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Organizational Maturity Services LLP

Wells Fargo: why business risk needs a Human Governance lens

WELLS FARGO

Recent revelations about Wells Fargo continue to raise concerns about the quality and ethical conduct of leading financial institutions in both the US and globally. The Maturity Institute and OMS believe that this example continues to demonstrate the need for an alternative and more rigorous approach to evaluating organizational risk relative to critical areas of human governance: such as corporate purpose, values, strategy and performance management, and their impact on corporate conduct. This was the headline from the Wall Street Journal on September 13th 2016:

> **Wells Fargo CEO Defends Bank Culture, Lays Blame With Bad Employees**
> Says that at the bank, 'There was no incentive to do bad things'

The CEO, John Stumpf goes on to speak about the organization's culture and underlying values and was quoted as saying *"… that some employees didn't honor the bank's culture. I wish it would be zero, but if they're not going to do the thing that we ask them to do—put customers first, honor our vision and values—I don't want them here." he said. "I really don't."* The article goes on: "The 5,300 employees who were fired over five years due to improper selling, Mr. Stumpf said, included bankers, managers and bosses of those managers. Chief Financial Officer John Shrewsberry said about 10% of the employees let go were branch managers or higher."

Shown below is an extract from the bank's website that clearly demonstrates the stated commitment to corporate values (readers may remember that ENRON also had such a document that ran to 65 pages (it remains available [for review here](#)).

> Our values should guide every conversation, decision, and interaction. Our values should anchor every product and service we provide and every channel we operate. If we can't link what we do to one of our values, we should ask ourselves why we're doing it. It's that simple.
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> All team members should know our values so well that if our policy manuals didn't exist, we would still make decisions based on our common understanding of our culture and what we stand for. Corporate America is littered with the debris of companies that crafted lofty values on paper but, when put to the test, failed to live by them. We believe in values lived, not phrases memorized. If we had to choose, we'd rather have a team member who lives by our values than one who just memorizes them.
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> We have five primary values that are based on our vision and provide the foundation for everything we do:
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> - **People as a competitive advantage**
> - **Ethics**
> - **What's right for customers**
> - **Diversity and inclusion**
> - **Leadership**

Clearly, there is a massive gap between what Wells Fargo purports to believe it has in place and what is actually happening in the front lines of the bank. There is a clear inconsistency between what is stated by CEO, company literature and what is done. 5,300 employees is too large a number to indicate that: *"…a few employees did not understand our values."*. In short, there is failure to align stated intent with actual action – as we have previously noted in other corporate examples, such action arises as a direct consequence of the board and executive sanctioning, facilitating, or being unaware of it. Either way, they have been failing in their duty of corporate and human governance.

One should also question why the senior manager responsible for this division apparently had no knowledge of what was generating the level of earnings that were being seen – which de facto went towards achieving corporate goals and contributing to compensation. The following was the recent headline from Fortune, that went on to describe how the person had decided in July to retire at the end of the year; the compensation was generated through multi-year incentives:

"Wells Fargo Exec Who Headed Phony Accounts Unit Collected $125 Million"

Anyone earning this level of compensation ought to understand what is driving the level of profit; or what is behind the numbers.

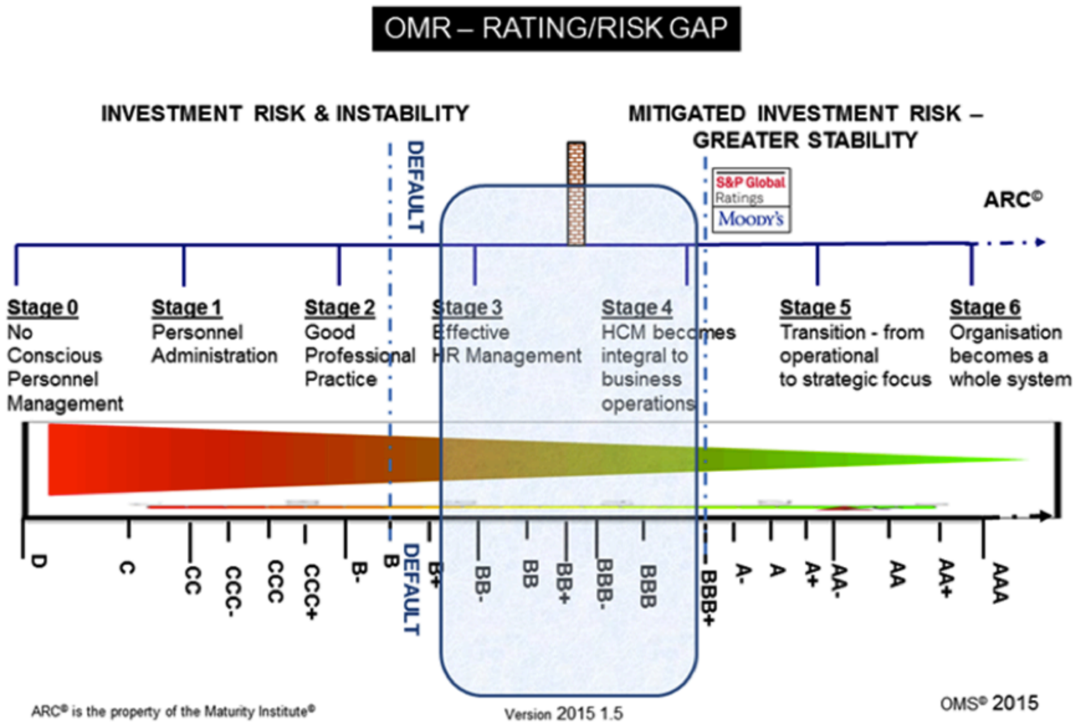
Depressingly, none of this is new. Wells Fargo has a long history of fines and prosecutions for poor conduct and here are just a few examples as quoted by The Corporate Research Project

- In November 2009 it had to agree to buy back $1.4 billion in auction-rate securities to settle allegations by the California attorney general of misleading investors.
- In May 2011 it was fined $1 million by FINRA for failing to send disclosure documents to customers.
- That same month, it agreed to pay up to $16 million to settle charges of violating the Americans with Disabilities Act.
- In July 2011 Wells Fargo agreed to pay $125 million to settle a lawsuit in which a group of pension funds accused it of misrepresenting the quality of pools of mortgage-related securities.
- That same month, the Federal Reserve announced an $85 million civil penalty against Wells Fargo for steering customers with good qualifications into costly subprime mortgage loans during the housing boom.
- In November 2011 Wells Fargo agreed to pay at least $37 million to settle a lawsuit accusing it of municipal bond bid rigging; and so on and so on…

The need for new insight

The value damage of the latest episode is already significant for all stakeholders. For investors, this hit has been significant - Warren Buffet stands to lose $1.4 billion as a result of the declining stock price (Bloomberg, September 13th 2016). So surely there should be a better way of assessing corporate risk? After all, Moody's, S&P and others rate Wells Fargo extremely low in terms of risk and all failed to predict such an outcome.

Traditional approaches to looking at financial risk based performance are no longer adequate in a world where human governance failures that drive poor behavior by staff can wipe billions off an organization’s value. This is where an assessment by OMS helps to uncover material misalignment, such as between stated values and actual corporate activity - the risk rating issued through our OMR helps senior leadership and the investor community identify what is missing. Consider the risk/ratings gap from our latest Human Governance Review for AT&T (rated at B+ on our OMINDEX):



Those responsible for corporate governance should be actively seeking greater transparency into what is going on behind the numbers. Moving beyond financial assessments will help investors become aware of the risk for surprises, will help the board start to ask the right questions and will help management identify critical actions that must be taken to more effectively convert intent into reality. Ignorance, as demonstrated by Wells Fargo CEO is no defence: Wells Fargo’s problem is systemic and requires substantial modification. In its current guise, maybe the bank is not just “too big to fail” but also “too big to manage?”

OMS Human Governance Reporting Team
Are all members of the Maturity Institute (MI), which aims to maximise societal and shareholder value through effective human governance and human capital management practice. MI adopts a whole system, evidence based approach based around its 10 Pillars and strategic framework. The OMR rating scheme is the property of OMS LLP with approval from MI. To produce an IHGR requires a multi-disciplinary team comprising members who understand each other’s expert perspective and combine it with their own to produce a seamless, whole system review. The designers and authors of our HGR come from a variety of backgrounds combining expertise and many years of experience in accounting, leadership, human capital management reporting and investment analysis: Nick Shepherd - FCPA, FCGA, FCMC, FCCA; Paul Kearns - Chair, Maturity Institute; Stuart Woollard - Managing Partner, OMS LLP

S&P500 OMINDEX Project
The Maturity Institute, OMS LLP, and Harvard Law School’s Pension and Capital Stewardship Project are collaborating on a research program to assess how Human Governance ratings of the S&P500 (and other global stock market indexes) are connected to societal and corporate value outcomes, the materiality of effective human governance and organizational maturity. It will also inform how human capital management practice is linked to financial outcomes, which is of material importance to investors.