Written Testimony of

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PUBLICCITIZEN

Mr. Chairman and Members of the Committee,

Thank you for the opportunity to testify today on regulatory policy issues. I am Robert Weissman, president of Public Citizen. Public Citizen is a national public interest organization with more than 400,000 members and supporters. For more than 40 years, we have advocated with some considerable success for stronger health, safety, consumer protection and other rules, and strong civil and criminal enforcement measures to punish and deter corporate wrongdoing.

My testimony today focuses on U.S. Department of Justice (DOJ) enforcement programs against corporate wrongdoers. It details significant failures in the Department, as well as the need for remedial legislation to curb corporate wrongdoing.

The first section of the testimony analyzes DOJ civil settlements with a number of Big Banks, concluding that those settlements failed to make crucial information available to the public, such that it is impossible to assess their reasonableness. The second section discusses DOJ's extensive use of deferred and non-prosecution agreements for corporate wrongdoers, a practice which has eroded the functioning of the criminal law and deterrence against corporate malfeasance. The third section explores a number of other policy considerations related to corporate wrongdoing. The final and concluding section briefly discusses the ongoing Wells Fargo scandal, pointing to the need for tougher penalties and a close examination of whether the period of systematic creation of fraudulent accounts extends further back in time than so far acknowledged.

I. Settling with the Big Banks

Eight years later, America is still recovering from the Great Recession, a world-historic economic calamity brought on by Big Bank and Wall Street recklessness. Lenders spread toxic and predatory mortgages that helped fuel the housing bubble. Deregulated Wall Street firms and big banks exhibited an insatiable appetite for mortgage loans, irrespective of quality, thanks to insufficiently regulated securitization, off-the-books accounting, the spread of shadow banking techniques, dangerous compensation incentives and inadequate capital standards. Reckless financial practices were ratified by credit ratings firms, paving the way for institutional funders to pour billions into mortgage-related markets; and an unregulated derivatives trade offered the illusion of systemic insurance but actually exacerbated the crisis when the housing bubble popped and Wall Street crashed.

The costs of this set of regulatory failures are staggeringly high. A GAO study found that "[t]he 2007-2009 financial crisis, like past financial crises, was associated with not only a steep decline in output but also the most severe economic downturn since the Great Depression of the 1930s."[1] Reviewing estimates of lost economic output, GAO reported that the present value of cumulative output losses could exceed $13 trillion.[2] Additionally, GAO found that "households collectively

[1] U.S. Government Accountability Office. (2013, Jan. 13). *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* p. 12. Available from: <http://www.gao.gov/products/GAO-13-180>.
[2] *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* p. 16.

lost about $9.1 trillion (in constant 2011 dollars) in national home equity between 2005 and 2011, in part because of the decline in home prices."[3]

The recession threw millions out of work, and left millions more jobless or underemployed. "The monthly unemployment rate peaked at around 10 percent in October 2009 and remained above 8 percent for over 3 years, making this the longest stretch of unemployment above 8 percent in the United States since the Great Depression," GAO noted.[4] Thanks to lost income and especially collapsed housing prices, families' net worth plummetted. According to the Federal Reserve's Survey of Consumer Finances, median household net worth fell by $49,100 per family, or by nearly 39 percent, between 2007 and 2010.[5]

Remarkably, given the scale of corporate wrongdoing and devastation wreaked, the perpetrators that caused the Great Recession escaped any criminal prosecution. No criminal prosecution of the giant corporations who ripped off borrowers; no criminal prosecutions for widespread securitization fraud, save for a single, relatively low-level case; no criminal prosecution for the ratings companies that knowingly blessed widespread misconduct. No criminal prosecution of the Big Banks, and no prosecution of their executives.

The failure to prosecute is a major blemish on the record of the Department of Justice. It enabled wrongdoers to escape accountability, left victims uncompensated and failed utterly to establish a commitment to enforcement that will deter future wrongdoing.

Very belatedly, as a kind of mop-up operation, the Department of Justice starting in 2013 entered into a series of settlements of civil claims against the largest banks. The first major "global settlement" was with JPMorgan, for a purported $13 billion, entered into in November 2013.[6] It was followed by a July 2014 purported $7 billion deal with Citigroup,[7] and a purported $16.6 billion settlement with Bank of America in August 2014.[8]

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[3] *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* p. 21. There is necessarily a significant amount of uncertainty around such analyses. Other estimates have placed the loss somewhat lower. A recent Congressional Budget Office study estimates the cumulative loss from the recession and slow recovery at $5.7 trillion." (Congressional Budget Office. 2012. *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*. p. 26.) One complicating issue is determining which losses should be attributed to the recession and which to other issues. For example, GAO notes, "analyzing the peak-to-trough changes in certain measures, such as home prices, can overstate the impacts associated with the crisis, as valuations before the crisis may have been inflated and unsustainable.[3] *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* p. 17.

[4] *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* pp. 17-18.

[5] Cited in *Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act.* p. 16.

[6] Department of Justice, "Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages," November 13, 2013, Available at: https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement.

[7] Department of Justice, "Justice Department, Federal and State Partners Secure Record $7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages," July 14, 2014, available at: https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement.

[8] Department of Justice, "Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis," August 21, 2014, available at: https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

Although the details of the settlements varied, they aimed to resolve claims related to the improper issuance of residential mortgage-backed securities.

Perhaps because of frustration and resignation over DOJ's decision not to engage in criminal prosecutions, or perhaps because the settlements did involve large sums of money, and although they were front-page news for a day, these giant deals received very little scrutiny. That was a mistake that this Subcommittee should remedy. These settlements were reached through secretive and faulty processes; they failed to provide any serious accounting to the public of what the Department had uncovered and why it thought billions of dollars in penalties and restitution were in order; the public relations hype around the settlements obscured the extent to which substantial portions of the settlement totals imposed no or minimal actual costs on the settling banks; and although the non-transparent aspect of the settlement makes this impossible to determine with certainty, they very likely let the banks off cheap relative to their potential liability. While "rough justice" is sometimes the best that can be obtained, there is an almost ad hoc element to these deals that suggests a mutually face-saving, slipshod negotiation rather than an appropriately deliberative and thoughtful process.

In the case of the JPMorgan settlement, for example, the Department never filed nor published a complaint against the megabank, though DOJ lawyers had apparently drafted a detailed version. Instead, the settlement contains only an 11-page statement of facts that purports to describe the misdeeds of JPMorgan and its acquired Bear Stearns and Washington Mutual operations. This statement of facts may generously be characterized as bare bones.

The organization Better Markets would subsequently challenge the JPMorgan settlement in federal court. Although Better Markets was not able to prevail as a legal matter, there is little doubt, in our view, that the organization was correct as a policy matter. In criticizing the nature of the statement of facts, it elaborated what was not disclosed:

> a. the scope of the investigation; b. the underlying illegal conduct; c. the specific violations of law committed; d. the benefits (monetary and otherwise) received by JPMorgan Chase; e. the damages inflicted on investors and other victims by JPMorgan Chase; f. the impact of those violations in terms of contributing to the financial crisis; g. the individuals involved in and responsible for the violations; and h. the appropriateness of the civil monetary penalty and other relief included in the $13 billion agreement under all the facts and circumstances.[9]

Most problematic, Better Markets argued,

> The $13 billion agreement does not describe in any meaningful detail the illegal conduct by JPMorgan Chase that gave rise to the civil monetary penalty, including an explanation of how those 1,605 Subprime Securities [identified in an annex] were selected for coverage under the $13 billion agreement; the number, type, and content of the

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[9] Better Markets v. The Department of Justice, Complaint for Declaratory and Injunctive Relief, February 10, 2014, available at: http://www.bettermarkets.com/sites/default/files/Better%20Markets%20v%20%20DOJ-%20Complaint-%202-10-14_0.pdf.

> misrepresentations and omissions that JPMorgan Chase committed, both in documents and orally; and when the acts of misconduct occurred. Nor does the $13 billion agreement attach any of the term sheets and offering materials for the Subprime Securities listed in Annex 3. Instead, the statement of facts employs vague terms and phrases, such as "large amounts;" "in certain instances;" "at least some of the loan pools;" "in various offering documents;" "certain pools;" "a number of;" "certain investors;" "purchasers;" and "a number of loans."[10]

Although the subsequent settlements contained slightly more detail of the covered misconduct than the JPMorgan statement of facts, they followed essentially the same template.

In the case of the JPMorgan settlement, some details are known about the negotiation process, due to subsequent New York Times reporting.[11] JPMorgan was desperate to prevent the filing of a case in court. Just before the DOJ was prepared to file a case, JPMorgan CEO Jamie Dimon called Tony West, then the number three official at DOJ, to negotiate a deal. West insisted that JPMorgan agree to pay billions more than it previously had offered in negotiations, and Dimon agreed. No complaint was filed.

Yet apparently JPMorgan had a copy of the complaint, and actively kept it secret. The Better Markets complaint details that the company refused to turn over a copy in subsequent litigation with the Federal Home Loan Board of Pittsburgh.

JPMorgan's refusal to make public a DOJ draft complaint – which presumably contains detailed allegations of JPMorgan wrongdoing, but obviously no admission from the company – underscores the value to the public of the information that DOJ never disclosed, and makes clear that the failure to publish the complaint, or at minimum a far more detailed statement of facts, with actual sources and citations, was a major public disservice.

We applaud the Department for seeking to impose harsh penalties on the Big Banks, and the New York Times reporting makes clear that the Department engaged in tough negotiations over the amount that JPMorgan, and presumably the other banks, would pay. But there is no real way to measure the adequacy of those fines and payments without reference to the wrongdoing and harms for which they are being imposed. Given the nature of Wall Street's wrongdoing, and top DOJ officials' claims that the settlements related to conduct that was centrally related to the mortgage meltdown and the Great Recession, there is good reason to suspect that the penalties are inadequate, both compared to the scale of damage and to achieve appropriate deterrence – particularly in light of the failure to bring any criminal claims.

It is also the case that key elements of the settlements, repeatedly touted by DOJ as "historic" and involving "record" sums, artificially inflate the actual cost to the banks. First, substantial portions appear to be tax deductible, meaning taxpayers are actually subsidizing a significant portion of the penalty payment. Second, each of the settlements involve billions of dollars in

[10] Better Markets v. The Department of Justice, Complaint.

[11] Ben Protess and Jessica Silver-Greenberg, "In Extracting Deal from JPMorgan, US Aimed for the Bottom Line," New York Times, November 19, 2013, available at: http://dealbook.nytimes.com/2013/11/19/13-billion-settlement-with-jpmorgan-is-announced.

relief aid to consumers. While such measures should appropriately be the top priority in mortgage fraud cases, bank write-downs and loan modifications of underwater loans do not impose costs on banks, or at the very least not in the sense that fines do. To be clear, loan modifications are a material benefit to underwater homeowners, and may permit them to stay in homes that they otherwise would be forced to leave. But writing down underwater loans is an action that banks should be taking irrespective of any government mandate, not to serve consumers but to properly account on their books for the value of their loans.

The Big Bank civil settlements deserve ongoing Congressional scrutiny, to determine bank compliance but especially to prevent such flawed deals in the future. One of the final such deals involving the Big Banks for conduct leading up to the financial meltdown, with Deutsche Bank, is now reportedly under negotiation, posing complicated specific questions of its own.[12] Whether by statute, through exercise of Congressional oversight or DOJ adoption of policy clarity, cases of this scale require a different kind of treatment.

- Such settlements must include a clear and detailed statement of the wrongs alleged, the evidentiary basis for those claims, the laws allegedly violated, and the harm allegedly inflicted.
- At a certain threshold of wrongdoing and penalty, there is a strong argument that such settlements should be subjected to judicial review for adequacy and protection of the public interest.
- Civil action must not be a substitute for criminal enforcement.

II. Inappropriate use of deferred and non-prosecution agreements

Far too often, corporations are able to commit crimes but escape criminal prosecution, even when caught. In the past decade, there has been a dramatic rise in federal prosecutors choosing not to prosecute corporations that have committed crimes. Instead, the U.S. Department of Justice has adopted an alternative approach, entering into agreements with corporations to either defer prosecution or abstain from prosecution entirely if the corporation meets the terms set out in these agreements. When first introduced, these types of agreements, also known as “pre-trial diversion,” were intended to apply not to corporations, but primarily to juvenile delinquents, with the aim of clearing the courts to allow them to attend to major criminal cases.[13] Yet, when deferred and non-prosecution agreements are used in response to massive corporate crimes, it is exactly such perpetrators of major crimes that reap the benefits. Indeed the extent and nature of deferred and non-prosecution of agreements is such that they have turned much of DOJ’s corporate criminal practice into a branch of civil enforcement – a deeply problematic state of affairs precisely because criminal and civil enforcement aim to achieve distinct if overlapping objectives.

[12] James Shotter, Laura Noonan and Thomas Hale, “Deutsche Bank denies seeking help from Berlin over DoJ,” Financial Times, September 26, 2016, available at: https://www.ft.com/content/c882de4e-83c1-11e6-a29c-6e7d9515ad15.
[13] Mokhiber, R. (2005). Crime without Conviction: The Rise of Deferred and Non Prosecution Agreements. Available from: <http://corporatecrimereporter.com/deferredreport.htm>.

Prior to 2003, the DOJ entered into fewer than five deferred prosecution agreements and non-prosecution agreements with corporations per year. In the first decade following the millennium, these numbers gradually crept upwards, entering the double digits by 2005. Numbers rose to a high of 42 deferred and non-prosecution agreements in 2007 and continue to number in the dozens every year, according to a forthcoming report from Public Citizen.[14]

Deferred and non-prosecution agreements are a special gift to large corporations, which are enabled to escape prosecution for serious crimes in a manner rarely afforded to individuals or small business. The logic of these agreements is that they permit prosecutors to put in place special compliance mechanisms to prevent future wrongdoing. These compliance mechanisms can equally be obtained through criminal plea agreements, however, so the claim that deferred and non-prosecution agreements offer some unique benefit is incorrect. Worse, deferred prosecution agreements offer little or no deterrent effect, either for the (non-)charged corporation or for others. Corporations entering into deferred and non-prosecution agreements have a strikingly high recidivism rate, including companies such as AIG, Barclays, Bristol-Myers Squibb, Chevron, GlaxoSmithKline, Hitachi, Lucent, Merrill Lynch, Pfizer, Prudential and UBS.[15]

Perhaps the most appalling example of the abuse of deferred prosecution—one which emphasizes how this kid-glove treatment is designed primarily for giant corporations—involves the banking giant HSBC. In December 2012, the company agreed to pay more than $1 billion in fines and entered into a deferred prosecution agreement for anti-money laundering and sanctions violations. Assistant Attorney General Lanny Breuer said the company was guilty of "stunning failures of oversight—and worse" and that the "record of dysfunction that prevailed at HSBC for many years was astonishing."[16]

Breuer was correct.

The statement of facts attached to the deferred prosecution agreement with HSBC is startling. Just two illustrative examples:

- As regards money laundering for Latin American drug cartels, "Senior business executives at HSBC Mexico repeatedly overruled recommendations from its own AML [anti-money laundering] committee to close accounts with documented suspicious activity. In July 2007, a senior compliance officer at HSBC Group told HSBC Mexico's Chief Compliance Officer that '[t]he AML committee just can't keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It

[14] Ben-Ishai, E. and Weissman, R. (forthcoming, 2016). Justice Deferred -- and Denied. Public Citizen. The most detailed account and analysis of deferred prosecution agreements is contained in Garrett, B. (2014.) Too Big To Jail: How Prosecutors Compromise with Corporations. Harvard University Press.
[15] Ben-Ishai, E. and Weissman, R. (forthcoming, 2016). Justice Deferred -- and Denied. Public Citizen.
[16] Breuer, L. (2012, December 11.) *Assistant Attorney General Lanny A. Breuer Speaks at the HSBC Press Conference*. Available from: <http://www.justice.gov/criminal/pr/speeches/2012/crm-speech-1212111.html>.

needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.'"[17]

- As regards efforts to facilitate evasion of U.S. government sanctions against other countries, the statement of facts says, "[B]eginning in the 1990s, HSBC Bank plc ("HSBC Europe"), a wholly owned subsidiary of HSBC Group, devised a procedure whereby the Sanctioned Entities put a cautionary note in their SWIFT payment messages including, among others, 'care sanctioned country,' 'do not mention our name in NY,' or 'do not mention Iran.' Payments with these cautionary notes automatically fell into what HSBC Europe termed a 'repair queue' where HSBC Europe employees manually removed all references to the Sanctioned Entities. The payments were then sent to HSBC Bank USA and other financial institutions in the United States without reference to the Sanctioned Entities, ensuring that the payments would be processed without delay and not be blocked or rejected and referred to OFAC. HSBC Group was aware of this practice."[18]

Why did a company engaging in such egregious practices, which facilitated illegal drug trafficking and evasion of U.S. sanctions against foreign countries, escape without a criminal prosecution?

According to Breuer, the worry was that a criminal prosecution of a giant bank like HSBC might bring down the company and threaten the global financial system's stability.[19] "In trying to reach a result that's fair and just and powerful, you also have to look at the collateral consequences," Breuer said at the news conference announcing the deferred prosecution deal.[20] "If you think that by doing a certain thing you risk either a charter being revoked, you think that counterparties in a massive financial institution may go away, you think that there is a risk that many, many innocent people will be harmed from a resolution, and by another resolution you think you can mitigate the risk of innocent people suffering, the economy being affected, and you can home in on those and the institutions and address the issues underlying, to the Department of Justice, that's a very real factor, and so it is a fact that you consider. It's one factor," Breuer said.[21]

In other words, the mere fact of its excessive size enabled HSBC to escape criminal penalties; it has been judged too big to jail.

A smaller bank, presumably, would have received no such deferential treatment.

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[17] United States of America Against HSBC Bank USA, N.A. and HSBC Holdings PLC, HSBC Deferred Prosecution Agreement Attachment - Statement of Facts. (2012, December 11.) p. 13. Available from: <http://www.justice.gov/opa/documents/hsbc/dpa-attachment-a.pdf>.
[18] HSBC Deferred Prosecution Agreement Attachment - Statement of Facts. pp. 22-23.
[19] O'Toole, J. (2012, December 12.) *HSBC: Too Big to Jail?* CNNMoney. Available from: <http://money.cnn.com/2012/12/12/news/companies/hsbc-money-laundering/index.html>.
[20] Viswanatha, A. and Wolf, B. (2012, December 12.) HSBC to pay $1.9 billion U.S. fine in money-laundering case. Reuters. Available from: <http://www.reuters.com/article/2012/12/11/us-hsbc-probe-idUSBRE8BA05M20121211>.
[21] Finkle, V. (2013, Jan. 22.) *Are Some Banks 'Too Big To Jail'?* American Banker. Available from: <http://www.americanbanker.com/issues/178_15/are-some-banks-too-big-to-jail-1056033-1.html?zkPrintable=1&nopagination=1>.

American Banker—not an outlet known for shrill criticism of the banking industry—eloquently captured the moral outrage of this state of affairs. Shortly after the HSBC deferred prosecution deal, American Banker highlighted the case of G&A Check Cashing, a small firm found to have violated anti-money laundering laws for over $8 million in transactions. (By contrast, HSBC was found to have laundered at least $881 million in drug trafficking proceeds, and failed to monitor properly $200 trillion in wire transfers.) Two of its executives were sentenced to jail terms, and the company was placed on probation for two years. The case highlights "the disparate treatment of certain institutions for violations of anti-laundering laws," American Banker commented. "[M]any have responded to the settlement with disdain for the basic message they said it sent about parity under the law."[22]

The HSBC deal looks even worse in retrospect, as its compliance monitor reports that the bank is failing to adopt appropriate compliance processes and federal prosecutors are considering filing a new criminal case, related to foreign exchange manipulations, against HSBC.[23]

In response to the very strong public criticism around the HSBC and other deferred prosecution deals, top officials at the Department of Justice walked back prior statements that such sweetheart deals were needed because of the potential systemic risk posed by prosecuting Wall Street giants. But there is little doubt that the too-big-to-jail comments reflected the actual views inside the Department of Justice.

Criticisms of disparate treatment for large banks did strike a chord inside the Department of Justice, however. DOJ has recently secured some criminal pleas from giant financial firms, most notably in regards to the extraordinary manipulation of foreign exchange markets by five major banks. These banks—Barclays, Citigroup, JP Morgan Chase, the Royal Bank of Scotland and UBS—colluded on the size, timing and nature of their buy and sell orders for U.S. dollars and euros. The conspirators referred to themselves as the "mafia," and one said, "if you ain't cheatin', you ain't tryin'." There is no question of intentionality in this case.[24]

Yet even though guilty pleas were obtained from four of the banks and a deferred prosecution agreement was rescinded for the fifth, UBS, the Department of Justice maneuvered yet again to protect the banks from the normal consequences of law-breaking. A final deal on the guilty pleas was apparently held off until the SEC granted waivers to the banks from rules that would otherwise prevent them from undertaking certain securities activities.[25] It is expected in the next several months that the Department of Labor will consider whether to waive its normal penalties for pension providers guilty of criminal wrongdoing. The very strong expectation, unfortunately, is that the Labor Department will follow the lead of the SEC—unless perhaps sufficient public and political pressure is brought to bear. It has also been reported that the Department of Justice

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[22] *Are Some Banks 'Too Big To Jail'?*

[23] Greg Farrell and Keri Geiger, "US Considers HSBC Charge That Could Upend 2012 Settlement," Bloomberg, September 7, 2016, available at: http://www.bloomberg.com/news/articles/2016-09-07/u-s-said-to-weigh-hsbc-charge-that-could-upend-2012-settlement.

[24] Department of Justice. (2015, May 20.) Five Major Banks Agree to Parent-Level Pleas. Available from: <http://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas>.

[25] Reuters. (2015, May 20.) U.S. SEC Grants Waivers to Banks After Guilty Pleas. Available from: <http://www.reuters.com/article/2015/05/20/banks-forex-settlement-waivers-idUSL1N0YB1GA20150520>.

obtained pleas from the banks' parent companies, rather than from subsidiaries, to protect those subsidiaries from other possible sanctions, including state charter revocation.[26]

DOJ's efforts to protect the banks from the consequences of a criminal plea are so far-reaching that it is fair to say that we may be entering the era of prosecution in name only—deferred prosecution by another name.

Again, it is virtually inconceivable that a small financial firm, or any small business, would be accorded such extraordinary accommodations in the context of pleading guilty to such a far-reaching conspiracy.

To be very clear, the inappropriate use of deferred and non-prosecution agreements is not limited to the financial sector. Consider, for example, the case of the GM ignition switch**.** Starting in 2002, GM sold a host of cars containing a faulty ignition switch that would suddenly shut off the engine during driving, and prevent airbags from deploying in the event of a crash. GM has acknowledged that 174 people have died as a result of ignition switch failures, and the actual number may be much higher.

The problems with the General Motors ignition switch began more than a decade before defective cars were finally recalled. "During the time between GM's approval of the low-torque ignition switch in 2002 and its 2014 recall of 2.6 million vehicles affected by the ignition switch defect, key facts were withheld by, or unrecognized within, GM, making detection of the connection between the faulty ignition switch and non-deployments of air bags difficult for both GM and NHTSA, and leading to a tragic delay in instituting a recall," a National Highway Transportation and Safety Administration (NHTSA) review found. "From 2007 to 2013, GM faced litigation on several more air bag non-deployment fatalities and was repeatedly warned by outside counsel that a defect existed. However, GM failed to make a defect determination and did not provide the required notification to NHTSA."[27] By spring 2012, the Department of Justice concluded and GM has agreed not to contest, the company definitively knew about the ignition switch failure and its consequences. Yet, it did not disclose the defect for an additional 20 months. "GM's delay in disclosing the defect at issue was the product of actions by certain personnel responsible for shepherding safety defects through GM's internal recall process, who delayed the recall until GM could fully package, present, explain, and handle the deadly problem," according to the Department of Justice.[28]

In September 2015, GM entered into a deferred prosecution agreement with the Justice Department. Simultaneous with the filing of the deferred prosecution agreement, prosecutors

[26] Protess, B. and Corkery, M. (2015, May 13.) 5 Big Banks Expected to Plead Guilty to Felony Charges, but Punishments May Be Tempered. New York Times. Available from: <http://www.nytimes.com/2015/05/14/business/dealbook/5-big-banks-expected-to-plead-guilty-to-felony-charges-but-punishments-may-be-tempered.html>.
[27] National Highway Traffic Safety Administration, NHTSA's Path Forward, June 2015, available at: www.nhtsa.gov/staticfiles/communications/pdf/nhtsa-path-forward.pdf.
[28] Department of Justice, "Manhattan U.S. Attorney Announces Criminal Charges Against General Motors And Deferred Prosecution Agreement With $900 Million Forfeiture," September 17, 2015, available at: http://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-criminal-charges-against-general-motors-and-deferred.

filed a criminal information against the company, alleging it had illegally concealed information from NHTSA (under 18 U.S.C. 1001) and engaged in wire fraud by misleading consumers as to the truth about the ignition switch.[29] GM agreed to pay $900 million in penalties as part of the deal. No individuals have been charged in connection with the case, and it is not expected that any will be.

Prosecutors were effusive in praising GM for its cooperation after it finally disclosed the defect, and this plainly impacted the decision to treat the company so lightly. It is notable in reflecting on corporate criminal prosecution that, for a period of six years, GM had notice of the problem with the ignition switch due to litigation with accident victims, and entered into civil settlement deals that required information about the defect be sealed;[30] yet prosecutors did not allege the company had knowledge of the defect during this period. It is notable as well that all reports indicate no individual will be held criminally responsible for any of the 174-plus deaths resulting from the defect and cover-up.

It turns out that a number of individual drivers were prosecuted for manslaughter for crashes that were in fact attributable to the ignition switch defect; the contrast with the ultimate treatment of GM could not be starker in showing the double standards applied to corporate criminal prosecutions and in underscoring the challenges in prosecuting individuals involved in such cases.[31]

When it comes to corporate wrongdoing, our system of criminal justice has gone awry. Because of a lack of will and/or statutory authority, prosecutors fail to prosecute corporations and corporate executives for reckless conduct the likes of which would generate full-on prosecution and harsh sentences if committed by individuals outside of the corporate context. Through deferred and non-prosecution agreements, large companies, and especially but not only big banks, get special treatment, enabling them to avoid criminal prosecution for egregious wrongdoing simply by promising not to commit wrongs in the future. And even criminal prosecutions are engineered to enable giant banks to avoid meaningful penalties.

Aggressive oversight can hopefully cure some of these problems, but oversight alone is not enough.

First, Congress should act to remedy the problem of insufficient criminal penalties by adopting a criminal statute to make it a crime for corporations or corporate executives to conceal information of hazards posing a risk of serious injury or death to workers or consumers. Senators Blumenthal and Casey have introduced such legislation, the Hide No Harm Act.

Second, the abuse of deferred and non-prosecution agreements must be curbed. Whether from inside the Department of Justice or imposed by Congress, there should be new guidelines

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[29] United States of America v. General Motors Company, Information, September 17, 2015, available at: http://www.justice.gov/usao-sdny/file/772301/download.
[30] Bill Vlasic, "Inquiry by General Motors Is Said to Focus on Its Lawyers," New York Times, May 17, 2014, available at: http://www.nytimes.com/2014/05/18/business/inquiries-at-gm-are-said-to-focus-on-its-legal-unit.html.
[31] See Jeff Bennett, "Texas Woman Driving GM Recalled Car Cleared In Death of Fiancé," Wall Street Journal, November 24, 2014, available at: http://www.wsj.com/articles/gm-confirms-texas-accident-linked-to-faulty-ignition-switch-1416842193.

regarding these arrangements. If they are not prohibited outright, at minimum a strong presumption against such deals should be established, so they are used only in rare cases upon specific showings of their necessity, and never in cases of repeat offenders.

Third, criminal prosecutions and guilty pleas should come with consequences, and not just fines which giant companies can easily absorb, almost no matter the size. If Congress has seen fit to adopt statutes that strip persons or corporations that have pled or been found guilty of a crime of the right to carry out certain activities, sell to the government, hold certain licenses or maintain privileges, then those sanctions should be enforced. Congress should look to prohibit the granting of waivers in these areas, or at minimum imposing tough standards as a prerequisite to such waivers.

Fourth, so long as deferred prosecutions and waivers continue, there should be greatly enhanced transparency around the decision-making process. If government officials are worried that prosecuting a financial firm will pose too much systemic risk, that has important policy consequences, and Congress and the public need to know. They also need to know who is expressing such worries, and how they are interacting with prosecutors. Similarly, if government prosecutors are declining to prosecute drug companies, or manipulating the corporate entity that they prosecute, out of a fear that the government would otherwise not be able to buy needed pharmaceuticals from that company, they should say so explicitly. There is little reason to expect this transparency to come voluntarily. Congress should pass legislation that requires it.

Last, and of crucial importance, there must be prosecution of corporate executives for corporate wrongdoing.[32] Although the DOJ through its Yates Memorandum has indicated that it will pursue such prosecutions as a priority matter, it remains to be seen if the memo will in fact change practice. The Wells Fargo matter, discussed briefly below, will be an important test case.

III. Other policy considerations related to corporate crime and wrongdoing

As the brief discussion above highlights, the rash of corporate crime and wrongdoing over the last decade has called attention to the need for far-reaching reform to penalize corporations and their executives for wrongdoing, provide restitution to victims and deter future misconduct. I have discussed some important reforms above. Here I briefly touch on some additional matters.

Tougher penalties. Although there are important exceptions, civil and criminal penalties for wrongdoing are generally too weak.

In 2015, Congress took a small step to remedy this problem by indexing penalties to inflation. This measure directed agencies to step-up penalties to reflect prior inflation and continuously make inflation adjustments to penalties. It is expected that these adjustments will yield more than $1 billion in additional fines over the next decade.[33]

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[32] For discussion of the kinds of remedies highlighted here, but also especially the need for individual corporate executive prosecutions, see Steinzor, R. (2014.) Why Not Jail? Cambridge University Press.

[33] Leon Greenfield, James Lowe, Jeffrey Ayer and Mi Hyun Yoon, "Civil Fines Jump Across Agencies Under Inflation Adjustment Act," July 13, 2016, available at: https://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubID=17179882162.

Generally, however, penalties remain far too weak, including for workplace safety deaths and injuries and for auto safety abuses. Remedial legislation related to the auto safety enforcement penalty structure has been introduced by Senators Blumenthal, Markey and Bill Nelson.[34] Compounding the problem of inadequate fines, agencies such as the Occupational Safety and Health Administration commonly impose fines below the maximum permissible.[35]

Tax Deductibility. Civil and criminal penalties should not be tax deductible, but they typically are. [36] A decade ago, GAO found companies claiming tax deductibility for 20 of 34 studied settlements.[37] Legislation should specify that taxpayers will not subsidize corporate wrongdoers, but DOJ can also take steps to solve the problem by including terms in its settlement agreements that prohibit tax deductibility. The Truth in Settlements Act, S1109, introduced by Senators Lankford and Warren, has passed the Senate and would at least require agencies to specify whether settlements are tax deductible. Senators Grassley and Reed have introduced a bill that would go further, and end deductibility.[38]

Corporate Monitors and Compliance Reports. Particularly with the rise of deferred and non-prosecution agreements, but sometimes also in connection with civil settlements, DOJ has required an array of corporations to install corporate monitors aimed at ensuring future compliance with the law. There is very little evidence that these monitors have materially affected corporate behavior, or what they have done at all.[39] Because of their crucial importance, and because they are often installed as a substitute for legitimate criminal prosecution, these monitors should be an object of Congressional oversight, with much more transparency required about their functioning.

Companies and monitors file frequent compliance reports pursuant to various settlement agreements, but these reports are typically not made public in full or at all. Whether by statute or DOJ practice, all of these reports should presumptively be public, with very little deference to claimed proprietary information. This is particularly important given the likely inadequacy of the monitors themselves.

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[34] See https://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-markey-nelson-introduce-bill-to-eliminate-cap-on-maximum-allowable-civil-fine-dot-can-levy-on-automakers.

[35] Martha T. McCluskey, Thomas O. McGarity, Sidney Shapiro, and Katherine Tracy, "OSHA's Discount on Danger: OSHA Should Revise Its Informal Settlement Policies to Maximize the Deterrent Value of Citations," Center for Progressive Reform, June 2016, available at: http://progressivereform.org/articles/OSHA_Discount_on_Danger_Report.pdf.

[36] U.S. PIRG, "No Tax Write-Offs for Wall Street Wrongdoing," February 20, 2014, available at: http://www.uspirg.org/resources/usp/no-tax-write-offs-wall-street-wrongdoing.

[37] Government Accountability Office, Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments, September 15, 2005, available at: http://www.gao.gov/products/GAO-05-747.

[38] See http://www.grassley.senate.gov/news/news-releases/reed-grassley-introduce-bill-prevent-corporate-penalties-becoming-tax-write-offs.

[39] See Brandon Garrett, *Too Big to Jail: How Prosecutors Compromise with Corporations*, Cambridge, MA: Belknap Press, 2014.

Third Party Payments. Unfortunately, one area where this committee has sought to legislate relates to third-party payments in the context of settlements over corporate wrongdoing. These payments, which often direct funds to nongovernmental service agencies to alleviate wrongdoing committed by settling defendants, are an important means by which defendants can be required to make restitution.

These third-party payments are especially important to address injuries to the public that may be either non-quantifiable or indeterminate, such as the ecological impact or public health hazards caused by violations of environmental laws, the collateral consequences to communities resulting from predatory lending by financial institutions, or unknown health outcomes to individuals resulting from chemical exposures in the workplace. Preventing such third-party payments would undermine law enforcement goals by reducing the availability of suitable remedies to address these kinds of injuries to the public caused by illegal conduct, and harm the families and communities impacted by injuries that cannot be addressed by direct restitution.

Direct Fines for Corporate Executives. To the extent possible under existing authority, agencies should seek to include direct fines for CEOs or other management level executives in civil settlements in addition to fines that apply to the entity, and Congress should act to create such authority as needed. Imposing civil penalties on executives would result in enhanced accountability particularly in circumstances where company executives were directly involved in the wrongdoing or were negligent in preventing it. Even more importantly, the prospect of such fines would have a far-reaching deterrent effect. The CFPB has begun incorporating direct fines for CEO in its settlements[40] and this practice should be encouraged across agencies.

IV. The Wells Fargo Scandal

The recent and ongoing Wells Fargo scandal, whereby the bank fraudulently created more than two million deposit and credit card accounts, throws into sharp relief many important questions relating to preventing corporate wrongdoing and holding corporate wrongdoers accountable.

First, as important as is public enforcement, private enforcement can frequently identify and deter problems before they are visible on enforcement agencies' radar screens. Yet private enforcement is commonly stifled through "ripoff clauses" – forced arbitration provisions and class action bans in form contracts – that effectively prevent individuals from holding corporate wrongdoers accountable. It's generally not worth the time and money to bring a case on an individual basis, and there's a disincentive to proceed in arbitration, where claims are decided by a private firm handpicked and paid by the corporation rather than a judge or jury.

Like most other big banks, and many other corporations, Wells Fargo buries ripoff clauses in the fine print of its customer contracts, and those provisions did in fact stifle litigation that may have put an early end to Walls Fargo's abuses. One customer sued Wells Fargo in California over a sham account created in his name in 2013, for example. The case should have been allowed to proceed in court, but was blocked by a ripoff clause. The consumer's lawyers argued that an arbitration provision in a legitimate account agreement should not bar him from suing over a

[40] http://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-rpm-mortgage-to-pay-19-million-for-steering-consumers-into-costlier-mortgages/

sham account he never agreed to open. However, feeling constrained by a handful of recent 5-4 Supreme Court decisions, the judge held that the ripoff clause in the original agreement blocked him from suing Wells Fargo for virtually any behavior.

This reality underscores the importance of the Consumer Financial Protection Bureau's proposed rule at least to end class action bans in consumer financial contracts. Ideally, that rule should prohibit forced arbitration provisions in consumer financial contracts altogether.

Second, executives, not just low-level employees, must be held accountable, or these kinds of abuses will continue. It is a positive sign that the Wells Fargo board is insisting on a clawback of some compensation to the bank's CEO and the executive in charge of compliance. But that clawback alone is not enough.

Third, there must be criminal prosecution for pervasive wrongdoing, and there should be criminal prosecution of responsible executives. The Wells Fargo scandal is a test case for the Yates memo.[41]

Fourth, the scandal reiterates the need for a legislative intervention to break up the big banks. They have proved not only too big to fail, too big to jail, but too big to manage.[42]

Fifth, while the Consumer Financial Protection Bureau should be credited with bringing the enforcement action against Wells Fargo, it is worth examining whether the agency's fine was sufficient, either for deterrence or to compensate consumers, including for potential damage to their credit scores. The unavailability of private rights of action against Wells Fargo makes it especially important that public enforcement actions provide full compensation to affected consumers.

Sixth, there needs to be ongoing Congressional investigation into what occurred at Wells Fargo. The scandal occurred over a long period, involving thousands of employees. Why did the bank's compliance department not recognize the scale of what was occurring? As thousands of employees were being fired for wrongdoing, why did the bank and bank executives not recognize the systemic nature of what was occurring? Or, if they did, why did they not act to end the abuses? What remedies did the bank offer to consumers as it was firing thousands of employees for fraudulently creating accounts? Why did the bank not recognize that its own high-pressured management and cross-selling targets were encouraging the widespread fraud – arguably making it inevitable? And, did the problem really begin in 2011, and not earlier? A Public Citizen report, issued today and attached to this testimony, documents the that Wells Fargo emphasized high and unrealistic targets for cross-selling going back at least to 1998. This raises the question about whether the abuses track back as much as a decade or more prior to 2011.

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[41] James Stewart, "Wells Fargo Tests Justice Department's Get-Tough Approach," New York Times, September 22, 2016, available at: http://www.nytimes.com/2016/09/23/business/wells-fargo-tests-justice-departments-get-tough-approach.html.

[42] Bartlett Naylor, *Too Big: The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage*, Washington, DC: Public Citizen, 2016, available at: http://www.citizen.org/pressroom/pressroomredirect.cfm?ID=7932.

As this brief testimony illustrates, corporate abuses are rampant in the American economy, and they can have devastating consequences on the lives of individuals, communities and even the entire country. That’s why aggressive enforcement and mechanisms of accountability are so important. In their absence, corporate catastrophes are sure to continue.

PUBLIC CITIZEN

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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[43]

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."[44]

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;"[45] the OCC described these as "unsafe or unsound practices in the Bank's risk management and oversight of the Bank's sales practices;"[46] 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."[47]

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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[43] THE VISION & VALUES OF WELLS FARGO, JOHN G STUMPF, CHAIRMAN & CEO, WELLS FARGO, at p. 29, http://bit.ly/2dxn3yx.
[44] *Id.*
[45] *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.
[46] *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.
[47] *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." [48]

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."[49] 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."[50] 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.[51]

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.[52]

In 1999, according to its annual report, Wells Fargo was: "Going for gr-eight product packages,"[53] establishing the long-held, and now infamous, goal of eight products per household.

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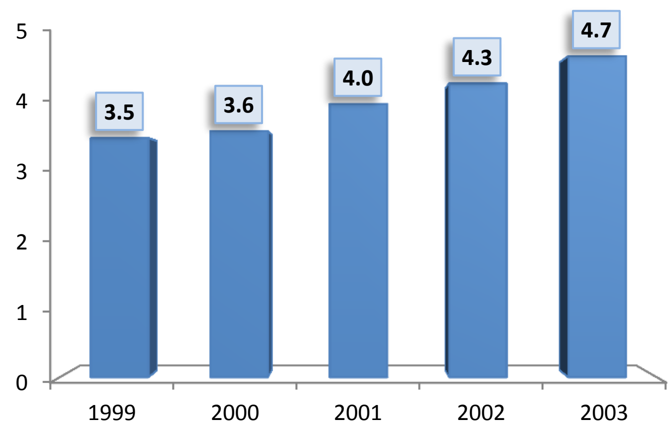
[48] *In the matter of: Wells Fargo Bank, N.A., Consent Order,* U.S. CONSUMER FINANCIAL PROTECTION BUREAU, (Sep. 8, 2016), at p. 5, 7, http://bit.ly/2dpnuyN.
[49] E-mail from CFPB to Public Citizen Researcher Michael Tanglis (Sept. 23, 2016). (On file with author.)
[50] E-mail from OCC to Public Citizen Researcher Michael Tanglis (Sept. 27, 2016). (On file with author.)
[51] Cross-selling disclosures from each annual report are quoted in the Appendix.
[52] Emily Glazer, *From 'Gr-eight' to 'Gaming,' a Short History of Wells Fargo and Cross-Selling*, THE WALL STREET JOURNAL, MONEY BEAT (Sep. 16, 2016), http://on.wsj.com/2di021o
[53] WELLS FARGO ANNUAL REPORT, WELLS FARGO (1999), at p.7, http://bit.ly/2ddwP9O.

Not only did Wells keep close track of its products per customer, it also monitored its products sold *per banker*, in this case on a per day basis, at least as early as 1999.[54] [See Figure 1]

Figure 1: Product Sales Per Banker Per Day



Source: Wells Fargo Annual Report, 2003

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."[55]

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."[56]

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."[57] According to CNN, "Fischer said she remembers her district manager instructing her in 2007 to make the employees reporting to her open unauthorized accounts."[58]

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.[59] For the next 10 years, Wells Fargo increased the ratio each year.[60] The streak ended in 2010 when the ratio dropped to 5.7 from 5.95.[61] 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]

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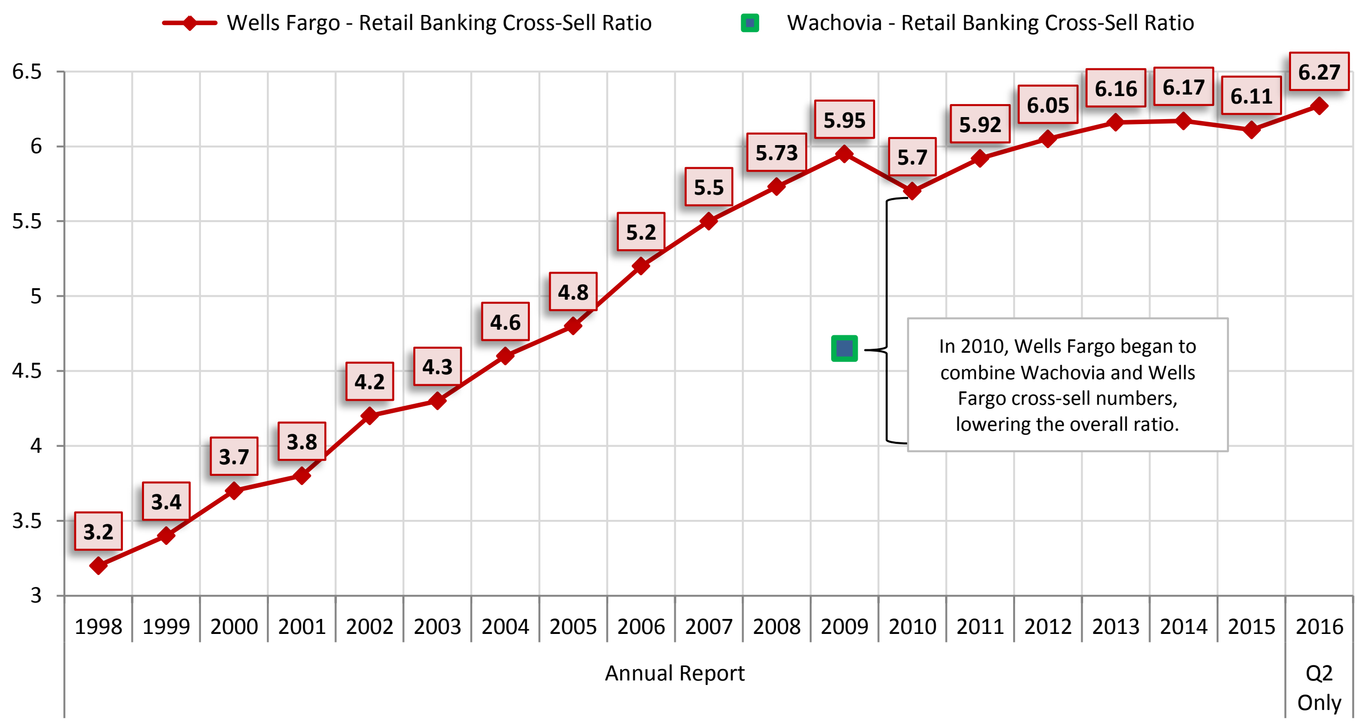
[54] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2003), at p. 15, http://bit.ly/2dxaBid.
[55] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2000), at p. 6, http://bit.ly/2dhISEB.
[56] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2010), at p. 5, http://bit.ly/2cTplHd.
[57] Matt Egan, *Wells Fargo Workers: Fake Accounts Began Years Ago*, CNN MONEY (Sep. 26, 2016), http://cnnmon.ie/2ddF1He.
[58] *Id.*
[59] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2010), at p. 6, http://bit.ly/2cTplHd.
[60] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2009), at p. 34, http://bit.ly/2dxemEC.
[61] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2009), at p. 34, http://bit.ly/2dxemEC,and WELLS FARGO ANNUAL REPORT, WELLS FARGO (2010), at p. 34, http://bit.ly/2cTplHd.

Figure 2: Wells Fargo Cross-Sell Ratio 1998 - Q2 2016[62]



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."[63]

In its 2011 annual report, Wells Fargo reported an eye-popping cross-sell ratio in its "top region" of **7.38 products**[64] – 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.[65]

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[62] Sourcing for chart is in Appendix.
[63] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2004), at p. 18, http://bit.ly/2dpvw6C.
[64] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2011), at p. 6, http://bit.ly/2czwfAn.
[65] Wells Fargo's Annual Reports 2012 through 2015

Conclusion

Wells Fargo has told the media that is reviewing its cross-selling practices to as early as 2009.[66] 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." [67]

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."[68]

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."[69]

According to a recent survey by consulting firm A.T. Kearney, "On average, bank customers had 2.71 products at their primary bank."[70] 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." [71]

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!'"[72]

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.

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

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

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

[69] *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.

[70] 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 .

[71] 2Q16 QUARTERLY SUPPLEMENT, WELLS FARGO (JULY 15, 2016), at p. 14, http://bit.ly/2d7jLUo.

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

Appendix

Wells Fargo Annual Report Quotes on Cross-Selling 1998 through 2015

"We expect the new Wells Fargo will generate higher earnings. 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[73]

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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[74]

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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[75]

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[73] Wells Fargo Annual Report, Wells Fargo (1998), at p.9, http://bit.ly/2d1owyg.
[74] Wells Fargo Annual Report, Wells Fargo (1999), at p.7, http://bit.ly/2ddwP9O.
[75] Wells Fargo Annual Report, Wells Fargo (2000), at p. 6, http://bit.ly/2dhISEB.

"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[76]

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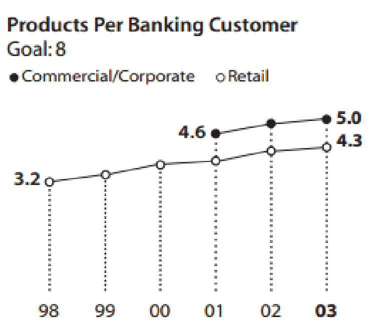
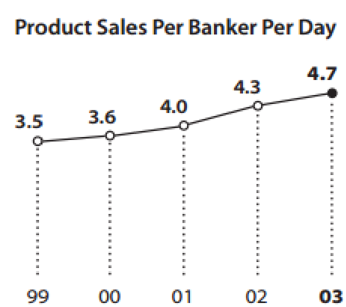
"The average financial service provider has about two products per customer. Four years ago, at the time of the Norwest-Wells Fargo merger, we had about three products per customer. Today, we average more than four. About a third of our banking customers have five products with is. Our goal is eight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

– 2002 Wells Fargo Annual Report[77]

***

"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."*





– 2003 Wells Fargo Annual Report[78]

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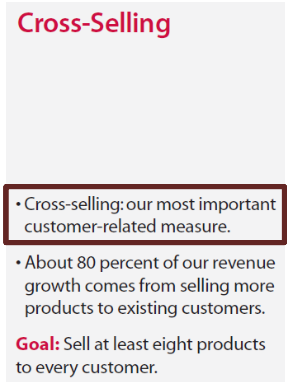
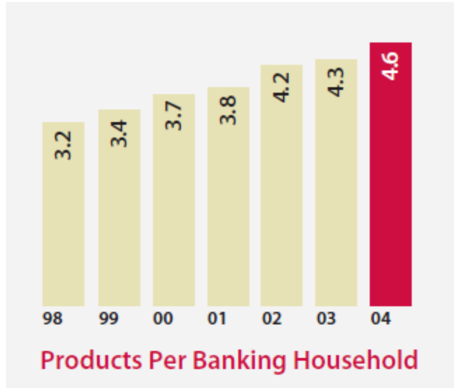
[76] Wells Fargo Annual Report, Wells Fargo (2001), at p. 20, http://bit.ly/2d1oIgL.
[77] Wells Fargo Annual Report, Wells Fargo (2002), at p. 16, 19, http://bit.ly/2cTni63.
[78] Wells Fargo Annual Report, Wells Fargo (2003), at p. 15, 16 and 34, http://bit.ly/2dxaBid.

*"**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."*





– 2004 Wells Fargo Annual Report[79]

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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[80]

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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[81]

***

*"**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[82]

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[79] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2004), at p. 18, http://bit.ly/2dpvw6C.
[80] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2005), at p. 5, http://bit.ly/2d7ysp3.
[81] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2006), at p. 3, http://bit.ly/2d7zMIp.
[82] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2007), at p. 34, http://bit.ly/2cANc2i.

*"**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[83]

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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[84]

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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[85]

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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[86]

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[83] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2008), at p. 34, http://bit.ly/2dAwhwI.
[84] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2009), at p. 34, http://bit.ly/2dxemEC.
[85] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2010), at p. 5, 6, http://bit.ly/2cTplHd.
[86] WELLS FARGO ANNUAL REPORT, WELLS FARGO (2011), at p. 6, http://bit.ly/2czwfAn.

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[87]

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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[88]

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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. household".*

– 2014 Wells Fargo Annual Report[89]

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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[90]

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"Retail banking cross-sell of 6.27 products per household."

– 2016 Wells Fargo Second Quarterly Supplement[91]

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[87] Wells Fargo Annual Report, Wells Fargo (2012), at p. 44, http://bit.ly/2ddE1mq.
[88] Wells Fargo Annual Report, Wells Fargo (2013), at p. 44, http://bit.ly/2dpTFxM.
[89] Wells Fargo Annual Report, Wells Fargo (2014), at p. 45, http://bit.ly/2dpCdpk.
[90] Wells Fargo Annual Report, Wells Fargo (2015), at p. 47, http://bit.ly/2cTs2bF
[91] 2Q16 Quarterly Supplement, Wells Fargo (July 15, 2016), at p. 14, http://bit.ly/2d7jLUo.