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Wells Fargo Customer Account Scandal: Regulatory Policy Issues

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Related Authors

- Edward V. Murphy
- Raj Gnanarajah

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Edward V. Murphy, Specialist in Financial Economics (tmurphy@crs.loc.gov, 7-6201)
Raj Gnanarajah, Analyst in Financial Economics (rgnanarajah@crs.loc.gov, 7-2175)
Sean M. Hoskins, Specialist in Financial Economics (shoskins@crs.loc.gov, 7-8958)

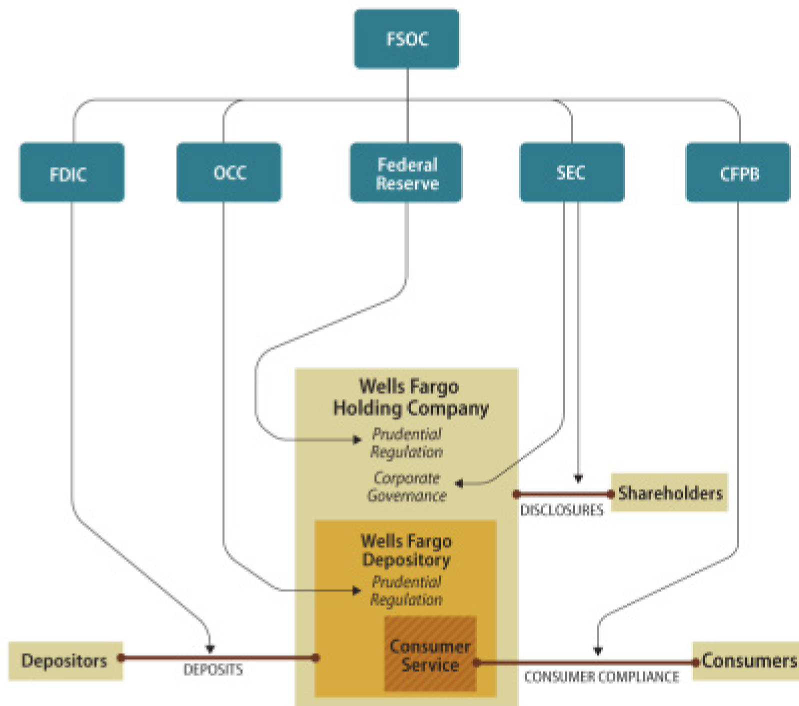
Wells Fargo Bank, N.A., is a large federally chartered depository bank. Reportedly, thousands of Wells Fargo employees harmed bank customers in a variety of ways, including opening unauthorized deposit and credit card accounts in customers' names, enrolling customers in online banking services they did not ask for, and transferring funds among existing and unauthorized accounts. These revelations present a number of policy issues in the areas of consumer protection, corporate governance, regulatory agency performance, and congressional oversight. This scandal is being examined at House and Senate hearings. For additional information about the Wells Fargo scandal, see CRS Legal Sidebar WSLG1671, *Wells Fargo's Selling Campaign—Enforcement Actions, Civil Penalties, and Possible Criminal Charges*, by M. Maureen Murphy.

Some agency actions have already been taken. On September 8, 2016, the Office of the Comptroller of the Currency (OCC) and the Consumer Financial Protection Bureau (CFPB), in coordination with the Los Angeles City Attorney (LACA), imposed a total of $185 million in civil money penalties on Wells Fargo Bank. In addition to the civil penalties, Wells Fargo is required to provide restitution to harmed customers but was not required to admit wrongdoing. These enforcement actions do not preclude further actions by regulators or criminal charges by federal prosecutors. Under the agencies' enforcement actions, no executives or employees have been penalized yet.

Figure 1 sketches the regulatory framework for the Wells Fargo account scandal apart from any potential criminal prosecutions of individual employees and executives. As a federally chartered depository bank, Wells Fargo is subject to comprehensive prudential regulation for safety and soundness by the OCC. Wells Fargo also must comply with prudential regulation from the Federal Deposit Insurance Corporation (FDIC) as an insured depository and from the Federal Reserve at the holding company level. The CFPB is responsible for regulating Wells Fargo's compliance with federal consumer protection laws. As a public company, Wells Fargo must comply with the securities laws and

Securities and Exchange Commission (SEC) regulations related to corporate governance, executive pay, and investor protection. The Financial Stability Oversight Council (FSOC) serves as a forum for cooperation among regulators.

Figure 1. Regulatory Oversight of Wells Fargo Customer Accounts



Source: CRS.

Prudential Regulation

Prudential regulators have broad powers to examine and supervise covered banks. Although the OCC, Federal Reserve, and FDIC each have safety and soundness authority, the OCC is the primary prudential regulator of Wells Fargo's bank subsidiary, including regulating its internal controls, management of operational and reputational risk, and every phase of its deposit and lending activities. The head of the OCC testified before the Senate Banking Committee on September 20, 2016, that the sales practices at the bank constituted unsafe and unsound practices, and reflected "a lack of effective risk management, a breakdown in controls, and an inappropriate incentive structure." The OCC testimony also noted that the OCC may take further enforcement actions against "directors, officers, and employees, who violate any law or regulation, engage in unsafe or unsound practices, or breach fiduciary duty."

Consumer Compliance

The CFPB has both activity-based authority and supervisory authority for consumer financial markets under some circumstances. For retail sales practices, the CFPB has rulemaking authority that applies to all consumer lenders and shares supervisory authority for banks with more than $10 billion in assets (such as Wells Fargo) with the OCC. Under the CFPB consent decree, Wells Fargo must set aside $5 million to compensate harmed consumers. Some forms of financial harm may be relatively straightforward to identify, such as fees that individuals paid on unauthorized accounts. Other forms of harm, however, may be more difficult to identify and measure. For example, an unauthorized credit card or checking account could affect a consumer's credit score which in turn could influence whether that consumer qualifies for credit and the price of that credit. CFPB action does not prevent individual consumers from suing Wells or joining class action suits; however, such redress may be limited by mandatory arbitration clauses that prohibit consumers from initiating or joining class action lawsuits. On May 5, 2016, the CFPB issued a proposed rule "that

would restrict the use of mandatory pre-dispute arbitration clauses in agreements for certain consumer financial products and services." The rule has not yet been finalized.

Corporate Governance

Wells Fargo is a publically traded firm, which means that it must comply with securities laws and the SEC's corporate governance rules. A major component of corporate governance is the business environment created by the board of directors and senior management. Regarding Wells Fargo, some have raised issues with the senior leadership's emphasis on cross-selling products and meeting specific sales goals that may have encouraged lower ranking employees' to perform unauthorized activities. A second area of concern is that securities laws govern the timing of disclosures to investors of potentially material losses. Although Wells Fargo argues the small amount of the fines paid related to the settlement was not material compared with their earnings, others argue the reputational risk made it material. Some in the investing community have questioned the bank's transparency and whether its size and complexity raises the need to break up the bank. A third corporate governance issue is whether Wells Fargo should claw back compensation paid to executives who oversaw the employees or managers involved in the unauthorized activity. Two executives recently agreed to forfeit compensation. The CEO will forfeit $41 million in stock, will not receive a bonus in 2016, and will not receive a salary while the company is investigating the accounts scandal. Another executive has left the company, will forfeit $19 million in stock and will not receive severance or a bonus in 2016. The clawback issues have highlighted a recently proposed rule by the financial regulators to prohibit compensation that incentivizes risk taking and allows pay to be clawed back in the case of certain types of misconduct.

Congressional Oversight

The Wells Fargo episode highlights a number of issues for congressional oversight about the performance of the federal regulators. On the one hand, several of the regulators, such as the OCC and the CFPB, had supervisory authority over Wells Fargo, yet did not prevent widespread fraudulent practices that occurred over an extended period of time. On the other hand, the OCC and the CFPB did issue the consent decree (with LACA) fining Wells Fargo and requiring restitution. Like many large bank incidents, the Wells Fargo account scandal involves overlapping authority of several regulators, which the FSOC is supposed to help facilitate.