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MARKETS

Next Test for Wells Fargo: Its Reputation

The bank's image is at risk following a $185 million fine for 'widespread illegal' sales practices

A customer leaves an ATM at the Wells Fargo bank in Denver. *PHOTO: RICK WILKING/REUTERS*

By **EMILY GLAZER**

Updated Sept. 9, 2016 10:19 p.m. ET

A $185 million fine is small change for Wells Fargo & Co., which had profit last year of almost $23 billion. But the reputational blow from claims of "widespread illegal" sales practices could prove costly.

The San Francisco bank, with its folksy stagecoach logo, has positioned itself as a solid, Main Street lender that avoided the excesses of the financial crisis and other missteps on Wall Street. That image is in danger now of being challenged by disclosures of improper account and product openings by employees unveiled in an enforcement action the bank entered into Thursday.

In that action, the bank was fined and had to submit to a consent order to settle civil claims brought by the Office of the Comptroller of the Currency, the Consumer

Financial Protection Bureau and the Los Angeles City Attorney's office.

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In other high-profile enforcement cases such as multibillion-dollar settlements related to mortgage underwriting and the sales of mortgage bonds, banks often have been able to use an agreement to put bad behavior behind them and move on. But in the case of Wells Fargo, banking specialists, analysts and investors say the damage may be just starting.

"This scandal, easy to understand and not nearly as complex as mortgage-backed securities, seriously undermines Wells Fargo's Main Street image," wrote Ian Katz, director at research firm Capital Alpha Partners LLC.

In a release, the bank said the settlement with regulators was reached "consistent with our commitment to customers and in the interest of putting this matter behind us."

Even so, rivals already are moving to capitalize on the disclosures. In a statement Friday, Camden R. Fine, president of the Independent Community Bankers of America, said the association and its nearly 6,000 community banks are "outraged" and called Wells Fargo's conduct "appalling and harmful to American consumers and communities." The National Association of Federal Credit Unions, whose members, like community banks, compete with Wells Fargo, issued a similarly harsh denunciation.

Such sentiments along with public opprobrium on the internet and social media had the bank in damage control mode. Executives were calling investors and analysts to try and tamp down fears over the impact, according to people familiar with the matter.

Jim Smith, head of virtual channels for Wells Fargo, wrote in a message to employees Thursday the bank had a "robust" communications plan to support staff. "The next few days will likely be very busy days…during this time, we take it one interaction at a time—one customer at a time," Mr. Smith wrote, according to the message reviewed by The Wall Street Journal.

Wells Fargo’s shares fell 2.4% Friday, a worse drubbing than other bank stocks in a down day for markets overall.

An immediate worry for investors is how customers react to news of how employees behaved. Regulators, for instance, said that Wells Fargo employees, often chasing sales goals and bonuses, created fake accounts for customers, invented personal identification numbers and moved funds between accounts without authorization.

Those allegations could hurt the bank’s ability to attract new customers, could prompt current customers to look for another bank and affect the amount of products and services Wells Fargo is able to sell to new or existing customers, said Allen Tischler, a senior vice president at Moody’s who focuses on U.S. banks.

A curtailment of Wells Fargo’s ability to cross-sell products to customers could crimp profits. The bank has long touted its cross-selling abilities as a reason for its success. It has noted in recent investor presentations and securities filings that its customers have more than six of its products per household.

The community banking segment at Wells Fargo, which handles most retail-banking products and services, generated $12.2 billion in revenue in the second quarter and net income of $3.2 billion. That was equal to 55% and 57%, respectively, of revenue and net income for the bank as a whole.

Any erosion of that business could affect returns on equity at the bank. Although this measure of profitability has been falling in recent quarters due to the squeeze of superlow interest rates, Wells Fargo has consistently posted the highest returns of big, U.S. banks in recent years.

In the immediate aftermath, investors want to see how the settlement affects the bank’s approach to business and to understand how widespread the roots of the alleged behavior run.

“Give me some assurances this isn’t an endemic thing in the organization,” said David Ellison, who manages a Hennessy Funds portfolio that owns $4 million worth of Wells Fargo stock.

Notably, Wells Fargo Chief Financial Officer John Shrewsberry is slated to speak at a financial services conference this upcoming Tuesday.

There are also worries among investors that the settlement and the behavior portrayed could cause regulators to subject the bank and its management to increased scrutiny.

During an interview on CNBC Friday, Federal Reserve Governor Daniel Tarullo, the central bank’s point person on regulation, said he couldn’t comment directly on the Wells Fargo case. But he said that, generally, banks’ cultures haven’t changed enough.

“Too many banks, instead of putting in place a comprehensive system for assuring that all their employees understand what is legal and ethical across the board, only respond when there is a particular problem,” he said.