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Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

# Global Risk Watch Newsletter

## The dark side of the current robust economy, etc.

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### 2. Overview of Development in Financial Regulations (Trends & Topics)

**# Investigation report on the illegal sales practices of a major financial institution (Yuri Nakano, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)**

In September 2016, the Consumer Financial Protection Bureau (CFPB) charged USD 190 million fine to a major American financial institution for secretly opening deposit and other accounts without clients' consent. From 2011 to 2015, employees of the bank in question have opened more than 1.5 million accounts and issued more than 560,000 credit cards without authorization. Certain clients were charged credit card fees, and the total damage amounted to USD 2.6 million. In response, the independent directors of the bank conducted an investigation on its sales practices and released a report.

This financial institution focuses on retail banking, and the risks from investment banking operations are limited. Therefore, business stability was considered its strengths in comparison with other major, international banks. The improper sales practice took place at the retail banking division that was considered to be most stable. The lack of proper culture and governance was identified as the root cause of these unlawful transactions. This institution addressed these issues by firing relevant employees every time a sales violation was discovered. In five years, approximately 5,300 employees had been terminated for such misconduct.

The report repeatedly points out the issue on the bank's problematic sales culture. The bank's community banking division had imposed excessive sales targets on its employees in order to promote cross-selling of financial products. Employees who engaged in misconduct most frequently associated their behavior with sales pressure, rather than compensation incentives. Furthermore, a culture of strong deference paid to the lines of business granted too much autonomy to the department, which eventually lead the division to run out of control.

The root cause of failure to correct improper sales culture for years can be attributed to the lack of corporate governance. The corporate control functions related to misconduct, such as corporate risk, law department, human resource, and internal control and audit, had access to the information on the issue, however, due to the decentralized corporate structure, the bank was unable to comprehend the whole picture of its sales practices and address them as a systemic issue.

Misconduct has been a focus of global regulators recently, and are critical risks that can damage reputation and brand. In Japan, the Principles for Customer-oriented Business Conducts were introduced, which require promotion of appropriate corporate culture as well as compensation and performance management systems and a solid governance structure. Although legitimate, churning and sales of products with high distribution fees, may also be questioned whether they suit clients' financial profile and pursue clients' best interests. Compensation and performance management systems need to focus on customer-oriented services. Moreover, since misconduct involves multiple departments including risk management, human resources, compliance, and internal audit, it is essential to build a cross-function corporate structure, capable of addressing misconduct risks.

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