Client Update
Banking Regulators Focus on Sales Practices

NEW YORK
Matthew L. Biben
mlbiben@debevoise.com

Gregory J. Lyons
gjlyons@debevoise.com

Liz Alspector
lalspector@debevoise.com

WASHINGTON, D.C.
Satish M. Kini
smkini@debevoise.com

David A. Luigs
daluigs@debevoise.com

In the wake of the record $185 million in fines levied against Wells Fargo, federal regulators have turned their scrutiny to cross-selling, incentive compensation and other sales practices of financial institutions. In the minds of regulators, the Wells Fargo situation revealed how misaligned incentives, an overemphasis on cross-selling and lack of adequate controls might allow improper sales practices to infect an institution, systematically harming consumers. Responding to criticism on their treatment of Wells Fargo, in recent congressional testimony, both Comptroller of the Currency Thomas J. Curry and Consumer Financial Protection Bureau (the "CFPB") Director Richard Cordray suggested that sales practices of other banking institutions would be investigated aggressively.[1]

Thus, it came as no surprise when it was widely reported that the Office of the Comptroller of the Currency (the "OCC") had embarked on a large-scale review of banks' sales practices. Additionally, the New York Department of Financial Services (the "NY DFS") weighed in, issuing public guidance on incentive compensation. This article briefly summarizes the key takeaways from the Wells Fargo settlement, describes the actions by regulators in the aftermath of that settlement and discusses some key considerations for institutions going forward.

WELLS FARGO SETTLEMENT

Regulators alleged that four main compliance issues at Wells Fargo resulted in the opening of millions of unauthorized accounts:

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1 *Testimony before the Sen. Comm. On Banking, Housing, and Urban Affairs*, 114th Cong. (Sept. 20, 2016) (testimony of Thomas J. Curry, Comptroller of the Currency), *available at* https://www.occ.gov /news-issuances/speeches/2016/pub-speech-2016-115.pdf; *Testimony before the Sen. Comm. On Banking, Housing, and Urban Affairs*, 114th Cong. (Sept. 20, 2016) (testimony of Richard Cordray, Director of the CFPB), *available at* http://www.consumerfinance.gov/about-us/newsroom/written-testimony-richard-cordray-director-cfpb-senate-committee-banking-housing-and-urban-affairs/.

- Misaligned incentive compensation practices, including sales quotas, that did not account for actual customer demand and that unduly pressured bank employees to sell products without customer authorization;
- The lack of a comprehensive complaint monitoring process;
- The lack of an enterprise-wide sales practices risk management and oversight program; and
- The lack of oversight, testing and monitoring of sales practices in the division of the bank that sold products to consumers.

Under the terms of the settlement, the bank will be required to develop a "Sales Practices Oversight Program," the first such program required by a public settlement. Notably, although the regulators alleged that the bank's practices resulted in $2.5 million of consumer harm in the form of fees, the bank was fined approximately forty times that amount—$100 million—by the CFPB alone, on top of the $35 million and $50 million penalties paid to the OCC and the City and County of Los Angeles, respectively, signaling the seriousness with which the regulators took the alleged concerns.

REGULATORY RESPONSE

Responding to public outcry that the federal regulators would not have spotted the issues at Wells Fargo without being prodded by local enforcement in Los Angeles, the Comptroller testified that he has directed OCC examiners to "review the sales practices of all of the large and mid-sized banks the OCC supervises and assess the sufficiency of controls with respect to these practices."[2] Formal letters requesting information were sent by the OCC in October.[3] The October letters reportedly sought information related to the banks' sales practices, including cross-selling practices and incentive-based compensation structures. Responses, which required data on sales practices over several years, were expected in as little as about two weeks, further highlighting sales practices as a high-priority area.

The OCC will coordinate its review, which includes on-site exams, with other federal regulators, including the CFPB, the Federal Deposit Insurance

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2 *Id.* (testimony of Curry).

3 Emily Glazer and Christina Rexrode, *Big U.S. Retail Bank Operations Under Scrutiny After Wells Scandal*, Wall Street Journal (Oct. 25, 2016), *available at* http://www.wsj.com/articles/big-u-s-retail-bank-operations-under-scrutiny-follow-wells-scandal-1477400747.

Corporation and the Federal Reserve Board.[4] Additionally, Fed Chairwoman Janet Yellen stated that the Fed would comprehensively review practices "not only in the consumer area but compliance generally, because there has been a very disturbing pattern of violations."[5]

On the state level, the NY DFS guidance addressing incentive-based compensation structure[6] requires that such arrangements, at a minimum, (1) appropriately balance risk and rewards, (2) be compatible with effective controls and risk management, and (3) be supported by effective corporate governance. According to the memorandum, these principles are based on the Interagency Guidance on Sound Incentive Compensation Policies issued in 2010 (the "2010 Interagency Guidance).[7] The NY DFS guidance applies to all banking institutions, branches and agencies chartered or licensed by New York.

GOING-FORWARD CONSIDERATIONS

Banking institutions should expect close scrutiny of their sales and compensation practices, and such concerns may spread to non-banks as well.[8] Regulatory investigations are increasing in intensity, and additional examinations and even new guidance should be anticipated. Furthermore, federal regulators might expect banking institutions to have already addressed some of these areas of concern, given the 2010 Interagency Guidance.

Institutions should not wait for new guidance or to become subjects to a formalized examination. Instead, institutions should begin reviewing their sales practices and the control processes around them.

This review should cover the following processes, among other considerations:

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4 *See* Jesse Hamilton, *Wall Street Banks to Face On-Site Reviews of Sales Practices*, Bloomberg (Oct. 25, 2016), *available at* http://www.bloomberg.com/news/articles/2016-10-25/wall-street-banks-to-face-on-site-reviews-of-sales-practices.

5 *Testimony before the H. Comm. On Financial Services*, 114th Cong. (Sept. 28, 2016) (testimony of Janet Yellen, Chair of the Board of Governors of the Federal Reserve System) *available at* https://www.federalreserve.gov/newsevents/testimony/yellen20160928a.htm.

6 NY DFS, Guidance on Incentive Compensation Arrangements (Oct. 11, 2016), *available at* http://www.dfs.ny.gov/legal/industry/il161011.pdf.

7 Interagency Guidance, 75 Fed. Reg. 122 (June 25, 2010), *available at* https://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-24.html.

8 *See, e.g.*, the Financial Industry Regulatory Authority's Review of Cross-Selling Programs, *available at* http://www.finra.org/industry/review-cross-selling-programs.

- *Issue Identification*: Institutions should collect information from multiple sources to identify concerns related to sales practices. Sources include whistleblowers, ethics hotlines, litigation, employee exit interviews and terminations or disciplinary action due to improper sales practices, management information systems data related to account openings, closings and activity, as well as the CFPB's complaint database.
- *Information Analysis*: Institutions should regularly monitor, analyze and test the information they collect on issues related to sales practices. This analysis should include synthesizing complaints and other red flags from all relevant information sources along with upticks in incentive compensation paid, abnormally high numbers of account terminations or accounts without activity and employee terminations or discipline due to improper sales practices. The analysis process should be formalized and documented.
- *Escalation, Reporting and Governance*: Once identified, concerns related to sales practices should be escalated and reported to appropriate channels, including senior management and the board. The institution should set a "tone at the top" of compliance and treating customers fairly.
- *Remediation*: Institutions should incorporate the feedback received through this process with appropriate steps such as adjusting sales quotas or other aspects of the incentive compensation program, implementing customer consent procedures, providing additional training to employees, remediating unearned fees to consumers and taking corrective action against employees or offices that raise concerns.

To the extent they are not already doing so, institutions should develop and implement policies to address all these controls.

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Please do not hesitate to contact us with any questions.