



# A BETTER UNDERSTANDING

This article explores how Wells Fargo employees rationalized their fraudulent activities that ultimately decreased customers' trust.

## OF THE WELLS FARGO FRAUD: THROUGH THE LENS OF THE FRAUD TRIANGLE

CHAD ALBRECHT, CONAN C. ALBRECHT, ANDREW N. SANFORD, AND VICTOR MORALES ROCHA

**I**n September 2016, Wells Fargo agreed to pay \$185 million in fines for creating 1.5 million unauthorized debit accounts and 500,000 unauthorized credit accounts. The company further agreed to refund \$5 million to customers.<sup>1</sup> Although investigations and court cases continue, it is believed that the fraud continued for at least five years.<sup>2</sup>

Before the fraud, John Stumpf, the 63-year-old CEO of Wells Fargo, had been lauded as an “everyday guy” who grew up working on a dairy farm. Stumpf had worked for Wells Fargo for 34 years and served as CEO since 2007. After the fraud became public, Stumpf was required to testify before Congress, forfeited much of his compensation for the year, and

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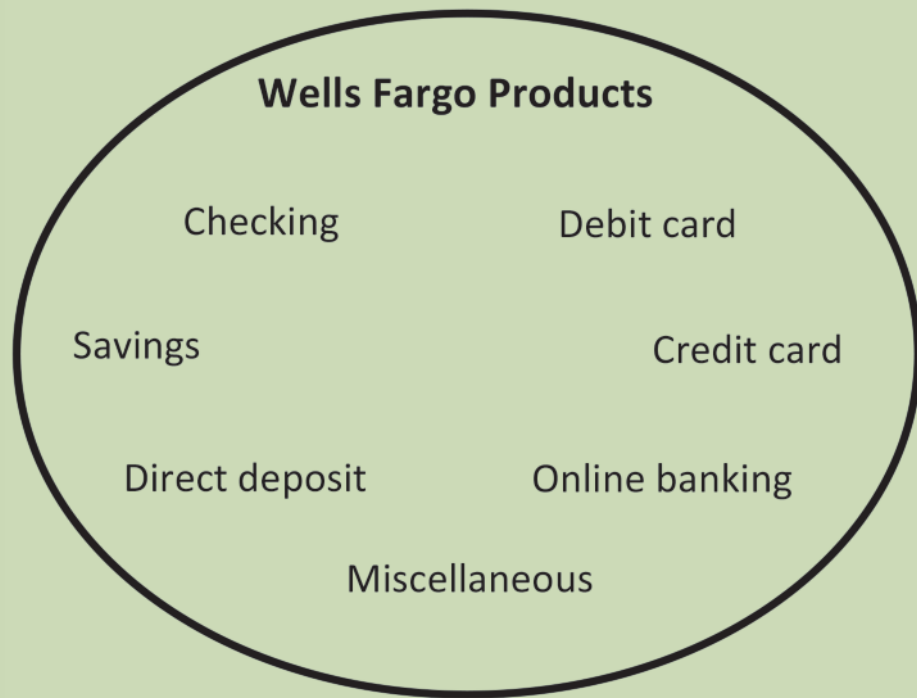
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## EXHIBIT 1 Product Categories



was eventually removed from his position as CEO.<sup>3</sup>

Because of the fraud, Wells Fargo's stock dropped more than 12 percent during September 2016.<sup>4</sup> In addition, many academics, regulators, and others are debating whether to make changes to the way banks are perceived and regulated. The following includes a list of questions that still need answers:

- Why were millions of fake accounts not caught by regulators and/or accounting firms?
- What other frauds might be occurring at Wells Fargo or other institutions within the banking industry?
- How should banking regulations be revised and improved?
- Have banks become a public utility?<sup>5</sup>

Wells Fargo, its investors, employees, and customers are facing major consequences, including both civil and criminal charges.<sup>6</sup> Furthermore, the Department of Justice is investigating the firing of some 5,300 employees.<sup>7</sup> In an effort to clear its name, Wells Fargo

appears to have fired employees who had no part in the fraud.

Perhaps most significantly, Wells Fargo was widely respected as the one of the only honest and trustworthy banks in the United States, especially after the widespread ethical lapses that took place during the Great Recession of the late 2000s.<sup>8</sup> Wells Fargo has now lost consumer and public confidence, leaving some individuals to wonder if they can trust any organization in the banking industry.<sup>9</sup> Wells Fargo's remaining bankers — of whom the vast majority were not connected to the fraudulent behavior — now have to deal with angry customers and difficult sales.<sup>10</sup>

In preparing this article, we analyzed reports and documents dating back to 2013. Additionally, we interviewed a former Wells Fargo employee who witnessed the unethical behaviors firsthand during the 2013–2016 period.

### The Wells Fargo fraud

Starting in 2011 (although some reports indicate as early as 2009), Wells Fargo

employees began creating fake accounts to meet sales quotas. The accounts were unauthorized and unknown by the customers who “owned” them. Although some report that accounts for fictitious individuals may have been created, the new accounts were largely created for real, existing customers.<sup>11</sup>

Internally, Wells Fargo groups its financial products into seven broad categories, which are presented in Exhibit 1. The frauds reported in the news concerned debit and credit cards, although unauthorized accounts were set up in other categories, especially online banking.

Bankers and tellers typically created the new accounts in existing customers’ names. On some accounts, employees contacted family members and friends to get permission to set up temporary accounts; other times, employees created new accounts without the knowledge of existing customers. To prevent customers from being notified of the new accounts, employees provided fake email addresses — often ending in *wellsfargo.com*. When account initializations required debit or credit cards to be mailed, the branch’s address was often used.<sup>12</sup>

In other cases, employees pressured customers to sign up for products without giving product details. Customers often returned to branches shortly afterward asking why they’d received mail regarding products and accounts they were unaware of.<sup>13</sup>

The misused information and consequential opening, closing, and reopening of accounts usually impacted customer credit scores negatively.<sup>14</sup> Damaged credit scores may have resulted in higher interest rates and denied credit. Because many potential employers look at credit scores, in some situations, customers may have even been denied employment. Determining how to recoup customer losses poses a difficult, if not impossible, task.

### Applying the fraud triangle

Regulators, law enforcement, attorneys, customers, and shareholders are asking questions about how the fraud occurred and continued for so many years with-

out being discovered and corrected. For example, why did a significant number of Wells Fargo employees engage in these risky (and likely fraudulent) behaviors? Why didn’t management intervene to correct the issues before they grew out of control?

In order to better understand these issues, we examine the Wells Fargo fraud through the lens of the fraud triangle, which provides a simple and parsimonious way to think about the events that transpired. According to the fraud triangle, fraud occurs due to the interaction of three underlying principles: perceived pressure, perceived opportunities, and rationalization (see Exhibit 2).

Perceived pressures — which only need to be real in the minds of perpetrators — can take the form of significant work expectations, sales quotas, stock market expectations, social wealth expectations, or unpayable bills.

Perceived opportunities — which can also be real or perceived — may take the form of lack of oversight (internal or external), a carefree or control-agnostic company culture, intimate knowledge by perpetrators of systems and processes, or an “ends justify the means” attitude.

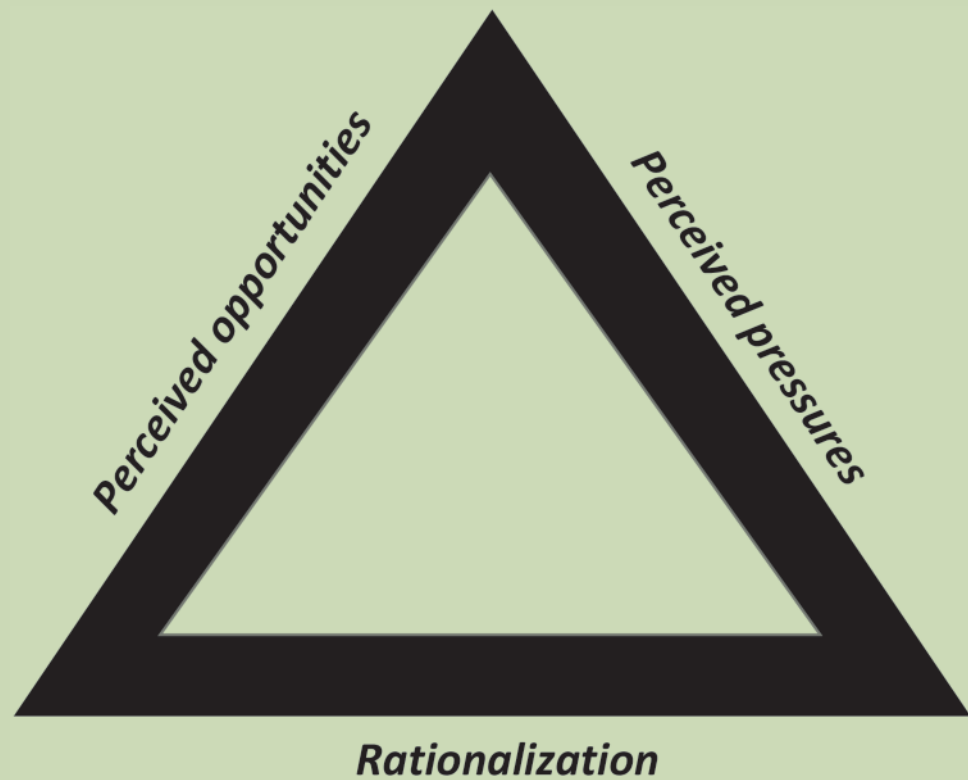
Rationalization stems from individual ethics and motives and is especially important when a potential act resides in a gray area. It may take the form of “everybody else in the company is doing it,” “management tacitly approves of a behavior if it increases sales,” or “no one will be hurt.” Because rationalizations are often based in individual values, organizations usually seek to hire employees with deep-rooted ethics. This vetting process utilizes background checks, reference checks, and/or ethics and honesty tests.

From a cultural standpoint, Wells Fargo had a very intense sales culture (the company has since banned all employee-initiated sales). One example is the “Gr-eight Initiative,” which aimed to increase the average customer’s number of financial products from six to eight. The CEO, John Stumpf, was known for his mantra “eight is great.” Goals were broken down into the following categories:



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DUE TO THE  
INTERACTION OF  
THREE  
UNDERLYING  
PRINCIPLES:  
PERCEIVED  
PRESSURE,  
PERCEIVED  
OPPORTUNITIES,  
AND  
RATIONALIZATION.**

**EXHIBIT 2** The Fraud Triangle



- daily solutions (checking, savings, online banking, debit cards, etc.);
- credit products;
- loan volume; and
- partner referrals (business referrals, insurance products, etc.).

Lower level employees were required to meet the set metrics in each of the four categories, and, in order to qualify for the quarterly bonus, employees needed to reach or exceed expectations in three of the four categories.

Each day, bankers created sales goals for that day. As is common in most businesses, managers coached employees in reaching their goals. However, when goals were not achieved, managers often put their employees in the hot seat. Some managers even reviewed employees' sales performance multiple times a day. If goals weren't met by end of the day, managers could assign employees to a "call night" on the prospector system, during which employees cold-called current

customers to upsell products and attain bonuses. The culture and policies at Wells Fargo placed immense pressure on both bankers and bank managers.

Looking at the company as a whole, low interest rates and rising costs of regulation, such as the Sarbanes–Oxley Act and the Dodd–Frank Wall Street Reform and Consumer Protection Act, led to lower profit margins for banks throughout the U.S. market.<sup>15</sup> With the entire banking industry being somewhat saturated, there were few new customers entering the market. As authors, we speculate that Wells Fargo was consequently looking for ways to maximize earnings from existing customers and chose to do so by imposing unrealistic sales goals on employees and promoting a permissive environment to meet those goals.

By allowing some 2 million accounts to be created — without active discovery or penalty — Wells Fargo provided numerous opportunities for fraud to

occur. Even basic checks, such as matching customer account addresses against organizational/employee addresses or pattern discovery of emails accounts ending in *wellsfargo.com*, were missing.

Rationalization was created by management not only condoning shady behavior, but also encouraging unethical behavior through poor oversight. There is even some evidence that managers punished whistleblowers. Lower management focused so intensely on reaching sales goals that other important aspects were dismissed and rationalization crept into the organization's culture.<sup>16</sup>

Employees who attempted to raise concerns about practices were harassed or fired.<sup>17</sup> This increased rationalization as employees saw the organization reward those creating fraudulent accounts and punish employees who spoke out.

## Learning from Wells Fargo

The Wells Fargo fraud is a prime example of the importance of the tone at the top — of promoting an ethical culture at the top level of management. Expectations for behavior must be clear, and violations must not be tolerated or overlooked. Continuing investigation may reveal more information about how much upper management knew about the fake accounts being created.

The normal sales pressures that companies place on managers and low-level employees must be tempered by clear policies and regular training that minimize rationalizations. Opportunities for fraudulent sales must also be minimized through solid internal controls and regular review by management (who, admittedly, often feel significant sales pressure).

Because fraud occurred from 2011–2016 (or even as early as 2009), the question arises of how the SEC and other regulators failed to catch this fraud.<sup>18</sup> Further investigation is warranted on how such substantial and pervasive fraud eluded earlier detection. The number of fake accounts seems to be at least 2 percent of all accounts opened during the fraudulent time period.

This fraud was not a singular occurrence, nor was it perpetuated by an individual employee. Creating fake accounts — which is fundamentally dishonest by any moral or legal standard — involved many employees throughout the organization. All three elements of the fraud triangle were present, laying the groundwork for the occurrence of systemic fraud that unfortunately persisted for many years. ■

## NOTES

<sup>1</sup>Vasilogambros, M., Wells Fargo's phony accounts, *The Atlantic* (Sept 8, 2016). Available at: <https://www.theatlantic.com/news/archive/2016/09/wells-fargo-phony-accounts/499232/>.

<sup>2</sup>Egan, M., "Wells Fargo workers: Fake accounts began years ago," CNN Money (Sept 26, 2016). Available at: <http://money.cnn.com/2016/09/26/investing/wells-fargo-fake-accounts-before-2011/>.

<sup>3</sup>Gonzales, R., "Wells Fargo CEO John Stumpf resigns amid scandal," NPR (Oct 12, 2016). Available at: <http://www.npr.org/sections/thetwo-way/2016/10/12/497729371/wells-fargo-ceo-john-stumpf-resigns-amid-scandal>.

<sup>4</sup>NYSE. (Sept 2016). Wells Fargo. Google Finance. Available at: <https://www.google.com/finance?q=NYSE%3AWFC&ei=mapDWMHhHoPDsQGvp7pY>.

<sup>5</sup>Shen, L., How Wells Fargo's scandal could change the way we bank, *Fortune* (Sept 30, 2016). Available at: <http://fortune.com/2016/09/30/wells-fargo-banking/>.

<sup>6</sup>Egan, M., "Wells Fargo's reputation is tanking, survey finds," CNN Money (Oct 24, 2016). Available at: <http://money.cnn.com/2016/10/24/investing/wells-fargo-fake-accounts-angry-customers/index.html>; McCoy, K., Wells Fargo fined \$185M for fake accounts; 5,300 were fired, *USA Today* (Sept 8, 2016). Available at: <http://www.usatoday.com/story/money/2016/09/08/wells-fargo-fined-185m-over-authorized-accounts/90003212/>.

<sup>7</sup>Masunaga, S. and Koren, J.R., Wells Fargo says the SEC is also investigating its account scandal, *Los Angeles Times* (Nov 3, 2016). Available at: <http://www.latimes.com/business/la-fi-wells-fargo-sec-20161103-story.html>.

<sup>8</sup>*Op. cit.* note 6 Egan.

<sup>9</sup>Egan, M., Wattles, J., and Alesci, C., "Wells Fargo CEO John Stumpf is out," CNN Money (Oct 12, 2016). Available at: <http://money.cnn.com/2016/10/12/investing/wells-fargo-ceo-john-stumpf-retires/>.

<sup>10</sup>*Op. cit.* note 6 McCoy.

<sup>11</sup>*Op. cit.* note 2; Personal communication with former Wells Fargo employee (2016).

<sup>12</sup>These actions raise many questions for the courts. For example, when accounts were listed under the customer's name but used the branch's address, did employees violate federal postal laws by retaining, opening, or destroying mail?

<sup>13</sup>*Op. cit.* note 11 personal communication.

<sup>14</sup>Zaroli, J., "Wells Fargo's unauthorized accounts likely hurt customers' credit scores," NPR (Sept 26, 2016). Available at: <http://www.npr.org/2016/09/26/495501008/wells-fargos-unauthorized-accounts-likely-hurt-customers-credit-scores>.

<sup>15</sup>"Thomson Reuters annual cost of compliance survey shows regulatory fatigue, resource challenges and personal liability to increase throughout 2015," Thomson Reuters (May 13, 2015) (press release). Available at: <https://www.thomsonreuters.com/en/press-releases/2015/05/cost-of-compliance-survey>.



**RATIONALIZATION WAS CREATED BY MANAGEMENT NOT ONLY CONDONING SHADY BEHAVIOR, BUT ALSO ENCOURAGING UNETHICAL BEHAVIOR THROUGH POOR OVERSIGHT.**

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<sup>16</sup> Reckard, S., Wells Fargo pressure cooker sales come at a cost, *Los Angeles Times* (Sept 20, 2016). Available at: <http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html>; *Op. cit.* note 11 personal communication.

<sup>17</sup> Egan, M., "I called the Wells Fargo ethics line and was fired," *CNN Money* (Sept 21, 2016). Available at: <http://money.cnn.com/2016/09/21/investing/wells-fargo-fired-workers-retaliation-fake-accounts/>.

<sup>18</sup> *Ibid.*; Davidson, A., How regulation failed with Wells Fargo, *The New Yorker* (Sept 12, 2016). Available at: <http://www.newyorker.com/business/currency/the-record-fine-against-wells-fargo-points-to-the-failure-of-regulation>.