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Wells Fargo's Reputational Crisis Is Unlike Any Other

By Kate Berry
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The piling on at Wells Fargo has reached an unprecedented level — even for a bank.

In the past six weeks, 15 investigations have been launched into Wells' phony accounts scandal, including probes by the Justice Department, the Labor Department and the Office of the Comptroller of the Currency.

Last week alone, California Attorney General Kamala Harris' office began a probe into criminal identity theft. Fitch Ratings downgraded Wells' credit rating to negative, the Better Business Bureau cut off its accreditation, and more states suspended the bank from municipal bond underwriting. Top leaders of the bank's hometown of the city of San Francisco even went so far as to ask if the OCC should revoke Wells' 160-year-old bank charter.

"This is what a reputational crisis looks like," said Dr. Nir Kossovsky, the CEO of Steel City Re, a Pittsburgh insurer of reputational risk. "In a reputational crisis, costs rise as stakeholder behavior changes and the economic consequences take effect."

Experts in the burgeoning field of reputational risk think Wells will become a case study for how a crisis can snowball, even one known about internally for many years.

They agree that Wells was unprepared for the backlash that began Sept. 8 with a $190 million settlement with the Los Angeles City Attorney, the OCC and the Consumer Financial Protection Bureau. Wells revealed it had fired 5,300 employees for opening 2 million unauthorized accounts from 2011 to 2015.

Though the public has almost become deadened to banking scandals at this stage, the Wells case is different. Scandals involving foreign exchange rates and the London Whale were hard to understand. In contrast, Wells' employees falsifying accounts and charging unfair fees is easy for consumers to grasp.

"There's a piling on because it has touched a raw nerve with the public," said Andrea Bonime-Blanc, the CEO of GEC Risk Advisory, a New York compliance and governance firm. "They violated the trust of customers and regulators. They made excuses about a culture at the top of meeting sales goals at all costs. Employees were incentivized to break the rules."

But reputational experts also fault the bank's response to the crisis, arguing it helped cascade problems further.

Wells former CEO John Stumpf repeatedly blamed low-level employees making as little as $12 an hour, appearing to deflect responsibility. His claims clashed with descriptions by former employees about the bank's high pressure sales tactics. Moreover, in lawsuits filed before 2013, some employees alleged they were fired for not meeting sales goals; others claimed they were fired after calling a whistleblower hotline.

"The reputational battle is huge. This scandal has a certain edge to it because the reputational risk hits on so many different levels and it looks so bad," said Claire Hill, a law professor and the James K. Krusemark chair at the University of Minnesota Law School.

As a result, government investigations are rapidly proliferating. "Every regulator, plaintiff's lawyer and ambitious and angry local official wants to get in on the act," Hill said. "All of these people complaining in this volume is an interesting trajectory."

Additionally, Wells continues to take hits over executive compensation. Though the bank is stopping bonuses slated to be paid to Stumpf and Carrie Tolstedt, the retiring head of the bank's community banking, consumers and lawmakers are still outraged to know both will receive millions in compensation as they leave.

Exactly how much this reputational damage will cost Wells is unclear, in part because it's not clear the scandal is over. But a reputational crisis or "event" can cost seven times more than the underlying operational failure, Kossovsky said. By his calculation, Wells' illegal sales practices could ultimately cost the firm upwards of $1 billion.

He has identified six areas that cause reputational risk: ethics, safety, security, quality, sustainability and innovation.

"This is a process failure and a communications failure," Kossovsky said. "Because there were so many stakeholders involved, this produced a cascading economic effect. This wasn't just noise."

On a third-quarter conference call on Oct. 14, Wells' CFO Johns Shrewsberry said Wells was "definitely going to have elevated compliance-related costs and operational loss-related costs."

It's also unclear how Wells can repair its tattered reputation. While the company has taken out several full-page ads in newspapers across the country, the key will be how it addresses its sales culture.

"How do you change the culture?" Hill asked. "Obviously nobody has a formula for this but promotions should not just go to people who produce revenue at all costs."

Pressuring low-paid bank tellers to sell products consumers did not want in order to meet sales goals has a similar ring to what happened with appraisers during the run-up in home prices in 2005, according to Hill. Appraisers were pressured by bank underwriters to inflate home appraisals, a contributing factor to the housing bubble.

Changing the narrative will be a challenge for Wells. Already the focus is shifting to the bank's board and what steps it can take to restore Wells' battered reputation by going beyond acknowledging that something went wrong.

"The question is, where does Wells go from here?" asked Kossovsky.

Pressure is also building on Wells to publicly release the results of its internal investigation into the illegal sales practices. Executives told analysts they were unclear whether the results would be made public.

"The point of the internal investigation is to identify what went wrong and to employ new standards to show they've fixed it," Kossovsky said. "They have to fix it and set higher standards."

"How it plays out will be determined by the underlying truth," Kossovsky.
