Protecting Health, Safety and Democracy

October 18, 2016

Mary Jo White
Chair
Securities and Exchange Commission

Re: "Disclosure Update and Simplification," Proposed Rule
File No. S7-15-16
RIN 3235-AL82

Dear Chair,

We oppose the proposed rule of the Securities and Exchange Commission's (SEC, Commission, or Agency) titled "Disclosure Update and Simplification." This enormously complex tangle of jolting alterations that is speeding through the Agency poses serious dangers. The Commission must withdraw this proposal and approach disclosure from the vantage point of what best serves investors.

Disclosure forms the foundation of market integrity, of how investors decide how to allocate their savings, and how the SEC can detect misconduct.[1] Changes to this foundation threaten the entire market. Changes cannot be made without extreme care.

Yet the SEC proposes a major devaluation of this disclosure framework and couches its proposal in the comforting phrase "disclosure simplification." On its face, the rulemaking may appear to be a series of innocuous changes. In fact, these proposals portend vast and dangerous consequences for investors and the market generally.

The recent revelations that Wells Fargo signed up customers for accounts without their consent serves as an obvious object lesson about the need for more, not less disclosure, and for better enforcement of existing disclosure rules. According to the Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency (OCC), and the Los Angeles (LA) City Attorney, Wells Fargo engaged in fraudulent cross-selling practices that were described respectively as "improper,"[2] "unsafe or unsound,"[3] and "an ambitious and

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[1] Joel Seligman, THE TRANSFORMATION OF WALL STREET, Houghton Mifflin (2003)
[2] *In the matter of: Wells Fargo Bank, N.A., Consent Order,* U.S. CONSUMER FINANCIAL PROTECTION BUREAU (Sep. 8, 2016), at p. 3, http://bit.ly/2dpnuyN.

strictly enforced sales quota system" in which "those failing to meet sales quotas are approached by management, and often reprimanded and/or told to 'do whatever it takes' to meet their individual sales quotas."[4] By Wells Fargo's own analysis, as noted in the CFPB consent order, "employees opened 1,534,280 deposit accounts that may not have been authorized and that may have been funded through simulated funding, or transferring funds from consumers' existing accounts without their knowledge or consent." Employees also "submitted applications for 565,443 credit-card accounts that may not have been authorized by using consumers' information without their knowledge or consent." [5] The CFPB's consent order covers January 1, 2011, to present. Public Citizen analyzed Wells Fargo's annual disclosure on cross sells and found that this figure rose even more markedly from 1998 to 2011 than from 2011 to present. Anecdotal reports suggest that the company was using fraudulent methods prior to 2011 to boost its cross-sell numbers. Former Wells Fargo Branch Manager Susan Fischer recently told CNN: "These practices were going on way before 2011."[6] According to CNN, "Fischer said she remembers her district manager instructing her in 2007 to make the employees reporting to her open unauthorized accounts."[7] We attach our report.

As Wells Fargo reported steadily rising figures, here are simply a few of the inconvenient items that are obviously material to how an investor values this stock that the SEC failed to ensure that Wells Fargo disclose.

- In 2009, Wells Fargo executives recognized that certain ambitious sales programs – such as "Jump into January" – were leading to the creation of fraudulent accounts. This was not disclosed.[8]
- In February 2011, Chairman and CEO John Stumpf reportedly received an email from a 22-year veteran of the company explaining how the appearance of growth in new accounts could be faked; this employee was subsequently terminated. This was never disclosed.[9]
- In 2011, employee satisfaction surveys reportedly found that bank employees were uncomfortable with instructions from management to push customers to buy products. [10] This was not disclosed.

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[3] *In the matter of: Wells Fargo Bank, N.A. Sioux Falls, South Dakota, Consent Order,* U.S. DEPARTMENT OF THE TREASURY COMPTROLLER OF THE CURRENCY, (Sep. 6, 2016), at p. 2, http://bit.ly/2dq1J1o.

[4] *Wells Fargo & Company, et al., Complaint for Equitable Relief and Civil Penalties,* THE PEOPLE OF THE STATE OF CALIFORNIA, (Sep. 6, 2016), at p. 2, 6, http://bit.ly/2cJ2Y9V.

[5] *In the matter of: Wells Fargo Bank, N.A., Consent Order,* U.S. CONSUMER FINANCIAL PROTECTION BUREAU, (Sep. 8, 2016), at p. 5, 7, http://bit.ly/2dpnuyN.

[6] Matt Egan, *Wells Fargo Workers: Fake Accounts Began Years Ago*, CNN MONEY (Sep. 26, 2016), http://cnnmon.ie/2ddF1He.

[7] *Id.*

[8] Letter to Stephen W. Sanger, Lead Director, Wells Fargo & Co Chair John Stumpf from Dieter Waizenegger, director, CtW Investment Group, (September, 2916)

[9] Letter to Chair John Stumpf from CtW Investment Group, (September, 2916)

[10] Letter to Chair John Stumpf from CtW Investment Group, (September, 2916)

- In 2012, the community banking unit began to investigate suspicious practices in areas with high levels of customer complaints, such as Southern California. These investigations reportedly led to the firing of 200 employees in February 2013.[11] This was not disclosed.
- In 2013, 2014, the board and management took action in response to these signals and at the request of regulators— including increasing risk management standards in the community banking divisions, modifying some sales goals, and conducting an internal investigation by Accenture and Skadden, Arps on which the board was reportedly updated. This was not disclosed.
- The Consumer Financial Protection Bureau began its investigation in 2013. This was not disclosed.
- Wells Fargo employees delivered petitions with more than 10,000 signatures to the board at both the 2014 and 2015 annual meetings that urged the board to recognize the link between Wells Fargo's high-pressure sales quotas and the fraudulent opening of accounts without customer permission. These petitions called on Wells Fargo to cease using these high-pressure quotas. This was not disclosed.
- The *New York Times* reports that even after the company began to recognize the problem and provide ethics training that warned against creating false accounts, the continued sales pressure from management overwhelmed the ethical training. When employees either refused to sell customers products they did not want, or reported fraudulent account creation to the Wells Fargo ethics line, they were subject to discipline including termination. This was not disclosed.

We believe a proposal by the SEC to relax disclosure requirements across a broad swath of operating areas is unacceptable when faced with the obvious need, as highlighted by Wells Fargo, to move in the opposite direction and tighten disclosure requirements as corporations seek to skirt them.

Unsound basis

The Agency's proposed rulemaking rests on two false premises.

The first is that investors are burdened with too much information from the companies in which they invest. The Agency explains that their objective is to "streamline disclosures for investors."[12] We are unaware of this burden, or of any demand, serious or otherwise, expressed in the investment community for less disclosure. On the contrary, investors consistently ask for more information. One clear example is political spending, as evidenced by a petition calling for this transparency with more than 1.2 million investor and public comments. Investors are not "buried," by too much disclosure. Analysts, Bloomberg technology, and journalists, have long found needles in haystacks; search engines have now

[11] E. Scott Reckard, *Wells Fargo's pressure cooker sales culture comes at a cost*, LOS ANGELES TIMES, (Oct 5, 2013), http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html
[12] Federal Register at P. 51615

revolutionized analysis of data.[13] Moreover, to the extent that some documents appear large, many of these disclosures are volunteered by issuers. For example, the JP Morgan annual report for 2015 (issued in the spring of 2016) spans 320 pagers. JPMorgan might have spared readers the first 64 pages altogether, which are a celebration of the company's fine achievements. These 64 pages are almost identical to the introduction in the previous annual reports. Of these 64 pages, 50 consist of a letter from CEO and Chairman James Dimon. A standard chair's report is 1 or 2 pages. And these 50 pages are almost identical each year. By contrast, there is almost no discussion of the company's swaps book, the mismanagement of which during the London Whale episode sent the stock price down nearly 30 percent. [14]

In fact, disclosure discrepancy forms the core for crashes:

- The crash in 1929 followed revolutions of watered stock and hidden debt. For example, First National Citibank (progenitor of today's Citigroup) sold as equity a stake in Cuban sugar plantations that were actually non-performing loans
- In the S&L crisis, senior managers cooked their disclosures. Texas thrifts concocted a daisy chain, temporarily parking bad assets at the lasted thrift the federal supervisor inspected until the supervisor came and finished their inspection.
- The Enron, WorldCom, Tyco, Healthsouth, Parmalot, etc. scandals at the turn of the millennium all built on non-disclosure. For example, Enron created special investment entities it claimed it did not control because they had outside investors, although the outside investor turned out to be insider Andrew Fastow. [15]
- The crash of 08 depended on moving liabilities out of view, "off balance sheet," to use industry's misdirecting euphemism. Chief among these liabilities were mortgage securitizations. However, these securitizations contained clauses requiring the bank to repurchase them should a certain volume of underlying mortgages fail, which they did. Had these liabilities been disclosed, that is, had they be on the balance sheet, investors might have slowed the mortgage securitization frenzy. [16]

In the absence of true investor demand, the SEC is paradoxically jumping this initiative to the head of a queue that remains log-jammed with dormant, vital, mandated requirements from the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. After soliciting comments to broad disclosure questions in their S-K concept release just months ago as a part of the agency's "disclosure effectiveness review" process, it seems unlikely that SEC could have digested the many thoughtful responses it received before it published this proposal to change disclosure rules. In fact, the "Disclosure Update and Simplification"

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[13]One wonders if this new search technology and analytics is what has prompted industry to seek less disclosure, since burying investors in unnecessary information doesn't hide the bad stuff as readily.

[14] See introduction of TOO BIG, by *Bartlett Naylor*, PUBLIC CITIZEN (June 22, 2016)

[15] See Mimi Schwartz, POWER FAILURE (2004)

[16] http://www.accounting-degree.org/scandals/

proposal that we presently review came out *before* the S-K comment deadline, making it certain that a set of the comments were not reviewed prior to its release.[17]

The second false premise is the idea that materiality (the standard upon which corporations base their disclosure decisions) is overbroad and should be narrowed to only "financial materiality."

Materiality applies to the notes in financial statements, namely, the description by management of specific items that are part of the aggregate quantifications in the financial statements, either the income statement or balance sheet. (For example, certain revenue and expense results at a fast food chain may be different than expected, and management may explain that restaurants in a region of the country suffered food poisoning from bad chicken.[18])

Currently, as described by the Financial Accountings Standards Board (FASB), materiality means information that "could" influence investor decisions. [19] FASB now proposes to change the definition of materiality from what "could" influence an investor, to what "would" influence the investor.[20][21] FASB further proposes to declare that materiality is a legal concept.[22] This makes a firm's legal officer the pivotal arbiter of the issue. Currently, an independent auditor might take a contest over whether an item should be discussed in the notes to the firm's board audit committee. With this dynamic in force, the company's financial officer might tend to accept the auditor's recommendation instead of facing board arbitration. Under the new FASB rubric, a dispute between the auditor and in-house finance

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[17] *Business and Financial Disclosure Required by Regulation S-K* (Release No. 33-10064 (Apr. 13, 2016) available at https://www.sec.gov/rules/concept/2016/33-10064.pdf ;

[18] One imagines that the accounting industry might have developed a manual that establishes numerical metrics. The question of materiality is undoubtedly informed by the hundreds of independent auditor hours expended each year at many thousands of public companies, a ritual that has taken place for many decades. Further, the stock market provides a minute-by-minute evaluation of information that changes stock prices. Given this one might hope that a concept so basic as materiality would enjoy a more muscular description than what seems little beyond a tautology, namely, that which could change an investor's view.

[19] The SEC was created to buffer investors from the unscrupulous huckster in the private sector; so trusting the private sector to set standards (via FASB) could mean that hucksters have taken over or at least are influencing that standard setting process. P. 51611

[20] See FASB Project Update, (website visited October 2015), Available at: http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156344894

[21] See press release, Univ of Tennessee, available at: http://tntoday.utk.edu/2015/10/29/carcello-speaks-proposed-rules-limiting-disclosure/

[22] These venues include the law, facts, and markets, which can be influence by emotion. Information contained in print may have a different impact than video. For example, it may be immaterial that a CEO is arrested for DUI. However, if this arrest is captured on video, this may lead to a different impression of the same information. See discussion, available at: http://www.theconglomerate.org/2010/10/is-your-ceo-being-arrested-for-dwidui-material.html. In another case, a CEO was caught on a surveillance camera abusing his dog. This became public, and the company was forced to issue a statement condemning its CEO. See San Diego Union, available at: http://www.sandiegouniontribune.com/news/2014/aug/25/centerplate-ceo-dog-kicking-san-diego-contracts/

official will be settled by the in-house counsel. With this dynamic, the company's auditor is less likely to contest the omission of what she might consider material information. In short, the FASB proposal will result in less information.

This forthcoming definition of materiality should be stopped in its tracks. A number of investor organizations have called on FASB to stop this effort. The SEC's own Investor Advisory Committee similarly warned against debasing the definition of materiality. [23]

Regrettably, the SEC seems to be moving in the same direction as FASB. Many of the changes proposed in the "disclosure simplification" that the agency is seeking comment on here would do away with SEC rules in favor of US GAAP, or generally accepted accounting principles disclosures, and would narrow the definition of materiality to that which is financially relevant. This could frustrate the investor demand for new information in many areas such as political spending disclosure. Corporate political expenditures may not be massive in aggregate amounts, but they are still risky because they involve politics and could embroil the company in reputational issues and ultimately hurt the bottom line.

On top of these two false premises nests a warren of indecipherable statutory, accounting, and legal terms masking some decidedly dangerous changes. SEC Commissioner Kara Stein emphasized this inscrutability:[24]

> Despite its 500 plus page length, this proposal may be framed in such a hyper-technical way that it fails to provide a bonafide opportunity for a wide variety of commenters to truly access and understand what is being proposed and what we are seeking comment on. Any rulemaking release on a technical subject matter can and should, be made accessible to all of the stakeholders who will be impacted if the proposal is adopted. Unfortunately, the release before the Commission today may exclude commenters from the dialogue and limit access to our rulemaking process to specialized experts. For example, how can non-experts compare distinctions between Rule 4-08(m)(1)(ii) of Regulation S-X and Accounting Standards Codification 860-30-50-7 without more information? How are investors to weigh in if they can't make heads or tails of the subject matter?

Only an attorney schooled in economics, business history, and accounting, and blessed with an encyclopedic understanding of SEC statutes, experience with the history of GAAP, IFRS and other standard setting wars, and afforded significant time for reading, study, review and consultation, could possibly proffer a thorough, definitive comment. And yet, the perils of

[23] Letter to the FASB from the SEC Investor Advisory Committee available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-materiality-012116.pdf

[24] Stein's continues: "How are investors to weigh in if they can't make heads or tails of the subject matter? I requested the release provide greater clarity and context for these topics and others. This was not adequately done. It is bitterly ironic that a release on disclosure effectiveness fails to present information in a clear, concise, and understandable way to the public. How can we require issuers to provide information in plain English, yet fail to meet this standard ourselves? Moreover, how are we to fulfill our mission of investor protection if we effectively exclude commenters from engaging on rulemakings that will impact the disclosure they receive? How are we to be the investor's advocate, if we do not provide investors with bonafide opportunities to engage? See: https://www.sec.gov/news/statement/stein-statement-open-meeting-071316-disclosure-update.html

not commenting on this rule could lead to a disastrous narrowing of the key standard upon which many investors seek increased disclosures.

Selected Specific Problems

We highlight only a few of the specific dangers beyond our general concerns regarding narrowing disclosure and the definition of materiality:

1. *Repurchase agreements.*

The Agency proposes to delete Rule 4-08(m)(1)(ii). (The Agency does not explain what this rule does in the preamble, simply the reasons it proposes to delete it.)[25] This rule requires that firms that borrow money through the repurchase agreement (repo) market should declare the details of these liabilities if they exceed 10 percent of the assets of the firm. This 10% dependence level is important both to investors in the borrowing firm, and to counterparties as they make credit decisions. The financial crisis demonstrated that firms such as Lehman had grown addicted to repo, and had manipulated tax and other rules to enable its dependency. In fact, repo disclosure should be enhanced, not deleted.[26] The Agency makes no reference to these issues; instead, the basic reason that the SEC proposes to eliminate this requirement is that U.S. GAAP provides for similar or overlapping reporting. Similar, overlapping standards are not the same standards, just as two photographs of a building from different angles or distances may be similar or overlapping, but are not the same. A photograph from 50 feet is similar but not the same as one from 500 feet.

GAAP, or generally accepted accounting principles, it must be noted, are not generally

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[25] Here is the rule:

> **(A)** If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount) of securities or other assets sold under repurchase agreements, other than securities or assets specified in paragraph (m)(1)(ii)(B) of this section, exceeds 10% of total assets, disclose in an appropriately captioned footnote containing a tabular presentation, segregated as to type of such securities or assets sold under agreements to repurchase (e.g., U.S. Treasury obligations, U.S. Government agency obligations and loans), the following information as of the balance sheet date for each such agreement or group of agreements (other than agreements involving securities or assets specified in paragraph (m)(1)(ii)(B) of this section) maturing (*1*) overnight; (*2*) term up to 30 days; (*3*) term of 30 to 90 days; (*4*) term over 90 days and (*5*) demand:
> ***(i)*** The carrying amount and market value of the assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit under the repurchase agreements; and
> ***(ii)*** The repurchase liability associated with such transaction or group of transactions and the interest rate(s) thereon.
> **(B)** For purposes of paragraph (m)(1)(ii)(A) of this section only, do not include securities or other assets for which unrealized changes in market value are reported in current income or which have been obtained under reverse repurchase agreements.

[26] *See, e.g.*, Steven Smalt and J. Marshall Mc Comb II, *An Examination of Repurchase Agreements*, Journal of Finance and Accountancy, Volume 19, March 2015 available at http://www.aabri.com/manuscripts/152156.pdf (outlining the accounting loophole that Lehman Brothers took advantage of in effecting its infamous "Repo 105" transactions. These accounting manoeuvers allowed Lehman Brothers to temporarily remove billions of dollars of assets from its balance sheet, thereby hiding the true extent of its leverage.)

accepted. Nor is the publication freely available. One edition spans 7,692 pages across four volumes.[27] U.S. GAAP differs from accounting standards in other countries (an acute problem given that many public companies operate in multiple nations). And it can change, regardless of what the SEC does. As with many other proposals, the Agency is ceding its responsibility to safeguard disclosure to private sector organizations, in this case GAAP and FASB. The SEC should instead oblige its mandate.

2. Pro forma business combination

The agency proposes[28] to delete pro forma (forward looking, with results combined for as yet separately operating units) financial information in interim filings for business combinations, as provided in Rule 8-03(b)(4). Annually, Berkshire Hathaway CEO Warren Buffett lectures on the accounting manipulations of those who merge companies, where promises are highlighted and problems not disclosed.[29] More than half of all mergers fail.[30] If financial reporting were accurate and frequent, accountants would be better positioned to recognize problems as they occur, and ideally, advise merger-inclined executives that the marriage may not be such a good idea; delayed reporting can allow hope to replace harsh, immediate reality. Requiring pro forma projections on an interim basis results in some discipline; eliminating this will permit even more whitewashing.

3. Executive compensation

The Agency proposes[31] to delete its requirement that executive compensation be disaggregated. Disaggregation allows investors to see what in the pay package is cash, stock, options, etc. The reason for the deletion is that the Agency notes that the major stock exchanges require such disaggregation as a listing requirement. As with GAAP, the agencies can change their listing standards. Wells Fargo faces scrutiny now because it failed to identify that bonus figures were tied to cross selling quotas that, in turn, proved illusory. Had it been clear to investors that the millions in bonuses for Named Executive Officers stemmed from line salespeople (paid $25,000 a year) to open eight accounts for each customer,[32] or be fired, or cheat and try not to get caught, then this runaway fraud might have lasted two years, instead of a possible two decades.[33] As with the other changes we mentioned, this is

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[27] Accounting Standards Codification, explained here: https://attestationupdate.com/2011/04/28/just-how-many-pages-are-there-in-gaap-sas-and-ssars/

[28] P. 51621

[29] Berkshire Hathaway, 10-k, http://www.berkshirehathaway.com/reports.html

[30] See, for example, *Why Half of All M&A Deals Fail, and What You Can Do About It,* Forbes editors FORBES (MARCH 19, 2012) http://www.forbes.com/sites/forbesleadershipforum/2012/03/19/why-half-of-all-ma-deals-fail-and-what-you-can-do-about-it/#75b3fd5020ae

[31] p 51626

[32] What average person holds eight accounts at a bank? Checking, credit card, mortgage, home equity line of credit, insurance, wealth management number six.

[33] See *An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response*, SENATE BANKING COMMITTEE (September 20, 2016) http://www.banking.senate.gov/public/index.cfm/hearings?ID=B80F9B81-4331-4F95-91BC-718288EC9DA0

presented as a modest change—but the consequences for information provided could be costly. Already, CEO pay is high and the metrics by which it is judged are opaque. Obscuring the information makes matters worse.

4. Bright Lines

The Commission proposes eliminating various bright line disclosure rules. In addition to the repo changed noted above, the Commission would eliminate disclosure of material restrictions on dividends, and the names of major customers. If Walmart is the major customer of a supplier, that's crucial to investors in that supplier. Among other problems, eliminating bright line rules will disable investor ability to compare companies who may decide differently as to whether and how information must be disclosed.

Economic Analysis

Following the Agency's breathtaking list of major changes comes what is labelled "Economic Analysis." We believe this term is generous, since this analysis is devoid of any hint of enumerated dollar costs or benefits. The economic analysis turns on the argument "We believe…," which is a shallow basis for what conventionally purports to be something based on numbers. Better would be: "Measurable results demonstrate that …" The analysis is also devoid of the phrase "impact on investors, " or any dollar amount of what missing information will cost the company's owners, or, for that matter, the benefit of not reading information because it's newly deleted.

What is the economic impact of reduced disclosure? As noted above, 1.2 million investors have petitioned the Agency because of incomplete disclosure on political spending. Firms disclose lobby expenses, and contributions from political action committees, but they also contribute vicariously, through opaque middle-man organizations such as the Chamber of Commerce, or even think tanks. Public Citizen sponsors Chamber Watch, which documents the wide ranging lobby efforts on behalf of large businesses. This lobbying by the Chamber is not pro bono; it is paid for and one can make an educated, cynical guess where the money comes from by the nature of the policy.[34] The very fact that this money is dark suggests that companies understand that if their shareholders found out, some of them might be unhappy and may revalue the stock by selling it.

Conclusion

[34] The Chamber's congressional testimony invariably begins with a paean to small business, then sets out promoting a policy of exclusive interest to large business.

If the Agency is truly interested in addressing disclosure, it should begin with a series of national listening sessions with investors to collect suggestions. It should also read the comments to the S-K release, which almost universally demand more disclosure. It may then relay the suggestions and comments to issuers (selected as those recognized by investors for good governance) to examine what they can and cannot do to accommodate investor interests.

Meanwhile, this proposal should be withdrawn.

For questions, please contact Lisa Gilbert at [redacted], or Bartlett Naylor at [redacted].

Sincerely,

Public Citizen

September 29, 2016

www.citizen.org

The “King of Cross-Sell” and the Race to Eight

An Analysis of Wells Fargo’s Cross-Sell Numbers Since 1998

Acknowledgments

This report was written by Michael Tanglis, Senior Researcher for Public Citizen's Congress Watch division and edited by Congress Watch Research Director Taylor Lincoln.

About Public Citizen

Public Citizen is a national non-profit organization with more than 400,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

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Introduction

"Cross-sell is the result of serving our customers extraordinarily well, understanding their financial needs and goals over their lifetimes, and ensuring we innovate our products, services, and channels so that we earn more of their business and help them succeed financially."
-John G. Stumpf, Chairman and CEO, Wells Fargo, The Vision & Values of Wells Fargo[35]

Cross-selling amounts to selling a new product to an existing customer. For example, if a customer only has a savings account with Wells Fargo, an employee may try to "cross-sell" that customer a checking, credit card, or other type of account.

According to Wells Fargo's Chairman and CEO, John G. Stumpf, cross-selling "is the result of serving our customers extraordinarily well, understanding their financial needs and goals over their lifetimes, and ensuring we innovate our products, services, and channels so that we earn more of their business and help them succeed financially."[36]

The Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency (OCC), and the Los Angeles (LA) City Attorney found the exact opposite – fining Wells Fargo $185 million for engaging in fraudulent cross-selling practices. The CFPB described these as "Improper Sales Practices;"[37] the OCC described these as "unsafe or unsound practices in the Bank's risk management and oversight of the Bank's sales practices;"[38] and the Los Angeles City Attorney wrote in its complaint that Wells Fargo imposed "an ambitious and strictly enforced sales quota system" in which "those failing to meet sales quotas are approached by management, and often reprimanded and/or told to 'do whatever it takes' to meet their individual sales quotas." The Los Angeles City Attorney also wrote: "Managers constantly hound, berate, demean and threaten employees to meet these unreachable quotas."[39]

By Wells Fargo's own analysis, as noted in the CFPB consent order, "employees opened 1,534,280 deposit accounts that may not have been authorized and that may have been funded through simulated funding, or transferring funds from consumers' existing accounts without their knowledge or consent." Employees also "submitted applications for 565,443 credit-card accounts

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[35] The Vision & Values of Wells Fargo, John G Stumpf, Chairman & CEO, Wells Fargo, at p. 29, http://bit.ly/2dxn3yx.
[36] *Id.*
[37] *In the matter of: Wells Fargo Bank, N.A., Consent Order,* U.S. Consumer Financial Protection Bureau (Sep. 8, 2016), at p. 3, http://bit.ly/2dpnuyN.
[38] *In the matter of: Wells Fargo Bank, N.A. Sioux Falls, South Dakota, Consent Order,* U.S. Department of the Treasury Comptroller of the Currency, (Sep. 6, 2016), at p. 2, http://bit.ly/2dq1J1o.
[39] *Wells Fargo & Company, et al., Complaint for Equitable Relief and Civil Penalties,* The People of the State of California, (Sep. 6, 2016), at p. 2, 6, http://bit.ly/2cJ2Y9V.

that may not have been authorized by using consumers' information without their knowledge or consent." [40]

The CFPB's consent order covers January 1, 2011, to present. As this report shows, Wells Fargo's proliferation in accounts per customer rose even more markedly from 1998 to 2011 than from 2011 to present. Anecdotal reports suggest that the company was using fraudulent methods prior to 2011 to boost its cross-sell numbers. When asked for comment, the CFPB told Public Citizen "our investigation found that the great majority of unlawful activity occurred from January 1, 2011, to present."[41] Still, the question remains: How much fraud did Wells Fargo commit prior to the time period for which it was fined by the CFPB earlier this month?

The OCC has ordered Wells Fargo to conduct a review of its sales practices and report the results to the government. When asked for comment, the OCC stated the "order does not specify a timeframe for the enterprise-wide risk review of sales practices required by article IV of our order against Wells Fargo nor does the order specify a specific time period for reimbursements."[42] This indicates that the OCC's ordered review is not limited to January 1, 2011, to present.

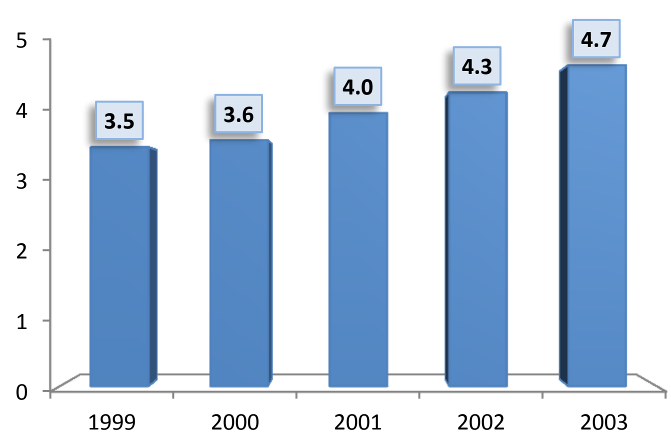
Wells Fargo's Emphasis on Cross-Selling Began at Least as Early as 1998

Public Citizen reviewed Wells Fargo's annual reports dating back to 1998 and found that the desire to sell more products, specifically eight products per household, has a long history at the bank.[43]

According to *The Wall Street Journal*, former Norwest Corp. CEO Richard Kovacevish introduced the concept of "cross-selling" to that bank in the late 1980s. Norwest Corp. would merge with Wells Fargo & Co. in 1998.[44]

In 1999, according to its annual report, Wells Fargo was: "Going for gr-eight product packages,"[45] establishing the long-held, and now infamous, goal of eight products per household.

Figure 1: Product Sales Per Banker Per Day



Not only did Wells keep close track of its products per customer, it also monitored its

[40] *In the matter of: Wells Fargo Bank, N.A., Consent Order,* 2016), at p. 5, 7, http://bit.ly/2dpnuyN.
[41] E-mail from CFPB to Public Citizen Researcher Michael T
[42] E-mail from OCC to Public Citizen Researcher Michael T.
[43] Cross-selling disclosures from each annual report are qu
[44] Emily Glazer, *From 'Gr-eight' to 'Gaming,' a Short Histo.* JOURNAL, MONEY BEAT (Sep. 16, 2016), http://on.wsj.com/2
[45] WELLS FARGO ANNUAL REPORT, WELLS FARGO (1999), at p.7,

products sold *per banker*, in this case on a per day basis, at least as early as 1999.[46] [See Figure 1]

In 2000, after reporting a 3.7 cross-sell ratio, Wells Fargo stated: "We're headed in the right direction but not fast enough. If we sell one new product to every customer every year we can get to eight products per banking household in about five years."[47]

In 2010, Wells said: "If anyone tells you it's easy to earn more business from current customers in financial services, don't believe them. We should know. We've been at it almost a quarter century. We've been called, true or not, the "king of cross-sell."[48]

Source: Wells Fargo Annual Report, 2003

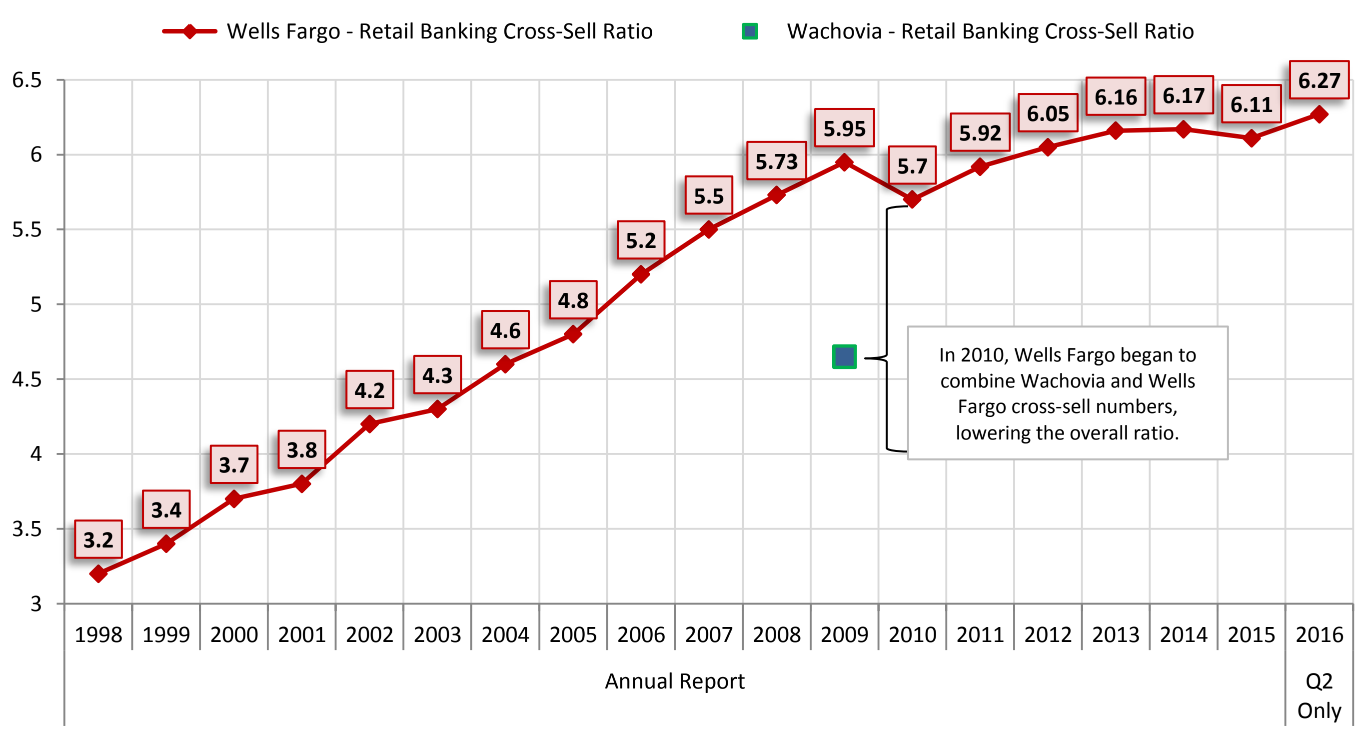
It does not appear that Wells' race for eight was always on the up and up, however.

Former Wells Fargo Branch Manager Susan Fischer recently told CNN: "These practices were going on way before 2011."[49] According to CNN, "Fischer said she remembers her district manager instructing her in 2007 to make the employees reporting to her open unauthorized accounts."[50]

18 Years of Cross-Sell Numbers Based on Wells Fargo Annual Reports

In 1998, Wells Fargo's retail banking cross-sell ratio was 3.2 products per household.[51] For the next 10 years, Wells Fargo increased the ratio each year.[52] The streak ended in 2010 when the ratio dropped to 5.7 from 5.95.[53] This drop occurred because that year, Wells combined its cross-sell ratio with that of the recently acquired Wachovia Bank, which had a substantially lower cross-sell ratio. [See Figure 2]

Figure 2: Wells Fargo Cross-Sell Ratio 1998 - Q2 2016[54]



[54] Sourcing for chart is in Appendix.

Sources: Wells Fargo annual reports. [Documented in Appendix]

*The y-axis does not begin at 0 in order to clearly show changes. The earliest cross-sell number reported by Wells Fargo was 3.2 in 1998. Cross-sell increases or decreases are typically noticeable by changes in the first or second decimal place. Even small increases are significant, as Wells Fargo points out many times in its annual reports. [See Appendix]

Wells Fargo touted its cross-sell numbers throughout the past 18 years. In its 2004 annual report, for instance, Wells Fargo declared "Cross-selling: our most important customer-related measure."[55]

In its 2011 annual report, Wells Fargo reported an eye-popping cross-sell ratio in its "top region" of **7.38 products**[56] – very close to the long-held goal of eight per household.

In the 2012 through 2015 annual reports, Wells began to describe its cross-sell numbers slightly differently, comparing quarterly and November numbers to previous quarters and Novembers.[57]

[55] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2004), at p. 18, http://bit.ly/2dpvw6C.
[56] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2011), at p. 6, http://bit.ly/2czwfAn.
[57] Wells Fargo's Annual Reports 2012 through 2015

Conclusion

Wells Fargo has told the media that it is reviewing its cross-selling practices to as early as 2009.[58] But the question remains, why not look back even further? Wells Fargo was aggressively pushing cross-selling a decade prior to 2009.

As early as 2000, after Wells Fargo had increased its cross-sell ratio to 3.7, Wells Fargo pointed out: "We're headed in the right direction but not fast enough. If we sell one new product to every customer every year we can get to eight products per banking household in about five years." [59]

Wells Fargo did not meet that five year goal. A former Wells Fargo branch manager, "remembers her district manager instructing her in 2007 to make the employees reporting to her open unauthorized accounts."[60]

According to the Los Angeles City Attorney, the pressure was immense, alleging in its complaint Wells Fargo "strictly enforced" its sales quotas. "Daily sales for each branch, and each sales employee, are reported and discussed by Well Fargo's District Managers four times a day, at 11:00 a.m., 1:00 p.m., 3:00 p.m., and 5:00 p.m., alleged the Los Angeles City Attorney."[61]

According to a recent survey by consulting firm A.T. Kearney, "On average, bank customers had 2.71 products at their primary bank."[62] If the 2.71 report is correct, that would indicate that Wells Fargo has had higher cross-sell numbers than the present day average since at least 1998. Recently, Wells Fargo reported a "retail banking cross-sell of 6.27 products per household." [63]

Wells Fargo never reached its goal of eight products per household. But even if it had, there is evidence that the goal post would have been moved: "Even when we get to eight, we're only halfway home. The average banking household has about 16. I'm often asked why we set a cross-sell goal of eight. The answer is, it rhymed with 'great.' Perhaps our new cheer should be: 'Let's go again, for ten!'"[64]

Well Fargo's management's never-ending quest for higher cross-sell numbers and the pressure-cooker atmosphere it created produced fertile ground for fraudulent activities. When the rampant fraud first began remains to be seen. But Wells Fargo's cross-sell data indicates the decade *preceding* the beginning of the CFPB settlement in 2011 requires further scrutiny.

Appendix

Wells Fargo Annual Report Quotes on Cross-Selling 1998 through Q2 2016

[58] Laura J Keller, *Warren Says Wells Fargo's Stumpf Should Resign, Face Criminal Investigation*, BLOOMBERG MARKETS (Sep. 20, 2016), http://bloom.bg/2da5VPL

[59] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2000), at p. 6, http://bit.ly/2dhISEB.

[60] Matt Egan, *Wells Fargo Workers: Fake Accounts Began Years Ago*, CNN MONEY (Sep. 26, 2016), http://cnnmon.ie/2ddF1He.

[61] *Wells Fargo & Company, et al., Complaint for Equitable Relief and Civil Penalties,* THE PEOPLE OF THE STATE OF CALIFORNIA, (Sep. 6, 2016), at p. 2, http://bit.ly/2cJ2Y9V.

[62] Rachel Louise Ensign, *What the Wells Fargo Cross-Selling Mess Means for Banks*, THE WALL STREET JOURNAL, MARKETS (Sep. 15, 2016), http://on.wsj.com/2dhY1FX .

[63] 2Q16 QUARTERLY SUPPLEMENT, WELLS FARGO (JULY 15, 2016), at p. 14, http://bit.ly/2d7jLUo.

[64] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2010), at p. 5, 6, http://bit.ly/2cTplHd.

*"We expect the new Wells Fargo will generate higher earnings per share growth than either company would have produced on its own. This includes the benefits of the merger-related cost savings, **increased cross-selling opportunities** and a stream of more diverse earnings in fast growing states."*
– 1998 Wells Fargo Annual Report[65]

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*"Our average banking household has 3.4 products with us. **We want to get to eight**."*


2. GOING FOR GR-EIGHT— PRODUCT PACKAGES Our average banking household has 3.4 products with us. We want to get to eight. To do that, we must offer customers a package of products all at once, not one at a time. In Lewiston, Montana, our first test site, our bankers sold an average of 2.39 products to new customers last year, up 62 percent from a year earlier.

– 1999 Wells Fargo Annual Report[66]

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*"When Norwest and Wells Fargo merged in November 1998 our combined cross-sell was about 3.3 products per retail banking household. At year-end 2000, it was about 3.7. To get to our goal of eight we need to double that. **We're headed in the right direction <u>but not fast enough</u>. If we sell one new product to every customer every year we can get to eight products per banking household in about five years**."*
– 2000 Wells Fargo Annual Report[67]

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*"We now sell an average of 3.8 products to every banking household compared with 3.3 when Norwest and Wells Fargo merged in late 1998. We can and must do better. We estimate the average U.S. household has 15 financial services products! ….. To save our customers time and money and earn more of their business, **we introduced packages of related products and services called Wells Fargo Packs^{sm} in the second quarter of 2001**."*
– 2001 Wells Fargo Annual Report[68]

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[65] Wells Fargo Annual Report, Wells Fargo (1998), at p.9, http://bit.ly/2d1owyg.
[66] Wells Fargo Annual Report, Wells Fargo (1999), at p.7, http://bit.ly/2ddwP9O.
[67] Wells Fargo Annual Report, Wells Fargo (2000), at p. 6, http://bit.ly/2dhISEB.
[68] Wells Fargo Annual Report, Wells Fargo (2001), at p. 20, http://bit.ly/2d1olgL.

"The average financial service provider has about two products per customer. Four years ago, at the time of the Norwest-Wells Fargo merger, we had about three products per customer. Today, we average more than four. About a third of our banking customers have five products with is. Our goal is eight – a total that 12 percent of our banking households already have with us."

– 2002 Wells Fargo Annual Report[69]

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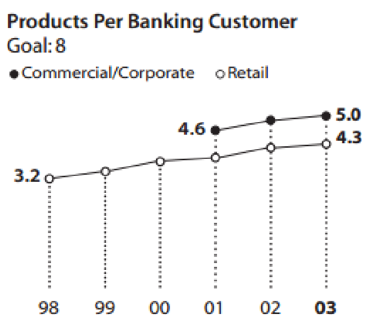
"Our cross-sell strategy and diversified business model facilitates growth in strong and weak economic cycles, as we can grow by expanding the number of products our current customers have with us. ***We estimate that each of our current customers has an average of over four of our products. Our goal is eight products per customer****, which is currently half of the estimated potential demand."*



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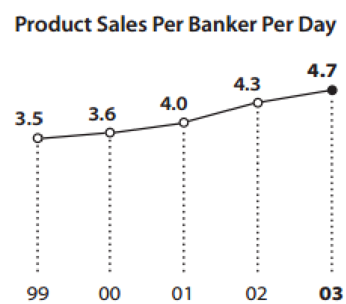

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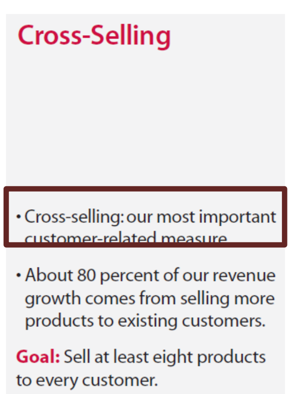
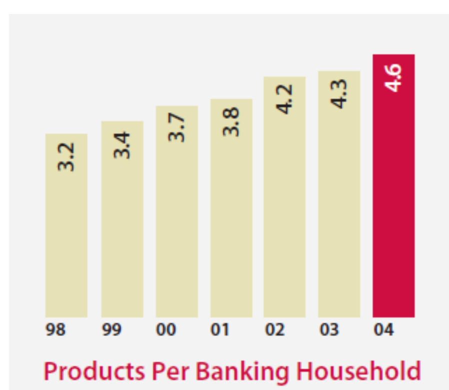
*"****We estimate that our average banking household now has 4.6 products with us, which we believe is among the highest, if not the highest, in our industry.*** *Our goal is* ***eight products per customer****, which is currently half of our estimate of potential demand."*





[69] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2002), at p. 16, 19, http://bit.ly/2cTni63.
[70] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2003), at p. 15, 16 and 34, http://bit.ly/2dxaBid.

– 2004 Wells Fargo Annual Report[71]

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*"**For the seventh consecutive year, our cross-sell reached record highs**—4.8 products per retail banking household…"*
– 2005 Wells Fargo Annual Report[72]

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*"**For the eighth consecutive year, our cross-sell reached record highs**—5.2 products per retail banking household (up from 3.2 in 1998)"*
– 2006 Wells Fargo Annual Report[73]

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*"**Our cross-sell set records for the ninth consecutive year**—our average retail banking household now has 5.5 products, almost one in five have more than eight…"*
– 2007 Wells Fargo Annual Report[74]

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*"**Our cross-sell set records for the 10th consecutive year**—our average retail banking household now has 5.73 products, one of every four has eight or more products, 6.4 products for Wholesale Banking customers, and our average middle-market commercial banking customer has almost eight products. Business banking cross-sell reached 3.61 products."*
– 2008 Wells Fargo Annual Report[75]

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*"**Our cross-sell at legacy Wells Fargo set records for the 11th consecutive year with a record** of 5.95 Wells Fargo products for retail banking households. Our goal is eight products per customer, which is approximately half of our estimate of potential demand. One of every four of our legacy Wells Fargo retail banking households has eight or more products and our average middle-market commercial banking customer has almost eight products. Wachovia retail bank households had an average of 4.65 Wachovia products. We believe there is potentially significant opportunity for growth as we increase the Wachovia retail bank household cross-sell"*
– 2009 Wells Fargo Annual Report[76]

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[71] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2004), at p. 18, http://bit.ly/2dpvw6C.
[72] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2005), at p. 5, http://bit.ly/2d7ysp3.
[73] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2006), at p. 3, http://bit.ly/2d7zMIp.
[74] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2007), at p. 34, http://bit.ly/2cANc2i.
[75] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2008), at p. 34, http://bit.ly/2dAwhwI.
[76] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2009), at p. 34, http://bit.ly/2dxemEC.

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"If anyone tells you it's easy to earn more business from current customers in financial services, don't believe them. We should know. We've been at it almost a quarter century. We've been called, true or not, the ***"king of cross-sell."***

*"**Even when we get to eight, we're only halfway home**. The average banking household has about 16. I'm often asked why we set a cross-sell goal of eight. The answer is, it rhymed with "great." Perhaps our new cheer should be:* ***"Let's go again, for ten!"***

– 2010 Wells Fargo Annual Report[77]

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*"**Our average retail bank household cross-sell reached a record 5.92 products** in 2011, up from 5.70 in the fourth quarter of 2010. In our Western markets it was a record 6.29, in the East 5.43, and **our top region had 7.38.** The opportunities, therefore, are immense. **Even if we get to eight products per retail bank household, we still have room to grow.** We believe the average American household has between 14 and 16 financial services products."*

– 2011 Wells Fargo Annual Report[78]

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*Our retail bank household cross-sell was 6.05 products per household in fourth quarter 2012, up from 5.93 a year ago. We believe there is more opportunity for cross-sell as we continue to earn more business from our customers. **Our goal is eight products per customer**, which is approximately half of our estimate of potential demand for an average U.S. household."*

– 2012 Wells Fargo Annual Report[79]

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*"Our retail bank household cross-sell was a record 6.16 products per household in November 2013, up from 6.05 in November 2012 and 5.93 in November 2011. We believe there is more opportunity for cross-sell as we continue to earn more business from our customers. **Our goal is eight products per household**, which is approximately one-half of our estimate of potential demand for an average U.S. household."*

– 2013 Wells Fargo Annual Report[80]

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*"Our retail banking household cross-sell was 6.17 products per household in November 2014, up from 6.16 in November 2013 and 6.05 in November 2012…We believe there is more opportunity for cross-sell as we continue to earn more business from our customers. **Our goal is eight products per household,** which is approximately one-half of our estimate of potential demand for an average U.S.*

[77] Wells Fargo Annual Report, Wells Fargo (2010), at p. 5, 6, http://bit.ly/2cTplHd.
[78] Wells Fargo Annual Report, Wells Fargo (2011), at p. 6, http://bit.ly/2czwfAn.
[79] Wells Fargo Annual Report, Wells Fargo (2012), at p. 44, http://bit.ly/2ddE1mq.
[80] Wells Fargo Annual Report, Wells Fargo (2013), at p. 44, http://bit.ly/2dpTFxM.

household".
– 2014 Wells Fargo Annual Report[81]

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*"**Our retail banking household was 6.11 products per household in November 2015,** compared with 6.17 in November 2014 and 6.16 in November 2013. The November 2015 retail banking household cross-sell ratio reflects the impact of the sale of government guaranteed student loans in fourth quarter 2014."*
– 2015 Wells Fargo Annual Report[82]

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"Retail banking cross-sell of 6.27 products per household."
– 2016 Wells Fargo Second Quarterly Supplement[83]

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[81] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2014), at p. 45, http://bit.ly/2dpCdpk.
[82] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2015), at p. 47, http://bit.ly/2cTs2bF
[83] 2Q16 QUARTERLY SUPPLEMENT, WELLS FARGO (JULY 15, 2016), at p. 14, http://bit.ly/2d7jLUo.