# WHAT SHOULD BANK DIRECTORS LEARN FROM THE FED'S ORDER AGAINST WELLS FARGO?

The Federal Reserve Board's February 2 Order against Wells Fargo has spread fear among some bank directors wondering whether they are next.

It is not so much a fear of what the Order actually says—the language in the Order is not very different from many other Orders, but for one big exception. It directs the board to better oversee the risk management process as it relates to growth and strategy, with special emphasis on the information flow from various management sources so that the board may act based on sufficient information. The one exception is the freeze on asset growth from the end of last year.

**David Baris**
*President*, American Association of Bank Directors
**Phone:** (202) 463-4888
**Email:** dbaris@aabd.org

No, it has more to do with the fact that Wells announced simultaneously with the issuance of the Order that it will replace four board members this year. The Order is silent on that point.

Also released were two letters of reprimand from the Fed directed to the former Chairman & CEO in addition to the former Lead Director.

Letters of reprimand are treated confidentially. It is extraordinary for them to be aired publicly. It is also extraordinary that a federal banking agency treats a Lead Director differently from other directors.

The Fed, as are the other federal banking agencies, is subject to federal law that limits its authority to remove directors and other insiders. The federal law requires the agencies to apply and meet high standards to remove insiders.

Insiders have a right to due process through an administrative process, including a fact finding hearing overseen by an administrative law judge, and ultimately, they have a right to appeal to a federal appeals court. None of that protective process was followed.

We don't have all the facts to understand whether the Fed forced Wells to remove directors or whether Wells acted on its own, but we do know that the directors in question had none of the due process protections afforded by law and the U.S. Constitution had the agency used its statutory powers to remove them.

Another aspect of the Order and related documents is the role that Sen. Elizabeth Warren played in the removal of Wells directors.

For months, Sen. Warren has called on the Fed to remove Wells directors who had served during the time that Wells had purportedly engaged in questionable sales practices. Initially, she based her demand on the results of the investigation conducted by an outside law firm on behalf of Wells' Board Audit Committee.

I've read the law firm report (May 2017), which is publicly available. My main takeaway was that the

Board had not received sufficient information from management that would have allowed the Board to properly oversee the implementation of Wells' sales practices. But Sen. Warren concluded that the board was responsible for flawed management sales practices even though the board was not sufficiently informed.

Sen. Warren followed up on numerous occasions through correspondence with then Fed Chairman Yellen and cross-examined Yellen in an October 2017 Senate banking committee hearing strongly urging the Fed to remove Wells directors.

Immediately following the publication of the Fed Order of February 2 and the announcement that Wells was removing four directors, Sen. Warren issued a press release proclaiming victory. The impression Sen. Warren has left is that without her persistence calling for the removal of Wells directors, the Fed would never had applied its influence over Wells to have the directors removed.

This is reminiscent of the Keating Five from the 1980s. Five U.S. Senators succeeded in influencing the Federal Home Loan Bank Board in its oversight of a savings bank controlled by Charles Keating. It was an example of how politics should have nothing to do with bank regulators' decisions relating to individual banks and individual bank directors.

For many years, members of Congress have recognized the difference between legitimate oversight of the agencies and interfering with decisions of the banking agencies on individual banks and insiders, and have honored that distinction in their oversight of the banking agencies.

The Fed has been a fiercely independent agency since its inception. It runs the risk that Sen. Warren's assertions and communications with the Fed over many months may lead to the perception that the Fed is not as independent as it has been and should be.

## WHAT SHOULD BANK DIRECTORS LEARN FROM THE FED-WELLS SAGA?

- Continue periodic review of Board processes to be sure that board members are receiving good information from various sources, including independent risk management and audit directly reporting to the board or a board committee.
- Evaluate how management decides when to elevate matters to the Board or a Board committee so that important matters are reported.
- Consider how the Board and Board committees may spend more time on important matters and less insignificant issues, and consider the content, presentation and effectiveness of board reports.
- Evaluate risk management in terms of growth strategies and implementation of those strategies.
- Recognize that regulatory focus on sales practices has substantially increased since the Wells matter surfaced in September 2016 and has continued to be a focus.
- Support AABD's efforts to help assure that bank directors' due process rights are protected under law and by the federal banking agencies.