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**TESTIMONY OF**

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**COMPTROLLER OF THE CURRENCY**

**before the**

**COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS**

**UNITED STATES SENATE**

**September 20, 2016**

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## **I. Introduction**

Chairman Shelby, Ranking Member Brown, and members of the Committee, thank you for the opportunity to testify today as the Committee reviews matters relating to certain sales practices at Wells Fargo Bank, N.A. (Bank or Wells Fargo). As described below, the Office of the Comptroller of the Currency (OCC) recently took public enforcement actions against Wells Fargo, finding that the Bank engaged in reckless unsafe or unsound banking practices and directing it to take comprehensive corrective action with regard to risk management of its sales practices, reimburse harmed customers, and pay \$35 million in civil money penalties (CMPs). The OCC's actions focused on safety and soundness issues, and we worked in close coordination with the Consumer Financial Protection Bureau (CFPB) and the Los Angeles City Attorney. I want to express my appreciation to Director Cordray of the CFPB and L.A. City Attorney Mike Feuer.

While the OCC continues to review our supervision and actions related to this case, my testimony provides additional detail, known today, regarding our supervisory response and the steps the OCC is taking to review our actions in this matter, as we continuously work to enhance our supervision of national banks and federal savings associations.

Before discussing the details of our supervisory response, I want to make clear that the unsafe and unsound sales practices at the Bank, including the opening and manipulation of fee-generating customer accounts without the customer's authorization, are completely unacceptable and have no place in the federal banking system. They reflect a lack of effective risk management, a breakdown in controls, and an inappropriate incentive structure. The actions announced on September 8, 2016, are intended to remediate and deter such practices and underscore the importance of robust risk management throughout the federal banking system.

The coordinated and complementary efforts by the OCC and the CFPB make clear to regulated institutions that compliance and safety and soundness go hand in hand.

The actions against the institution hold it accountable, and consistent with our practice in such enforcement matters, the OCC has also initiated a review of individual misconduct and culpability. The OCC may take formal enforcement actions against institution-affiliated parties, including directors, officers, and employees, who violate any law or regulation, engage in unsafe or unsound practices, or breach fiduciary duty. These actions include personal cease and desist orders and CMPs. In addition, the OCC has the authority to remove and prohibit individuals from serving as directors, officers, or employees of federally insured depository institutions if the legal standards for such action are met. Removal and prohibition amount to a lifetime ban on the culpable individual working in the banking industry.

While I believe we have made progress since the financial crisis in fostering healthier cultures at the largest institutions, meaning a commitment to compliance with applicable laws, effective risk management, good governance, and fair treatment of customers, there is clearly more work to do. Regulators and the institutions themselves must be especially vigilant when it comes to practices that can undermine the trust and confidence in financial institutions.

## **II. OCC Supervision of the Bank's Sales Practices**

The OCC charters, regulates, and supervises national banks, federal savings associations, and the federal branches and agencies of foreign banks. Our mission is to ensure these institutions operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. Compliance with consumer protection laws is dependent upon a bank's ability to manage operational risk and conduct its

business in a safe and sound manner, and the opposite is also true: you cannot manage operational risk without an effective compliance program.

OCC-regulated institutions are subject to comprehensive, ongoing supervision designed to enable examiners to identify problems and obtain corrective action. Such supervision permits most bank problems to be resolved through the supervisory process without formal enforcement action. Relevant examples of written supervisory actions include comprehensive Reports of Examination, Supervisory Letters, and Matters Requiring Attention (MRAs) tailored to the specific weaknesses existing at a bank.<sup>1</sup> MRAs focus the bank management's and board's attention on supervisory concerns that require the board's immediate acknowledgment and oversight to ensure timely corrective action. In financial institutions with more than \$10 billion in assets, such as Wells Fargo, the OCC's supervisory responsibilities are related to, and sometimes overlap with, the supervisory responsibilities of the CFPB for financial institution activities subject to certain consumer financial laws and regulations, including retail sales practices. Pursuant to a 2012 interagency memorandum of understanding (MOU) on supervisory coordination, the OCC's regular practice in these areas is to provide the CFPB with copies of Reports of Examination and formal supervisory correspondence. The OCC also shares other material supervisory information with the CFPB pursuant to that MOU and a subsequent statement of principles between the two agencies.

In March 2012, the OCC received a small number of complaints from consumers and Bank employees alleging improper sales practices at Wells Fargo, which were forwarded to

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<sup>1</sup> MRAs describe practices that deviate from sound governance, internal control, and risk management principles, and have the potential to adversely affect the bank's condition, including its financial performance or risk profile, if not addressed; or result in substantive noncompliance with laws and regulations, enforcement actions, supervisory guidance, or conditions imposed in writing in connection with the approval of any application by the bank. The OCC clarified its use of MRAs in 2014 (<http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-52.html>).

OCC supervision staff assigned to the Bank, consistent with agency practice at the time. Following these inquiries and a *Los Angeles Times* article<sup>2</sup> in December 2013 regarding the Bank's aggressive sales practices, the examiners initiated a series of meetings with various levels of Bank management, including executive leadership, to evaluate the Bank's activities and actions. The Bank stated that it terminated employees as a result of consumer and internal ethics complaints, and that it was investigating such reports and re-evaluating its oversight of sales practices at the Bank. During this time, the OCC examiners were also reviewing, and meeting with the Bank to discuss, the Bank's development of a corporate risk strategy, risk framework, and implementation plan that included its sales practices.

Between January 2012 and July 2016, the OCC conducted multiple supervisory activities related to Wells Fargo, which included ongoing supervision and targeted examinations through which examiners assessed the Bank's governance and risk management practices related to compliance and operational risk. These activities included assessments of compliance with the OCC's heightened standards requirements that I discuss further below, as well as other regulatory expectations for compliance risk management. These activities also included components that involved assessment of risk management related to sales practices. The supervisory conclusions associated with these activities are summarized below.

### 2011-2014 Examination Activity

#### *Consumer Compliance Risk Management Assessment*

Following earlier examination work relating to consumer practices at the Bank that began in late 2011, the OCC took further supervisory actions related to compliance risk management at

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<sup>2</sup> See "Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost. *Los Angeles Times*, Dec. 22, 2013 (<http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html>).

the Bank in early 2013 and 2014. In February 2013, the OCC issued a Supervisory Letter<sup>3</sup> requiring the Bank to develop its operational risk compliance program. In early 2014, the agency directed the Bank to address weaknesses in compliance risk through the establishment of a comprehensive compliance risk management program related to unfair and deceptive practices. Further, the OCC identified the need to assess cross-selling and sales practices as part of its upcoming examination of the Bank's governance processes. Examiner planning for that examination included meetings with Bank management throughout 2014, as well as the review of the Bank's management information systems, internal audit findings, and documents describing the Bank's efforts to improve its capabilities to manage and monitor the quality of compliance oversight. OCC examiners continued their dialogue with Bank management to supervise and monitor these efforts.

## 2015 Examination Activity

### *Compliance Management Reviewed Under Heightened Standards*

The OCC's ongoing review and supervisory response to the matters discussed above continued into 2015, and included periodic meetings with Bank management and review of extensive documentation, including internal reports, board packages, and internal audit findings. In March 2015, OCC examiners completed a multi-year assessment of the Bank's compliance management systems, applying the OCC's rule on heightened standards for large banks that took

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<sup>3</sup> A Supervisory Letter to a large bank such as Wells Fargo is an official OCC communication that formally conveys supervisory findings and conclusions, including any supervisory concerns, from the OCC's ongoing supervision of the institution.

effect in November 2014,<sup>4</sup> and identified the need for the Bank to improve its risk management and governance related to operational and compliance risk.

#### *Community Bank Operational Risk Management Reviewed*

The OCC conducted an examination of the Bank's Community Bank Operational Risk Management in February 2015. The review focused on governance of operational risk, use of risk tools, implementation of strategic plans and new products, internal loss oversight, complaints management processes, and sufficiency and quality of staff. The examiners also evaluated the Community Bank division's sales practices oversight. The examiners' conclusions noted that the Bank lacked a formalized governance framework to oversee sales practices and thus, the OCC issued a Supervisory Letter in April 2015 that included an MRA requiring the Bank to address the governance of sales practices within its Community Bank division.

#### *Enterprise Sales Practices Reviewed*

The OCC issued an additional Supervisory Letter to the Chairman and Chief Executive Officer in June 2015 identifying matters related to the Bank's enterprise-wide risk management and oversight of its sales practices that required corrective action by the Bank. The OCC letter included five MRAs that required the Bank to take significant action to address the inappropriate tone at the top, that included the lack of an appropriate control or oversight structure given corporate emphasis on product sales and cross-selling; the lack of an enterprise-wide sales practices oversight program; the lack of an effective enterprise-wide customer complaint process; the lack of a formalized governance process to oversee sales practices and effectively

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<sup>4</sup> See OCC Bulletin 2014-45, "Heightened Standards for Large Banks; Integration of 12 CFR 30 and 12 CFR 170." Sept. 25, 2014 (<http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-45.html>).

oversee and test branch sales practices; and the failure of the Bank's audit services to identify the above issues or to aggregate sales practice issues into an enterprise view.

The June 2015 Supervisory Letter also instructed the Bank to take certain corrective actions to address the practices at issue, including improving processes to manage sales practices risk; re-evaluating compensation and incentive plans to ensure they did not provide an incentive for inappropriate behavior; improving processes to independently oversee sales practices risk at an enterprise-wide level; accelerating the implementation of a fully effective customer complaint process and establishing policy and processes for evaluating complaints related to protected classes; having management of the Bank's Community Bank division establish effective oversight, as well as a testing and quality assurance function, to review branch sales practices; and having the Bank's audit services develop an enterprise-wide risk management process for sales practices. The OCC also instructed the Bank to remediate any consumer harm that resulted from the sales practices at issue.

As part of the corrective actions required by the June 2015 Supervisory Letter, the OCC also ordered the Bank to retain an independent consultant to conduct a thorough review of the Bank's approach to enterprise-wide sales practices and to assess consumer harm. The Bank retained two consultants—one to review the practices and another to assess consumer harm. The consultants issued their findings in October 2015, February 2016, and May 2016. The consultants' work and findings further informed OCC's ongoing supervision and consideration of the matter.

#### *2015 Report of Examination Issued*

The OCC issued its annual Report of Examination in July 2015 and noted the Bank needed to act more proactively to control compliance and operational risk. The July Report of



Examination was followed by a Notice of Deficiency on July 28 citing the Bank's failure to comply with the safety and soundness expectations in the OCC's heightened standards rule. The OCC issued this notice to help ensure that Bank management adhered on a timely basis to its plan to implement an effective enterprise-wide compliance risk management program.

### 2016 Examination Activity

#### *2016 Report of Examination Issued and Supervisory Letter Finding Unsafe or Unsound Practices*

The OCC continued its ongoing review of these matters into 2016, holding monthly meetings with Bank management in order to monitor and follow up on the Bank's progress in addressing the corrective actions required by the OCC. The OCC concluded its 2016 examination work in July, and issued its Report of Examination findings and a letter to the Board. The Report of Examination communicated the findings and conclusions that the Bank's sales practices were unethical; the Bank's actions caused harm to consumers; and Bank management had not responded promptly to address these issues. A Supervisory Letter to the Bank's Chairman on July 18, 2016, also stated the Bank engaged in unsafe or unsound banking practices and shortly thereafter, the OCC's Major Matters Supervision Review Committee approved recommendations to issue the Consent Order and assess CMPs against the Bank for reckless unsafe or unsound sales practices and the Bank's risk management and oversight of those practices.

### *Enforcement Actions*

The OCC's enforcement actions were coordinated closely with the CFPB and the L.A. City Attorney and issued on September 8, 2016.<sup>5</sup> Many of the elements of the cease and desist order reflect requirements included in the various OCC supervisory communications discussed above, which were issued as part of the OCC's ongoing supervision prior to issuance of the order.

The September 2016 OCC enforcement actions included the assessment of \$35 million in CMPs, and required the Bank to make restitution to customers who were harmed by the Bank's unsafe or unsound sales practices and to develop a comprehensive enterprise-wide action plan to address the underlying causes of the harm. The Bank was also required to conduct a comprehensive assessment of any new or materially revised incentive compensation structure in its sales practices prior to implementation. Such an assessment is intended to ensure that the risks related to the Bank's incentive compensation structure are well managed, controlled, and adhere to policies, procedures, and processes designed to prevent potentially unsafe or unsound sales practices.

Restitution payments made by the Bank to customers pursuant to the OCC's order will also satisfy identical obligations required by the CFPB and the L.A. City Attorney.

### **III. Next Steps**

While the OCC has made many improvements to our supervisory program in recent years, the actions against Wells Fargo highlight that we must continue our efforts to improve and refine the agency's supervisory program, to sharpen our early warning processes, and to enhance

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<sup>5</sup> See NR 2016-106. "OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices." Sept. 8, 2016 (<http://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html>).

our supervisory capabilities, particularly with respect to our largest, most complex banks. And while the examination and investigation needed to bring comprehensive and coordinated enforcement action against Wells Fargo required deliberation and care, it is critically important that the OCC identify issues and act more quickly. To that end, I have asked the Senior Deputy Comptroller for Enterprise Governance to conduct a review of our actions taken in this matter in order to identify gaps in our supervision and assess any lessons the agency can learn from it.

At the same time, I have directed our examiners to review the sales practices of all the large and midsize banks the OCC supervises and assess the sufficiency of controls with respect to these practices.

#### **IV. Enhancements to the OCC's Supervisory Programs**

Since I began my term as Comptroller in April 2012, I have sought to strengthen the OCC's supervisory programs. The enhancements described below have put the agency on track to act in a more timely and effective manner to address unsafe and unsound practices and violations of law.

##### Heightened Standards

The financial crisis showed that supervisory expectations for front line units, risk management, internal audit, and corporate governance in our largest and most complex banks needed to be substantially higher, especially for the most systemically important institutions. To achieve that goal, the OCC developed a set of "heightened expectations." Starting in 2010, the agency introduced these expectations to the large banks we supervise. By 2012, the OCC began assessing compliance with the expectations, and incorporated our findings into our risk

assessments of those institutions. We found that progress was too slow and that a more robust approach, providing for the possibility of an enforceable response, was needed. Thus, in January 2014, the OCC proposed enforceable guidelines and, in September 2014, issued final enforceable guidelines. Under this approach, if a bank fails to satisfy a standard in the guidelines, the OCC may require it to submit a compliance plan detailing how it will correct the deficiencies and the applicable timeline. The OCC can issue an enforceable order if the bank fails to submit an acceptable compliance plan or fails in any material way to comply with an OCC-approved plan.

The heightened standards guidelines have two major components. The first sets forth the minimum standards for the design and implementation of a covered bank's risk governance framework, stipulating that it should be based on what the industry commonly refers to as the three lines of defense: front line units, independent risk management, and internal audit. The risk governance framework and the three lines of defense are intended to ensure that the bank has an effective system to identify, measure, monitor, and control risk-taking and standards of behavior. Those units must ensure that boards of directors have enough information on their bank's risk profiles and risk management practices so that the bank operates within the risk appetite established by management and the board.

The second component of our heightened standards guidelines pertains to the responsibilities of boards of directors. The guidelines establish criteria to ensure that bank boards have a minimum number of independent directors and that all board members have the information they need to provide effective oversight, including the ability to pose a credible challenge to management. The guidelines also require each bank to establish and maintain an ongoing training program for all board members and to conduct an annual self-assessment of the

board's effectiveness in meeting the standards in the guidelines. The date for the largest banks to comply with these standards was in November 2014.

#### Major Matters Supervision Review Committee

As Comptroller, I established a committee comprised of my most senior and expert executives to review major supervisory matters. The committee operates independently of the supervision function and replaces a less robust review and decision-making process previously in place for significant enforcement cases, thereby strengthening and enhancing the governance over decision-making.

The Committee's role is to ensure OCC bank supervision and enforcement policies are applied fairly, effectively, and consistently. The Committee considers all major enforcement cases, and its charter recently was expanded as the Committee has added value to the OCC's supervisory program. The matters that must be brought before the Committee include all enforcement actions against large banks (informal and formal) based on safety and soundness; all large bank enforcement actions that include articles addressing the Bank Secrecy Act (BSA); all enforcement actions against any bank based in whole or in part on unfair or deceptive acts or practices in violation of section 5 of the Federal Trade Commission Act; and certain fair lending referrals and actions. The Committee's charter also requires vetting by senior executives on the Committee of decisions made outside of the Committee *not* to pursue enforcement actions that would otherwise come before the Committee.

## Compliance and Community Affairs (CCA)

Earlier this year, I established Compliance and Community Affairs (CCA), a new business unit within the OCC's organizational structure. CCA, led by a Senior Deputy Comptroller, is separate from the existing supervisory units and is charged with addressing all aspects of compliance and community affairs. The assignment of these responsibilities to one unit avoids the risk of a fragmented approach to these issues and inconsistent outcomes among different OCC supervisory lines of business. The establishment of the CCA unit reflects the significance of consumer and BSA/anti-money laundering compliance issues within the OCC and the banking industry, and the extent to which compliance risk management deficiencies may pose the risk of great harm to consumers and the safety and soundness of banks. The need for ongoing communication and effective collaboration with a wide range of other regulatory agencies in these areas also contributed to my decision to establish the CCA unit. By establishing this unit with both supervision and policy functions, I recognized the need for a change in the OCC's organizational structure to provide the best possible platform and support for this work throughout the agency. Fairness and compliance are critical aspects of the OCC's mission and are interconnected with, and as important as, safety and soundness. As I noted earlier, compliance and safety and soundness go hand in hand. The compliance discipline, like its safety and soundness sibling, requires dedicated staff and strong infrastructure to ensure the OCC takes timely and appropriate actions with respect to compliance and related safety and soundness issues.

## Coordination Principles

The enforcement action against Wells Fargo follows other coordinated enforcement actions we have issued with the CFPB since 2012. The actions have included significant consumer restitution as well as penalties assessed by the OCC and the CFPB against institutions that were found to have engaged in unfair billing practices and deceptive sales and marketing practices, among other issues. However, our coordination is not limited to enforcement actions. In June of this year, the OCC and the CFPB jointly issued a set of ten coordination principles to guide how the staffs of the two agencies collaborate and share information. The principles build on the 2012 interagency MOU on supervisory coordination that I noted earlier and a 2012 interagency MOU on information sharing, and reflect how closely the two agencies work together to ensure that our country's financial services industry meets the needs of consumers, communities, and businesses. Key to the principles and the underlying coordination is that OCC and CFPB employees should be responsive and share information; communicate openly with each other; consult with each other especially when working on a joint project; elevate to management issues of importance; coordinate on approaches to their work; and respect the goals and mission of each agency.

## **V. Additional Actions Required**

It is clear from our work and the actions announced on September 8 against the Bank that the misaligned priorities and unacceptable behavior at Wells Fargo resulted in unsafe and unsound practices that led to widespread consumer harm. Issues of incentive compensation are relevant to ensuring behavior aligns with acceptable corporate practice. For those reasons, the

OCC strongly supports issuing a final rule on incentive compensation that would address some of the issues I am raising today.

The OCC, along with the Federal Reserve, Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency, and the National Credit Union Administration, issued a proposed rule on incentive-based compensation earlier this year that would apply to financial institutions with total consolidated assets of \$1 billion or more. The proposed rule would prohibit incentive-based compensation arrangements that provide excessive compensation and that could lead to material financial loss to a financial institution. A financial institution covered by the proposed rule would not be permitted to provide an incentive-based compensation arrangement unless the arrangement appropriately balanced risk and reward, was compatible with effective risk management and controls, and was supported by effective governance.

The proposed rule also includes specific requirements for incentive-based compensation arrangements at the largest financial institutions, like Wells Fargo, with total consolidated assets of \$50 billion or more. The most notable of these is the requirement that larger financial institutions defer a certain percentage (40 – 60 percent) of the incentive-based compensation they pay to certain senior executive officers and significant risk-takers for a minimum period of time (one to four years). Those deferred amounts would be subject to a forfeiture review by the financial institution if certain triggering events, such as a material risk management or control failure, occurred. Incentive-based compensation paid to these employees would also be subject to claw back for seven years. Additionally, the proposed rule would prohibit larger financial institutions from providing incentive-based compensation based solely on transaction volume or revenue, without regard to transaction quality or compliance with sound risk management.



Further, the proposed rule includes risk management requirements, including an independent compliance program and independent monitoring of incentive-based compensation plans and programs. The comment period for the proposed rule closed on July 22, 2016. The agencies are carefully reviewing the comments that we received and are working toward completion of a final rule. I strongly supported the proposed rule,<sup>6</sup> and while the content of the final rule will not be determined until it is considered by the agencies' principals, I also strongly support completing the work as quickly as practical.

## **VI. Conclusion**

I remain committed to ensuring the OCC completes its review of this matter and takes additional actions to hold the bank and individuals accountable as warranted. Moreover, I will work to foster continuous improvements at the OCC to fulfill our mission. I want to close by expressing my appreciation again for my colleagues at the CFPB and in the L.A. City Attorney's office. Our nation's financial services industry is complex and dynamic. Effective supervision and enforcement requires regulators to work together to achieve a safe and sound banking system that treats customers fairly. I look forward to continued collaboration with my fellow regulators.

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<sup>6</sup> See NR 2016-46, "Comptroller Statement Regarding the Proposed Incentive-Based Compensation Rule." Apr. 26, 2016 (<http://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-49.html>).