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Culture Eats Compliance for Lunch: Behavioral Science Lessons From the Wells Fargo Scandal (Part One of Three)

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Renowned management guru Peter Drucker famously warned that "culture eats strategy for breakfast." If the 2016 Wells Fargo fraud scandal teaches us anything about organizational management, perhaps it's that culture also eats compliance controls for lunch. By applying the principles of behavioral science to the facts of the Wells Fargo case, we can illustrate some of the profound ways that common biases can impact corporate culture and amplify organizational risk.

In this three-part article series, we will demonstrate how ordinary examples of conformity bias, issue framing and motivated reasoning can, when unchecked, have disastrous financial and reputational consequences for unwary organizations. Additionally, we will provide practical advice for organizations seeking to apply these lessons when evaluating their own ethics and compliance risk. In this first article in the series, we describe the scandal and discuss why Wells Fargo's extensive control infrastructure was insufficient to prevent such pervasive misconduct.

See "Ian Hawkins of NBCUniversal on How Nudge Theory Can Improve a Compliance Program" (Jul. 25, 2018).

Wells Fargo's Fall From Grace

In 2016, Wells Fargo was the envy of the banking world. Grossing over $90 billion in revenues, it had just finished 7th on Barron's list of the world's most respected companies, by far the highest of any of its peers. At the time, Wells Fargo was a regular on the list, ranking first in the banking sector for five straight years. In 2013, American Banker magazine named CEO John Strumpf "Banker of the Year" and deemed Carrie Tolstedt, head of Wells Fargo's formidable consumer banking division (the Community Bank), "The Most Powerful Woman in Banking." In 2015, Strumpf followed up his win by beating out Amazon's Jeff Bezos and GE's Jeff Immelt to be named CEO of the Year (across all industries) by respected research firm Morningstar Inc. Speaking to his success when being interviewed by American Banker, Strumpf commented: "If I have any one job here, it's keeper for the culture."

Fast forward less than a year, and both Strumpf and Tolstedt were pariahs in the banking world, forced out at Wells Fargo amid allegations of widespread fraud and customer abuse at the Community Bank. Their collective fall from grace included a litany of critical media reports, a scathing congressional hearing at which Strumpf was called to account for his "gutless" leadership, and over $75 million in stock options clawed back by the Wells Fargo Board of Directors.

Simultaneously, Wells Fargo's former sterling corporate reputation was in ruins. In 2016, it dropped from 7th to dead last on Barron's aforementioned list of respected companies – beat out by Ford, which was reeling from a major ignition-switch scandal that killed over 120 people, and Fox News, which had been hit with several high-profile sexual harassment cases. In responding to the fraud allegations, Wells Fargo announced it would pay $185 million in fines and settlements, admitting that its employees had fraudulently used confidential customer information to create as many as two million accounts for customers without their knowledge or permission. Subsequent investigations would show this number to be as high as 3.5 million.

Although $185 million in fines was hardly a catastrophic penalty for one of the world's largest financial institutions, the increased regulatory scrutiny it generated seemed to cascade into a succession of increasingly costly scandals and investigations. In 2018 alone, Wells Fargo would be fined $1 billion for mortgage and insurance abuses, and $2.1 billion for a securities scandal. All told, some analysts believe the total costs of Wells Fargo's string of scandals may be upwards of $100 billion, when considering loss of market value.

You Get What You Measure

Central to the scandal was the practice of "cross-selling," by which Wells Fargo employees were urged to sell multiple financial products to existing customers in order to increase their ties, and ultimately loyalty, to the bank. In 2015, this concept was nothing new to the banking world, but Wells Fargo was the self-styled "king." Cross-selling is consistently highlighted as a strategic initiative in every annual report the bank released going back to 1998, including being mentioned 22 times the year before the scandal broke.

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In 1999, Wells Fargo established its "going for gr-eight product packages" sales initiative, which would infamously come to dominate the Community Bank's culture over the next decade. When creating the goal, by which employees were pushed to sell eight financial products to each Community Bank customer, senior leadership seemed to give no thought as to whether the goal was realistic or consistent with customer needs. Rather, as Strumpf put it simply in the company's 2010 Annual Report: "It rhymed with great!"

In pursuit of the "going for gr-eight" goal, management held Wells Fargo employees to strict daily quotas for cross-sales, requiring them to sell a minimum of four products to 80 percent of customers. As a result, management got what they asked for. In 2013, Wells Fargo boasted that their retail customer households used an average of 6.15 financial products, which was nearly quadruple the industry average.

However, these numbers were coming at a cost to the Community Bank's working culture. A 2013 Los Angeles Times report described extreme sales pressure that trickled down to rank-and-file employees from the highest levels of management. Rumors circulated that in order to hit their sales goals, Wells Fargo employees would commonly open new accounts and issue debit or credit cards without customer knowledge, in some cases by forging signatures. This eventually led to a lawsuit by the City of Los Angeles and a parallel investigation by the Consumer Financial Protection Bureau (CFPB).

Although Community Bank leadership claimed that these incidents were isolated, in reality, Wells Fargo had been aware of a trend of misconduct that had been developing for quite a while. Going back to at least 2007, the bank was aware of steadily increasing incidences of sales misconduct. After the City of Los Angeles filed its lawsuit, it came to light that the bank had fired over 5,300 employees for the precise type of sales misconduct alleged in the lawsuit. Later reports showed that leadership up to, and including, Strumpf himself were well-aware of the misconduct and for the most part chose to keep the status quo.

See "DOJ Steers the Compliance Conversation Toward Culture" (Apr. 18, 2018).

Culture Trumps Compliance Controls

When viewed in hindsight, it is difficult to understand why Wells Fargo's leadership was so slow to stamp out the systemic cheating. Although the practice of aggressive cross-selling was certainly a profitable enterprise for the bank, the 3.5 million fraudulent accounts were not. By their nature, these accounts were typically just empty numbers in a computer network. Very few bank customers ever even knew their fraudulent accounts existed, much less ever made a deposit into one. Without deposit activity, these accounts had almost no value to the bank, or to the leadership who were compensated based on the bank's financial performance.

Nor can the sustained cheating be explained solely by monetary incentives offered to employees, as the typical retail banker who engaged in fraud only stood to gain somewhere between $250 and $800 per quarter by hitting his or her cross-sale numbers. District manager incentivizes were higher, but in line with industry standards. In other words, there was a somewhat paradoxical situation in which employees at large had very little monetary incentive to cheat, and leadership had very little monetary incentive to let cheating slide, yet both came to pass. This raises the question – how did cheating become so pervasive at Wells Fargo, and how did the bank's collective risk management infrastructure fail so miserably in responding?

It certainly wasn't due to a lack of compliance resources. Just a few months before the scandal broke, Wells Fargo's former CEO appeared on CNBC and commented somewhat disparagingly that the bank was spending an "absurd" amount of money on compliance. In 2015, Wells Fargo had over 10,000 employees dedicated to organizational risk and compliance, with plans to grow its headcount and budget another 16 percent in the coming year. Additionally, Wells Fargo had an extensive and benchmarked compliance infrastructure, which included a comprehensive code of conduct, a confidential "Ethics Line," and active oversight at the most senior levels of the company. The Community Bank had its own Sales Integrity Task Force, which created training materials for managers and employees, including appropriate and inappropriate sales activity and consequences of misconduct. The bank's compliance organization also monitored metrics appropriate to each risk type across the enterprise, including fraud-risk assessments, monitoring of consumer feedback and close tracking of the organization's culture.

Later, in an attempt to understand the root causes of the scandal, the board of directors commissioned an independent report to evaluate the bank's leadership, compliance and risk-management functions. The resulting 113-page report made no critique of Wells Fargo's compliance budget, resources, policies, training or monitoring. What it did critique, over and over, was a "lack of understanding" or a "lack of recognition" of the bank's cultural issues and the gravity of the risk those issues presented.

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Employee Satisfaction Metrics Obfuscate the Cultural Issues

Speaking to the bank's culture, media reports in the wake of the scandal painted a picture of a toxic workplace in which sales misconduct was common, customer trust was violated and whistleblowers were retaliated against. In pursuit of increasingly unrealistic cross-sales goals, one branch manager said "we were constantly told we would end up working for McDonald's, . . . if we did not make the sales quotas . . . we had to stay for what felt like after-school detention or report to a call session on Saturdays." Other employees identified in the lawsuit supported this narrative, describing the Community Bank as "cutthroat," "toxic," and a "pressure-cooker," with oppressive quotas and management that made employees' lives "a living hell."

See "Former Sales Exec Discusses How to Combat Corruption in the Field" (Aug. 19, 2015).

And yet, in the three years immediately prior to the scandal, Wells Fargo was one of the few companies in the world (and the only bank) to receive Gallup's "Great Places to Work" award every year. The award, which is based on surveys of employees across functions and geographies, consistently placed Wells Fargo in the top quartile of all companies measured. Glassdoor.com, which aggregates and measures employee feedback for large companies, lists over 40 workplace-related awards for Wells Fargo dating back to 2011, including World's Most Admired Companies, Top 10 Companies for Executive Women, Top 20 Happiest Companies for Vets, Best of the Best List: Top Financial Employer, Best Places to Work for LGBT and multiple other awards for diversity, equality and inclusivity.

Strumpf and others in leadership positions would later point to these metrics as evidence that there were no systemic issues with the sales culture at Wells Fargo. The independent Board report even seems to support this conclusion to a degree, although lacking in detail, when it notes that "top-line" metrics of employee satisfaction for the years immediately preceding the scandal were "positive." Specifically, with regard to Tolstedt – painted by many as the chief villain behind the bank's toxic sales culture – the report noted that "Community Bank employee engagement and customer satisfaction surveys reinforced [a] positive view of her leadership and management." In the wake of the lawsuit, Strumpf continually pointed to the fact that 5,300 employees caught partaking in sales misconduct represented only about 1 percent of the work force and that the vast majority of Community Bank employees "did it right."

See "Hui Chen Suggests Companies Focus on Ethics and Metrics to Move Beyond a Rules-Based Approach to Compliance" (Nov. 15, 2017).

A Fundamental Misunderstanding of Human Nature

We do not wish to imply that media characterizations of the toxic culture at Wells Fargo were inaccurate; however, how is one to square those stories with the survey results and other metrics that Strumpf and other leaders relied on, so much to their detriment? Additionally, how can the bank's lack of a meaningful response be explained in the context of the massive financial and reputational iceberg that seemed to be in their path in the years leading up to the lawsuit?

It is tempting as a compliance professional to boil the answer down to organizational greed and managerial incompetence. This invites the assumption that such a massive failure must have been caused by equally massive mistakes and, therefore, all an organization needs to do to avoid Wells Fargo's fate is not be exceedingly greedy, gutless or incompetent. Although comforting, we believe this narrative to be mistaken.

In reality, what is extraordinary (and frightening) about the Wells Fargo scandal is that it was caused not by egregious mistakes and gutless incompetency, but rather by a culmination of quite ordinary biases and misconceptions that could probably happen to anyone. Indeed, in studying the Wells Fargo scandal, we see evidence of a fundamental lack of understanding of human behavior and decision-making tendencies that, in our experience, is all too common in the corporate world.

Companies can learn much from Wells Fargo's systematic corporate compliance and ethics failures. In the next article in this series, we will examine the scandal through the lens of behavioral science, discussing how conformity bias, issue framing, motivated reasoning and confirmation bias all likely contributed to the breakdown of an otherwise robust compliance infrastructure. Our third article will provide companies with practical advice for incorporating these lessons into their compliance programs.

See "Guide to Creating an Effective Compliance-Based Employee Incentive Program (Part One of Two)"E (Jan. 7, 2015); Part Two (Jan. 21, 2015).

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