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## SENATE COMMITTEE ON BANKING AND FINANCIAL INSTITUTIONS

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## WELLS FARGO'S SALES PRACTICES AND CORPORATE ACCOUNTABILITY

### BACKGROUND PAPER

MAY 17, 2017

JOINT INFORMATIONAL HEARING OF THE

SENATE BANKING AND FINANCIAL INSTITUTIONS  
COMMITTEE  
Bill Dodd, Chair

and the

ASSEMBLY BANKING AND FINANCE COMMITTEE  
Matt Dababneh, Chair

## INTRODUCTION

On September 8, 2016, the Consumer Financial Protection Bureau (CFPB), Office of the Comptroller of the Currency (OCC), and Office of Los Angeles City Attorney Mike Feuer announced they had entered into separate regulatory settlements with Wells Fargo Bank, N.A., in connection with Wells Fargo's illegal practice of opening deposit and credit card accounts that has not been requested or authorized by their accountholders.

The September, 2016 regulatory settlements and the public announcement that accompanied them caused several subsequent actions to be taken by Wells Fargo and its Board of Directors. This background paper focuses on the outcome of one of these actions: a decision by Wells Fargo's Board of Directors to hire an independent third party to undertake a detailed review of the origin and evolution of the improper sales practices; investigate when, how, and by whom the wrongdoing was brought to the attention of members of the Board of Directors; and develop recommendations for use by the Board going forward.<sup>1</sup>

The Sales Practices Investigation Report prepared by the law firm of Shearman & Sterling at the request of the Independent Directors of Wells Fargo's Board represents the first publicly available, detailed review of the problems that were first brought to light in a *Los Angeles Times* story in December, 2013 and which remained largely hidden from public view until September, 2016. Because of the wealth of information contained in that report, the importance of fully understanding how the problems arose and were allowed to continue for such a long time, and the need to learn whether the Bank and its Board of Directors have taken sufficient steps to prevent any future problems of this type or severity, the California State Senate Banking and Financial Institutions Committee and California State Assembly Banking and Finance Committee will convene an oversight hearing on May 17th, 2017 to examine the report's findings and conclusions. This May, 2017 hearing is a follow-up to hearings the committees held in October and November, 2016, shortly after news of the sales practices scandal broke.

During the May, 2017 hearing, corporate governance experts will be asked to answer four questions for Committee members:

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<sup>1</sup> On September 27, 2016, the Independent Directors of Wells Fargo created a four-person Oversight Committee to take all actions deemed appropriate and necessary to examine the issues relating to improper sales practices and to make findings and recommendations to the Independent Directors. The Independent Directors are those members of the Board who are neither employees nor executive officers of Wells Fargo Bank; in practice, fourteen of the fifteen members of Wells Fargo's Board are "independent;" they include every director except for Tim Sloan, the Bank's President. The four members of the Oversight Committee include the Chair and Vice-Chair of the Board (Stephen Sanger and Elizabeth Duke); Enrique Hernandez, Jr., Chair of the Board's Risk Committee and Finance Committee; and Donald James, member of the Board's Finance and Human Resources Committees. To assist the Oversight Committee, the Independent Directors retained Shearman & Sterling, a law firm the Board determined to be independent of Wells Fargo, to conduct an in-depth investigation into the improper sales practices, and to prepare a report documenting its findings. The 110-page report (<https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf>) was released to the public on April 10, 2017.

- 1) What key information did you learn from reading the Sales Practices Investigation Report?
- 2) What questions, if any, do you have for Wells Fargo Bank or Wells Fargo's Board of Directors after having read the report?
- 3) Do you believe that the actions Wells Fargo and Wells Fargo's Board of Directors have taken to address the root causes of the scandal and mitigate future inappropriate acts by employees and management of Wells Fargo will protect the bank and its customers going forward?
- 4) Are there any additional actions you would recommend be taken by Wells Fargo or the Wells Fargo Board of Directors in light of the findings of the report?

The remainder of this background paper is intended to provide interested parties with a summary of the key findings contained in the report and key questions identified by Committee staff based on a review of that report.

### **WHAT THE REPORT INCLUDES AND WHAT IT LACKS**

The Sales Practices Investigation Report documents Shearman & Sterling's findings and conclusions, details the facts and circumstances that form the basis for those findings and conclusions, and documents some of the remedial steps undertaken by the Bank and the Board of Directors to address them. The report does not contain any recommendations. When asked why recommendations were excluded, representatives of Shearman & Sterling explained that they provided recommendations to Board members during regular reports the law firm made to the Oversight Committee and the entire Board while its investigation was ongoing.<sup>2</sup> In lieu of recommendations, the report documents steps taken by the Board to respond to Shearman & Sterling's findings.

### **THE ROOT CAUSES OF THE PROBLEM**

In its report, Shearman & Sterling identify four root causes of the sales practices misconduct: an overaggressive approach to sales; significant decentralization of the Bank's control functions coupled with a "run it like you own it" approach to managing the Bank's divisions; a disinclination among the Bank's management to see the sales practice problem as systemic; and inappropriate actions by a select number of high-level employees of the Bank.

**ROOT CAUSE NUMBER 1: OVERAGGRESSIVE APPROACH TO SALES:** "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."<sup>3</sup> "The Community Bank's senior management tolerated low quality accounts as a necessary by-product of a sales-driven

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<sup>2</sup> Page 2 of the Sales Practices Investigation Report. Unless otherwise noted, all page numbers cited in footnotes refer to that report.

<sup>3</sup> Page 7.

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."<sup>4</sup>

"Many employees felt that failing to meet sales goals could (and sometimes did) result in terminations 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."<sup>5</sup> "Employees only infrequently referenced incentive compensation as a motivating factor in their misconduct...it is consistent with other evidence indicating that sales pressure and goals, rather than incentive compensation directly, were the primary motivators of improper practices."<sup>6</sup>

Shearman & Sterling's Finding: "As this investigation confirmed, the only way to definitively address the broken sales model and the root cause of sales practice abuses was to emphasize other metrics for performance and to abandon exerting pressure through sales goals and sales-driven incentive programs."<sup>7</sup>

Wells Fargo's decision to eliminate product sales goals within its Community Bank, effective October 1, 2016, has been widely reported. According to representatives of Shearman & Sterling, this decision applied to both incentive compensation and employee performance ratings. Thus, effective October 1, 2016, a Community Bank employee's sales numbers are not considered for purposes of calculating that employee's incentive compensation payments, nor in connection with promotions or terminations.

#### **Questions For Wells Fargo and its Board of Directors:**

- During the Fourth Quarter of 2016, Wells Fargo implemented a new incentive compensation plan for Community Bank retail branch employees, in which incentives are focused on customer experience, with metrics designed to emphasize customer service, retention and long-term relationship building.<sup>8</sup> What assurances do we have that the new performance metrics will be any less likely to incentivize inappropriate behavior than the old ones? If "customer experience" is the new metric, what steps has the Bank taken to ensure that employees won't devise ways to game that metric?
- What steps will Bank management and the Board of Directors take to vet any future changes to incentive compensation and employee performance metrics?

**ROOT CAUSE NUMBER TWO: DECENTRALIZATION OF THE BANK'S CONTROL FUNCTIONS<sup>9</sup> COUPLED WITH A "RUN IT LIKE YOU OWN IT" APPROACH TO RUNNING ITS DIVISIONS:** "It was the responsibility of Community Bank leadership to run

<sup>4</sup> Page 5.

<sup>5</sup> Page 7.

<sup>6</sup> Page 38.

<sup>7</sup> Page 8.

<sup>8</sup> Pages 51 and 52.

<sup>9</sup> In its report, Shearman & Sterling identify four key control functions, including Corporate Risk, the Law Department, Human Resources, and Internal Investigations and Audit. See p. 11.

the business 'like they owned it.'"<sup>10</sup> "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."<sup>11</sup> "Similarly, the decentralized structure of Human Resources contributed to a lack of visibility into the scope and nature of sales practice problems...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."<sup>12</sup>

Shearman & Sterling's Findings: "Wells Fargo should have moved toward the centralization of the risk function earlier than it did."<sup>13</sup> "The fragmentation and decentralization of control functions needs to be and is being addressed."<sup>14</sup>

- "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...In 2016, Corporate Risk realigned 4,100 risk employees from the business units to the central risk organization, with an additional 1,100 to be realigned in 2017."<sup>15</sup>
- "Similarly, the decentralized structure of Human Resources contributed to a lack of visibility into the scope and nature of sales practice problems...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."<sup>16</sup> "In 2016, Wells Fargo realigned and centralized various HR groups, including compensation and employee relations, so that they now report to Corporate HR rather than to the lines of business. As a result, the head of HR in the Community Bank now reports to Corporate HR rather than to the head of the Community Bank."<sup>17</sup>

Shearman & Sterling's Finding: "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."<sup>18</sup>

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<sup>10</sup> Page 10.

<sup>11</sup> Page 11.

<sup>12</sup> Page 12.

<sup>13</sup> Page 16.

<sup>14</sup> Page 12.

<sup>15</sup> Page 12.

<sup>16</sup> Ibid.

<sup>17</sup> Pages 12 and 13.

<sup>18</sup> Pages 13 and 47.

### **Questions For Wells Fargo and its Board of Directors:**

- Wells Fargo Bank and Wells Fargo's Board of Directors have taken a number of steps, detailed immediately above, to centralize control functions within the bank and minimize the extent to which each of Wells Fargo's separate divisions can supervise itself. It is less clear what steps the Bank has taken to mitigate the "run it like you own it" culture of substantial deference it has historically given each of its division heads. Is there any reason to believe that division heads are now unable to exercise the same level of independence that Carrie Tolstedt did when she repeatedly minimized problems within the Community Bank in communications with others, including the Board of Directors?

#### **ROOT CAUSE NUMBER THREE: SLOW RESPONSE TIME DUE TO A**

**DISINCLINATION TO SEE THE PROBLEM AS SYSTEMIC:** "While the Community Bank did take steps over time to address issues associated with sales practice violations and aggressive sales goals, these 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."<sup>19</sup> "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 issues were a problem of relatively modest significance"<sup>20</sup>

Shearman & Sterling's Finding: Wells Fargo also failed to frame the issue appropriately.<sup>21</sup> "First, insufficient regard was paid to the effect of the violations on customers... absent clear theft or specific customer complaints, the potential effect on customers was not regularly assessed." "Second, the Community Bank did not consider non-financial harm to customers resulting from the misuse of personal information or in the opening of accounts in their names without their authorization. Third, the Community Bank did not adequately consider the significant reputational risk associated with sales practice misconduct. Failure to frame the issue properly extended to senior management's view that firing 1% of the Community Bank workforce every year for sales integrity violations was acceptable."<sup>22</sup>

### **Questions For Wells Fargo and its Board of Directors:**

- What changes has Wells Fargo Bank and Wells Fargo's Board of Directors made to ensure that any future systemic problems are identified and mitigated more quickly? Are these changes all organizational (such as the centralization of control functions) or do they extend to the corporate culture and corporate policies and procedures?

**ROOT CAUSE NUMBER FOUR: INAPPROPRIATE ACTIONS BY A SELECT NUMBER OF HIGH-LEVEL EMPLOYEES:** The Shearman & Sterling report focuses on six members of senior management, who are believed to have been directly responsible for encouraging or

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<sup>19</sup> Page 6.

<sup>20</sup> Page 14.

<sup>21</sup> Page 32.

<sup>22</sup> Ibid.

failing to act swiftly enough to stop the sales practice violations: John Stumpf, Carrie Tolsted, Matthew Raphaelson, Claudia Russ Anderson, Shelley Freeman, and Pam Conboy. The report paints Tolsted as the most responsible party, though Shearman & Sterling document multiple instances of wrongdoing by all six.<sup>23</sup> All six have left the company, either vis retirement or termination for cause. All six have also forfeited significant amounts of compensation. According to representatives of Shearman & Sterling, the combined \$140 million in clawbacks applied to Stumpf and Tolsted are the largest ever in financial history.

The Sales Practices Investigation Report also touches briefly on Tim Sloan, who joined Wells Fargo in 1987 and held various leadership roles over the course of his Wells Fargo career before being elevated to Chief Executive Officer (CEO) in October, 2016, upon John Stumpf's retirement. Positions held by Sloan prior to his elevation to CEO include Chief Administrative Officer (2010 to 2011), Chief Financial Officer (2011 to 2014), Head of Wholesale Banking (2014 to 2015), Chief Operating Officer (2015 to October 2016), and President (2015 through the present). The report largely absolves Sloan of responsibility for the scandal, noting that, "while Sloan had some awareness of sales practice issues within the Community Bank prior to the publication of the *Los Angeles Times* articles, including from sporadic internal discussions with colleagues and anonymous complaint emails, he was not aware of the magnitude of the issues or of their potential to cause customer harm. The decentralized, 'run it like you own it' structure and ethos within Wells Fargo limited the amount of negative information Sloan received regarding the Community Bank and the opportunities Sloan had to engage on Community Bank issues."<sup>24</sup>

Notably, the report excludes any discussion of Richard Kovacevich, Mr. Stumpf's predecessor at the helm of Wells Fargo and the first person to oversee Wells Fargo following its 1998 merger with Norwest Bank. Mr. Kovacevich was President and CEO immediately after Wells Fargo's 1998 merger with Norwest and was named Chairman of the merged bank in 2001. Because some have suggested that the aggressive sales culture which fueled the sales practice scandal originated with Norwest Bank, it might have been valuable for Shearman & Sterling to document the extent to which the culture of Wells Fargo changed following the merger. However, when asked why Mr. Kovacevich was not questioned during Shearman & Sterling's investigation, Shearman & Sterling representatives pointed to the long period of time since his leadership of the Bank and to the relative difficulty in locating him for an interview.

### **FOR HOW LONG WERE SALES PRACTICE VIOLATIONS ALLOWED TO OCCUR**

One of the most significant findings of the Sales Practices Investigation Report is the length of time sales practice violations have been occurring at the Bank. Despite the focus of the September, 2016 regulatory enforcement actions on the 2011 to 2015 time period, Shearman & Sterling uncovered evidence that sales practice violations were occurring within Wells Fargo's Community Bank Division as far back as 2002. "In 2002, the Community Bank took steps to address an increase in sales practice violations, including the creation of a sales integrity task

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<sup>23</sup> See pages 22 through 26, 45 through 51, and 53 through 56.

<sup>24</sup> Page 57.

force.”<sup>25</sup>

Further, in 2004, a Wells Fargo Internal Investigations report found, “it is the conclusion by Corporate Security Internal Investigations that whether real or perceived, team members on the current Corporate Sales Incentive Plan feel they cannot make sales goals without gaming the system. The incentive to cheat is based on the fear of losing their jobs for not meeting performance expectations.”<sup>26</sup> Significantly, the 2004 report was sent to, among others, the Chief Auditor, a senior in-house employment lawyer, Community Bank HR personnel, the head of sales & service development in the Community Bank, and Michael Bacon (the head of Corporate Security, who refused to be interviewed by Shearman & Sterling). There is no evidence that the report and its recommendations were further escalated.<sup>27</sup>

The Law Department was also aware of sales misconduct resulting in employee terminations dating back at least to 2002, but from 2002 through the filing of City Attorney Mike Feuer’s lawsuit in May, 2015, “the Law Department’s focus was principally on quantifiable monetary costs – damages, fines, penalties, restitution. Confident those costs would be relatively modest, the Law Department did not appreciate the sales integrity issues reflected a systemic breakdown in Wells Fargo’s culture and values and an ongoing failure to correct the widespread breaches of trust in the misuse of customers’ personal data and financial information.”<sup>28</sup>

There is also evidence that the problem grew steadily between 2007 and 2013. The number of sales integrity-related allegations and resignations increased relatively steadily from the second quarter of 2007, and both peaked in the fourth quarter of 2013, when the *Los Angeles Times* article was published.<sup>29</sup>

#### **Questions for Wells Fargo and Its Board of Directors:**

- Is Wells Fargo taking any steps to quantify fees that may have been charged and other monetary harm that may have been resulted to accountholders who had accounts fraudulently opened in their names prior to the 2009 time period cited by the Bank as its starting point for this type of investigation?
- Can a bank that allowed its employees to create millions of fraudulent customer accounts over a period of fifteen years be trusted to police its own activities going forward?

#### **DISPROPORTIONATE IMPACT ON CALIFORNIA ACCOUNTHOLDERS**

FTI Consulting, a firm hired to help Shearman & Sterling review Wells Fargo’s internal human resources data, examined overall sales practice misconduct allegations and terminations/resignations by state during the period April 2007 to March 2016. California had by far the highest number of sales practice-related allegations (27.9% of total) and

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<sup>25</sup> Page 31.

<sup>26</sup> Page 89.

<sup>27</sup> Page 90.

<sup>28</sup> Page 78.

<sup>29</sup> Page 6.



terminations/resignations (28.2% of total). When FTI looked at the data on a “per-employee” basis, California was among the top five states.<sup>30</sup>

**Questions for Wells Fargo and its Board of Directors:**

- Why was so much wrongdoing centered in California?

**STATUS OF OTHER INVESTIGATIONS RELATED TO THE COMMUNITY BANK**

According to the Sales Practices Investigation Report, “In November, 2016, Prudential Insurance Company of America informed Wells Fargo that it had received a customer complaint through its fraud hotline alleging that a Prudential simplified term life insurance policy had been purchased for a Wells Fargo Community Bank customer without the customer’s consent, and that the customer had only become aware of this policy when he received a cancellation notice in the mail. Wells Fargo has retained outside counsel to conduct an investigation with respect to sales practices involving Community Bank online insurance product referrals. That investigation is ongoing, and Shearman & Sterling is actively monitoring its progress.”<sup>31</sup>

**Questions for Wells Fargo and its Board of Directors:**

- When will the investigation into unauthorized insurance policies be completed, and will results be made public when it is?

**COULD THERE BE PROBLEMS IN OTHER DIVISIONS OF THE BANK**

To date, all of the investigations conducted by Wells Fargo and by Shearman & Sterling have focused on the Community Bank, one of several divisions of Wells Fargo Bank, N.A. Yet, many of the root causes that are believed to have led to the Community Bank sales practice violations are present in other divisions of the Bank, such as the use of sales goals as the basis for incentive compensation and performance evaluations, the decentralization of control functions, and a “run it like you own it” mentality that affords great deference to division heads.

In information provided by Wells Fargo to the California State Senate Banking and Financial Institutions Committee and to the United States Senate Committee on Banking, Housing, and Urban Affairs, the Bank has indicated that its decision to discontinue sales goals in October, 2016 did not extend to its entire bank; it only extended to business groups within its Community Banking Division. “Several business groups outside of Community Banking – such as Consumer Lending, Wealth and Investment Management, Wholesale Bank, Insurance, and Capital Finance – also offer incentive compensation plans to some of their team members. Many of these team members are in business development or sales roles, offering customers home mortgages, commercial loans, wealth management advice, insurance plans, or other Wells Fargo products and services. While some of these plans use production thresholds, many are predominantly commission-based and have no product, revenue, or volume goals or thresholds. Wells Fargo is currently reviewing all of its incentive compensation plans to ensure the

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<sup>30</sup> Pages 34 and 35.

<sup>31</sup> Page 36.

structures and production thresholds are appropriate to the roles and do not inadvertently incent inappropriate sales practices.”<sup>32 33</sup>

The Sales Practices Investigation Report cites a different comprehensive review of the Bank’s sales practices. At a meeting of the Wells Fargo Board of Directors meeting in June, 2015, Chief Risk Officer Michael “Loughlin reported that Corporate Risk was now planning a comprehensive review and initiative regarding the company’s sales practices, to cover Community Bank, Mortgage Banking and Wealth Brokerage and Retirement. He also planned to retain a third-party consulting firm to conduct an independent review of Wells Fargo’s training, compensation and sales practices.”<sup>34</sup>

### **Questions for Wells Fargo and its Board of Directors:**

- If the problems that led to the sales integrity violations within the Community Bank went all the way to the top of Wells Fargo, as the Sales Practices Investigation Report suggests, is there any reason to believe that other divisions of the Bank, which directly serve members of the public, were insulated from the same types of sales pressure that was evident within the Community Bank?
- What is the status of Wells Fargo’s reviews of incentive compensation plans and sales practices in divisions of the Bank other than the Community Banking Division? Has Wells Fargo made any changes to incentive compensation plans or sales practices in divisions of the Bank other than the Community Banking Division?

### **WHEN, HOW, AND FROM WHOM DID WELLS FARGO’S BOARD OF DIRECTORS LEARN OF THE WRONGDOING, AND DID THE BOARD TAKE APPROPRIATE ACTION ONCE IT WAS INFORMED:**

The Sales Practices Investigation Report appears to absolve the Board of Directors of responsibility for the sales practice violations, pointing to the fact that the Board was deprived of relevant information about the problems and, at times, misled by Carrie Tolstedt. “Prior to 2014, sales practice or sales integrity issues were not flagged as noteworthy risks either to the Board of Directors as a whole or to any Board committee.”<sup>35</sup> “Sales integrity issues received heightened Board reporting and attention in 2014 following publication of a December 21, 2013 *Los Angeles Times* article about improper sales-related conduct, principally in Los Angeles.”<sup>36</sup> “In April 2015, Tolstedt presented to the Risk Committee on sales practices...The Risk Committee members viewed Tolstedt’s presentation as too superficial and optimistic.”<sup>37</sup>

<sup>32</sup> Written responses from Wells Fargo to Senator Steven Glazer dated November 6, 2016. See Appendix A of <http://sbnk.senate.ca.gov/sites/sbnk.senate.ca.gov/files/Well%20Fargo%20Agenda.PDF>.

<sup>33</sup> Pages 7-8 of Wells Fargo’s written response to the U.S. Senate Committee on Banking, Housing, and Urban Affairs. See Appendix B of <http://sbnk.senate.ca.gov/sites/sbnk.senate.ca.gov/files/Well%20Fargo%20Agenda.PDF>.

<sup>34</sup> Page 106.

<sup>35</sup> Page 97.

<sup>36</sup> Page 100.

<sup>37</sup> Page 103.

Tolstedt was summoned to present to the Risk Committee regarding sales again in May, 2015. “The message communicated to the Risk Committee was that: (i) as a result of an investigation commenced in Southern California and thereafter expanded across ‘the retail banking footprint’ in 2013 and 2014, 230 employees had been terminated; (ii) 70% of the terminations were related to telephone number changes (principally to frustrate telephone quality control surveys) and 30% to simulated funding abuses; (iii) the root cause was intentional employee misconduct, not systemic issues arising from sales goals or compensation; and (iv) Wells Fargo’s controls had been effective in detecting improper behavior. The Risk Committee was highly critical of the presentation. The 230 number from the 2013-14 investigation was the first time the directors had heard of large-scale terminations and...the committee felt blindsided by the disclosure...The actual aggregate termination numbers for 2013 and 2014 of 1,229 and 1,293, respectively, as determined by Internal Investigations, went unmentioned at the May 19 meeting.”<sup>38</sup>

“The Board only learned that approximately 5,300 employees had been terminated for sales practices violations through the September 2016 settlements with the Los Angeles City Attorney, the OCC and the CFPB.”<sup>39</sup>

Wells Fargo’s Board of Directors began taking action to revise its governance structure in December, 2016. On December 1, 2016, Wells Fargo’s Board of Directors changed its bylaws to split the roles of CEO and Chairman of the Board and required the Board’s Chair and Vice Chair to be independent directors.<sup>40</sup> The bylaw changes formalized a structure the Bank had adopted following John Stumpf’s retirement, when it elevated Bank President Tim Sloan to CEO and appointed Independent Director Stephen Sanger as Chairman. As noted earlier in this report, an independent director is one who is neither an employee nor an executive officer of a company; Tim Sloan is the only member of Wells Fargo’s Board who is not considered an independent director.

The Sales Practices Investigation Report documents additional changes made by the Board to its structure and responsibilities. “Without waiting for completion of this investigation, the Board made several changes to its own corporate governance. In early 2017, Wells Fargo combined Global Ethics and Integrity, Internal Investigations and sales practices and complaint oversight into a new Office of Ethics, Oversight, and Integrity, and the Risk Committee’s responsibilities have been expanded to include oversight of that office. In addition, the Office of Ethics, Oversight, and Integrity will report on its activities to the full Board at least twice a year. The Human Resources Committee’s charter was modified to expand oversight of the incentive compensation risk management program, with support from Corporate HR, and to increase its oversight of terminations, culture and EthicsLine implementation. The Corporate Responsibility Committee’s charter was also amended to require that the committee receive enhanced reporting from management on customer complaints and allegations from other sources, such as the EthicsLine, relating to customers. And the A&E Committee’s oversight responsibilities for legal and regulatory compliance were broadened to include the company’s compliance culture. These steps should help to clarify Board oversight of conduct risk, provide for greater centralization of

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<sup>38</sup> Pages 105 and 106.

<sup>39</sup> Overview of the Sales Practices Investigation Report (unnumbered page immediately prior to the Table of Contents).

<sup>40</sup> “Wells Fargo Formally Separates Chairman, CEO Roles,” *Wall Street Journal*, December 1, 2016.

review and oversight and augment reporting to the Board of the type of issues that contributed to the breakdown in Wells Fargo's sales culture.<sup>41</sup>

**Questions for Wells Fargo and its Board of Directors:**

- Would the Board have been made aware of the sales practice violation problems earlier if the aforementioned corporate governance changes had been in place in 2002, when the sales practice violation issues are believed to have begun?
- There is ample evidence that members of the Wells Fargo Board of Directors were deeply concerned about Carrie Tolstedt long before she was asked to leave in 2016.<sup>42</sup> Will the Board be any more likely to recommend the removal of high-level executives within Wells Fargo Bank, now that it has access to additional information regarding the performance of individual divisions of the Bank?
- Under the formerly decentralized system, "the Chief Risk Officer did not have any line authority or directive power to enforce changes on the lines of business. He could, and did, try to exercise his influence to encourage the businesses to address risk issues and to air them more broadly within the bank."<sup>43</sup> Have any of the changes implemented by the Board of Directors increased the authority provided to the Bank's Chief Risk Officer?

**TREATMENT OF WHISTLEBLOWERS**

The Sales Practices Investigation Report spends little time on the question of whether employees who complained about sales pressure or practices were subject to retaliation by the Bank. In a footnote, the firm notes, "Based on a limited review completed to date, Shearman & Sterling has not identified a pattern of retaliation against Community Bank employees who complained about sales pressure or practices." The firm notes, however, that its review is ongoing and had not been completed as of the date of the Sales Practices Investigation Report.

**Questions for Wells Fargo and its Board of Directors:**

- When will the investigation into whistleblower cases be complete, and will results of that investigation be made public?
- What changes, if any, has Wells Fargo Bank made to its EthicsLine to ensure anonymity and protection against retaliation?
- What changes, if any, has Wells Fargo made to its internal procedures to investigate complaints received by customers and employees to its EthicsLine?

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<sup>41</sup> Pages 17 and 18.

<sup>42</sup> For example, Stumpf "was aware that many doubted Carrie Tolstedt 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 the Risk Committee." (Page 10). "By 2015, many Board members believed that she was intentionally understating the problem which she had helped to create." (Page 48).

<sup>43</sup> Page 60.