

Although many of the people who file for bankruptcy have considerable credit card debt, those researchers that asserted that life events were the primary explanation for filings noted that the role played by credit cards varied. According to one of these researchers, individuals who have filed for bankruptcy with outstanding credit card debt could be classified into three groups:

- Those who had built up household debts, including substantial credit card balances, but filed for bankruptcy after experiencing a life event that adversely affected their expenses or incomes such that they could not meet their obligations.
- Those who experienced a life event that adversely affected their expenses or incomes, and increased their usage of credit cards to avoid falling behind on other secured debt payments (such as mortgage debt), but who ultimately failed to recover and filed for bankruptcy.
- Those with very little credit card debt who filed for bankruptcy when they could no longer make payments on their secured debt. This represented the smallest category of people filing for bankruptcy.

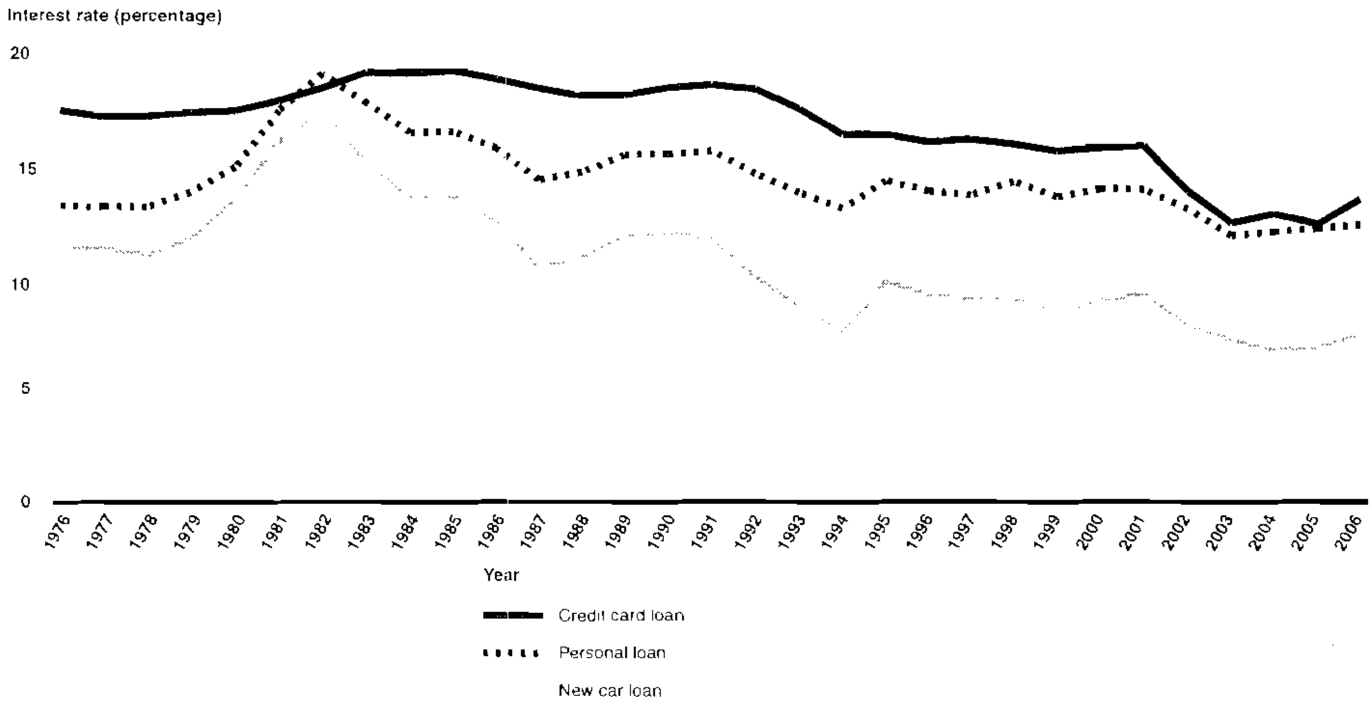
[9] Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, "The Growing Threat to Middle Class Families," *Brooklyn Law Review*, (April 2003).

Factors Contributing to the Profitability of Credit Card Issuers

Various factors help to explain why banks that focus on credit card lending generally have higher profitability than other lenders. The major source of income for credit card issuers comes from interest they earn from their cardholders who carry balances—that is, do not payoff the entire outstanding balance when due. One factor that contributes to the high profitability of credit card operations is that the average interest rates charged on credit cards are generally higher than rates charged on other types of lending. Rates charged on credit cards are generally the highest because they are extensions of credit that are not secured by any collateral from the borrower. Unlike credit cards, most other types of consumer lending involve the extension of a fixed amount of credit under fixed terms of repayment (i.e., the borrower must repay an established amount of principal, plus interest each month) and are collateralized—such as loans for cars, under which the lender can repossess the car in the event the borrower does not make the scheduled loan payments. Similarly, mortgage loans that allow borrowers to purchase homes are secured by the underlying house. Loans with collateral and fixed repayment terms pose less risk of loss, and thus lenders can charge less interest on such loans. In contrast, credit card loans, which are unsecured, available to large and heterogeneous populations, and can be repaid on flexible terms at the cardholders' convenience, present greater risks and have commensurately higher interest rates.

As shown in figure 27, data from the Federal Reserve shows that average interest rates charged on credit cards were generally higher than interest rates charged on car loans and personal loans. Similarly, average interest rates charged on corporate loans are also generally lower than credit cards, with the best business customers often paying the prime rate, which averaged 6.19 percent during 2005.

Figure 27: Average Credit Card, Car Loans and Personal Loan Interest Rates

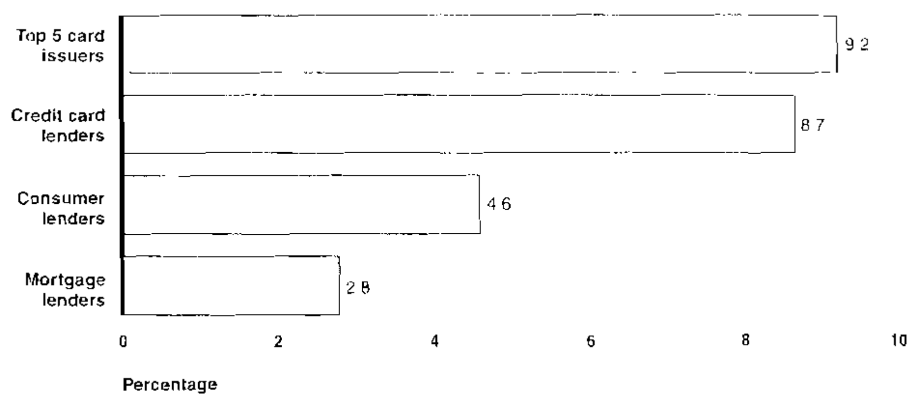


Source: Federal Reserve

Moreover, many card issuers have increasingly begun setting the interest rates they charge their cardholders using variable rates that change as a specified market index rate, such as the prime rate, changes. This allows credit card issuers' interest revenues to rise as their cost of funding rises during times when market interest rates are increasing. Of the most popular cards issued by the largest card issuers between 2004 and 2005 that we analyzed, more than 90 percent had variable rates that changed according to an index rate. For example, the rate that the cardholder would pay on these large issuer cards was determined by adding between 6 and 8 percent to the current prime rate, with a new rate being calculated monthly.

As a result of the higher interest charges assessed on cards and variable rate pricing, banks that focus on credit card lending had the highest net interest margin compared with other types of lenders. The net interest income of a bank is the difference between what it has earned on its interest-bearing assets, including the balances on credit cards it has issued and the amounts loaned out as part of any other lending activities, and its interest expenses. To compare across banks, analysts calculate net interest margins, which express each banks' net interest income as a percentage of interest-bearing assets. The Federal Deposit Insurance Corporation (FDIC) aggregates data for a group of all federally insured banks that focus on credit card lending, which it defines as those with more than 50 percent of managed assets engaged in credit card operations; in 2005, FDIC identified 33 banks with at least this much credit card lending activity. As shown in figure 28, the net interest margin of all credit card banks, which averaged more than 8 percent, was about two to three times as high as other consumer and mortgage lending activities in 2005. Five of the six largest issuers reported to us that their average net interest margin in 2005 was even higher, at 9 percent.

Figure 28: Net Interest Margin for Credit Card Issuers and Other Consumer Lenders in 2005

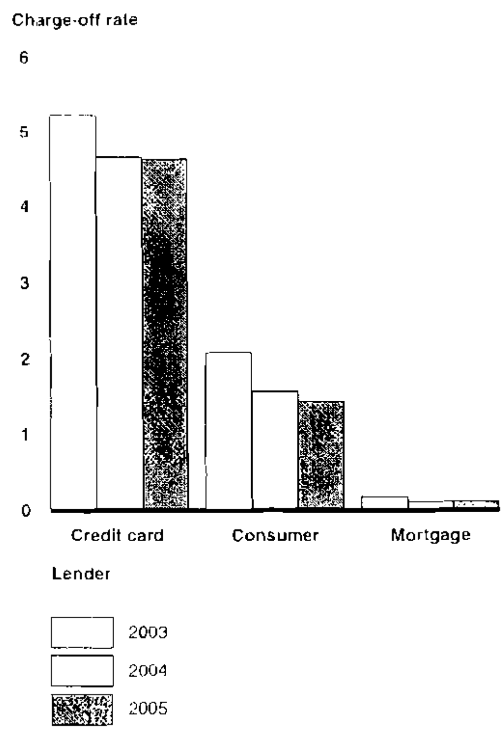


Source GAO analysis of public financial statements of the five largest credit card issuers

Credit Card Operations Also Have Higher Rates of Loan Losses and Operating Expenses

Although profitable, credit card operations generally experience higher charge-off rates and operating expenses than those of other types of lending. Because these loans are generally unsecured, meaning the borrower will not generally immediately lose an asset—such as a car or house—if payments are not made, borrowers may be more likely to cease making payments on their credit cards if they become financially distressed than they would for other types of credit. As a result, the rate of losses that credit card issuers experience on credit cards is higher than that incurred on other types of credit. Under bank regulatory accounting practices, banks must write off the principal balance outstanding on any loan when it is determined that the bank is unlikely to collect on the debt. For credit cards, this means that banks must deduct, as a loan loss from their income, the amount of balance outstanding on any credit card accounts for which either no payments have been made within the last 180 days or the bank has received notice that the cardholder has filed for bankruptcy. This procedure is called charging the debt off. Card issuers have much higher charge-off rates compared to other consumer lending businesses as shown in figure 29.

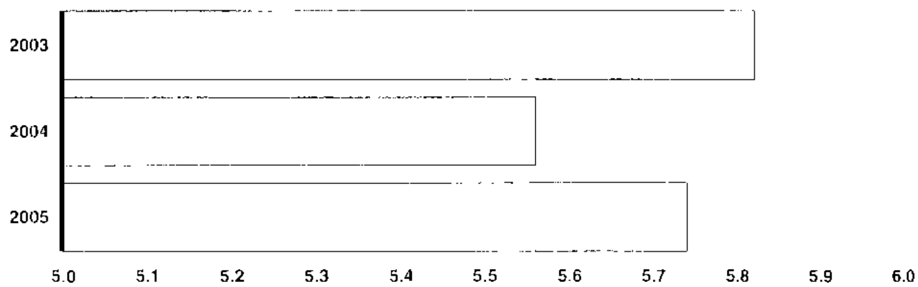
Figure 29: Charge-off Rates for Credit Card and Other Consumer Lenders, 2004 to 2005



Source FDIC

The largest credit card issuers also reported similarly high charge-off rates for their credit card operations. As shown in figure 30, five of the top six credit card issuers that we obtained data from reported that their average charge-off rate was higher than 5.5 percent between 2003 and 2005, well above other consumer lenders' average net charge-off rate of 1.44 percent.

Figure 30: Charge-off Rates for the Top 5 Credit Card Issuers, 2003 to 2005

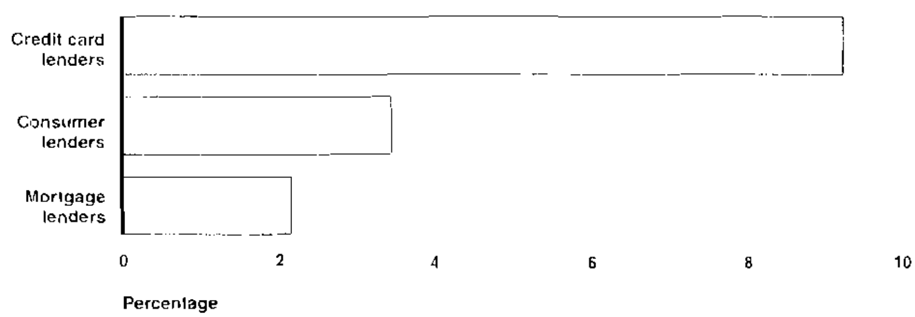


Source: GAO analysis of public financial statements of the five largest credit card issuers

Credit card issuers also incur higher operating expenses compared with other consumer lenders. Operating expense is another one of the largest cost items for card issuers and, according to a credit card industry research firm, accounts for approximately 37 percent of total expenses in 2005. The operating expenses of a credit card issuer include staffing and the information technology costs that are incurred to maintain cardholders' accounts. Operating expense as a proportion of total assets for credit card lending is higher because offering credit cards often involves various activities that other lending activities do not. For example, issuers often incur significant expenses in postage and other marketing costs as part of soliciting new customers. In addition, some credit cards now provide rewards and loyalty programs that allow cardholders to earn rewards such as free airline tickets, discounts on merchandise, or cash back on their accounts, which are not generally expenses associated with other types of lending. Credit card operating expense burden also may be higher because issuers must service a large number of relatively small accounts. For example, the six large card issuers that we surveyed reported that they each had an average of 30 million credit card accounts, the average outstanding balance on these accounts was about $2,500, and 48 percent of accounts did not revolve balances in 2005.

As a result, the average operating expense, as a percentage of total assets for banks, that focus on credit card lending averaged over 9 percent in 2005, as shown in figure 31, which was well above the 3.44 percent average for other consumer lenders. The largest issuers operating expenses may not be as high as all banks that focus on credit card lending because their larger operations give them some cost advantages from economies of scale. For example, they may be able to pay lower postage rates by being able to segregate the mailings of account statements to their cardholders by zip code, thus qualifying for bulk-rate discounts.

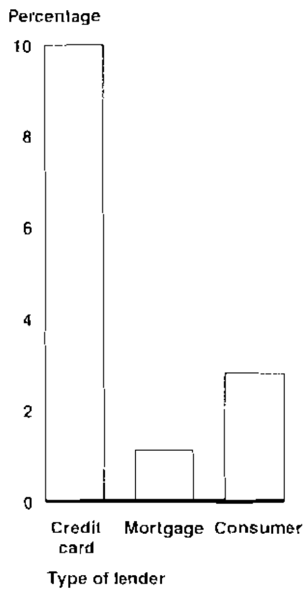
Figure 31: Operating Expense as Percentage of Total Assets for Various Types of Lenders in 2005



Source: FDIC

Another reason that the banks that issue credit cards are more profitable than other types of lenders is that they earn greater percentage of revenues from noninterest sources, including fees, than lenders that focus more on other types of consumer lending. As shown in figure 32, FDIC data indicates that the ratio of noninterest revenues to assets—an indicator of noninterest income generated from outstanding credit loans—is about 10 percent for the banks that focus on credit card lending, compared with less than 2.8 percent for other lenders.

Figure 32: Non-Interest Revenue as Percentage of Their Assets for Card Lenders and Other Consumer Lenders



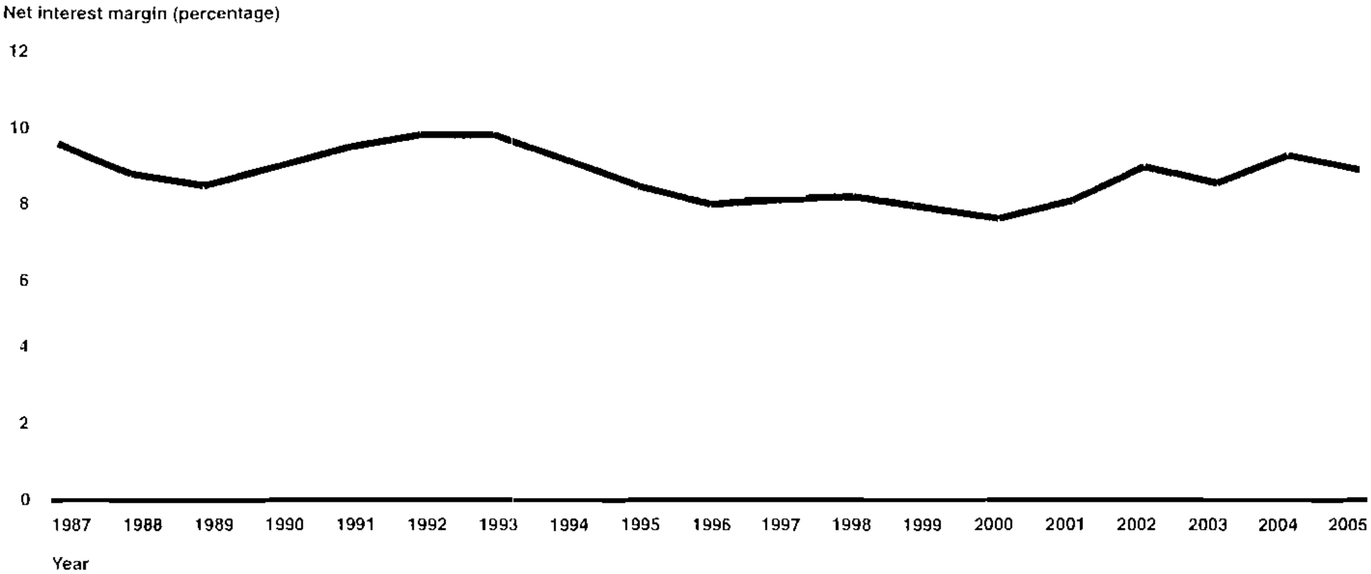
Source GAO analysis of FDIC data

Effect of Penalty Interest and Fees on Credit Card Issuer Profitability

Although penalty interest and fees apparently have increased, their effect on issuer profitability may not be as great as other factors. For example, while more cardholders appeared to be paying default rates of interest on their cards, issuers have not been experiencing greater profitability from interest revenues. According to our analysis of FDIC Quarterly Banking Profile data, the revenues that credit card issuers earn from interest generally have been stable over the last 18 years.[1] As shown in figure 33, net interest margin for all banks that focused on credit card lending has ranged between 7.4 percent and 9.6 percent since 1987. Similarly, according to the data that five of the top six issuers provided to us, their net interest margins have been relatively stable between 2003 and 2005, ranging from 9.2 percent to 9.6 percent during this period.

[1]The Quarterly Banking Profile is issued by the FDIC and provides a comprehensive summary of financial results for all FDIC-insured institutions This report card on industry status and performance includes written analyses, graphs, and statistical tables.

Figure 33: Net Interest Margin for All Banks Focusing on Credit Card Lending, 1987-2005



Source: FDIC

These data suggest that increases in penalty interest assessments could be offsetting decreases in interest revenues from other cardholders. During the last few years, card issuers have competed vigorously for market share. In doing so, they frequently have offered cards to new cardholders that feature low interest rates—including zero percent for temporary introductory periods, usually 8 months—either for purchases or sometimes for balances transferred from other cards. The extent to which cardholders now are paying such rates is not known, but the six largest issuers reported to us that the proportion of their cardholders paying interest rates below 5 percent—which could be cardholders enjoying temporarily low introductory rates—represented about 7 percent of their cardholders between 2003 and 2005. To the extent that card issuers have been receiving lower interest as the result of these marketing efforts, such declines could be masking the effect of increasing amounts of penalty interest on their overall interest revenues.

Although revenues from penalty fees have grown, their effect on overall issuer profitability is less than the effect of income from interest or other factors. For example, we obtained information from a Federal Reserve

Bank researcher with data from one of the credit card industry surveys that illustrated that the issuers' cost of funds may be a more significant factor for their profitability lately. Banks generally obtain the funds they use to lend to others through their operations from various sources, such as checking or savings deposits, income on other investments, or borrowing from other banks or creditors. The average rate of interest they pay on these funding sources represents their cost of funds. As shown in table 4 below, the total cost of funds (for $100 in credit card balances outstanding) for the credit card banks included in this survey declined from $8.98 in 1990 to a low of $2.00 in 2004—a decrease of 78 percent. Because card issuers' net interest income generally represents a much higher percentage of revenues than does income from penalty fees, its impact on issuers' overall profitability is greater; thus the reduction in the cost of funds likely contributed significantly to the general rise in credit card banks' profitability over this time.

Table 4: Revenues and Profits of Credit Card Issuers in Card Industry Directory per $100 of Credit Card Assets

Revenues and profits	1990	2004	Percent change
Interest revenues	$16.42	$12.45	-24%
Cost of funds	8.98	2.00	-78
Net interest income	7.44	10.45	40
Interchange fee revenues	2.15	2.87	33
Penalty fee revenues	0.69	1.40	103
Annual fee revenues	1.25	0.42	-66
Other revenues	0.18	0.87	383
Total revenue from operations	11.71	16.01	37
Other expenses	8.17	10.41	27
Taxes	1.23	1.99	62
Net income	2.30	3.61	57

Source: GAO Analysis of Card Industry Directory data

Although card issuer revenues from penalty fees have been increasing since the 1980s, they remain a small portion of overall revenues. As shown in table 4 above, our analysis of the card issuer data obtained from the Federal Reserve indicated that the amount of revenues that issuers collected from penalty fees for every $100 in credit card balances outstanding climbed from 69 cents to $1.40 between 1990 and 2004—an increase of 103 percent. During this same period, net interest income collected per $100 in card balances outstanding grew from $7.44 to $10.45—an increase of about 41 percent. However, the relative size of each of these two sources of income indicates that interest income is between 7 to 8 times more important to issuer revenues than penalty fee income is in 2004. Furthermore, during this same time, collections of annual fees from cardholders declined from $1.25 to 42 cents per every $100 in card balances—which means that the total of annual and penalty fees in 2004 is about the same as in 1990 and that this decline may also be offsetting the increased revenues from penalty fees.

Comments from the Federal Reserve Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
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August 23, 2006

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U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr Wood

Thank you for the opportunity to comment on the GAO's draft report entitled Credit Cards Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers. As the report notes, the Federal Reserve Board has commenced a comprehensive rulemaking to review the Truth in Lending Act (TILA) rules for open-end (revolving) credit including credit card accounts. The primary goal of the review is to improve the effectiveness and usefulness of consumer disclosures and the substantive protections provided under the Board's Regulation Z, which implements TILA. To ensure that consumers get timely information in a readable form, the Board is studying alternatives for improving both the content and format of disclosures, including revising the model forms published by the Board.

The draft GAO report specifically recommends that the Board revise credit card disclosures to emphasize more clearly the account terms that can significantly affect cardholder costs, such as default or other penalty pricing rates We agree that increased complexity in credit card pricing has added to the complexity of the disclosures To help address this, the Board has invited public comment on ways in which the disclosures required under Regulation Z can be made more meaningful to consumers. The Board is conducting extensive consumer testing to determine what information is most important to consumers, when that information is most useful, what language and formats work best, and how disclosures can be simplified, prioritized, and organized to reduce complexity and information overload To that end, the Board has hired design consultants to assist in developing model disclosures that are most likely to be effective in communicating information to consumers Importantly, the Board also plans to use consumer testing to assist in developing model disclosure forms. Based on this review and testing, the Board will revise Regulation Z and, if appropriate, develop suggested statutory changes for congressional consideration.

Mr David G Wood
Page 2

The Board's staff has provided technical comments on the draft GAO report separately We appreciate the efforts of your staff to respond to our comments.

Sincerely,

c Cody Goebel, Assistant Director, GAO

GAO Contact and Staff Acknowledgments

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Staff Acknowledgments

In addition to those named above, Cody Goebel, Assistant Director; Jon Altshul; Rachel DeMarcus; Kate Magdelena Gonzalez; Christine Houle; Christine Kuduk; Marc Molino; Akiko Ohnuma; Carl Ramirez; Omyra Ramsingh; Barbara Roesmann; Kathryn Supinski; Richard Vagnoni; Anita Visser; and Monica Wolford made key contributions to this report.