AGENDA
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Wells Fargo Smackdown Shocks Governance Experts

By Tony Chapelle February 5, 2018

A cross section of governance experts weighed in on Monday about the surprise announcement last Friday that the **Federal Reserve** had smacked down **Wells Fargo**'s board of governors for continually failing to govern risks related to the fake accounting scandal. The Fed took the unusual step of prohibiting the nation's third-largest bank by assets from increasing those from their Dec. 31 level.

The regulator also publicly blamed the board and castigated former chairman-CEO **John Stumpf** and his successor, chairman **Stephen Sanger,** for not upholding previous risk management compliance measures that the bank had promised it would. Meanwhile, the bank has agreed to replace four of its current directors.

The Fed took the unusual measure of requiring every board director to sign an attestation – not unlike the Section 302 attestation required of CEOs and CFOs in Sarbanes-Oxley – that they understand the cease and desist order. It also instituted a series of timetables for management and board to report on their risk management improvements.

Here are some governance and risk experts' reactions to the news.

Jeffrey Sonnenfeld, senior associate dean for leadership studies; professor of leadership practice, **Yale School of Management**:

"What is different here is the Fed's politically motivated pile-on effect on an institution which had already very effectively addressed its admitted earlier missteps. This board did what the Fed asked for long before **Janet Yellen**'s **Elizabeth Warren**-pressured 12th hour demands for the same actions. There has been a huge sweep out of the old management and more than a 50% change out of board compensation – with a terrific new board and dramatic new corrective management processes. Had the Fed required changes in the board, these would have been included in the Consent Order. Rather, Wells Fargo shared its profound change plans regarding the board and the Fed effectively seized credit for what the bank had already done. I would like to see **Chipotle**, **Takata**, or **Carnival** approach this degree of diligence."

Nir Kossovsky, CEO, **Steel City Re**, which creates reputation insurance products:

"Increasing a board's liability on top of increasing culpability is a punitive approach that may possibly scare board members into doing a better job, but will likely increase D&O liability costs with or without improving the quality of risk oversight, and may deter highly qualified board members for accepting going-forward duties. Rather than a punitive approach, board members need to understand how operational risks impact stakeholders and make sure there's a solid plan for mitigating those risks. Board members

would sign off on their oversight and third parties (such as Steel City Re) would attest to the meaningfulness of the plans (and the signatures) with reputation risk insurance. Steel City Re recommends this plan to meet regulator expectations for accountability: For every entry in a company's 10K item 1A risk disclosure, a board-directed enterprise risk management committee would identify the affected stakeholder(s) and how that risk would impact them. For every stakeholder identified for each 10K item 1A risk, define the company's risk mitigating efforts, how the company is verifying that those efforts are being executed, and how the company corrects for deficiencies in execution. For every stakeholder and risk, define the strategy for managing a control failure that results in a reputation crisis."

Douglas Chia, executive director, **The Conference Board** Governance Center:

"The board only knows as much as management tells it. If management is slow to tell the board or downplays it the board is in a bad position. They may not feel they have much control over the flow of information. Also, the Fed last year came out with proposed guidance on how they view the job of boards at financial institutions. Those notices would, if the proposal were adopted, go more directly to management and fewer to the board, which, in the wake of Dodd-Frank, has been overburdened with compliance duties. The idea is to pull back and free up more time for the board to spend on strategy discussions. But when you look at what's happened at Wells over the last few days, it begs the question as to which message the Fed is really trying to send. The decision by the Fed now shows that it's definitely not swinging the pendulum back. The thought had been that, with the Trump Administration and the Republican Congress, they'd roll back a lot of regulatory requirements at banks. But this Wells Fargo decision is evidence that's probably not going to happen any time soon. This decision effectively sets the bar for all boards of directors."

Stephen M. Davis, senior fellow, **Harvard Law School** Program on Corporate Governance:

"The move by the Fed is really a remarkable break from past practice because they're singling out a company and spelling out the board's obligations to manage risk to pass Fed muster. It may also be an overall shift in U.S. regulatory strategy. This is a shift towards regulation at the cost of putting much more responsibility on the shoulders of corporate directors. So, while there may be a retreat by the [Trump] administration, there may be a parallel practice of giving the board more responsibility to police themselves. It brings to mind the standards that the Financial Reporting Council has done in the U.K, which has been to set out suitability standards for individual directors at financial institutions. U.K. regulators have to be satisfied that directors who are nominated by boards are fit and proper. This [Wells action] may signal that the Fed and maybe other regulatory bodies too are going to move away from overall market regulation and toward policing of individual boards and directors. What was a lightning rod for Congress was that Wells' board appointed someone CEO [Tim Sloan] who'd been at the bank a long time. That made it tougher for them to make the case that they'd turned the corner."