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June 19, 2017

The Honorable Janet Yellen
Chair
Federal Reserve Board of Governors
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Dear Chair Yellen:

I write to urge the Federal Reserve Board of Governors (the "Federal Reserve") to invoke its authority under 12 U.S.C. § 1818(e) to remove the twelve current members of the Wells Fargo Board of Directors ("the Board") who served on the Board between May 2011 and July 2015 – the period in which the bank concedes its fake accounts scandal was ongoing.[1]

Last September, Wells Fargo entered into a settlement agreement in which it disclosed that it had opened more than two million fake retail customer accounts and fired more than 5000 employees for improper sales practices between 2011 and 2015. Employees opened fake accounts in response to demanding sales targets and incentives imposed by the bank's senior management. The fake accounts scandal cost Wells Fargo customers millions of dollars in unauthorized fees and damaged many of their credit scores.

The scandal also revealed severe problems with the bank's risk management practices – problems that justify the Federal Reserve's removal of all responsible Board members. Congress has empowered the Federal Reserve to remove board members if they "violated any law or regulation" or "engaged or participated in any unsafe or unsound practice" that caused an insured depository institution to "suffer financial loss" and that demonstrated "continuing disregard . . . for the safety or soundness" of that institution. The public record – including an April 10, 2017 investigative report into the Board's conduct released by the law firm Shearman & Sterling (the "Shearman & Sterling Report")[2] – establishes each of these elements:

- According to the Shearman & Sterling Report, the Board failed to create an adequate risk management framework that would have alerted it to systemic problems with retail sales practices. This failure violated Federal Reserve regulations on risk management at large banks and represented an unsafe and unsound practice. Indeed, Federal Reserve guidance explicitly states that a large bank's "failure to establish a management structure that

[1] The twelve Board Members are John D. Baker II, John S. Chen, Lloyd H. Dean, Elizabeth A. Duke, Enrique Hernandez, Jr., Donald M. James, Cynthia H. Milligan, Federico F. Peña, James H. Quigley, Stephen W. Sanger, Susan G. Swenson, and Suzanne M. Vautrinot.

[2] Sales Practices Investigation Report, Wells Fargo (April 10, 2017) (online at https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf) ("Shearman & Sterling Report").

adequately identifies, measures, monitors, and controls the risks involved in its various products and lines of business *has long been considered unsafe and unsound conduct*."[3]

- The Board's improper conduct caused Wells Fargo to suffer massive financial losses, including nearly $200 million in settlements with government entities and exposure to substantial additional losses in private litigation. It also caused long-lasting reputational damage to the bank that has eroded the bank's customer base.[4]

- The Board's failure to establish adequate risk management practices and uncover these improper retail sales practices demonstrated "continuing disregard" for the bank's safety and soundness. The Shearman & Sterling Report details the Board's refusal to seriously address improper sales practices despite years of red flags. By any measure, a bank's risk management practices cannot be adequate if they permitted more than 5000 employees to open more than two million sham accounts in a four-year span.

While other federal regulators with jurisdiction over this scandal – the Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency (OCC) – have taken steps to hold Wells Fargo accountable and promote the integrity of the banking system, the Federal Reserve has done nothing to date, despite its ample statutory authority. I urge you to use the tools Congress has given you to remove the responsible Board members and protect the continued safety and soundness of one of the country's largest banks.

I. Background

On September 8, 2016, the CFPB, OCC, and the City and County of Los Angeles announced a settlement with Wells Fargo relating to the bank's improper retail sales practices.[5] The settlement imposed a total of $185 million in penalties on Wells Fargo after they "opened roughly 1.5 million bank accounts and applied for 565,000 credit cards that may not have been authorized by customers" in an effort to meet unrealistic sales targets from May 2011 through July 2015.[6] Wells Fargo also admitted that it terminated roughly 5,300 employees during this

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[3] "Rating Risk-Management Processes and Internal Controls of BHCs Having $50 Billion or More in Total Assets," *Federal Reserve Supervisory Manual* 4070.1, 1 (July 2016) (online at https://www.federalreserve.gov/boarddocs/supmanual/bhc/4000p2.pdf) (emphasis added).

[4] *See* Emily Glazer, "Wells Fargo's New Mission: Growth, Not Scandal," Wall Street Journal (June 8, 2017) (online at https://www.wsj.com/articles/wells-fargo-focuses-on-pivot-from-scandal-to-growth-1496914205?tesla=y); *see also* Matt Egan, "Wells Fargo's reputation is tanking, survey finds," *CNN Money* (Oct. 24, 2016) (online at http://money.cnn.com/2016/10/24/investing/wells-fargo-fake-accounts-angry-customers/index.html); *see also* Gillian B. White, "The Toll of Wells Fargo's Account Scandal," *The Atlantic* (Apr. 19, 2017) (online at https://www.theatlantic.com/business/archive/2017/04/wells-fargo/523578/).

[5] Michael Corkery, "Wells Fargo Fined $185 Million for Fraudulently Opening Accounts," *New York Times* (Sept. 8, 2016) (online at https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html); *see also* Consent Order 2016-CFPB-0015, Consumer Financial Protection Bureau (Sept. 8, 2016) (online at http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf).

[6] Michael Corkery, "Wells Fargo Fined $185 Million for Fraudulently Opening Accounts," *New York Times* (Sept. 8, 2016) (online at https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html).

time period – that is, approximately 1 percent of the employees in its Community Bank group were fired each year – in relation to its sales goals.[7]

In its consent order, the CFPB stated that Wells Fargo's Community Bank had (1) "opened unauthorized deposit accounts for existing customers and transferred funds to those accounts" without their knowledge; (2) "submitted applications for credit cards in consumers' names using consumers' information" without customers' knowledge or consent; (3) "enrolled consumers in online-banking services" without their knowledge or consent; and (4) "ordered and activated debit cards using consumers' information" without obtaining their consent.[8]

Shortly after the settlements were announced, Wells Fargo created an Oversight Committee to "conduct a comprehensive investigation of sales practice issues that arose in Wells Fargo's Community Bank."[9] Four members of the Board sat on the Committee: Stephen Sanger, Elizabeth Duke, Donald James, and Enrique Hernandez, Jr.[10] The Committee retained the law firm Shearman & Sterling to conduct an independent investigation and write a report on the fake accounts scandal at the bank. The Committee released Shearman & Sterling's 110-page investigative report on April 10, 2017.

The Shearman & Sterling Report was the result of exhaustive investigation. The firm "conducted 100 interviews of current and former employees," focusing on "senior members of management across all of the areas that had significant contact with sales practice issues."[11] Shearman & Sterling also reviewed over 35 million documents from Wells Fargo, in addition to reviewing "information concerning more than 1,000 investigations of lower level employees terminated for sales integrity violations."[12] And the firm retained FTI Consulting, Inc., a "forensic consulting and data analytics firm," to review Wells Fargo's accounts and systems.[13]

Two weeks after the release of the Shearman & Sterling Report, the Wells Fargo shareholders voted to retain all fifteen Board members, including the twelve who served on the Board during some or all of the period covered by the bank's September 2016 settlement agreement.[14] Although each Board member received at least 50 percent of the vote, shareholder support hit historic lows for several members who served throughout all or part of the fake accounts scandal.[15] Chairman Sanger, along with three others, failed to reach 60 percent shareholder support, and none of the twelve holdover Board members reached 80 percent support.[16] All twelve holdover Board members are still serving on the Board as of today.

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[7] *Id.*; *see also* Shearman & Sterling Report.
[8] Consent Order 2016-CFPB-0015, Consumer Financial Protection Bureau (Sept. 8, 2016) (online at http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf).
[9] Shearman & Sterling Report at 1.
[10] *Id.* at 2.
[11] *Id.* at 2–3.
[12] *Id.* at 3.
[13] *Id.*
[14] Stacy Cowley, "Wells Fargo Shareholders Tepidly Re-elect Bank's Directors," *New York Times* (Apr. 25, 2017) (online at https://www.nytimes.com/2017/04/25/business/dealbook/wells-fargo-board.html).
[15] *Id.*
[16] Dan Freed and Ross Kerber, "Wells Fargo board gets black eye in shareholder vote," *Reuters* (Apr. 25, 2017) (online at http://www.reuters.com/article/us-wells-fargo-accounts-meeting-idUSKBN17R0AM).

II. The Federal Reserve Is Authorized to Remove the Holdover Wells Fargo Board Members.

The Federal Reserve has the legal authority to remove Wells Fargo Board members under 12 U.S.C. § 1818(e). The statute empowers the Federal Reserve to "remove [a] party from office or to prohibit any further participation by such party, in any manner, in the conduct of the affairs of any insured depository institution."[17] Such parties include "[a]ny director...of [a] depository institution holding company."[18]

Among other reasons, the Federal Reserve is authorized to remove a director if she "violated . . . any law or regulation" or "engaged or participated in any unsafe or unsound practice,"[19] and that conduct caused the insured depository institution "financial loss or other damage" and demonstrated "continuing disregard . . . for the safety or soundness" of the institution.[20]

III. The Federal Reserve Should Remove the Holdover Wells Fargo Board Members.

The Federal Reserve should exercise its authority under 12 U.S.C. § 1818(e) to remove the twelve holdover Wells Fargo Board members. The conduct of these Board members satisfies the requirements of Section 1818(e).

A. The Holdover Board Members Violated Federal Reserve Regulations and Participated in Unsafe and Unsound Practices by Failing to Establish an Adequate Risk Management Structure.

The failure of the Wells Fargo Board to create adequate risk management practices – as detailed in the Shearman & Sterling Report – both violated Federal Reserve regulations and constituted unsafe and unsound practices under Federal Reserve guidance.

In 2014, the Federal Reserve promulgated regulations applying enhanced prudential standards to bank holding companies with $50 billion or more in assets.[21] The regulations went into effect on January 1, 2015. Wells Fargo is subject to these enhanced standards.

The enhanced prudential standards include standards relating to risk management. Those standards state that a "bank holding company's global risk-management framework must be commensurate with its structure, risk profile, complexity, activities, and size and must include:"

- "Processes and systems for identifying and reporting risks and risk-management deficiencies, including regarding emerging risks, and ensuring effective and timely implementation of actions to address emerging risks and risk-management deficiencies for its global operations;"

[17] 12 U.S.C. § 1818(e); *See* 12 U.S.C. § 1813(q)(3).
[18] 12 C.F.R. § 359.1(h).
[19] 12 U.S.C. § 1818(e)(A)
[20] *Id.* § 1818(e)
[21] Board of Governors of the Federal Reserve System, "Federal Reserve Board approves final rule strengthening supervision and regulation of large U.S. bank holding companies and foreign banking organizations," press release (Feb. 18. 2014) (online at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140218a.htm).

- "Processes and systems for establishing managerial and employee responsibility for risk management;"

- "Processes and systems for ensuring the independence of the risk-management function;" and

- "Processes and systems to integrate risk management and associated controls with management goals and its compensation structure for its global operations."[22]

The Federal Reserve has also stated that failing to create an adequate risk management framework is a form of unsafe and unsound conduct. In a set of guidelines the Federal Reserve issued last year on risk management processes at institutions with more than $50 billion in assets, the Federal Reserve stated:

> A bank holding company's failure to establish a management structure that adequately identifies, measures, monitors, and controls the risks involved in its various products and lines of business *has long been considered unsafe and unsound conduct.*[23]

The Shearman & Sterling Report establishes that the holdover Wells Fargo Board members violated the Federal Reserve's risk management regulations and its guidance on unsafe and unsound conduct. The bank failed to establish a "global risk-management framework . . . commensurate with its structure, risk profile, complexities, [and] activities," and failed to set up risk-management processes that "ensur[ed] effective and timely implementation of actions to address emerging risks and risk-management deficiencies."[24]

The Shearman & Sterling Report describes the bank's highly decentralized and hands-off approach to risk management, despite a series of red flags about the failure of that approach. Wells Fargo management acknowledged the need to increase oversight of sales practices in 2013, and yet "no one from Corporate Risk was assigned responsibility as the 'owner' of that area until 2015."[25] This was in part due to the "incorrect belief, extending well into 2015, that improper [sales] practices did not cause any 'customer harm.'"[26]

In February 2015, Wells Fargo's internal risk-assessment process for "Noteworthy Risks" downgraded the risks associated with sales practices from "High" to "Medium."[27] Just months later, in April and May 2015, Carrie Tolstedt, the President of the Community Bank, gave two "highly unsatisfactory" presentations regarding sales practices to the Board's Risk Committee,

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[22] 12 C.F.R. § 252.33(a)(2).
[23] "Rating Risk-Management Processes and Internal Controls of BHCs Having $50 Billion or More in Total Assets," *Federal Reserve Supervisory Manual* 4070.1, 1 (July 2016) (online at https://www.federalreserve.gov/boarddocs/supmanual/bhc/4000p2.pdf) (emphasis added).
[24] 12 C.F.R. § 252.33(a)(2).
[25] Shearman & Sterling Report at 63.
[26] *Id.* at 14.
[27] *Id.* at 69.

yet the Board continued to defer to management while taking no direct action to address the problems.[28]

During these meetings, Tolstedt reported incomplete numbers on terminations, claimed that the root cause of sales practice problems was employee misconduct rather than improper incentives, and assured the Board that the bank's controls had been "effective" in detecting the issues.[29] In October, the Board was again critical of a presentation on sales practices from the President of the Community Bank, but took no direct action.[30] As the Shearman & Sterling Report acknowledges, Wells Fargo's decentralized risk management allowed Tolstedt to suppress crucial information and downplay the risks within the Community Bank to the Board.[31]

In late 2015, years after the problem first arose, and nearly a full year after the obligation to adopt an adequate risk management framework, Wells Fargo finally established a Sales Practice Oversight Group within its Corporate Risk group.[32] In May 2016, the Sales Practice Oversight Group admitted it still had "considerable work to do in order to build a fully functioning, integrated, and sustainable" oversight program.[33] That same month, Wells Fargo finally made changes to its internal structure in order to remove "organizational impediments" that had resulted in the Board's ignorance of sales practice issues.[34]

According to the Shearman & Sterling Report, in September 2016, the Board learned for the first time that thousands of employees had been fired for sales practices violations.[35] And in 2017, the Board and the Risk Committee finally begin insisting on more detailed and concrete plans from the Community Bank, a practice which the Shearman & Sterling Report admits the Board should have begun much earlier.[36]

Despite its highly decentralized risk management process and its failure to adequately address improper retail sales practices, the Board itself assured shareholders in 2013 that it was responsible for effective risk management. The Board noted that risk management started "at the top," and stated that "the Board and the Operating Committee are the starting point for establishing and reinforcing our risk culture and have *overall and ultimate responsibility for oversight of our risks*."[37] While the Board claimed it was responsible for risk management in 2013, there was, as the Shearman & Sterling Report explains, a "culture of substantial deference."[38]

Wells Fargo's commitment to a decentralized oversight approach and its pattern of inaction in the face of numerous red flags represent a clear "failure to establish a management structure"

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[28] *Id.* at 70.
[29] *Id.* at 105.
[30] *Id.* at 107.
[31] *Id.* at 8, 11-12, 60.
[32] *Id.* at 70–71.
[33] *Id.* at 71.
[34] *Id.*
[35] *Id.* at 109.
[36] *Id.* at 16-18.
[37] "Annual Report 2013," *Wells Fargo & Company* 51 (2014) (online at https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2013-annual-report.pdf) (emphasis added).
[38] Shearman & Sterling Report at 13.

that adequately identified and controlled risks. Simply put, the Board cannot possibly have satisfied its risk-management obligations under Federal Reserve regulations and guidance while allowing more than 5000 employees to create more than two million fake accounts over a four-year span.

B. The Improper Conduct of the Holdover Wells Fargo Board Members Caused Wells Fargo to Suffer Financial Loss.

Wells Fargo suffered significant financial loss as a result of the Board's failures. The regulatory settlements cost the bank nearly $200 million.[39] A recent class action settlement cost the bank another $110 million,[40] and, as the Shearman & Sterling Report states, there has been a "cascade of civil litigation" following the revelation of the scandal.[41]

Beyond these immediate costs, the scandal has caused "serious harm to Wells Fargo's reputation"[42] and eroded Wells Fargo's customer base. Since the September 2016 settlement, the bank's revenue has fallen for the first time in years, and its shares are performing worse than the other three largest U.S. banks.[43] Wells Fargo's return on equity sunk to 11.5 percent last quarter, down from a high of 14 percent in 2014.[44] And consumers are abandoning the bank, with individual checking-account openings down 35% from last year, and credit card applications down 42% during the same period.[45] These trends will have a significant negative impact on Wells Fargo's revenue.

C. The Conduct of the Holdover Wells Fargo Board Members Demonstrated Continuing Disregard for the Safety and Soundness of the Bank.

The holdover members of the Board exhibited "continuing disregard . . . for the safety and soundness" of the bank. An individual's conduct satisfies the "continuing disregard" standard of Section 1818(e) if it was "voluntarily engaged in [that conduct] over a period of time with heedless indifference to the prospective consequences."[46] As detailed earlier in this letter, the Shearman & Sterling Report establishes that the Board ignored several red flags about the bank's sales practices over the course of several years. That long-standing failure satisfies Section 1818(e)'s continuing disregard requirement.

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[39] Michael Corkery, "Wells Fargo Fined $185 Million for Fraudulently Opening Accounts," *New York Times* (Sept. 8, 2016) (online at https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html).

[40] "Wells Fargo announces agreement in principle to settle class action lawsuit regarding retail sales practices," *Wells Fargo* (Mar. 28, 2017) (online at https://www.wellsfargo.com/about/press/2017/class-action_0328/).

[41] Shearman & Sterling Report at 76.

[42] *Id.*

[43] Emily Glazer, "Wells Fargo's New Mission: Growth, Not Scandal," *Wall Street Journal* (June 8, 2017) (online at https://www.wsj.com/articles/wells-fargo-focuses-on-pivot-from-scandal-to-growth-1496914205?tesla=y).

[44] *Id.*

[45] *Id.*

[46] *Candelaria v. F.D.I.C.*, 134 F.3d 382 (10th Cir. 1998) (internal quotations and citations omitted).

IV. Conclusion

I urge you to exercise your legal authority to remove the holdover Wells Fargo Board members. Federal Reserve regulations and guidance impose clear risk-management obligations on the Board – obligations that are quite demanding for a bank as large and complex as Wells Fargo. The Shearman & Sterling Report – an exhaustive investigation into the Board's conduct – establishes that the Board failed to satisfy its risk-management obligations. The Board did nothing to stop rampant misconduct in the Community Bank that resulted in more than 5000 bank employees creating more than two million fake accounts over four years.

The 2008 financial crisis demonstrated the danger of inadequate risk-management practices at the country's largest banks. The Federal Reserve must hold the Wells Fargo Board members accountable for their risk-management failures – both to ensure the safety and soundness of one of the country's biggest banks and to show the rest of the banking industry that poor risk-management practices will not be tolerated. The CFPB and the OCC have acted within their jurisdiction in response to the Wells Fargo scandal. It is time for the Federal Reserve to act as well.

Sincerely,

Elizabeth Warren

Elizabeth Warren
Ranking Member
Senate Subcommittee on Financial Institutions and Consumer Protection