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RICHARD L. D. MORSE

The article below is dedicated to the memory of Richard L. D. Morse, who died on June 3, 2000, at age 83. He was Professor Emeritus of Family Economics at Kansas State University. Dick was widely known for his tireless efforts in the measurement and disclosure of interest rates. He has been called "the father of Truth in Lending legislation," was said to have coined the phrase "annual percentage rate," and was involved in the development of Truth in Savings and Truth in Packaging legislation. He served on the Board of Directors of Consumers Union and the Consumer Advisory Council of the Federal Reserve Board. He led a productive life and made important contributions to the economic welfare of consumers.

THE AFTERMATH OF BANK ONE'S QUIET INTEREST RATE REDUCTION ON MARKET INDEX ACCOUNTS

In our December 1999 issue, we explained how Bank One quietly changed its interest crediting methodology early in 1999 so as to reduce rates on "market index" accounts. We also described further changes the bank made later in the year. Since then the spread between the rates credited and the rates that would have been credited if the changes had not been made has grown steadily and is now large. This article describes the spread and discusses the views of bank regulators about disclosure of the changes.

The Changes

Prior to the changes, Bank One credited each week—on market index accounts with balances of at least $15,000—an interest rate equal to the "all taxable 7-day simple yield" published the previous week by IBC Financial Data. Interest is calculated daily and compounded monthly. Over a three-week period in March 1999, the bank phased in an interest rate reduction; after the phase-in period, the annual percentage yield, which reflects compounding, was equal each week to the IBC rate published the previous week. (The details are described more fully in our December 1999 article.) At the interest rate levels that were in effect in March 1999, the change produced an interest rate reduction of nine basis points. A basis point is one hundredth of a percentage point.

In December 1999, Bank One made three other significant changes. First, the bank said the annual percentage yield each week would be equal to between 90 and 110 percent of the IBC rate published the previous week. Second, the bank increased from $15,000 to $25,000 the account balance above which the crediting rate would be related to the IBC rate. Third, the bank established three account size

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brackets—$25,000 and below $50,000, $50,000 and below $100,000, and $100,000 and above—thereby allowing the bank to credit different rates depending upon the size of the account.

The Growing Spread

Since March 1999, there has been steady growth in the spread between the interest rate credited and the rate that would have been credited if the changes had not been made. The table at the right shows the rates that would have been credited on an account with a balance of $25,000 and below $50,000 during selected weeks if none of the changes had been made, the rates that were credited during those weeks, and the spread expressed in basis points. The spread grew from zero basis points in February 1999, before any of the changes were made, to 61 basis points in the week of June 26, 2000. For a $40,000 account, a 61 basis point spread means a $244 reduction in interest in a year without the effect of compounding, or about $257 including monthly compounding.

In the week of June 26, 2000, the spread was 85 basis points for balances of $15,000 and below $25,000; in that bracket, the rates credited beginning in December 1999 were no longer related to the IBC rate. The rate for that bracket has been unchanged at 5.03 percent since January 3, 2000, during a period when the IBC rate increased 75 basis points. In the week of June 26, 2000, the spread was 51 basis points for balances of $50,000 and below $100,000, and 42 basis points for balances of $100,000 and above.

For balances below $15,000, Bank One credited an interest rate of 2 percent during 1999 and the early months of 2000. Beginning in the week of April 10, 2000, the bank reduced the rate to 1.49 percent.

BANK ONE'S GROWING SPREAD

Week	IBC Rate*	Bank One Rate**	Spread (basis points)
2/1/99	4.40%	4.40%	0
4/5/99	4.35	4.26	9
8/2/99	4.47	4.38	9
12/6/99	5.03	4.91	12
2/7/00	5.14	5.03	11
3/6/00	5.27	5.03	24
4/3/00	5.38	5.03	35
4/10/00	5.47	5.03	44
4/17/00	5.45	5.03	42
4/24/00	5.47	5.03	44
5/1/00	5.45	5.03	42
5/8/00	5.45	5.08	37
5/15/00	5.48	5.08	40
5/22/00	5.55	5.13	42
5/30/00	5.69	5.13	56
6/5/00	5.76	5.18	58
6/12/00	5.81	5.18	63
6/19/00	5.85	5.18	67
6/26/00	5.88	5.27	61

*These are the rates that would have been credited by Bank One if neither the March 1999 change nor the December 1999 changes had been made.

**Beginning with the week of April 10, 2000, the rates shown here are those credited when the account balance was at least $25,000 and below $50,000.

The Disclosure Issue

Before the March 1999 change, Bank One printed a message on monthly statements. Here is the message:

> **EFF. 3-1-99, BANK ONE MARKET INDEX ACCOUNT ANNUAL PERCENTAGE YIELD FOR BALANCES OF $15,000 OR MORE WILL BE BASED ON NO LESS THAN IBCS MONEY FUND REPORT AVERAGES ALL TAXABLE 7-DAY SIMPLE YIELD WHICH IS THE INDEX USED TO DETERMINE THE INT. RATE (OR IF UNAVAILABLE, A SIMILAR INDEX SELECTED AT BANK ONE'S DISCRETION).**

The message did not disclose that Bank One was implementing an interest rate reduction; almost no one would realize from the wording that a reduction was occurring. The message could easily have disclosed the reduction by opening with this sentence: "Effective March 1, 1999, we are reducing the interest rates on your market index account."

Section 230.5 of Regulation DD on Truth in Savings is entitled "Subsequent Disclosures." A portion of the section requires that affected consumers be given 30 days' advance notice of a change "if the change may reduce the annual percentage yield or adversely affect the consumer," and requires that the notice "include the effective date of the change."

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Our book entitled *Viatical Transactions* is $30. The "ratings package," which consists of the September 1999 and February 2000 issues, is $20. The July 1999 issue is $20. The October 1999, June 2000, and July 2000 issues are $10 each. The January 1998, December 1999, and May 2000 issues are $5 each.

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Comments by the OCC

On November 15, 1999, we wrote to the Office of the Comptroller of the Currency (OCC) and sent our December 1999 issue. The OCC regulates national banks such as Bank One. We asked whether the bank's statement message to its depositors about the March 1999 change complied with the disclosure requirements imposed by the regulation.

Angela Willis, an OCC customer assistance specialist, replied in a letter dated February 14, 2000. She concluded: "It does not appear, from the information obtained from your article, that the bank has violated any portions of the regulation." In a telephone conversation, she expressed the view that the regulation does not require the bank to say there is a change, say there is a reduction in the annual percentage yield, or describe the size of the reduction.

Comments by the Fed

We also wrote to the Federal Reserve Board, which promulgated Regulation DD. We did not receive a written reply; instead, we spoke with Kyung Cho-Miller, a Fed attorney. Her interpretation of the regulation was the same as that expressed by Ms. Willis.

On February 11, 2000, we wrote to Ms. Cho-Miller asking the Fed to reconsider its interpretation of the regulation with regard to "subsequent disclosures." We said the stated purposes of the Truth in Savings Act and Regulation DD suggest the bank should be required to disclose that a change is occurring, disclose that the change is a reduction in the annual percentage yield, and describe the size of the reduction.

Ms. Cho-Miller said the Fed would reconsider its interpretation of the regulation the next time the agency reviews truth-in-savings matters; we do not know when the review will occur. She also said that, if the Fed concludes that its interpretation should be changed, the Fed would invite public comment. That procedure is necessary, she said, because many people rely on the Fed's interpretation. We think inviting public comment is an appropriate procedure.

(The Fed's procedure differs sharply from that followed in an analogous situation by the New York insurance department. After secret deliberations initiated by two insurance companies, and without inviting public comment, the department changed its interpretation of an exception in New York's Freedom of Information Law. See our July 2000 issue.)

