OFFICE OF ENTERPRISE GOVERNANCE AND THE OMBUDSMAN

ENTERPRISE GOVERNANCE SUPERVISION

LESSONS LEARNED REVIEW OF SUPERVISION OF SALES PRACTICES AT WELLS FARGO

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BACKGROUND

On September 6, 2016, the Office of the Comptroller of the Currency (OCC) issued a consent order and related civil money penalty (CMP) action against Wells Fargo Bank, N.A. (WF), finding that the bank engaged in reckless unsafe or unsound banking practices. Wells Fargo's (WF) improper sales practices, including the opening and manipulation of customer accounts without the customer's authorization, are completely unacceptable and have no place in the banking system. The actions of WF highlight that the OCC must continue our efforts to improve and refine the agency's supervisory program, to sharpen our early warning processes, and to enhance our supervisory capabilities.

Toward that end, the Comptroller directed the Enterprise Governance division to perform an independent review of the WF supervisory record to identify any supervision gaps and lessons learned to improve the OCC's supervisory processes going forward. This report summarizes that review.

Large Bank Supervision (LBS) had an opportunity to provide comments regarding their assessment of the effectiveness of supervision over sales practices.

OBJECTIVES

The objectives of this review were to:

- Evaluate LBS supervision of WF sales practices and incentives and identify any gaps in supervision.
- Determine if there are lessons learned that can result in improved supervision processes.

REVIEW SCOPE AND METHODOLOGY

To achieve the objectives, Enterprise Governance Supervision (EGS):

- Reviewed documents to gain an understanding of key dates and related supervisory activities since 2009. EGS used this information to search eDocs for supervisory records.
- Validate the key documents or events within the sales practices and incentives supervisory timeline.

- Assessed LBS adherence to incentive plan and sales practices supervisory guidance, processes, and examination expectations. Evaluated WF supervisory strategies and related activities since at least 2012.
- Assessed LBS adherence to consumer complaint and whistleblower supervisory guidance, processes, and examination expectations. Evaluated the adequacy of the WF team's analysis of bank customer and employee complaint data since at least 2012 and assessed the bank's monitoring of complaint and whistleblower activity related to sales practices and incentives since 2010, as available.

Additionally, an examiner from Enterprise Risk Management independent of EGS:

- Obtained and reviewed specific CAG Whistleblower complaints sent to the WF EIC. Assessed WF team's supervisory actions to follow up with WF management on the reported issues.
- Assessed CAG unit complaint and whistleblower processes for Large Banks.

The scope of this review did not include an assessment of the consent order process or supervisory activities conducted in fiscal year 2016.

REFERENCES

Comptroller's Handbook "Bank Supervision Process" (BSP) Booklet, dated September 2007, updated December 2015

Comptroller's Handbook "Large Bank Supervision" Booklet, dated January 2010, updated May 2013

Comptroller's Handbook "Consumer Compliance Management" Booklet, dated August 1996

PPM 5400-11, "Matters Requiring Attention," dated October 9, 2014 (MRA PPM)

PPM 5400-8 (Rev), "Supervision Workpapers," dated October 23, 2002 (Workpaper PPM)

FINDINGS

The OCC did not take timely and effective supervisory actions after the bank and the OCC identified significant issues with complaint management and sales practices. In Supervisory Letter (SL) 2009-46 – Compliance and Enterprise Risk Management, the OCC issued an MRA requiring an enterprise-wide system for complaint management. This 2009 MRA remained uncorrected and was incorporated into the 2016 consent order. Over the course of this seven year period, there were opportunities for the OCC to escalate supervisory action to resolve this issue. EGS did not find supervisory records of comprehensive complaint[1] analyses by the WF team from 2010 to June 2015. Supervisory strategies should have been expanded to compensate for the bank's inadequate complaint management program.

The issues with sales practices were identified in the bank's audit committee reports as early as 2005 and in OCC core assessment conclusions since at least 2010. EGS observed supervision gaps or deficient OCC processes that could have improved the timeliness and effectiveness of supervision of sales practices. They include untimely and ineffective supervision of complaints and whistleblower cases, untimely and ineffective supervision of incentive programs related to sales practices, ineffective MRA communication and follow-up, ineffective supervision of reputation risk, unclear supervisory records, and noncompliance with OCC guidance. These supervision gaps or OCC process concerns are discussed below.

1. **Untimely and Ineffective Supervision of Complaints and Whistleblower Cases**

   The WF team's supervision of consumer complaints, employee complaints received through the bank's EthicsLine, and whistleblower cases did not ensure examiners evaluated root causes (i.e., aggressive incentives, weak preventive controls) so supervisory strategies and corrective actions could have been designed to correct systemic, inappropriate practices that were the root cause.

[1] Complaints are received by the OCC through its CAG unit. The bank also receives consumer complaints, as well as employee complaints received by the bank's EthicsLine.

The supervisory record indicated several missed opportunities to perform comprehensive analyses and take more timely action beginning in 2010. There were instances where the WF team:

1. focused too heavily on bank processes versus what those processes were actually reporting,
2. reached conclusions without testing or determining the root causes of complaints despite the existence of red flags,
3. failed to follow-up on significant complaint management and sales practices issues although they were included in successive strategies, and
4. failed to document resolution of whistleblower cases.

- Following a January 13, 2010, meeting with senior bank management in which the high number of complaints were discussed, EGS found no evidence that examiners required the bank to provide an analysis of the risks and controls, or investigated these issues further to identify the root cause and the appropriate supervisory actions needed. In the meeting, examiners asked Senior Executive Vice President Tolstedt about the 700 cases of whistleblower complaints related to gaming of incentive plans. Ms. Tolstedt responded that the primary reason for the high number of complaints is that the culture encourages valid complaints which are then investigated and appropriately addressed. She also said incentive programs are capped in the stores at 10% to 20% of total cash compensation to keep motivation in check.

- SL 2010-38 – Fraud Risk Management, focused on evaluating the adequacy of the overall whistleblower processes rather than also raising concerns about the highest levels of internal EthicsLine cases which were gaming sales incentives.

- Since 2005, the bank's Board received regular Audit & Security reports indicating the highest level of EthicsLine internal complaint cases, employee terminations, and [redacted] were related to sales integrity violations. Since at least early 2010, the WF team received these same reports; however, the supervisory record does not indicate examiners investigated the root cause.

- In 2010, the WF team did not take appropriate supervisory action after attributing the complaints to cross-selling incentives and stating in the September 30, 2010, Core

Assessment, “We are aware of no assessment of the risks and controls associated with the corporate goal of cross-selling eight products per household.”

- SL 2011-14 – Operations Risk Group/Enterprise Complaints, did not include testing complaints or evaluating root causes.

- SL 2011-63 - UDAP Horizontal Discovery Review, was not issued until over two years later on January 16, 2014. The strategy for this review was to evaluate complaints for trends, patterns, and wide-spread applicability; however, the SL did not contain conclusions on these items.

- Core assessments from 2011 to 2014 did not include conclusions on the nature and volume of complaints, which is in noncompliance with the LBS Handbook.

- SL 2013-15 – ERM Reputation Risk Management (RRM), issued November 26, 2013, did not specifically identify a key continuing concern with complaint processes reported by consultants. Instead, the WF team issued a new high-level second line of defense (SLOD) MRA based in part on the consultants’ findings. The SL or MRA does not specifically discuss the complaint process concern. One of the strategy activities was, “We could review how well management monitors customer comments and complaints.” A key finding by the McKinsey & Company consultant’s report dated July 18, 2013, states the bank needs a centralized consumer complaint analysis process.

- SL 2015-07 - Community Banking (CB) Operational Risk Management, examination scope was deficient and concluded complaint oversight was satisfactory, yet there was an open MRA on complaint management. The scope did not include testing of complaints despite the negative press in 2013, the lack of complaint testing during the 2013 UDAP review, and the approved fiscal year (FY) 2015 supervisory strategy identifying “Sales Conduct, Practices and the Consumer Business Model” as a primary supervisory objective. The strategy noted “With the recent negative press in Los Angeles regarding sales practices, management has heightened the focus on consumer customers and is discussing the risks associated with sales practices, their cross sell strategy and team member conduct.” The conclusion memo for the complaints review portion of this target noted “My specific objective was to complete a review of complaints oversight. This primarily consisted of documenting the proposed changes to the structure currently in place. To accomplish this objective, we held a meeting with CB management and asked clarifying questions of management as necessary."

- From March 12, 2012 to September 8, 2016, LBS received 14 whistleblower cases from CAG related to sales practices; however, eight or 57% had no eDocs documentation. The WF team did not have an effective business process to ensure whistleblower cases were properly researched, analyzed (both individually and systemically), and resolved with supporting documentation. Contributing to the ineffective follow up conducted by the WF team is the fact that LBS does not have an end-to-end process for whistleblower cases that includes a central repository[2] to capture and monitor these cases to timely resolution, accountability checkpoints, and systemic analysis.

2. **Untimely and Ineffective Supervision of Incentive Sales Program**

The WF team missed opportunities to address concerns with unsafe or unsound sales practices in the WF Community Banking division earlier. As discussed previously, the OCC identified concerns with aggressive sales practices as early as 2010 and examiners concluded that the OCC was unaware of risk assessments or controls related to these activities. There is a 2010 workpaper that indicates the bank's 2006 #2 strategic initiative was "Going for Gr-Eight," which promoted doubling the number of products per customer to eight. The aggressive sales concern was a factor contributing to the [redacted] operational risk rating. Despite ongoing red flags from both OCC and WF internal whistleblower cases as well as internal EthicsLine complaints regarding sales integrity violations and gaming sales incentive programs, EGS found no evidence that supervisory activities included in-depth review and testing of monitoring systems and controls over this area, at least from 2011 through 2014.

Supervisory strategies for FY 2011 and FY 2013 included plans to perform incentive plan sampling and testing; however, those plans were not executed. Based on EGS review of the supervisory record, the following appear to be missed opportunities for earlier supervisory actions:

[2] Whistleblower cases are currently housed in three business unit systems, with CAG's Remedy system serving as the only comprehensive view of all whistleblower cases (excluding the ultimate resolution of each case). Legal uses AMS to track legal work performed on whistleblower cases, and LBS uses eDocs.

- The FY2011 strategy originally included a July 2011, 66-day target to review non-executive compensation; however, it was incorporated into an audit review without sampling or conclusions on compensation. The strategy noted the "Objective could be accomplished via a companywide survey or a risk-based sampling." LBS management documented approval to delay the review and change the scope to a 20-day examination of audit's coverage of compensation**.** Per LBS management response, the related SL 2011-45 did not include conclusions on compensation.

- SL 2012-49 – Talent Management and Compensation, focused on the high level scope of Heightened Expectations and did not include specific testing of governance monitoring and controls over compensation programs. To reach conclusions, the WF team primarily relied on interviews that the WF EIC conducted with bank management, bank audit conclusions, and leveraged incentive compensation work performed by the Federal Reserve (FRB) over the past few years. The WF team did not reference the [redacted] in the OCC's supervisory record and formally follow-up and document adequacy of the bank's corrective actions.

- The 2013-11 – Community Banking UDAP examination Scope Memo included plans to review the following areas: oversight of UDAP compliance, UDAP and cross sell compliance testing, cross sell strategy and incentive compensation structure, effectiveness of UDAP complaint resolution process, and transaction testing of complaints. While examiners received a PowerPoint presentation from the bank with details on the WF retail banking incentive compensation program, only a "high level" review was performed. The Conclusion Memo (CM) dated November 1, 2013, stated "We were unable to fully assess the effectiveness of the CB UDAP program due to the complexity of the CB UDAP risk profile and our limited examination staffing." The CM also states "These areas will be tested at the next UDAP examination of Community Banking in FY2015." The SL dated January 7, 2014, concluded "This was the first examination of UDAP in the Community Banking LOB. No MRAs were identified. We performed a high-level review of the Retail Bank incentive compensation program. We did not identify any program features that would encourage bankers to engage in aggressive or egregious sales practices to maximize incentive compensation. We performed a high-level review of the Regional Bank Sales Quality team and how Corporate Security captures, investigates, resolves, and reports the EthicsLine allegations. These allegations involve employees with potential UDAP violations, including non-compliance with the sales incentive program**.** We did not perform transaction testing of allegations." SL 2013-11 was issued to the bank in January 2014, after the October and December 2013 LA Times articles were published. The next target review of this area did not commence until February 2015, over one year later.

- SL 2014-25 **–** Compensation and Performance Management, focused on Heightened Expectations (now Standards) and the scope was at a high level. The SL, dated September 3, 2014, concluded that "Management has met the spirit of OCC's Heightened Expectations for Talent Management and Compensation with respect to the design of the programs and processes. However, in light of the number and severity of risk events at the bank, there were not a sufficient number of covered employees that had adverse ratings in their risk management performance or a correlated reduction of incentive compensation. In addition, the CRO indicated he had discussions with individuals regarding adverse risk management performance. The CRO should document his discussions with senior executives regarding their adverse risk management performance." The OCC issued an MRA for WF to address the abovementioned issues; however, the SL did not contain information regarding the specific risk events or senior executive discussions, and EGS did not find detail in the supervisory record regarding these issues. The bank source report was provided by the examiner. One of the risk events in the bank source report dated February 18, 2014, to CEO Stumpf regarding incentive compensation was to monitor the sales integrity violations in Community Banking in 2014.

EGS recognizes that OCC guidance and examination expectations specific to review of incentive programs related to sales practices was limited. Recently, work programs with examiner guidance and specific procedural steps to facilitate review of this area was developed for the horizontal review being conducted. This guidance may have assisted examiners in identifying concerns and taking needed corrective actions earlier.

3. **Ineffective MRA Communication and Follow-up**

EGS found unclear and ineffective communication and follow-up of the following MRAs. The MRA deficiencies described below are now addressed in the MRA PPM[3].

- SL 2009-46, Compliance and Enterprise Risk Management, dated March 22, 2010, contained an MRA requiring implementation of an enterprise-wide complaint management system. The MRA had the following communication deficiencies: not addressed to Board, not listed as an unsafe or unsound practice, and not naming root cause or responsible parties. Additionally, the follow-up scheduled in FY 2011 on the MRA was delayed, which resulted in an extended due date into 2012. Then, in October 2013 the MRA was closed without being fully corrected and the WF team rolled the tracking of implementation into a high-level Regulatory Risk Management (RRM) MRA. The timeframe for completion of the complaint process improvements in the RRM MRA was January 2016. As noted earlier in this report, the enterprise-wide complaint management MRA is still not corrected and has now been escalated to an article in the 2016 Consent Order.

4. **Noncompliance with OCC guidance**

EGS identified the following instances of noncompliance:

- Noncompliance with the LBS Supervision Booklet as there was no evidence in the Core Assessment, from 2011-2014, that examiners considered the nature and amount of exposure from customer complaints in the Reputation Risk assessment.

- Noncompliance with the MRA PPM regarding not conveying MRAs to the Board or a Board Committee:

[3] On October 9, 2014, the OCC issued PPM 5400-11, developing a new process to governing the issuance and tracking of OCC “Matters Requiring Attention,” (MRA PPM).

- SL 2015-07 – contains a First Line of Defense (FLOD) Risk Management - Sales Practice MRA. The SL was addressed to SEVP Tolstedt and not issued to Board or Board committee.
- SL 2015-36 – contains five MRAs addressing various Sales Practice concerns. The SL was addressed to Chairman/CEO Stumpf and not issued to Board or Board committee.

5. **Unclear Supervisory Records**

EGS noted the following supervisory record concerns:

- lack of documented analysis of bank source documents (i.e., EthicsLine quarterly audit reports, 2006 Strategic Initiatives),
- difficulty tracking strategy execution (i.e., 2011 Compensation Audit review),
- difficulty tracking follow-up on MRAs (i.e., MRA 2009-46), and
- difficulty tracking the specific support for conclusions. (i.e., SL 2014-25 regarding "risk events"; SL 2010-38 – documentation of sample not found for 14 EthicsLine cases)

In addition to evaluating the WF team's supervision of sales practices and incentives to identify any gaps in supervision, the scope of this review also assessed CAG unit complaint and whistleblower processes for Large Banks. Findings from that portion of this review follow:

Satisfactory CAG unit complaint and whistleblower processes for LBS.

- As the agency's only customer-facing unit, CAG currently serves as the intake avenue for whistleblower cases. This unit has well developed and understood procedures around processing of these cases, including communication of whistleblower cases to both Legal and Supervision. CAG's mission is to provide an avenue for customers to pursue questions or complaints, and it is important to make the distinction that whistleblower cases are separate and distinct from consumer complaints. With the formation of the CFPB in 2011, CAG began referring all consumer complaints for which the CFPB has authority to that agency. Responsibility for researching and resolving large bank complaints that fall outside the CFPB's authority rests primarily with CAG, while responsibility for whistleblower case research and resolution rests with Supervision and Legal as these cases are considered safety and soundness related.

- CAG makes complaint data internally available for review and analysis through its CAG Wizard. Users can sort information in meaningful ways and export each data set into Excel spreadsheets for further analysis (e.g. by bank, category whistleblower indicator).

- As of September 2016, CAG enhanced its customer assistance 800# by adding a separate queue for routing whistleblower calls. CAG changed the call script to take detailed information verbally instead of taking high level information and referring them to the online complaint filing system (they still encourage online filing). CAG expanded the analyst team to review coding of all written cases to specifically identify trends and outliers on a monthly bases with the intention of providing additional reports to appropriate lines of business.

LESSONS LEARNED

Wells Fargo supervision since 2010 provides meaningful lessons learned about the importance of comprehensive LBS complaint and whistleblower analysis and follow-up, effective supervision of controls around high risk incentives, quality MRA communication and follow-up, clear supervisory records, supervision of reputation risk, and an enterprise-wide whistleblower processes.

1. Implement a LBS process to ensure periodic, comprehensive analysis of complaints and whistleblower cases which includes testing, analysis of systemic root causes, and appropriate follow up.

2. Ensure effective and timely LBS supervision by improving controls to ensure supervisory strategies include testing of risk areas and issues, proper execution of strategies, and timely supervisory actions. Additionally, when a major issue is identified that initiates the MMSRC process, LBS should have a process to evaluate the need for a horizontal survey or analysis of other large banks to determine if the issue is systemic.

3. Ensure LBS governance processes evaluate systemic root causes of reputation risk, especially when the quantity of risk is moderate and increasing or high, and take appropriate supervisory action.

4. Ensure effective communication, follow-up, and validation of MRAs by complying with PPM 5400-11, "Matters Requiring Attention," dated October 9, 2014 (MRA PPM).

5. Ensure the supervisory record is clear. At a minimum, LBS should enhance the supervisory record trail by requiring use of the related document function in eDocs.

6. Develop an enterprise-wide whistleblower process and update external-facing interfaces (occ.gov and helpwithmybank.gov) to inform the public or other governmental agencies how to communicate whistleblower information to the OCC. Based on the findings from this review, LBS would have benefited from having well-developed whistleblower protocols in place to research each individual case, document resolution of those cases, and analyze potential systemic risk. By extension, the agency would have benefited from well-developed whistleblower protocols by having an earlier indication of potential reputation or supervision risk for the agency.

7. Improve collaboration processes between teams on multi-discipline issues such as the inappropriate sales practices which were reviewed by operational risk, enterprise risk management, and compliance risk.

8. Improve processes to include earlier collaboration with appropriate units outside of the line of business (i.e., legal, policy, etc.) when issues are identified.

9. Ensure issues or concerns are followed through to effective corrective action rather than incorporated into higher-level supervisory activities or process MRAs that delays corrective actions. (i.e., sales incentive issues identified in 2010 were incorporated into an audit review and enterprise-wide complaint management MRA concern identified in 2009 was incorporated into a second line of defense MRA.)

Although not a lessons learned, the OCC may want to review our whistleblower process for collaborating with other regulators including the CFPB.