

Sales Misconduct at Wells Fargo Community Bank

What Wells really excels at [. . .] is managing its employees well, providing the right incentives to enthuse them about pushing what the bank has to offer.

—*The Economist*, September 14, 2013

Wells Fargo, America's third-biggest bank by assets, castigated John Stumpf, its former boss, for tolerating sales practices that led to the opening of 2m-odd ghost accounts.

—*The Economist*, April 12, 2017

On September 8, 2016, Wells Fargo bank of San Francisco, California announced a \$185 million settlement with three United States regulatory agencies over widespread misconduct in sales practices at its consumer retail banking arm, the Community Bank (see **Exhibit 1**). From 2011 to 2016, Community Bank employees opened 2 million unauthorized customer accounts and credit cards and sold products and services to customers under false pretenses in order to boost sales figures. In its announcement, the bank stated that, since 2011, it had dismissed 5,300 employees in relation to fraudulent and improper sales practices.³

The settlement sparked an uproar among the public and press. Wells Fargo's shares fell from \$48.77 on September 7, 2016, to a low of \$43.83 on October 3 (see **Exhibit 2**).⁴ On September 27, Head of the Community Bank Carrie L. Tolstedt, who had previously announced she would retire at the end of the year, was dismissed for cause. By the end of September, Congressional hearings to investigate the bank were convened, and Wells Fargo Chairman and CEO John Stumpf testified before the House of Representatives and Senate regulatory committees. On October 12, Stumpf resigned. The bank dismissed three other executives and by April 2017 clawed back a total of \$180 million, including \$67

million from Tolstedt and \$69 million from Stumpf, in stock options, bonuses, and other compensation.⁵ Throughout the episode, Wells Fargo remained one of the biggest retail banks in the U.S., ending 2016 with \$1.9 trillion in assets and a market capitalization of \$277 billion (see **Exhibit 3** for comparison to largest banks).⁶

On April 25, 2017, investors met for the bank's annual shareholder meeting to vote to reelect the Board of Directors. Leading proxy advisors Institutional Shareholder Services (ISS) and Glass Lewis had recommended a vote against several members of the Board, holding them accountable for the scandal. In response to the scandal, Wells Fargo had already made some changes to operations, governance and risk management but not to the Board. It remained to be seen whether investors were satisfied by the Board's response thus far or whether Board changes were needed to demonstrate accountability.

Wells Fargo History & Background

In 1852, Henry Wells and William Fargo formed Wells Fargo & Co., opening the bank's first branches in San Francisco and Sacramento, California.⁷ Early on, the bank provided banking and express services—inspiring the company's stagecoach branding—in Texas and the Southwest. It built its reputation on protecting prospectors' and mining interests' gold during the California gold rush.

During the 20th century, Wells Fargo was a banking industry innovator, with a particular focus on cost savings. It was among the earliest banks to adopt extended hours on weekdays and Saturdays, as well as branch and customer service innovations, such as “one-stop-shopping banking center[s] which included a full service branch, a Starbucks coffee outlet, a dry cleaner and a photocopying service all under one roof.”⁸ The bank took advantage of creative channels, such as by placing automatic teller machines (ATMs) in grocery stores, saving costs on capital investment and operations while offering customers more convenient service.⁹ Carl Reichardt, chairman from 1983 to 1994, cultivated a culture that promoted personal responsibility and ambition among employees, popularizing the slogan “Run it like you own it” among the workforce, by which employees were encouraged to run their own business activities and “independently exercise staff and control functions.”¹⁰

In 1998, following a trend toward consolidation among U.S. banks, Wells Fargo acquired Minneapolis, Minnesota-based retail bank Norwest Corporation for \$31.4 billion in a “merger of equals.”^{11,12} In the early-2000s, Wells Fargo was focused on retail banking throughout the Western U.S., offering a wide variety of consumer products. The bank had relatively small investment or capital markets operations, instead focusing on generating revenue through cross-selling, i.e., selling multiple products—such as deposit accounts, credit cards, and loans—to each customer.¹³ In 2008, Wells Fargo acquired Wachovia for \$15.1 billion, expanding its footprint from the West to the entire U.S. and doubling its number of branches.^{14,15} It became the largest national player in auto and small business loans and boosted its insurance and stock brokerage segments to be among the top three, respectively.¹⁶

Wells Fargo excelled at its mortgage business. Prior to the financial crisis of 2007-2008, Wells Fargo had opted not to purchase Countrywide, the biggest mortgage firm in the U.S., thus avoiding a balance sheet full of the bad loans at the heart of the market crash.¹⁷ By 2013, the bank had almost one-fourth of the U.S. market in home loans and was issuing almost one-third of new residential mortgages.¹⁸ It was a leader in auto lending and student loans. By 2017, Wells Fargo had 269,000 employees serving 40 million retail customers and 3 million small businesses (see **Exhibit 3**).¹⁹ That year, Wells Fargo was fifth on the *Forbes* 2 000 list of the world's biggest companies, with a market capitalization approaching \$275 billion, and ranked number eight in profits at \$21.9 billion.²⁰

Retail Banking Sector in 2017

Retail banking encompassed banking services and products for individual consumers and small businesses (non-retail banking referred to investment banking and commercial and wholesale banking offered to corporations, other banks, governments, and other larger institutions). Typical retail offerings included deposit accounts—checking accounts, market-rate savings accounts—debit cards, basic investment vehicles such as certificates of deposit (CDs), mortgages, auto loans, other types of personal loans, credit cards, and lines of credit.

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Competitive pressures in the sector stemmed from: changing customer behaviors that made physical networks outmoded and required investment in new technologies, such as mobile banking capabilities; significant differences across geographies, e.g., different competitive landscapes and customer demographics, required market-specific services; economic and regulatory considerations, such as interest rates, economic cycles, income distribution, and external factors; competitor distribution, e.g., where they located branches and ATMs and which digital options they offered.²¹

Banking was among the most-regulated industries; U.S. retail banks were licensed and regulated by a patchwork of different agencies and statutes. The Federal Reserve Board wrote and enforced banking regulations. The FDIC insured deposits of at least \$250,000 per depositor at commercial banks. The Office of the Comptroller of the Currency (OCC) was an independent bureau within the U.S. Department of the Treasury, whose purview included regulation, chartering, and supervision of all national banks.²² More recently, as a consequence of the financial crisis of 2008-2009, the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act established the Consumer Financial Protection Bureau (CFPB), among many other changes. The CFPB was charged with monitoring and enforcing against harmful lending practices and other activities on behalf of consumers.

Community Bank: Running a Retail Operation

In 2017, the Community Bank, Wells Fargo's retail arm, had 6,000 branches in 39 states and the District of Columbia; it had an ATM within two miles of 50% of U.S. households, a total of more than 13,000 ATMs.²³ The bank claimed that 33% of U.S. consumer households and 10% of small businesses in the U.S. had accounts with the Community Bank, with more than 1.6 billion customer interactions at banks or ATMs annually.²⁴ More than 21 million households^a made use of at least one Community Bank offering, such as checking and savings accounts, debit and credit cards, savings certificates, individual retirement account (IRA) certificates of deposit or savings accounts, personal loans or lines of credit, and automobile, student, home, and small business lending.^{25,26} By 2017, the Community Bank employed 80,000 people.²⁷

In 2016, the Community Bank brought in 55% of Wells Fargo revenue, with \$49 billion.²⁸ Net income was \$12.4 billion, down 8% from the previous year.²⁹ It had average loans of \$476 billion, and average deposits of \$654 billion.³⁰ While 61% of Community Bank income derived from interest, the majority of the remainder came from fees: for example, service charges on deposit accounts (\$3.1 billion), trust and investment fees (\$2.6 billion), card fees (\$3.6 billion); \$5.6 billion in revenue came from mortgage banking.³¹ (See Exhibits 4 and 5 for Wells Fargo and Community Bank financials.)

By 2017, the Community Bank had been led by Tolstedt for 10 years. Tolstedt's career began in Wells Fargo's Central California region, where she headed the regional Community Bank before becoming head of the entire region in 2002.³² In 2007, Tolstedt was promoted to executive vice president and head of the Community Bank. Tolstedt had a reputation for running an efficient organization and was praised for the Community Bank's strong financial performance under her leadership. She won praise from management and the board, which wrote in their investigation report, "Stumpf had enormous respect for Tolstedt's intellect, work ethic, acumen and discipline, and thought she was the 'most brilliant' Community Banker he had ever met."³³ In 2015, *Fortune* put Tolstedt at number 27 on its annual list of Most Powerful Women list, calling her "the most powerful female banker in the U.S."³⁴ a A household meant the aggregate of all accounts at a single address.

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Cross Selling

Community Bank sales strategy focused on cross selling, or the practice of selling additional products to the same customers. The value proposition of cross selling was that using the same bank for multiple products and services offered conveniences such as consolidated billing and familiar locations and staff, as well as a history of trust. For example, if a customer opened a checking and savings account, employees were encouraged to sell the customer additional products, such as a credit card or loan. When the same customer later needed a mortgage or auto loan, they were likely to return to the same bank. Cross selling could take place at the time a customer was shopping for the original product or at a later time. Successful cross selling also served to more deeply tie the customer to the bank: it lowered barriers when customers were seeking new products or services, due to familiarity and ease of access, and it

raised switching costs. Cross selling was facilitated by the bank offering discounts, fee waivers, and other perks to customers that would purchase more than one service.

Cross selling was a common tactic in retail banking and other sectors. Wells Fargo's 2015 annual reports characterized cross selling as a way to provide customers with "the most relevant products, services, advice, and guidance" throughout the duration of their relationship with the bank.^{3 5} The report also stated that Wells Fargo's cross selling was "needs based" and acknowledged that not all customers benefited equally from each offering.^{3 6} Branch and regional managers held Wells Fargo employees to strict quotas for opening new customer accounts and selling customers additional products and add-ons.^{3 7} Employees quoted by the *Los Angeles Times* stated that the sales goals for employees included selling a minimum of four products to 80% of customers, including overdraft protection on checking accounts, credit cards, mortgages, advisory services, and wealth management.^{3 8} In 2013, Wells Fargo reported that their retail customer households used an average of 6.15 financial products—nearly four times the industry average.^{3 9} In 2015, retail customers had 6.11 products per household, down slightly from the previous two years.

Eight is Great

Community Bank performance assessment was heavily based on year-over-year increases in the volume of products sold. Corporate and Community Bank executives set sales goals for the entire Community Bank, which regional managers then cascaded down to the branch level and individual employees. At each tier, employees were then ranked within their branch and region against one another according to their relative performance.^{4 0} Rankings and performance relative to goals correlated to incentive compensation and promotion opportunities.^{4 1}

The Community Bank engaged in several sales campaigns each year. During these periods, management put special emphasis on sales through higher-than-normal quotas and goals and special rewards for exceeding sales goals.^{4 2} The most prominent bank-wide campaign was "Jump Into January," motivating employees to start the new year by meeting and exceeding January goals.^{4 3}

According to December 2013 *Los Angeles Times* article, top executives pressured employees to target the "great 8"—i.e., selling an average of eight financial products per household. Daily and monthly "motivator" reports ranked Wells Fargo retail banking districts against one another's performance on monthly, quarterly, and year-to-date (YTD) goals. Daily retail scorecards ranked individual employees on their performances against their individual sales-plan goals.^{4 4} Daily measurement of sales performance was based on the executives' expectation that branch managers would not only reach but pass the sales quotas that were assigned to them by regional managers. Results were reviewed in daily conference

calls, and managers that had not met their goals were “chastised and embarrassed in front of 60-plus managers in your area by the Community Banking president.”⁴

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Behaviors that resulted in high sales volumes were often spread as best practices. As an example, Tolstedt held Pam Convoy, who had driven the Arizona Regional Banking operations from last place to first within two years of her appointment, as a model of successful behavior. In 2010, Convoy was asked to speak at a leadership conference and was involved in training other regional leaders. Her sales technique included a widespread use of “morning huddles,” where district managers would review the previous day’s results, as well as several calls to check on branch managers’ progress toward their assigned goals. Convoy was known for encouraging subordinates to “operate at the minimum standards of quality required by the

Bank in order not to miss productive sales opportunities.”^{4 6}

Community Bank hiring and promotion practices further contributed to deepening the sales- centered culture. Consistent with a view that the Community Bank was a retail operation, Tolstedt considered an employee turnover rate of 30% to be within normal ranges. It was her view that “there were always people willing to work for Wells Fargo,” therefore she felt comfortable allowing the high pressure, sales-focused culture to operate as a selection mechanism.^{4 7} Wells Fargo employees were generally inexperienced and behaved in line with the widespread belief that success and promotions depended on selling more than their peers. Promotions were predominantly driven by sales performance. Inexperienced bankers, promoted on the basis of their aggressive sales performance, would become inexperienced managers that fostered the approach to sales that made them successful.

Successful managers were often moved to locations where sales performance needed improvement, further spreading the culture of aggressive sales tactics. For example, Shelly Freeman was asked to lead the Florida Region based on her performance results as Regional Manager in Los Angeles. During her time in Los Angeles, she crafted a personalized email motivator, in which she stated “This morning [. . .] we are at 99% of solutions, 93% of profit, and 105% of checking. I hate numbers that start with a 9. I like ones that have three digits and start with a 1, as in 105 or 110.”^{4 8} When she moved to Florida, she started emphasizing tradeoffs favorable to hitting sales goals at the expense of lower quality of sales.

Sales and Compensation

Bank employees engaged in sales made base salaries of around \$30,000 annually, with bonuses ranging from \$500 to \$2,000 each quarter for hitting sales targets.^{4 9} To qualify for incentive pay, bankers had to clear minimum sales thresholds—for example, products sold per day, daily profit, packages sold per quarter, partner referrals, number of loans made per quarter, or performance on an internal customer service measure—which varied depending on current position.^{5 0} “In the first quarter of 2012, for example, a banker who achieved approximately nine qualifying daily sales [over the course of a quarter] could receive a \$250 quarterly payout; a banker who achieved approximately 11 qualifying daily sales could

receive a quarterly payout twice that amount, and a banker who achieved 13 qualifying daily sales could receive an \$800 quarterly payout.”^{5 1} District manager incentive compensation included bonuses that reached \$10,000 to \$20,000 (see **Exhibit 6** for information on the general incentive elements at Wells Fargo).^{5 2}

Sales were a large component of incentive compensation not only for employees at the branch level, but also for district and regional managers and higher executives. Incentive compensation was based on sales volume, a profit proxy metric, customer experience measures, and, beginning in 2010, sales quality.^{5 3} The main sales quality metric was the rolling funding rate—that is, the average percentage of customer accounts that were funded beyond their minimum balances, indicating customers were using the product. “District managers were required to achieve a Rolling Funding Rate of 85%, or risk having their incentive compensation reduced,” the board reported.^{5 4}