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Editor's note: The lead article in this issue does *not* mean that we are now *The Insurance and Banking Forum*. In our October 1999 issue, in an article entitled "The Stunning Default at General American Life," we discussed the favorable indexed interest rates in the funding agreements between General American and institutional investors such as money market mutual funds. We decided to take a close look at the indexed interest rates in our own "market index" account at Bank One, and were surprised to learn that the bank altered its methodology early this year in such a way as to reduce the interest rates on the account. What prompted us to write this article was a combination of the lack of disclosure of the interest rate reduction and the clever manner in which the bank accomplished the reduction.

HOW BANK ONE QUIETLY REDUCED INTEREST RATES ON MARKET INDEX ACCOUNTS—A CASE STUDY IN THE LACK OF DISCLOSURE

Bank One Corporation, which operates in 14 states, offers "market index" accounts. When the account balance exceeds a specified level, the interest rate changes weekly and is tied to an index. In March 1999, the bank altered its methodology in such a way as to reduce interest rates. The bank did not disclose to its depositors that the alteration constituted an interest rate reduction, and the incident shows that the insurance industry is not alone in failing to disclose important information to its customers.

The Account

Bank One recently announced several major changes in its market index accounts, as discussed on page 307. However, the primary focus of this article is on the alteration in methodology that resulted in an interest rate reduction in March 1999.

Interest on Bank One's market index accounts is calculated daily, credited monthly, and compounded monthly. When the account balance is below $15,000, the interest rate is 2 percent—the rate on regular savings accounts. When the balance is at least $15,000 (the only range discussed in this article), the rate changes weekly and is indexed to a figure published by IBC Financial Data (Ashland, Massachusetts). When the balance falls below $2,000, the bank imposes a service charge of $10 per month.

The Index

Bank One uses as an index what IBC calls the "all taxable 7-day simple yield." It is one of several averages published by IBC, but is the only IBC figure discussed in this article. IBC publishes the figure each Thursday, and Bank One uses it during the following week. The IBC figure is based on interest rates reported by over 900 money market mutual funds with combined assets of about $1.3 trillion. The figure is an unweighted average of the rates reported; that is, the figure is not weighted by fund asset size.

The IBC figure is a "nominal" rate; that is, it does not include the effect of compounding. For example, IBC published the figure of 4.74 percent on Thursday,

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October 7. The corresponding "annual percentage yield," which includes the effect of compounding, was 4.85 percent.

The September 1998 Booklet

Bank One mentions the IBC rate in a booklet entitled "More Specifics About Your Account." In the description of the market index account, the September 1998 version of the booklet said:

> **Interest rates are determined weekly and are based on no less than IBC's MONEY FUND REPORT AVERAGES/All Taxable 7-Day Simple Yield (or if unavailable, a similar independent index selected at Bank One's discretion) for balances of $15,000 and over.**

Rates Before the Reduction

Early in 1999, Bank One used interest rates equal to the IBC rates. For example, here were the IBC rates (publication dates are shown in parentheses) and the Bank One rates (effective dates are shown in parentheses) for three weeks in February:

IBC Rates		Bank One Rates	
4.40%	(1/28/99)	4.40%	(2/1/99)
4.41	(2/4/99)	4.41	(2/8/99)
4.37	(2/11/99)	4.37	(2/16/99)

The above are nominal rates that do not reflect compounding. At those levels, the difference between a nominal rate and the corresponding annual percentage yield, which reflects compounding, is ten basis points. For example, the nominal rate of 4.40 percent shown above corresponds to an annual percentage yield of 4.50 percent. To calculate the amount of interest earned on a market index account on any particular day, Bank One multiples the balance at the end of the day by the nominal rate expressed as a decimal, and, in a 365-day year, divides the product by 365.

Rates After the Reduction

Later in 1999, Bank One used interest rates below the IBC rates. For example, here were the IBC rates and the Bank One rates for three weeks in April:

IBC Rates		Bank One Rates	
4.35%	(4/1/99)	4.26%	(4/5/99)
4.38	(4/8/99)	4.29	(4/12/99)
4.31	(4/15/99)	4.22	(4/19/99)

Again, the above are nominal rates that do not reflect compounding, and each Bank One rate above was used to calculate the amount of interest earned on any particular day. However, the annual percentage yields (reflecting compounding) corresponding to the Bank One rates are equal to the IBC rates. For example, the annual percentage yield corresponding to Bank One's rate of 4.26 percent for the week of April 5 is 4.35 percent, which is the IBC rate published on April 1. In short, Bank One reduced its interest rates by the difference between the nominal rates and the annual percentage yields.

Rates in March 1999

Bank One did not implement the entire reduction in one week. Instead, the bank phased it in over a three-week period in March. Here are the figures, including those for the week before the phase-in period:

IBC Rates		Bank One Rates	
4.36%	(2/18/99)	4.36%	(2/22/99)
4.34	(2/25/99)	4.30	(3/1/99)
4.37	(3/4/99)	4.29	(3/8/99)
4.35	(3/11/99)	4.26	(3/15/99)

For the week of March 1, Bank One reduced the interest rate by six basis points—from 4.36 percent for the week of February 22 to 4.30 percent. However, the IBC rate decreased by only two basis points—from 4.36 percent published on February 18 to 4.34 percent published on February 25. Thus Bank One's rate for the week of March 1 was four basis points below what it would have been without the reduction.

For the week of March 8, Bank One reduced the interest rate by one basis point, although the IBC rate *increased* by three basis points. Thus Bank One's rate for the week of March 8 was eight basis points below what it would have been without the reduction.

For the week of March 15, Bank One reduced the interest rate by three basis points, although the IBC rate decreased by only two basis points. Thus Bank One's rate for the week of March 15 was nine basis points—the full amount of the difference between the nominal rate and the annual percentage yield—below what it would have been without the reduction. We do not know why the bank phased in the reduction rather than implementing it all at once.

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Announcement of the Reduction

In September, we wrote to John B. McCoy, chairman of Bank One Corporation, and sent a copy of the letter to Joseph D. Barnette, president of Bank One Indiana. In response, we received a letter from William J. Cafaro, a senior vice president of Bank One Indiana. He said the "change was communicated" in a message printed on monthly statements. We looked through our statements and found the following message, which was on a statement we received early in February:

> **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).**

Bank One also mentioned the alteration in its methodology when it issued a new version of the "More Specifics About Your Account" booklet. The current (June 18, 1999) version says:

> **Annual percentage yield for balances of $15,000 or more is based on no less than IBC's MONEY FUND REPORT AVERAGES/All Taxable 7-Day Simple Yield which is the index used to determine the interest rate (or if unavailable, a similar independent index selected at Bank One's discretion).**

The Lack of Disclosure

The announcements did not disclose that Bank One was implementing an interest rate reduction. Almost no one would realize it was a reduction (we did not realize it until we looked into the matter in September), for at least three reasons. First, the previous language was not shown, and almost no one had easy access to the previous language. Second, even if the previous language had been available, almost no one would grasp the significance of the subtle change from "interest rates" to "annual percentage yield." Third, almost no one is familiar with the IBC figures. No one at our local bank or at the bank's toll-free information number was able to tell us what the IBC figures were. After some digging, we learned that the figures are published in a small article in the third section of *The Wall Street Journal* each Thursday, and on IBC's website (www.ibcdata.com).

Bank One's statement message could have disclosed the reduction by opening with this simple sentence: "Effective March 1, 1999, we are reducing the interest rates on your market index account." The message could have gone on to explain the reduction, and could have ended with an invitation to call a toll-free number if the depositor had questions.

Impact of the Reduction

Bank One used the interest rate reduction discussed in this article for only about ten months—from March 1 to December 20. (The major changes effective December 20 are discussed in the next section.) For many depositors, the reduction involved a small but nonetheless significant amount of money. For example, a depositor with a $60,000 account received about $50 less interest during the ten-month period than would have been received without the reduction.

For Bank One, the interest rate reduction was a significant item. We estimate that it produced a savings of about $25 million during the ten-month period.

The December 20 Changes

In a message printed on statements distributed late in October, Bank One announced that major changes in its market index accounts will be effective on December 20. The message said:

> **EFFECTIVE DECEMBER 20, THE INTEREST RATE ON THE MARKET INDEX ACCOUNT WILL BE TIERED AT $15,000; $25,000; $50,000 AND $100,000; AND WILL NOW BE DETERMINED DAILY AT BANK ONE'S DISCRETION ON BALANCES UP TO $25,000.**
>
> **THE ANNUAL PERCENTAGE YIELD (APY) ON BALANCES OF $25,000 OR MORE WILL BE AT LEAST 90% AND UP TO 110% OF IBC'S MONEY FUND REPORT AVERAGES/ ALL TAXABLE 7-DAY SIMPLE YIELD, AND THE MINIMUM BALANCE TO AVOID THE MONTHLY SERVICE FEE WILL BE $5,000.**

Thus Bank One will increase from $15,000 to $25,000 the minimum balance tied to the IBC rate, and will increase from $2,000 to $5,000 the minimum balance to avoid the monthly service charge. Also, the bank may use different rates in various brackets.

The most significant change is the introduction of a range of 90 percent to 110 percent of the IBC rate. That means the interest rates are tied so loosely to the IBC rate that the accounts should no longer be referred to as market index accounts. For example, suppose IBC publishes a rate of 4.80 percent on December 8 and Bank One uses a nominal rate corresponding to an annual percentage yield of 4.80 percent for the week of December 13. Under the new rules, the IBC rate will have to increase more than 53 basis points—to over 5.33 percent (4.80 percent is 90 percent of 5.33 percent)—before Bank One will be required to use a nominal rate corresponding to an annual percentage yield higher than 4.80 percent.

At the time of this writing (late October), we do not know what impact the December 20 changes will have on the interest rates that Bank One credits to its market index accounts. Close scrutiny will be important because market interest rates have been increasing in recent months and may continue to increase.

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