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Don Regan on executive knowledge

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Don Regan as chief of staff for President Reagan offered an excellent and probably widely panned retort to accusations that he was responsible for "chaos that descended upon the White House" following the Iran-Contra revelations. He as ex-CEO of Merrill Lynch and secretary of the Department of the Treasury prior to his stint in the White House had as good perspective as any executive when he offered, "Does a bank president know whether a bank teller is fiddling around with the books? No."

Wells Fargo & Co. Chairman and CEO John Stumpf could offer a similar response regarding revelations that rogue employees opened more than 2 million deposit and credit card accounts that may not have been authorized. If comparable actions had occurred in the brokerage industry in which trades were generated without the customers' knowledge to produce commissions, it would be called "churning." Wells Fargo Bank NA employees called it sandbagging. Wells Fargo has or will have 5,300 fewer employees as a result. Their termination is stunning to me, and is much more of an indictment than $185 million of penalties that the company will pay. Penalties are a tax; canning employees is serious business.

Was the opening of unauthorized accounts in a gray zone of behavior? Of course it is not, though from a broader perspective the regulatory interpretation of what is permissible has evolved in recent years. Traditional bank regulators have not led the change; rather it is the Consumer Financial Protection Bureau that has in my view. The CFPB has a regulatory sledgehammer over banks. Ally Financial Inc. and BancorpSouth Inc. among others have had run-ins with the CFPB related to auto and mortgage finance that may serve as industry templates for dos and don'ts. Although not directly CFPB-related, Regions Bank's and Fifth Third Bank's CRA ratings were downgraded to "needs to improve" this year. The regulatory apparatus has been pushed by the political establishment and CFPB to tighten enforcement and interpretation of laws and regulation related to fair lending standards.

Wells Fargo's run-in appears to be the opening of a new front. Aside from outrageous behavior the CFPB, OCC and city of Los Angeles flagged, the CFPB may have another industrywide template related to sales practices. Wells Fargo has been the envy of the industry for years because it has a strong sales culture that is reflected in its high retail cross-sale ratio of over six products per household. In an industry that used to be derided for an order-taking mentality, Wells Fargo was a pioneer and evangelist for a sales culture. Stumpf's predecessor, Richard Kovacevich, was a key architect of the effort that included calling branches "stores."

The settlement implicates the culture, but not the executives directly. The culture apparently strayed in recent years as employees signed-up customers for additional products to produce incremental incentive pay. Camden Fine, president & CEO of the Independent Community Bankers of America, raised the question as to how the bank passed compliance exams and opined there is a pay-to-play aspect for megabanks that community banks do not have (and could not afford). It is a legitimate question and observation.

It appears so far that the only possible executive casualty is longtime Wells Fargo veteran Corrie Tolstedt, who will retire at year-end and, effective July 31, stepped aside as head of community banking. She is leaving with a nine-figure paycheck. Was the departure timed to precede the settlement announcement? Perhaps, but it does not look as though she is walking the plank.

And what about CEO Stumpf? I do not think it is conceivable he had any direct or even indirect knowledge of what occurred among a few thousand employees — some of who probably are being terminated for technical discrepancies so that Wells Fargo will comply with a regulatory order. But should he be held accountable? The $185 million fine in terms of what banks have paid in the post-crisis years is nothing, but customer trust is a big deal.

Wall Street will disagree with the premise of my question. Stumpf (and Kovacevich) have been great value creators for shareholders. Executive management has more than goodwill with institutional investors; they have produced alpha as it relates to investing in a tough sector when measured from the pre-crisis years. Stumpf became CEO in June 2007. From June 1, 2007, through Sept. 9, 2016, Wells Fargo produced a total return for common shareholders of 71% compared to negative 21% for the SNL U.S. Bank Index. Management largely sidestepped the subprime lending fiasco. Shareholders were rewarded with a bargain purchase of Wachovia Corp. at the depth of the financial crisis that accounts for some if not a lot of the outperformance of the shares since then. Management of Bank of America Corp. thought they were buying Countrywide Financial Corp. for a song in 2008, but contingent liabilities in the form of penalties and remediation expenses assumed with the purchase have contributed to a total return of negative 64% over the same period.

The Wells Fargo story is not old news yet. It is not clear to me it will go away with the payment of a fine or that Stumpf will survive, though perhaps I am reading too much into the story to suggest that.

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