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"We're Not Wells Fargo" Won't Cut It With Regulators

Excerpted from the American Banker BankThink, Oct 21, 2016.

In the wake of the Wells Fargo scandal, many inside and outside the industry are asking a very simple question: "Are the unethical sales practices unique to Wells Fargo or do they have broader industry implications?"

Those who believe opening phony accounts is restricted to Wells Fargo note that the bank has touted its cross-sell success as a core component of its overall performance and valuation for years. Others, mostly industry critics, claim that the situation is symptomatic of just another industrywide practice designed to maximize profitability at the expense of customers.

The regulatory, management, reputational and risk oversight implications of the Wells Fargo scandal will be (and already are) significant for the industry as a whole.

To respond quickly and credibly to regulatory inquiries and examination requests, get the data and programs in place now: scrub sales and customer data for low balance and/or inactive accounts to estimate the size and scope of potentially inappropriate sales behavior; evaluate sales reports to identify outliers; and look at specific branches where sales and cross-sell performance far exceeds averages.

While this initial analysis will help to determine immediate issues and risks, it is probably not sufficient to determine how, and if, existing programs and practices should be changed. It is incumbent on retail and executive management to answer these questions:

- Do our performance metrics reflect the full range of activities and expectations of the branch and personnel, or do they primarily reward sales?

Continued on back

Strategy Spotlight: Culture and Control

The recent events at Wells Fargo have put a spotlight on a critical component of performance: culture drives behavior. CPG consultants have seen this time and again at client companies where cultures rooted in "the customer comes first" philosophy create environments where customers become advocates for the bank and the best and brightest customers want to be on the team. Wells Fargo's recent fiasco provides a contrasting example where making money came first for a large portion of the customer-facing workforce. This is not just a disaster for Wells Fargo. It tarnishes the image of the entire industry.

The only way to ensure that culture is driving the right kinds of behaviors is through controls. It's a pretty simple idea, but one that gets lost when a management team fails to realize that culture must be reinforced every day through control mechanisms, including measurement and reporting, communications, customer feedback, and incentive systems. If "culture eats strategy for breakfast" (as Peter Drucker is quoted as saying but never actually said), remember that weak controls will nibble away at culture all day, every day.

Recent Regulatory Enforcement Actions

Recent enforcement actions show that regulators remain vigilant in their efforts to penalize banks for engaging in illegal practices.

- On September 8th, regulators fined Wells Fargo & Co. $185 million for cross-selling and sales tactics. According to the Consumer Financial Protection Bureau (CFPB), Wells Fargo employees secretly opened deposit and credit card accounts as well as enrolled in online banking without the customers' authorization to increase sales figures. The bank terminated 5,300 employees over the past 5 years who engaged in the fraudulent activity. Wells Fargo is now facing several lawsuits connected to their sales tactics, including a class-action suit as well as a Justice Department probe.
- On July 14th, Santander Bank N.A. was fined $10 million by the CFPB for alleged illegal overdraft service practices. According to the CFPB, the bank's telemarketing vendor used deceptive marketing practices to enroll customers into its "Account Protector" overdraft services between 2010 and 2014.
- On September 13th, Regions Financial Corp. agreed to settle for $52 million with the DOJ and HUD – without admitting liability – as a result of an investigation into the origination, underwriting, and quality control practices for FHA-insured loans.
- On July 26th, State Street Corp. agreed to a number of settlements totaling $530 million, with the DOJ, the Labor Department, and the Massachusetts Attorney General. The agreements related to claims arising from its indirect foreign exchange businesses.

Also, enforcement actions related to conduct during the financial crisis are still being resolved.

- In August, Barclays Plc. agreed to settle for about $100 million with 44 U.S. states over allegations of manipulating the London Interbank Offered Rate.
- On September 28th, Royal Bank of Scotland Group Plc. settled with the US National Credit Union Administration for $1.1 billion over allegations that it missold mortgage-backed securities in the run-up to the financial crisis. Two credit unions that RBS sold securities to, U.S. Central Federal Credit Union and Western Corporate Federal Credit Union, failed during the financial crisis.
- Orrstown Financial agreed to pay the Securities and Exchange Commission $1 million to settle charges that the bank misled investors when it failed to disclose credit problems in the aftermath of the financial crisis. The company did not disclose credit problems with $70 million in commercial loans when holding two securities offerings between 2010 and 2011.

These enforcement actions demonstrate that compliance and reputation risk remains very high in financial services, particularly consumer financial services. In this environment, executives must remain mindful of these risks when contemplating new initiatives.

To support a more proactive approach to risk management, Capital

Continued on back

We're Not Wells Fargo (continued)

- Are the goals based on the characteristics and potential of each individual branch market or are all branches and bankers expected to achieve the same results?
- Do sales metrics measure quality of sales as well as quantity?
- Do we reward quality relationship management?
- Have we developed reporting and monitoring systems to systemically identify potential risks?
- Do we have a system in place to ensure proactive communications with customers to verify account opening and thank them?
- Are we doing the in-the-field management work required to monitor behavior?
- Do our incentive compensation programs clearly align with overall bank goals and with our cultural values?
- Have we created a process and supportive environment to respond to employee questions and concerns?
- Can we prove that there is consistent alignment between policies and practices and that there are proven methods in place to identify where and when there is a disconnect between the two?

This type of review is essential to assure that retail management, executive leadership and the board all have a consistent and confident view of the processes and practices in place to mitigate risk, grow the franchise, support the culture and achieve enterprise-wide objectives.

Contact Mary Beth Sullivan at msullivan@capitalperform.com if CPG can assist with an audit on your bank's retail sales practices.

Recent Regulatory Enforcement Actions (continued)

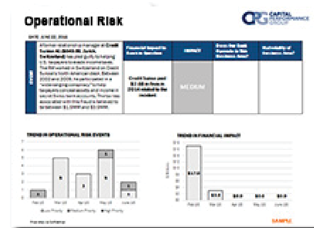
Performance Group has created the RISK EVENTS MONITOR, a product that streamlines the process of reviewing and responding to outside events with risk implications.

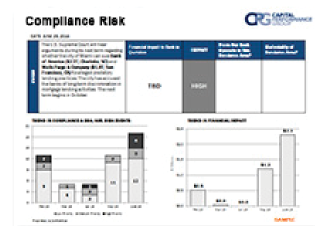
Each report includes:

- A monthly summary of events – including events that could have implications for reputational and strategic risk.
- Information on the relative impact of events.
- Tools to help you identify priority events for your bank.

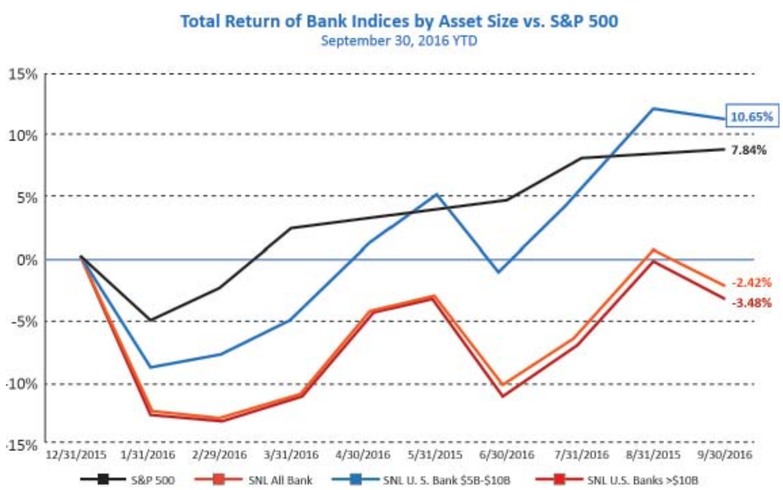
With the MONITOR, institutions can manage external risk more efficiently and effectively. While institutions have systems in place to monitor internal risk, external risk can be harder to track.

For more information, please contact Claude Hanley at chanley@capitalperform.com or 202-337-7875.





Bank Stocks Report Card



Source: SNL Financial, LC, 2016.
Note that the SNL indices includes all Major Exchange (NYSE, NYSE MKT, NASDAQ) Banks in SNL's coverage.

Through the first three quarters of 2016, bank stocks were unable to produce positive returns. This was largely due to the sector's rocky start to the year along with an underperforming month of June. Among bank group asset sizes, U.S. banks with assets between $5 billion and $10 billion produced the highest returns at 10.65% and beat the overall stock market. Large banks experienced lower returns than the overall sector with a total return of -3.48% through the first three quarters of 2016.

The three banks with the highest total return for the first half of 2016 among U.S. Banks with assets between $5B and $10B were:

1. Southside Bancshares Inc., Tyler, TX
2. OFG Bancorp, San Juan, PR
3. Independent Bk Group Inc., McKinney, TX

Announcements

CPG Welcomes Mary Ellen Georgas-Tellefsen!

Mary Ellen joins CPG as a Managing Director specializing in strategic planning, product management and marketing. Mary Ellen is re-engaging a 20-year financial services career after a 7-year hiatus as a small business owner and award-winning innkeeper. In addition to her experience as a small business owner, Mary Ellen brings a wealth and depth of experience in the financial services industry to the firm. Her industry experience in commercial banking and digital delivery includes strategic planning, online banking, product management, marketing, and treasury services. She will bring valuable advisory services and project management skills to CPG clients. Contact Mary Ellen at 917-328-7872 or megeorgas@capitalperform.com.

Speaking Events

Mary Beth Sullivan and Mark Gibson presented "Meeting the ROI Challenge Head On" and "Building a Data-Driven Marketing Organization" at the NEFMA Fall Conference in Hartford, CT on October 14th.

Mary Beth also presented "Achieving Top Tier Performance: Strategies for Growth and Profitability" at the New York Banker's 2016 Financial Services Forum on October 17th in New York City.