Operational Risk failure at Wells Fargo

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Wells Fargo, a leading US bank is currently facing a crisis to operational risk failure. This write up is based on articles which have recently appeared in The Economist and the Los Angeles Times.

Wells was one of the few banks to emerge healthy from the global financial crisis of 2007-08. The bank expanded its presence across USA from its base on the west coast after buying Wachovia, once the country's fourth-largest bank, in 2008. Thanks to the acquisition, Wells doubled its branch count. At the same time, Wells took a wise decision not to go ahead with the acquisition of Countrywide, the large mortgage underwriter. Bank of America made that acquisition and ran into serious trouble thereafter.

Wells' philosophy was cross-selling, i.e. persuading customers to buy more products and services. In the second quarter of 2016, households with current (checking) accounts at Wells had on an average 6.27 products. The bank developed a great reputation for incentivising its employees to push the different products in its portfolio.

Ironically enough, those incentives now seem to have backfired. It seems that for about five years, starting in 2011, up to 1.5m deposit accounts and 565,000 credit-card accounts may have been opened without the permission of clients. It also looks as though some unwanted debit cards were issued and fake e-mail addresses were created to enroll people for online banking.

Tough daily sales goals created a pressure cooker culture in the bank. A former employee was quoted in the Los Angeles Times: "At the end of the day, the manager had to report how many accounts he had. And I think he really got yelled at if he didn't have the numbers. So then he, in turn, would turn around and scream at us." The employee who had earlier worked at Chase added: "At Chase, they were more interested in getting money from people — getting deposits. With Wells Fargo, they just cared about how many accounts you opened. That's where it started with all those employees doing fraudulent activities."

It appears Wells bankers would get credit for opening a savings account once a minimum deposit of $25 was made, even if that money came from another Wells account and even if the account was not used afterwards. The Consumer Financial Protection Bureau (This is a relatively new federal agency with a mission to protect average Americans from abuses by banks and other firms.) investigation has revealed that Wells workers would routinely transfer money from customers' legitimate accounts into unauthorized ones to obtain credit under the incentive-compensation program.

At $185m, the initial fine announced by regulators on September 8th is small. But the damage to Wells' reputation is more significant. Federal prosecutors have reportedly begun investigations. CEO John Stumpf has appeared before the Senate Banking Committee where he has faced intense grilling by American politicians, for whom it is a great opportunity to score points just before the US elections. Some local and state governments on the west coast are also trying to dig deeper into what happened. At the same time, some of these governments have also indicated that they may stop doing business with Wells till the matter is sorted out. One government official was quoted in the Los Angeles Times: "The intent is to begin to look at ways to hold banks accountable to ensure customers are protected from predatory practices. Obviously the city can't regulate the banks, but the city can use its power, through contracts, to really put in protections for consumers."