THE WELLS FARGO CROSS-SELLING SCANDAL

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JANUARY 8, 2019

INTRODUCTION

In recent years, more attention has been paid to corporate culture and "tone at the top," and the impact that these have on organizational outcomes. While corporate leaders and outside observers contend that culture is a critical contributor to employee engagement, motivation, and performance, the nature of this relationship and the mechanisms for instilling the desired values in employee conduct is not well understood.

For example, a survey by Deloitte finds that 94 percent of executives believe that workplace culture is important to business success, and 62 percent believe that "clearly defined and communicated core values and beliefs" are important.[1] Graham, Harvey, Popadak, and Rajgopal (2016) find evidence that governance practices and financial incentives can reinforce culture; however, they also find that incentives can work in opposition to culture, particularly when they "reward employees for achieving a metric without regard to the actions they took to achieve that metric." According to a participant in their study, "People invariably will do what you pay them to do even when you're saying something different."[2]

The tensions between corporate culture, financial incentives, and employee conduct is illustrated by the Wells Fargo cross-selling scandal.

WELLS FARGO CULTURE, VALUES, AND MANAGEMENT

Wells Fargo has long had a reputation for sound management. The company used its financial strength to purchase Wachovia during the height of the financial crisis—forming what is now the third-largest bank in the country by assets—and emerged from the ensuing recession largely unscathed, with operating and stock price performance among the top of its peer group (see Exhibit 1). *Fortune* magazine praised Wells Fargo for "a history of avoiding the rest of the industry's dumbest mistakes."[3] *American Banker* called Wells Fargo "the big bank least tarnished by the scandals and reputational crises."[4] In 2013, it named Chairman and CEO John Stumpf "Banker of the Year."[5] Carrie Tolstedt, who ran the company's vast retail banking division, was named the "Most Powerful Woman in Banking."[6] In 2015, Wells Fargo ranked 7th on *Barron's* list of "Most Respected Companies."[7]

Wells Fargo's success is built on a cultural and economic model that combines deep customer relations with an actively engaged sales culture. The company's operating philosophy includes the following elements:

Vision and values. Wells Fargo's vision is to "satisfy our customers' needs, and help them succeed financially." The company emphasizes that:

> *Our vision has nothing to do with transactions, pushing products, or getting bigger for the sake of bigness. It's about building lifelong relationships one customer at a time. ... We strive to be recognized by our stakeholders as setting the standard among the world's great companies for integrity and principled performance. This is more than just doing the right thing. We also have to do it in the right way.*[8]

The company takes these statements seriously. According to Stumpf, "[Our vision] is at the center of our culture, it's important to our success, and frankly, it's been probably the most significant contributor to our long-term performance."[9] … "If I have any one job here, it's keeper for the culture."[10]

Cross-selling. The more products that a customer has with Wells Fargo, the more information the bank has on that customer, allowing for better decisions about credit, products, and pricing. Customers with multiple products are also significantly more profitable (see Exhibit 2). According to Stumpf:

> *To succeed at it [cross-selling], you have to do a thousand things right. It requires long-term persistence, significant investment in systems and training, proper team member incentives and recognition, [and] taking the time to understand your customers' financial objectives.*[11]

Conservative, stable management. Stumpf's senior management team consisted of 11 direct reports with an average of 27 years of experience at Wells Fargo.[12] Decisions are made collectively. According to former CEO Richard Kovacevich, "No single person has ever run Wells Fargo and no single person probably ever will. It's a team game here."[13] Although the company maintains independent risk and oversight mechanisms, all senior leaders are responsible for ensuring that proper practices are embedded in their divisions:

> *The most important thing that we talk about inside the company right now is that the lever that we have to manage our reputation is to stick to our vision and values. If we are doing things for our customers that are the right things, then the company is going to be in very good shape. ... We always consider the reputational impact of the things that we do. There is no manager at Wells Fargo who is responsible for reputation risk. All of our business managers in all of our lines of business are responsible.*[14]

Wells Fargo has been listed among Gallup's "Great Places to Work" for multiple years, with employee engagement scores in the top quintile of U.S. companies.

CROSS-SELLING SCANDAL

In 2013, rumors circulated that Wells Fargo employees in Southern California were engaging in aggressive tactics to meet their daily cross-selling targets.[15] According to the *Los Angeles Times*, approximately 30 employees were fired for opening new accounts and issuing debit or credit cards without customer knowledge, in some cases by forging signatures. "We found a breakdown in a small number of our team members," a Wells Fargo spokesman stated. "Our team members do have goals. And sometimes they can be blinded by a goal."[16] According to another representative, "This is something we take very seriously. When we find lapses, we do something about it, including firing people."[17]

Some outside observers alleged that the bank's practice of setting daily sales targets put excessive pressure on employees. Branch managers were assigned quotas for the number and types of products sold. If the branch did not hit its targets, the shortfall was added to the next day's goals. Branch employees were provided financial incentive to meet cross-sell and customer-service targets, with personal bankers receiving bonuses up to 15 to 20 percent of their salary and tellers receiving up to 3 percent.

Tim Sloan, at the time chief financial officer of Wells Fargo, refuted criticism of the company's sales system: "I'm not aware of any overbearing sales culture."[18] Wells Fargo had multiple controls in place to prevent abuse. Employee handbooks explicitly stated that "splitting a customer deposit and opening multiple accounts for the purpose of increasing potential incentive compensation is considered a sales integrity violation."[19] The company maintained an ethics program to instruct bank employees on spotting and addressing conflicts of interest. It also maintained a whistleblower hotline to notify senior management of violations. Furthermore, the senior management incentive system had protections consistent with best practices for minimizing risk, including bonuses tied to instilling the company's vision and values in its culture, bonuses tied to risk management, prohibitions against hedging or pledging equity awards, hold-past retirement provisions for equity awards, and numerous triggers for clawbacks and recoupment of bonuses in cases where they were inappropriately earned (see Exhibit 3). Of note, cross-sales and products-per-household were not included as specific performance metrics in senior executive bonus calculations even though they were for branch-level employees.[20]

In the end, these protections were not sufficient to stem a problem that proved to be more systemic and intractable than senior management realized. In September 2016, Wells Fargo announced that it would pay $185 million to settle a lawsuit filed by regulators and the city and county of Los Angeles, admitting that employees had opened as many as 2 million accounts without customer authorization over a five-year period.[21] Although large, the fine was smaller than penalties paid by other financial institutions to settle crisis-era violations. Wells Fargo stock price fell 2 percent on the news (see Exhibit 4). Richard Cordray, director of the Consumer Financial Protection Bureau, criticized the bank for failing to

> *... monitor its program carefully, allowing thousands of employees to game the system and inflate their sales figures to meet their sales targets and claim higher bonuses under extreme pressure. Rather than put its customers first, Wells Fargo built and sustained a cross-selling program where the bank and many of its employees served themselves instead, violating the basic ethics of a banking institution including the key norm of trust.*[22]

A Wells Fargo spokesman responded that, "We never want products, including credit lines, to be opened without a customer's consent and understanding. In rare situations when a customer tells us they did not request a product they have, our practice is to close it and refund any associated fees."[23] In a release, the banks said that, "Wells Fargo is committed to putting our customers' interests first 100 percent of the time, and we regret and take responsibility for any instances where customers may have received a product that they did not request."[24]

The bank announced a number of actions and remedies, several of which had been put in place in preceding years. The company hired an independent consulting firm to review all account openings since 2011 to identify potentially unauthorized accounts. $2.6 million was refunded to customers for fees associated with those accounts. 5,300 employees were terminated over a five-year period.[25] Carrie Tolstedt, who led the retail banking division, retired. Wells Fargo eliminated product sales goals and reconfigured branch-level incentives to emphasize customer service rather than cross-sell metrics.[26] The company also developed new procedures for verifying account openings and introduced additional training and control mechanisms to prevent violations.[27]

Nevertheless, in subsequent weeks, senior management and the board of directors struggled to find a balance between recognizing the severity of the bank's infractions, admitting fault, and convincing the public that the problem was contained. They emphasized that the practice of opening unauthorized accounts was confined to a small number of employees: "99 percent of the people were getting it right, 1 percent of people in community banking were not. … It was people trying to meet minimum goals to hang on to their jobs."[28] They also asserted that these actions were not indicative of the broader culture:

> *I want to make very clear that we never directed nor wanted our team members to provide products and services to customers that they did not want. That is not good for our customers and that is not good for our business. It is against everything we stand for as a company.*[29]

> *If [employees] are not going to do the thing that we ask them to do—put customers first, honor our vision and values—I don't want them here. I really don't. ... The 1 percent that did it wrong, who we fired, terminated, in no way reflects our culture nor reflects the great work the other vast majority of the people do. That's a false narrative.*[30]

They also pointed out that the financial impact to the customer and the bank was extremely limited. Of the 2 million potentially unauthorized accounts, only 115,000 incurred fees; those fees totaled $2.6 million, or an average of $25 per account, which the bank had refunded. Affected customers did not react negatively:

> *We've had very, very low volumes of customer reaction since that happened. ... We sent 115,000 letters out to people saying that you may have a product that you didn't want and here is the refund of any fees that you incurred as a result of it. And we got very little feedback from that as well.*[31]

The practice also did not have a material impact on the company's overall cross-sell ratios, increasing the reported metric by a maximum of 0.02 products per household.[32] According to one executive, "The story line is worse than the economics at this point."[33]

Nevertheless, although the financial impact was trivial, the reputational damage proved to be enormous. When CEO John Stumpf appeared before the U.S. Senate, the narrative of the scandal changed significantly. Senators criticized the company for perpetuating fraud on its customers, putting excessive pressure on low-level employees, and failing to hold senior management responsible. In particular, they were sharply critical that the board of directors had not clawed back significant pay from John Stumpf or former retail banking head Carrie Tolstedt, who retired earlier in the summer with a pay package valued at $124.6 million.[34] Senator Elizabeth Warren of Massachusetts told Stumpf:

> *You know, here's what really gets me about this, Mr. Stumpf. If one of your tellers took a handful of $20 bills out of the cash drawer, they'd probably be looking at criminal charges for theft. They could end up in prison. But you squeezed your employees to the breaking point so they would cheat customers and you could drive up the value of your stock and put hundreds of millions of dollars in your own pocket. And when it all blew up, you kept your job, you kept your multimillion dollar bonuses, and you went on television to blame thousands of $12-an-hour employees who were just trying to meet cross-sell quotas that made you rich. This is about accountability. You should resign. You should give back the money that you took while this scam was going on, and you should be criminally investigated by both the Department of Justice and the Securities and Exchange Commission.*[35]

Following the hearings, the board of directors announced that it hired external counsel Shearman & Sterling to conduct an independent investigation of the matter. Stumpf was asked to forfeit $41 million and Tolstedt $19 million in outstanding, unvested equity awards. It was one of the largest clawbacks of CEO pay in history and the largest of a financial institution. The board stipulated that additional clawbacks might occur. Neither executive would receive a bonus for 2016, and Stumpf agreed to forgo a salary while the investigation was underway.[36]

Two weeks later, Stumpf resigned without explanation. He received no severance and reiterated a commitment not to sell shares during the investigation. The company announced that it would separate the chairman and CEO roles.[37] Tim Sloan, chief operating officer, became CEO. Lead independent director Stephen Sanger became nonexecutive chairman; and Elizabeth Duke, director and former Federal Reserve governor, filled a newly created position as vice chairman.

INDEPENDENT INVESTIGATION REPORT

In April 2017, the board of directors released the results of its independent investigation which sharply criticized the bank's leadership, sales culture, performance systems, and organizational structure as root causes of the cross-selling scandal (see Exhibit 5).

Performance and incentives. The report faulted the company's practice of publishing performance scorecards for creating "pressure on employees to sell unwanted or unneeded products to customers and, in some cases, to open unauthorized accounts."[38] Employees "feared being penalized" for failing to meet goals, even in situations where these goals were unreasonably high:

> *In many instances, community bank leadership recognized that their plans were unattainable. They were commonly referred to as 50/50 plans, meaning that there was an expectation that only half the regions would be able to meet them.*

The head of strategic planning for the community bank was quoted as saying that the goal-setting process is a "balancing act" and recognized that "low goals cause lower performance and high goals increase the percentage of cheating."

The report also blamed management for, "tolerating low quality accounts as a necessary by-product of a sales-driven organization." …

> *Management characterized these low quality accounts, including products later canceled or never used and products that the customer did not want or need, as "slippage" and believed a certain amount of slippage was the cost of doing business in any retail environment.*

The report faulted management for failing to identify "the relationship between the goals and bad behavior [even though] that relationship is clearly seen in the data. As sales goals became more difficult to achieve, the rate of misconduct rose." Of note, the report found that "employees who engaged in misconduct most frequently associated their behavior with sales pressure, rather than compensation incentives."

Organizational structure. In addition, the report asserted that "corporate control functions were constrained by [a] decentralized organizational structure" and described the corporate control functions as maintaining "a culture of substantial deference to the business units."

Group risk leaders "took the lead in assessing and addressing risk within their business units" and yet were "answerable principally to the heads of their businesses." For example, the community bank group risk officer reported directly to the head of the community bank and only on a dotted-line basis to the central chief risk officer. As a result,

> *Risk management … generally took place in the lines of business, with the business people and the group risk officers and their staffs as the "first line of defense."*

John Stumpf believed that this system "better managed risk by spreading decision-making and produced better business decisions because they were made closer to the customer."[39]

The board report also criticized control functions for not understanding the systemic nature of sales practice violations:

> *Certain of the control functions often adopted a narrow "transactional" approach to issues as they arose. They focused on the specific employee complaint or individual lawsuit that was before them, missing opportunities to put them together in a way that might have revealed sales practice problems to be more significant and systemic than was appreciated.*

The chief operational risk officer

> *did not view sales practices or compensation issues as within her mandate, but as the responsibility of the lines of businesses and other control functions (the law department, HR, audit and investigations). She viewed sales gaming as a known problem that was well-managed, contained and small.*

The legal department focused

> *principally on quantifiable monetary costs—damages, fines, penalties, restitution. Confident those costs would be relatively modest, the law department did not appreciate that sales integrity issues reflected a systemic breakdown.*

Human resources

> *had a great deal of information recorded in its systems, [but] it had not developed the means to consolidate information on sales practices issues and to report on them.*

The internal audit department

> *generally found that processes and controls designed to detect, investigate and remediate sales practice violations were effective at mitigating sales practices-related risks. … As a general matter, however, audit did not attempt to determine the root cause of unethical sales practices.*

The report concluded that

> *while the advisability of centralization was subject to considerable disagreement within Wells Fargo, events show that a strong centralized risk function is most suited to the effective management of risk.*

Leadership. Furthermore, the board report criticized CEO John Stumpf and community banking head Carrie Tolstedt for leadership failures.

According to the report, Stumpf did not appreciate the scope and scale of sales practices violations: "Stumpf's commitment to the sales culture … led him to minimize problems with it, even when plausibly brought to his attention." For example, he did not react negatively to learning that 1 percent of employees were terminated in 2013 for sales practices violations: "In his view, the fact that 1 percent of Wells Fargo employees were terminated meant that 99 percent of employees were doing their jobs correctly." Consistent with this, the report found that Stumpf "was not perceived within Wells Fargo as someone who wanted to hear bad news or deal with conflict."

The report acknowledged the contribution that Tolstedt made to the bank's financial performance:

> *She was credited with the community bank's strong financial results over the years, and was perceived as someone who ran a "tight ship" with everything "buttoned down." Community bank employee engagement and customer satisfaction surveys reinforced the positive view of her leadership and management. 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.*

At the same time, it was critical of her management style, describing her as "obsessed with control, especially of negative information about the community bank" and faulting her for maintaining "an 'inner circle' of staff that supported her, reinforced her views, and protected her." She "resisted and rejected the near-unanimous view of senior regional bank leaders that the sales goals were unreasonable and led to negative outcomes and improper behavior."

> *Tolstedt and certain of her inner circle were insular and defensive and did not like to be challenged or hear negative information. Even senior leaders within the Community Bank were frequently afraid of or discouraged from airing contrary views.*

Stumpf "was aware of Tolstedt's shortcomings as a leader but also viewed her as having significant strengths." … He "was accepting of Tolstedt's flaws in part because of her other strengths and her ability to drive results, including cross-sell."

Board of Directors. Finally, the report evaluated the process by which the board of directors oversaw sales-practice violations and concluded that "the board was regularly engaged on the issue; however, management reports did not accurately convey the scope of the problem." The report found that

> *Tolstedt effectively challenged and resisted scrutiny from both within and outside the community bank. She and her group risk officer not only failed to escalate issues outside the community bank, but also worked to impede such escalation. … Tolstedt never voluntarily escalated sales practice issues, and when called upon specifically to do so, she and the community bank provided reports that were generalized, incomplete, and viewed by many as misleading.*

Following the initial *Los Angeles Times* article highlighting potential violations, "sales practices" was included as a "noteworthy risk" in reports to the full board and the board's risk committee. Beginning in 2014 and continuing thereafter, the board received reports from the community bank, the corporate risk office, and corporate human resources that "sales practice issues were receiving scrutiny and attention and, by early 2015, that the risks associated with them had decreased."

Board members expressed the view that "they were misinformed" by a presentation made to the risk committee in May 2015 that underreported the number of employees terminated for sales-practice violations, that reports made by Tolstedt to the committee in October 2015 "minimized and understated" the problem, and that metrics in these reports suggested that potential abuses were "subsiding."

Following the lawsuit by the Los Angeles City Attorney, the board hired a third-party consultant to investigate sales practices and conduct an analysis of potential customer harm. The board did not learn the total number of employees terminated for violations until it was included in the settlement agreement in September 2016.

Wells Fargo response. With the release of the report, Wells Fargo announced a series of steps to centralize and strengthen control functions. The board also announced that it would claw back an additional $47.3 million in outstanding stock option awards from Tolstedt and an additional $28 million in previously vested equity awards from Stumpf.[40]

LONG-TERM OVERHANG

The board report and related actions did not put an end to shareholder and regulatory pressure. At the company's 2017 annual meeting, 9 of the company's 15 directors received less than 75 percent support and 4 received less than 60 percent, including board chairman Stephen Sanger (56 percent), head of the risk committee Enrique Hernandez (53 percent), head of the corporate responsibility committee Federico Peña (54 percent), and Cynthia Milligan who headed the credit committee (57 percent).[41] The bank subsequently announced the resignations of 6 directors, including Sanger, who was replaced by Elizabeth Duke as board chair.

Wells Fargo continued its efforts to reexamine all aspects of its business. In August 2017, the company increased its estimate of the number of potentially unauthorized consumer accounts to 3.5 million and issued an additional $2.8 million in refunds.[42] The bank also announced that it identified sales practice violations in both its auto and mortgage lending divisions. In February 2018, citing "widespread consumer abuses," the Federal Reserve Board took the unprecedented action of placing a strict limit on the company's asset size, forbidding the bank from growing past the $1.95 trillion in assets it had at year end until it demonstrated an improvement in corporate controls. According to Federal Reserve Board Chair Janet Yellen:

> *We cannot tolerate pervasive and persistent misconduct at any bank and the consumers harmed by Wells Fargo expect that robust and comprehensive reforms will be put in place to make certain that the abuses do not occur again. The enforcement action we are taking today will ensure that Wells Fargo will not expand until it is able to do so safely and with the protections needed to manage all of its risks and protect its customers.*[43]

In April 2018, the bank agreed to a $1 billion settlement with the Consumer Financial Protection Bureau and the Office of the Comptroller of the Currency to resolve auto and mortgage lending violations. Two weeks later it agreed to pay $480 million to settle a securities class action lawsuit over cross-selling. In December 2018, the company settled with 50 state attorneys general to resolve civil claims for cross-selling, auto lending, and mortgage lending violations and agreed to pay $575 million.

WHY THIS MATTERS

1. The Wells Fargo compensation system emphasized cross-selling as a performance metric for awarding incentive pay to employees. The company also published scorecards that ranked individual branches on sales metrics, including cross-selling. Was the company wrong to use cross-selling as a metric in its incentive systems? Would the program have worked better if structured differently? The independent report suggests that employee pressure was a greater contributor to misconduct than financial incentives. Is this assessment correct?
2. Branch-level employees were incentivized to increase products per household but the senior-executive bonus system did not include this metric. Did this disconnect contribute to a failure to recognize the problem earlier?
3. Wells Fargo prides itself on its vision and values and culture. By several measures, these have been highly beneficial to the company's performance. What factors should senior executives consider to ensure that compensation and performance systems encourage the achievement of company objectives without compromising culture?
4. The dollars involved in the Wells Fargo cross-selling scandal were small (less than $6 million in direct fees) but the reputational damage to the bank was massive. How can a company prepare against problems that do not seem to be "material" in a financial sense but ultimately have a material impact on the business and its reputation?
5. The independent investigation concludes that "a strong centralized risk function is most suited to the effective management of risk." Is this conclusion correct? What steps can executives in a decentralized organization take to minimize gaps in oversight without creating unnecessary bureaucracy?
6. The Wells Fargo cross-selling scandal highlights the challenge of a high-performing executive whose behavior ultimately does not align with company values. How much autonomy should high-performing executives be afforded? How can a company balance autonomy and accountability?
7. The independent investigation largely exonerates the Wells Fargo board of directors. How much blame does the board deserve? What could it have done differently to prevent the cross-selling issue from snowballing?
8. Wells Fargo had the elements in place of a properly functioning governance system, including risk management, audit, legal, and human resources. Furthermore, each of these groups was—at least to some degree—aware of sales practice violations in the consumer bank. And yet no one recognized the systemic nature of the problem or took the necessary steps to address it. How can a company gauge whether its governance system is *effective* in identifying and mitigating risk? ■

[1] Deloitte, "Core Beliefs and Culture: Chairman's Survey Findings," (2012).

[2] John R. Graham, Campbell R. Harvey, Jillian Popadak, and Shiva Rajgopal, "Corporate Culture: Evidence from the Field," *Social Science Research Network* (2016).

[3] Adam Lashinsky, "Riders on the Storm," *Fortune* (May 4, 2009).

[4] Maria Aspan, "Wells Fargo's John Stumpf, the 2013 Banker of the Year," *American Banker* (Nov. 21, 2013).

[5] Ibid.

[6] Tolstedt was named to the list continuously from 2003 to 2015 and named number 1 in 2010. See Sara Lepro, "Wells' Tolstedt at Top of Power List," *American Banker* (Sep. 27, 2010).

[7] Vito J. Racanelli, "Apple Tops Barron's List of Respected Companies," *Barron's* (Jun. 27, 2015).

[8] Wells Fargo's *Vision & Values* was written in booklet form in the early 1990s and is distributed to all employees. See Wells Fargo, "The Vision and Values of Wells Fargo," (Accessed Nov. 1, 2016).

[9] "Wells Fargo & Co. at Goldman Sachs U.S. Financial Services Conference," *CQ FD Disclosure* (Dec. 8, 2015).

[10] Maria Aspan, loc. cit.

[11] Wells Fargo, 2010 Annual Report.

[12] Wells Fargo, "Wells Fargo & Co. 2016 Investor Day," *CQ FD Disclosure* (May 24, 2016).

[13] Maria Aspan, loc. cit.

[14] Pat Callahan, Executive Vice President, "Wells Fargo & Company 2010 Investor Conference," *CQ FD Disclosure* (May 14, 2010).

[15] There is some evidence that employees were discussing sales pressure on social media sites, such as Glassdoor, as far back as 2010; however, the frequency is modest (less than 10 percent of employee reviews). Research by the author.

[16] E. Scott Reckard, "Wells Fargo Fires Workers Accused of Cheating on Sales Goals," *Los Angeles Times* (Oct. 3, 2013).

[17] E. Scott Reckard, "Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost," *Los Angeles Times* (Dec. 21, 2013).

[18] Ibid.

[19] Cited in Emily Glazer, "How Wells Fargo's High-Pressure Sales Culture Spiraled Out of Control," *The Wall Street Journal* (Sep. 16, 2016).

[20] Wells Fargo, Form DEF-14A (Mar. 16, 2016).

[21] The fine comprised of $100 million to the Consumer Financial Protection Bureau, $35 million to the Office of Comptroller of the Currency, and $50 million to the city and county of Los Angeles. In addition, the bank refunded customers for fees they incurred on these accounts. Accounts included deposit accounts, checking accounts, debit cards, and credit cards. The lawsuit was first filed in 2015. James Rufus Koren, "Wells Fargo to Pay $185 Million Settlement for 'Outrageous' Sales Culture," *Los Angeles Times* (Sep. 8, 2016).

[22] "Full Committee Hearing on 'An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response," *Federal News Service* (Sep. 20, 2016).

[23] Emily Glazer, "Wells Fargo to Pay $185 Million Fine Over Account Openings," *The Wall Street Journal* (Sep. 8, 2016).

[24] Wells Fargo press release, "Wells Fargo Issues Statement on Agreement Related to Sales Practices," *BusinessWire* (Sep. 8, 2016).

[25] This represented 1 percent per year of the approximately 100,000 Wells Fargo employees working in retail branches. 10 percent of the terminated employees were at the manager level or above. The review was subsequently expanded to include 2009 and 2010.

[26] Emily Glazer "Can This Woman Save Wells Fargo's Consumer Banking Business?" *The Wall Street Journal* (Oct. 19, 2016).

[27] Wells Fargo press release, (Sep. 8, 2016), loc. cit.

[28] CFO John Shrewsberry in "Wells Fargo's (WFC) Management Presents at Barclays Global Financial Services Conference (Transcript)," *Seeking Alpha* (Sep. 13, 2016).

[29] CEO John Stumpf in "Full Committee Hearing on 'An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response,'" *Federal News Service* (Sep. 20, 2016).

[30] CEO John Stumpf in Emily Glazer and Christina Rexrode, "Wells Boss Says Staff at Fault for Scams," *The Wall Street Journal* (Sep. 14, 2016).

[31] CFO John Shrewsberry in "Wells Fargo's (WFC) Management Presents at Barclays Global Financial Services Conference (Transcript)," loc. cit.

[32] According to CEO Timothy Sloan, "Let me clarify that these accounts had a *de minimis* impact to the retail banking household cross-sell ratio that we report on a quarterly basis, with the maximum impact in any one quarter of 0.02 products per household or 0.3% of the reported metric. At no time were all of the identified accounts included in our reported cross-sell ratio because unused deposit accounts rolled off." See "Wells Fargo & Company's (WFC) CEO Timothy Sloan on Q3 2016 Results—Earnings Call Transcript," *Seeking Alpha* (Oct. 14, 2016).

[33] CFO John Shrewsberry in Emily Glazer, "Wells Maps a Crisis Plan—Executives Say Bank's Situation Will Get Harder Before It Gets Better After Scandal," *The Wall Street Journal* (Oct. 12, 2016).

[34] Note that the majority of this compensation represented equity-awards accrued over her 27 year tenure with the company and were subject to the company's hold-past-retirement policy. See Exhibit 3 and Wells Fargo, Form 8-K (Jul. 12, 2016).

[35] "Full Committee Hearing on 'An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response,'" loc. cit.

[36] Wells Fargo press release, "Independent Directors of Wells Fargo Conducting Investigation of Retail Banking Sales Practices and Related Matters," *BusinessWire* (Sep. 28, 2016).

[37] For more information on the impact of separating the chairman and CEO roles see: David F. Larcker and Brian Tayan, "Chairman and CEO: The Controversy Over Board Leadership Structure," Stanford Closer Look Series (Jun. 24, 2016); and David F. Larcker and Brian Tayan, "Independent Chairman," Stanford Quick Guide Series: Research Spotlight (Nov. 2015).

[38] Unless otherwise specified, quotations in this section are derived from: "Independent Director of the Board of Wells Fargo & Company: Sales Practices Investigation Report," (April 10, 2017), available at: https://www.wellsfargo.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf. Edited lightly for clarity or grammar.

[39] Senior executives separately have noted that decentralization is an important element of the company's credit culture and has allowed the company to record lower credit losses over multiple economic cycles because small dollar loans are made faster and closer to the customer. Interview with the author May 2, 2018.

[40] Wells Fargo press release, "Wells Fargo Board Releases Findings of Independent Investigation of Retail Banking Sales Practices and Related Matters," *BusinessWire* (Apr. 10, 2017).

[41] Average support in an uncontested director election is 94 percent. According to Institutional Shareholder Services, over the 10 year period 2007-2016, approximately 22 directors per year among all S&P 500 companies received less than 60 percent support, on average. See Emily Glazer, "Wells Fargo Directors Face Shareholders' Ire," *The Wall Street Journal* (April 26, 2017); and Wells Fargo press release, "Wells Fargo Announces Preliminary Voting Results of 2017 Annual Meeting," *BusinessWire* (April 25, 2017).

[42] The additional accounts resulted from an increase in the scope of the years covered, from January 2009 to September 2016. The bank noted that its estimate was conservative and likely included properly authorized accounts: "The analysis was data-driven and looked at account usage patterns. Since usage patterns of some authorized accounts opened with a customer's consent can be similar to some unauthorized accounts, it is likely that some properly authorized accounts were included in the population identified as unauthorized accounts." Wells Fargo press release, "Wells Fargo Reports Completion of Expanded Third-Party Review of Retail Banking Accounts, Paving Way to Complete Remediation Effort," *BusinessWire* (August 31, 2017).

[43] Federal Reserve press release, "Responding to widespread consumer abuses and compliance breakdowns by Wells Fargo, Federal Reserve restricts Wells' growth until firm improves governance and controls. Concurrent with Fed action, Wells to replace three directors by April, one by year end," (February 2, 2018).

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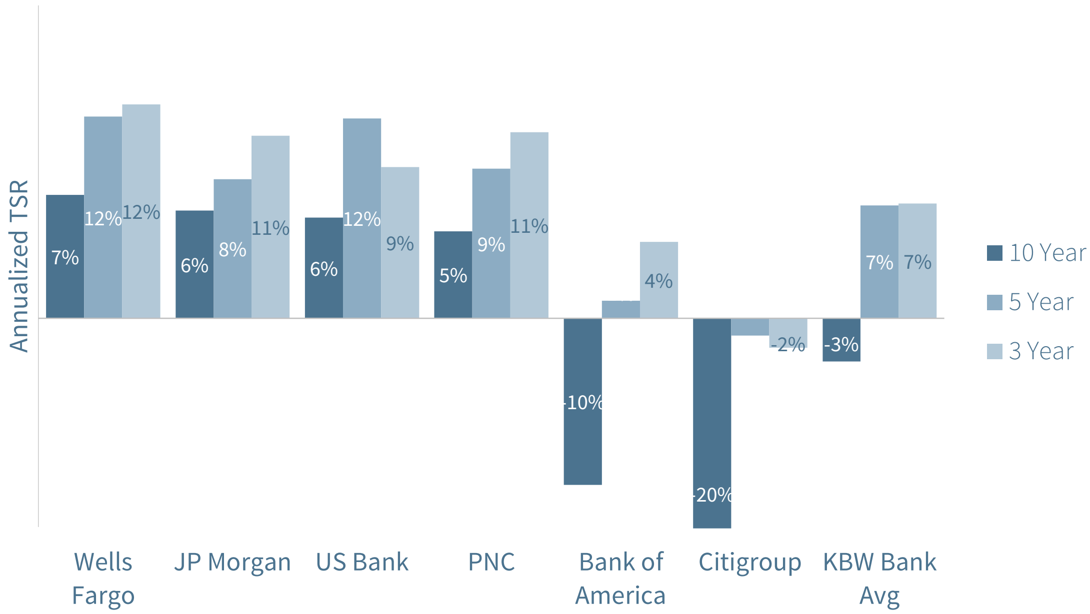
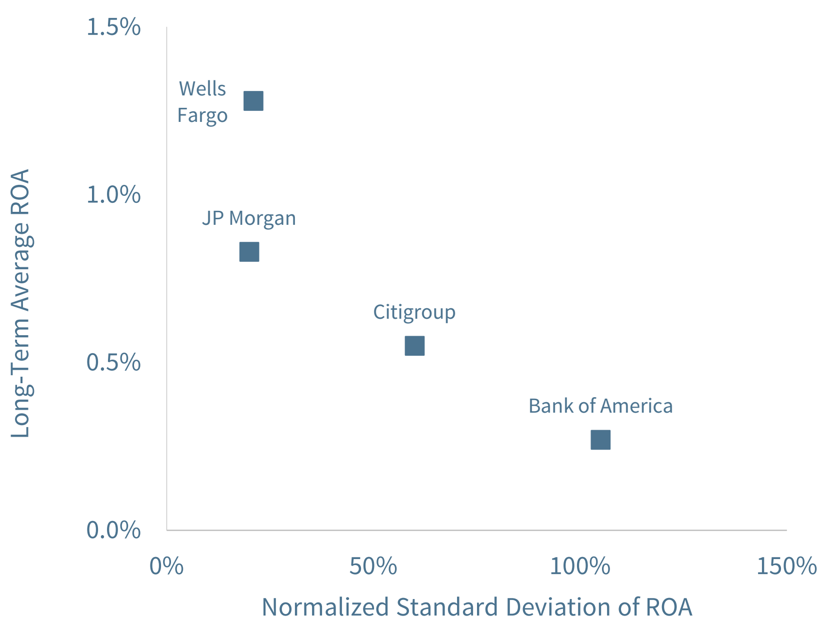
EXHIBIT 1 — WELLS FARGO: SELECTED PERFORMANCE METRICS

TOTAL SHAREHOLDER RETURN



As of March 21, 2016, rounded to the nearest percentage.

RELATION BETWEEN RETURNS AND VOLATILITY

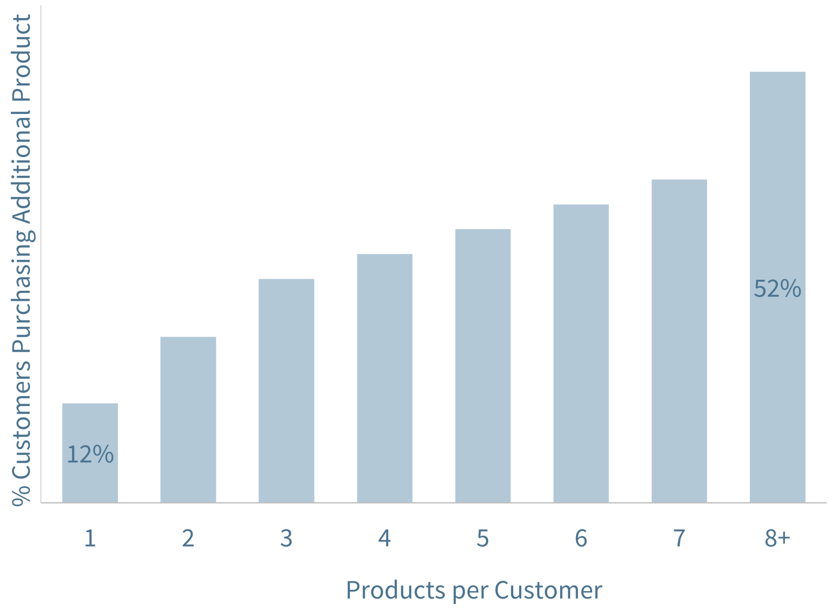


Based on quarterly results, Q1 2009 through Q4 2015.

Sources: Wells Fargo, Investor Day (May. 24, 2016); Wells Fargo, Credit Suisse Financial Services Forum (Feb. 9, 2016).

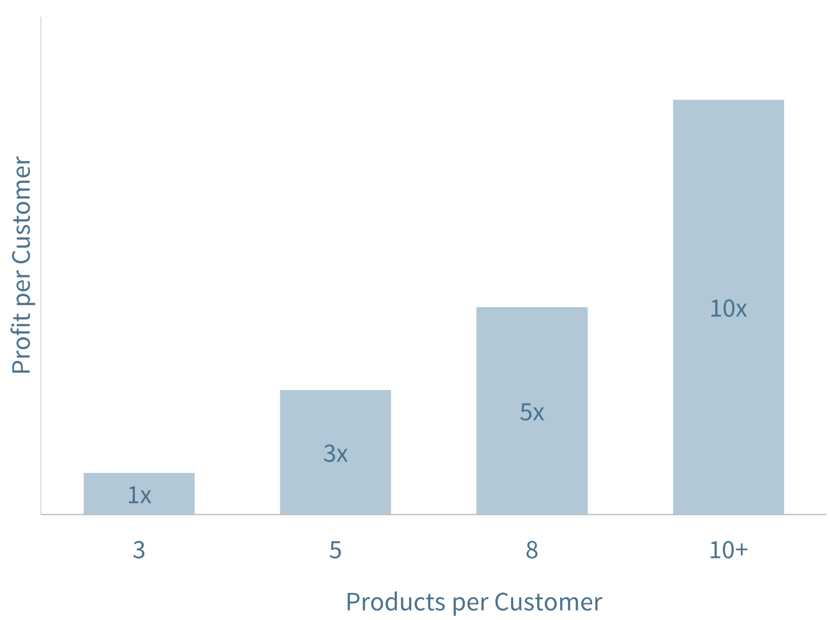
EXHIBIT 2 — WELLS FARGO: CROSS-SELLING METRICS

RELATION BETWEEN NUMBER OF PRODUCTS PER CUSTOMER AND FUTURE PURCHASES



Note: Shows the relationship between the number of products that a retail banking customer holds with Wells Fargo and the percentage of those customers who make an additional product purchase from Wells Fargo in the subsequent year.

RETAIL BANKING PROFIT PER CUSTOMER



Source: Wells Fargo, Investor Day (May 20, 2014).

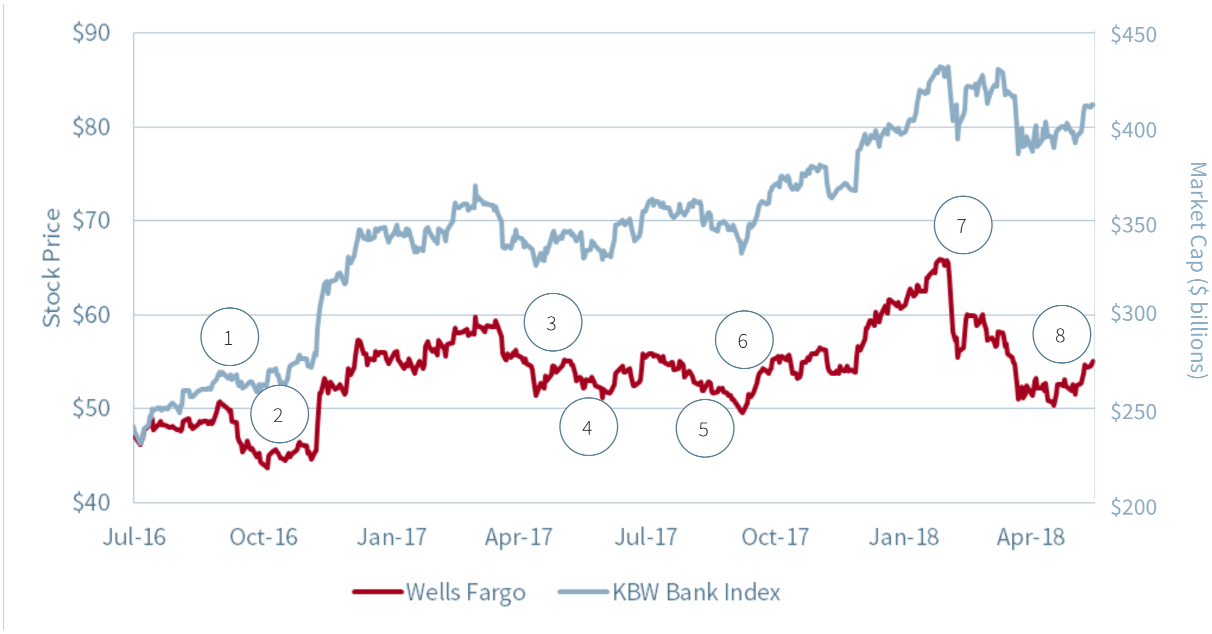
EXHIBIT 3 — WELLS FARGO: SELECTED EXECUTIVE COMPENSATION PROVISIONS

Policy / Provision	Requirement / Trigger
Executive Officer Stock Ownership Policy	Until one year following retirement, our executive officers must hold shares equal to at least 50% of the after-tax profit shares (assuming a 50% tax rate) acquired upon the exercise of options or vesting of RSRs [Restricted Share Rights] and Performance Shares, subject to a maximum requirement of ten times the executive officer's cash salary.
Unearned Compensation Recoupment	Misconduct by an executive that contributes to the Company having to restate all or a significant portion of its financial statements.
Extended Clawback Policy	Incentive compensation was based on materially inaccurate financial information, whether or not the executive was responsible.
Performance-Based Vesting Conditions	Misconduct which has or might reasonably be expected to have reputational or other harm to the Company or any conduct that constitutes "cause." Misconduct or commission of a material error that causes or might be reasonably expected to cause significant financial or reputational harm to the Company or the executive's business group. Improper or grossly negligent failure, including in a supervisory capacity, to identify, escalate, monitor or manage in a timely manner and as reasonably expected, risks material to the Company or the executive's business group. The Company or the executive's business group suffers a material downturn in financial performance or suffers a material failure of risk management.

Note: Edited slightly for length.

Source: Wells Fargo, Form DEF-14A (Mar. 16, 2016).

EXHIBIT 4 — WELLS FARGO: STOCK PRICE AND MARKET CAPITALIZATION



1. Wells Fargo announces $185 million settlement with CFPB and OCC.
2. Stumpf resigns as CEO; replaced by Sloan.
3. Wells Fargo board of directors releases report of independent investigation.
4. Wells Fargo annual meeting; 9 directors reelected with less than 75 percent support.
5. Wells Fargo discloses auto loan insurance violations; mortgage product violations.
6. Wells Fargo increases the number of potentially unauthorized consumer accounts to 3.5 million.
7. Federal Reserve imposes asset cap on Wells Fargo; the bank enters into a consent order.
8. Wells Fargo announces $1 billion settlement with CFPB and OCC.

Note: Prices of the KBW Bank Index re-indexed to coincide with Wells Fargo stock price as of September 1, 2016.

Source: Yahoo! Finance.

EXHIBIT 5 — INDEPENDENT INVESTIGATION REPORT: EXECUTIVE SUMMARY (EXCERPTS)

When the Independent Directors of the Board authorized this investigation, the purpose was to examine the root causes of sales practice abuses and to assess how issues of corporate structure and culture as well as individual actions contributed to the injuries inflicted upon Wells Fargo's customers and the extraordinary damage to Wells Fargo's brand and reputation, not merely to determine compensation or disciplinary action. The Board did so in the spirit of lessons to be learned, to promote accountability, to strengthen the organization and to minimize the likelihood of future occurrences. This section of the Report summarizes the factual findings of the investigation, which are developed in greater detail in the subsequent sections. …

THE COMMUNITY BANK

Wells Fargo, with its successful Community Bank, had a long history of strong performance as a self-identified sales organization with a decentralized corporate structure guided by its Vision & Values statement. While there is nothing necessarily pernicious about sales goals, a sales-oriented culture or a decentralized corporate structure, these same cultural and structural characteristics unfortunately coalesced and failed dramatically here. There was a growing conflict over time in the Community Bank between Wells Fargo's Vision & Values and the Community Bank's emphasis on sales goals. Aided by a culture of strong deference to management of the lines of business (embodied in the oft-repeated "run it like you own it" mantra), the Community Bank's senior leaders distorted the sales model and performance
management system, fostering an atmosphere that prompted low quality sales and improper and unethical behavior.

Senior management in the Community Bank had a deep-seated adherence to its sales model. The model generally called for significant annual growth in the number of products, such as checking accounts, savings accounts and credit cards, sold each year. Even when challenged by their regional leaders, the senior leadership of the Community Bank failed to appreciate or accept that their sales goals were too high and becoming increasingly untenable.

Over time, even as senior regional leaders challenged and criticized the increasingly unrealistic sales goals — arguing that they generated sales of products that customers neither needed nor used — the Community Bank's senior management tolerated low quality accounts as a necessary by-product of a sales-driven organization. In particular, the Community Bank's senior leaders were concerned that tightening up too much on quality would risk lowering sales of products that customers actively used; and, more generally, the senior leaders were reluctant to take steps that they believed might have a negative impact on the Community Bank's financial performance. They also failed to adequately consider that low quality accounts could be indicative of unauthorized accounts. …

To assist the investigation, Shearman & Sterling retained FTI Consulting. The firm analyzed various metrics to assist in determining the impact of the Community Bank's sales culture. First, it examined Wells Fargo's investigations data for allegations of sales integrity violations and associated terminations and resignations. And second, it analyzed information relating to the rate at which the Community Bank's customers were funding — that is, making initial deposits into — new checking and savings accounts. While there can be many reasons a customer might not fund an account, lower funding rates (the proportion of new accounts with more than de minimis deposits) suggest that some customers were sold accounts that they may not have wanted or needed.

Trends in the data show, perhaps not surprisingly, that as sales goals became harder to achieve, the number of allegations and terminations increased and the quality of accounts declined. Thus, the number of sales integrity-related allegations and associated terminations and resignations increased relatively steadily from the second quarter of 2007 and both peaked in the fourth quarter of 2013, when a newspaper article brought to light improper sales practices in Los Angeles. After the Community Bank and the corporate control functions started to focus more resources and attention on the problem and the growth of sales goals moderated somewhat starting in 2013, the number of sales integrity-related allegations and associated terminations and resignations steadily fell.

EXHIBIT 5 — CONTINUED

This was mirrored by the funding rate. It dropped steadily, from approximately 90% in 2005 to below 80% in 2012; it then rose somewhat in 2013, continued climbing thereafter, and exceeded 95% by 2016, paralleling Wells Fargo's increasing focus on sales practices after 2013.

As reflected in the reduction in plan sales goals for 2013, while the Community Bank did take steps over time to address issues associated with sales practice violations and aggressive sales goals, those steps were incremental, implemented slowly and insufficient to address the root cause of the problem. There was a disinclination among the Community Bank's senior leadership, regardless of the scope of improper behavior or the number of terminated employees, to see the problem as systemic. It was common to blame employees who violated Wells Fargo's rules without analyzing what caused or motivated them to do so. …

In addition, keeping the sales model intact and sales growing meant that the Community Bank's performance management system had to exert significant, and in some cases extreme, pressure on employees to meet or exceed their goals. Many employees felt that failing to meet sales goals could (and sometimes did) result in termination or career-hindering criticism by their supervisors. Employees who engaged in misconduct most frequently associated their behavior with sales pressure, rather than compensation incentives, although the latter contributed to problematic behavior by over-weighting sales as against customer service or other factors. Conversely, employees saw that the individuals most likely to be praised, rewarded and held out as models for success were high sales performers. …

The Community Bank identified itself as a sales organization, like department or retail stores, rather than a service-oriented financial institution. This provided justification for a relentless focus on sales, abbreviated training and high employee turnover.

Wells Fargo's decentralized organizational structure and the deference paid to the lines of business contributed to the persistence of this environment. Carrie Tolstedt and certain of her inner circle were insular and defensive and did not like to be challenged or hear negative information. Even senior leaders within the Community Bank were frequently afraid of or discouraged from airing contrary views. Tolstedt effectively challenged and resisted scrutiny both from within and outside the Community Bank. She and her group risk officer not only failed to escalate issues outside the Community Bank, but also worked to impede such escalation, including by keeping from the Board information regarding the number of employees terminated for sales practice violations. Although they likely did so to give themselves freedom to address these issues on their own terms, rather than to encourage improper behavior, the dire consequences and cost to Wells Fargo are the same. …

SENIOR MANAGEMENT

John Stumpf

… After decades of success, Stumpf was Wells Fargo's principal proponent and champion of the decentralized business model and of cross-sell and the sales culture. His commitment to them colored his response when sales practice issues became more prominent in 2013 and subsequent years and led him to stand back and rely on the Community Bank to fix the problem, even in the face of growing indications that the situation was worsening and threatened substantial reputational harm to Wells Fargo. Because it was the responsibility of Community Bank leadership to run the business "like they owned it," Stumpf did not engage in investigation and critical analysis to fully understand the problem. And, as discussed below, the corporate control functions that reported to him and upon which he relied were similarly constrained by Wells Fargo's decentralized model.

Stumpf's commitment to the sales culture also led him to minimize problems with it, even when plausibly brought to his attention. Stumpf was by nature an optimistic executive who refused to believe that the sales model was seriously impaired. His reaction invariably was that a few bad employees were causing issues, but that the overwhelming majority of employees were behaving properly. He was too late and too slow to call for inspection of or critical challenge to the basic business model.

EXHIBIT 5 — CONTINUED

Stumpf's long-standing working relationship with Tolstedt influenced his judgment as well. Tolstedt reported to Stumpf until late 2015 and he admired her as a banker and for the contributions she made to the Community Bank over many years. At the same time, he was aware that many doubted that she remained the right person to lead the Community Bank in the face of sales practice revelations, including the Board's lead independent director and the head of its Risk Committee. Stumpf nonetheless moved too slowly to address the management issue. …

CORPORATE CONTROL ORGANIZATIONS

Sections of the Report below describe how Wells Fargo control functions, specifically Corporate Risk, the Law Department, Human Resources, Internal Investigations and Audit, dealt with sales practice issues in the Community Bank. Several common themes — again, substantially related to Wells Fargo's culture and structure — hampered the ability of these organizations to effectively analyze, size and escalate sales practice issues.

First, Wells Fargo's decentralized organizational structure meant that centralized functions had parallel units in the Community Bank, which impeded corporate-level insight into and influence over the Community Bank. Historically, the risk function at Wells Fargo was highly decentralized. The line of business risk managers were answerable principally to the heads of their businesses and yet took the lead in assessing and addressing risk within their business units. The Risk Committee of the Board, consisting of the chairs of all the Board's standing committees, was created in 2011 to oversee risk across the enterprise. This involved a multi-year plan starting in 2013 to substantially grow Corporate Risk, to move toward centralization of more risk functions and to enhance Corporate Risk's ability to oversee the management of risk in the lines of business. Consistent with this plan, the Board supported major funding increases for Corporate Risk for 2014-2016. But, as problems with sales practices in the Community Bank became more apparent in 2013-2015, Corporate Risk was still a work in progress and the Chief Risk Officer had limited authority with respect to the Community Bank. As events were unfolding, his visibility into risk issues at the Community Bank was hampered by his dependence on its group risk officer and he was essentially confined to attempting to cajole and persuade Tolstedt and the Community Bank to be more responsive to sales practice-related risks.

Similarly, the decentralized structure of Human Resources contributed to a lack of visibility into the scope and nature of sales practice problems. Almost all sales integrity cases and issues touched upon some facet of the HR function, including with respect to employee terminations, hiring, training, coaching, discipline, incentive compensation, performance management, turnover, morale, work environment, claims and litigations. Despite this, there was no coordinated effort by HR, either within the Community Bank or in Corporate HR, to track, analyze or report on sales practice issues.

The fragmentation and decentralization of control functions needs to be and is being addressed. …

Second, and relatedly, the culture of substantial deference accorded to the lines of business carried over into the control functions. Even when senior executives came to recognize that sales practice issues within the Community Bank were a serious problem or were not being addressed timely and sufficiently, they relied on Tolstedt and her senior managers to carry out corrective actions. This culture of deference was particularly powerful in this instance since Tolstedt was respected for her historical success at the Community Bank, was perceived to have strong support from the CEO and was notoriously resistant to outside intervention and oversight.

Third, certain of the control functions often adopted a narrow "transactional" approach to issues as they arose. They focused on the specific employee complaint or individual lawsuit that was before them, missing opportunities to put them together in a way that might have revealed sales practice problems to be more significant and systemic than was appreciated. As an example, while HR had a great deal of information recorded in its systems, it had not developed the means to consolidate information on sales practice issues and to report on them.

EXHIBIT 5 — CONTINUED

Similarly, attorneys in the Law Department's Employment Section had visibility into the scope and causes of sales practice misconduct and in fact made commendable attempts to address it through, among other things, work on various committees. However, the Law Department, particularly at its senior levels, did not discuss or appreciate the seriousness and scale of sales practice issues within the Community Bank or fully consider whether there might be a pattern of illegal conduct involved. Rather, the Department's focus was on advising on discrete legal problems as they arose and on managing Wells Fargo's exposure to specific litigation risks.

The same holds true for Audit. Audit reviewed relevant controls and processes and largely found them to be effective; however, while it had access to information regarding sales practice concerns, it did not view its role to include analyzing more broadly the root cause of improper conduct.

Finally, until as late as 2015, even as sales practices were labeled a "high risk" in materials provided to the Risk Committee of the Board, there was a general perception within Wells Fargo's control functions that sales practice abuses were a problem of relatively modest significance, the equivalent of a tolerable number of minor infractions or victimless crimes. This under reaction to sales practice issues resulted in part from the incorrect belief, extending well into 2015, that improper practices did not cause any "customer harm"; and "customer harm" itself was narrowly construed to mean only financial harm such as fees and penalties. This flawed perspective made it easy to undervalue the risk to Wells Fargo's brand and reputation arising from the misuse of customer information and the breaches of trust occasioned by
improper sales practices. …

Source: Independent Director of the Board of Wells Fargo & Company: Sales Practices Investigation Report, (April 10, 2017).