

February 24, 2020

## **Wells Fargo Reaches Resolutions with DOJ and SEC for \$3 Billion, Agrees to a Deferred Prosecution Agreement**

On February 21, 2020, Wells Fargo & Company and its subsidiary, Wells Fargo Bank, N.A. (collectively, “Wells Fargo”), entered into resolutions with the Department of Justice (“DOJ”) and the Securities and Exchange Commission (the “SEC”) requiring Wells Fargo to pay a combined \$3 billion in penalties in connection with its improper sales practices. Of this amount, \$500 million would be received by the SEC for distribution to harmed investors. Specifically, Wells Fargo entered into:

- a three-year Deferred Prosecution Agreement (the “DPA”) with DOJ, in which it admitted to two criminal violations—creating false bank records and identify theft;<sup>1</sup>
- a settlement agreement with DOJ that resolves civil claims under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”) based on the false bank records conduct;<sup>2</sup> and
- a cease-and-desist order with the SEC<sup>3</sup> to settle allegations that it misled investors about the “success of its core business strategy at a time when it was opening fake accounts for unknowing customers and selling unnecessary products that went unused.”<sup>4</sup>

In its press release, DOJ stated that the \$3 billion penalty is appropriate given the “staggering size, scope and duration of Wells Fargo’s illicit conduct, which spanned well over a decade,” and that this action shows that “no institution is too big, too powerful, or too well-known” to be held accountable.

These resolutions follow on a series of enforcement actions and lawsuits against Wells Fargo and its former executives, which we have discussed in prior memoranda.<sup>5</sup> Most recently, the Office of the Comptroller of the Currency took the unprecedented steps last month of reaching a \$17.5 million settlement (and industry bar) with former Wells Fargo Chairman and CEO John Stumpf and filing enforcement actions seeking millions of dollars of penalties against five former Wells Fargo executives.

### **DOJ Deferred Prosecution Agreement and FIRREA settlement**

Wells Fargo reached a three-year DPA with the U.S. Attorneys’ Offices for the Central District of California and the Western District of North Carolina.<sup>6</sup> DOJ emphasized that Wells Fargo’s misconduct occurred over a period of 15 years and that “top Community Bank leaders” had knowledge of the conduct. DOJ’s key factual allegations, to which Wells Fargo admitted, are summarized below:

- In 1998, Wells Fargo increased its focus on sales volume and annual sales growth. The “foundation” of its business model was its “cross-sell strategy” to sell existing customers additional financial products.

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In contrast to its public statements and disclosures about selling based on customers' "needs," the Community Bank implemented a model in which employees were directed and pressured to sell large volumes of products to existing customers, often with little regard to actual customer need or expected use. This business model led thousands of its employees to engage in unlawful conduct, including fraud, identity theft, and the falsification of bank records.

- Many of these practices were referred to within Wells Fargo as "gaming," including using existing customers' identities, without their consent, to open checking and savings, debit card, credit card, bill pay, and global remittance accounts. From 2002 to 2016, gaming practices included forging customer signatures to open accounts without authorization, creating PINs to activate unauthorized debit cards, and moving money from millions of customer accounts to unauthorized accounts (in a practice known as "simulated funding"). Also, employees would alter customers' true account information to prevent customers from learning of unauthorized accounts and prevent Wells Fargo from reaching customers to conduct customer satisfaction surveys.
- The top managers of the Community Bank were aware of these practices as early as 2002 and knew that the conduct was increasing due to onerous sales goals. One internal investigation in 2004 called the problem a "growing plague," and another investigator in 2005 said the problem was "spiralling out of control." Complaints and objections about the sales goals were regularly made to Community Bank's leadership. Despite knowledge of the illegal sales practices, Community Bank senior leadership failed to take sufficient action. Instead, they minimized the problems to Wells Fargo management and its board of directors, by casting the problem as one of individual misconduct instead of one involving the sales model itself.
- Wells Fargo admitted that it collected millions of dollars in fees and interest to which it was not entitled, harmed the credit ratings of certain customers, and unlawfully misused customers' sensitive personal information, including customers' means of identification.<sup>7</sup>

DOJ stated that its decision to enter into the DPA took into account a number of factors, including the long duration of the improper sales practices and the role of certain "Wells Fargo senior leaders in causing and/or allowing the conduct to occur"; Wells Fargo's extensive cooperation (including assisting DOJ in "complex data analytics projects") and its continuing cooperation in the investigations; its admission of wrongdoing; its prior regulatory and civil settlements, including ongoing consent orders; and its remedial actions, including "significant changes in Wells Fargo's management and its board of directors, and enhanced compliance program, and significant work to identify and compensate customers who may have been victims."<sup>8</sup>

As is standard, the DPA does not preclude DOJ from investigating or prosecuting past or present Wells Fargo officers or employees. News reports last month stated that multiple former Wells Fargo executives were under DOJ criminal investigation.<sup>9</sup>

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Wells Fargo's FIRREA settlement was reached with DOJ's Civil Division (Commercial Litigation Branch) and the U.S. Attorney's Office for the Central District of California. The settlement agreement adds no new factual allegations.

### **SEC Order**

According to the SEC, its order arises out of a "fraud committed by Wells Fargo from 2012 through 2016, when the Company misled investors regarding the success of the core business strategy of the Community Bank operating segment, its largest business unit." The SEC concluded that Wells Fargo violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 based on the following allegations, among others:

- In its annual reports and quarterly and annual filings with the SEC during this period, Wells Fargo published a Community Bank "cross-sell metric" that it defined as the ratio of the number of accounts and products per retail bank household.
- In contrast to Wells Fargo's public statements and disclosures that its sales strategy was "needs-based," the Community Bank implemented a volume-based sales model in which employees were directed and pressured to sell large volumes of products to existing customers.
- This sales model led to widespread unlawful and unethical misconduct between 2002 and 2016, as it effectively encouraged employees to engage in "gaming" conduct and to cause or persuade customers to receive unnecessary accounts. Wells Fargo failed to disclose to investors that it had opened or sold millions of accounts and financial products that were unauthorized or fraudulent, and that the publicly reported cross-sell metric included significant numbers of such unused or unauthorized accounts, which also rendered its investor disclosures regarding needs-based selling misleading.
- During its investor presentations and analyst conferences, Wells Fargo characterized its cross-sell strategy as a key component of its business model and its ability to grow revenue and earnings, and it referred to the cross-sell metric as proof of its success at executing on this core business strategy. In more than one instance, it responded to direct questions about the cross-sell metric with incomplete and misleading answers.
- In a January 12, 2015 response to an SEC comment letter that asked how the cross-sell metric was calculated (and in its 2014 and 2015 annual reports), Wells Fargo provided a misleading description of the metric and the extent to which accounts and products were "used" by its customers. The SEC found that the inclusion of the word "used" was misleading, as Community Bank executives knew that the metric included many products that in fact were not used by customers.
- Certain Community Bank senior executives who reviewed or approved the disclosures knew, or were reckless in not knowing, that disclosures regarding its purported needs-based selling model were misleading or incomplete.

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- Community Bank senior leadership and others considered releasing an alternative metric that would capture products that had been used. In developing this “active cross-sell” metric, Community Bank senior leadership recognized that as many as 10 percent of accounts included in the cross-sell metric had not been used within the previous 12 months, but they ultimately concluded that its release would cause investors to raise questions about Wells Fargo’s historical sales practices.

Wells Fargo agreed to cease and desist from committing or causing any future violations of the antifraud provisions of the Exchange Act, and to pay a \$500 million civil money penalty that will be deposited into a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 for distribution to harmed investors.

### **Implications**

These DOJ and SEC resolutions are further illustration that a range of federal agencies have felt justified in taking aggressive and punitive action against Wells Fargo and its former executives in light of the size, scale, and nature of the conduct involved. This action shows DOJ’s willingness, at least in circumstances it judges sufficiently serious and unique, to pursue a criminal resolution for conduct that has normally been treated civilly under the rubric of consumer protection violations. DOJ has also shown its continued readiness to deploy its broad civil authority under FIRREA in enforcement actions against banks. The SEC, for its part, has also sent a strong signal that financial results that are based on misleading sales metrics and consumer protection violations can form the basis of a securities fraud action.

In prior memoranda, we have discussed various “lessons learned” emerging from the fake accounts scandal, including suggestions for strengthening board and management reporting and oversight, control functions, institutional culture, and sales practices and incentive compensation controls.<sup>10</sup> We look forward to providing further updates on this topic.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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- <sup>1</sup> See Department of Justice, *Wells Fargo Agrees to Pay \$3 Billion to Resolve Criminal and Civil Investigations into Sales Practices Involving the Opening of Millions of Accounts without Customer Authorization* (Feb. 21, 2020), available [here](#); and Deferred Prosecution Agreement Between the United States Attorney's Office for the Central District of California and the United States Attorney's Office for the Western District of North Carolina, and Wells Fargo & Co. and Wells Fargo Bank, N.A. (Feb. 20, 2020), available [here](#). The Statement of Facts appears as Exhibit A to the Deferred Prosecution Agreement.
  - <sup>2</sup> Settlement Agreement Between (a) the United States of America, acting through the Civil Division of the DOJ and the Attorney's Office for the Central District of California, and (b) Wells Fargo & Co. and Wells Fargo Bank, N.A. (Feb. 20, 2020), available [here](#).
  - <sup>3</sup> Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, In the Matter of Wells Fargo & Company (Feb. 21, 2020), available [here](#).
  - <sup>4</sup> Securities and Exchange Commission, Press Release, *Wells Fargo to Pay \$500 Million for Misleading Investors About the Success of Its Largest Business Unit* (Feb. 21, 2020), available [here](#).
  - <sup>5</sup> See, e.g., Paul, Weiss Client Memorandum, "OCC Takes Unprecedented Enforcement Actions Against Eight Former Wells Fargo Executives, Including the Former Chairman & CEO, Head of the Bank, General Counsel, and Risk and Audit Executives" (Jan 28, 2020), available [here](#); Paul, Weiss Client Memorandum, "Implications of the Federal Reserve's Enforcement Action Against Wells Fargo" (Feb. 12, 2018), available [here](#); Paul, Weiss Client Memorandum, "The OCC Issues 'Lessons Learned' Review of Its Supervision of Sales Practices at Wells Fargo" (Apr. 21, 2017), available [here](#); Paul, Weiss Client Memorandum, "Lessons Learned from the Wells Fargo Sales Practices Investigation Report" (Apr. 18, 2017), available [here](#); and Paul, Weiss

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Client Memorandum, “Bulk of Wells Fargo Shareholder Derivative Suit Survives Motions to Dismiss” (Dec. 4, 2017), *available* [here](#).

- <sup>6</sup> DOJ noted investigative assistance by the FBI and the inspectors general of the FDIC, the FFHA, and the Federal Reserve.
- <sup>7</sup> The DOJ’s statement of facts also contained allegations about the bank’s disclosure of cross-sell statistics and other statements to the investing public. These allegations are described in the SEC section below.
- <sup>8</sup> DOJ also made a reference to its anti-“piling on” policy: “The global settlement also reflects coordination between the Department of Justice and the SEC to ensure a resolution that appropriately addresses the severity of the defendants’ conduct while avoiding the imposition of fines and penalties that are unnecessarily duplicative.”
- <sup>9</sup> See Kevin Wack, “Former Wells Fargo execs may face criminal charges in coming weeks,” *American Banker* (Jan. 3, 2020), *available* [here](#).
- <sup>10</sup> See *supra* footnote 5. For additional risk-mitigation considerations, see Paul, Weiss Client Memorandum, “Increasing Regulatory Focus on Reforming Financial Institution Culture and Addressing Employee Misconduct Risk” (Feb. 21, 2018), *available* [here](#).