NASHVILLE NOTES

For Wells Fargo, the volcano beckons

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Tim Sloan, the ex-CEO of Wells Fargo & Co., jumped into the volcano last week before he was explicitly pushed. John Stumpf, Sloan's predecessor, jumped in October 2016 on the heels of the still stunning story of Wells Fargo employees gaming an incentive plan to create several million fake accounts. Sloan's departure was inevitable once news stories emerged that the Office of the Comptroller of the Currency, which regulates subsidiary Wells Fargo Bank NA where the bulk of the company's $1.9 trillion of assets reside, was considering a forced change in management. If that came to pass, the Federal Reserve presumably would act in conjunction with a parallel move to affect the same changes at the bank holding company level.

Lose the confidence of your regulators and it is game over for any high-level bank executive. The question in my mind that goes unanswered is this: Did the regulators lose confidence in Sloan's leadership because it is that bad or because of hectoring from the likes of Rep. Maxine Waters and Sen. Elizabeth Warren?

Washington has always mattered for banks, at least the national ones. Consult the history of the First Bank of the United States championed by Alexander Hamilton and the Second Bank of the United States and you will find a titanic struggle between varied interests that met at the intersection of economics and politics. The Capitol Hill-Wall Street bond has grown much deeper in the last 80 years with the implementation of deposit insurance in the early 1930s to stem a banking panic and a bailout of the financial system through the Troubled Asset Relief Program in the most recent crisis.

Wells Fargo does not operate in a vacuum. It is subject to intense regulatory scrutiny that may be unfair, but that is how it goes. Wells Fargo has become the anti-Teflon corporation to which everything significant and trivial seems to stick. The irony is incredibly thick.

Wells Fargo and JPMorgan Chase & Co. were the clutch players of the 2008 financial crisis. JPMorgan acquired Bear Stearns and Washington Mutual, while Wells Fargo acquired Wachovia by outmaneuvering a failing Citigroup Inc. When asked to take one for the team at the height of the crisis by accepting TARP capital, JPMorgan's Jamie Dimon stepped up to the plate. Wells Fargo's Richard Kovacevich, then chairman and previously CEO, reportedly had to be physically restrained and removed to another room. Presumably, Kovacevich was indignant because Wells Fargo did not need government capital — unlike Goldman Sachs Group Inc. and Morgan Stanley, which were saved by becoming bank holding companies in order to accept TARP.

Wells Fargo and JPMorgan were the star pupils among the large banks when the panic subsided. Goldman survived and appeared as though it would thrive as trading turned around in 2009, but then Matt Taibbi dubbed the company a "great vampire squid" in a 2010 *Rolling Stone* article. Goldman has been subject to more scrutiny since and today is dealing with fallout from the Malaysian influence peddling scandal allegedly promulgated by one of its ex-employees.

JPMorgan would incur a multibillion-dollar loss from the London Whale affair and would incur billions of dollars of fines primarily from contingent liabilities assumed in the Bear Stearns acquisition that were not adequately vetted in that shotgun marriage.

On the other hand, Wells Fargo retained its good name in the years after the financial crisis by sticking to its basic — if not boring — business model of banking Main Street. The company was only loosely connected to Wall Street as a traditional commercial bank. Further, the company did not have an outsized toxic mortgage portfolio to deal with beyond what Wachovia conveyed to it.

No doubt Wells Fargo had issues prior to the fake account scandal that would not read well in the newspaper if widely known. Most companies have "issues" that periodically develop and must be decisively addressed. The volcano continues to beckon at Wells Fargo for the valid reason that executive management did not have control of an organization in which there apparently was a wide-scale practice among some retail employees to commit fraud by opening fake accounts for financial gain.

There is irony in the story, too, because Kovacevich as CEO had championed a retail strategy that called branches "stores" and pushed to create one of the best cross-sale ratios among banks. I do not think most of you reading this would dispute the precept that Wells Fargo should be a top-notch sales organization that meets the needs of its customers, but somehow the institutional controls to do so were utterly inadequate.

Now there is indignation being expressed by some that Washington forced a CEO change at Wells Fargo. I am inclined to share that view, but I am surprised the board did not make a clean break with the executive team when the scandal rose to the front page of the *USA Today* a few years ago. It was then and still is today a stunning lapse of executive and board control over a basic function at a bank such as opening new accounts.

Wells Fargo now has a political problem in which any issue that becomes public is greatly magnified in the media, on Capitol Hill and with regulators. Perhaps worse from a regulatory perspective is that the fake account scandal story was broken by the *Los Angeles Times*, not the regulators.

As the board searches for Sloan's replacement, it seems logical that the successor will have strong ties to Washington and perhaps the Democratic Party, given that the loudest voices for change at Wells Fargo are coming from progressives. Maybe a name that the board will consider is Eugene Ludwig, who was a vice chairman of Bankers Trust/Deutsche Bank and Comptroller of the Currency from 1993 to 1998. Although he is not a young man and currently is CEO of Promontory Financial Group LLC, it may take an ex-regulator like Ludwig to soothe Capitol Hill and regulators and thereby push Wells Fargo to the back page of the newspapers.

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