IBM Algo FIRST for banking

Qualitative and quantitative database of external risk loss events

Highlights

- Helps users understand, identify and manage operational risk
- Recognized by analysts and practitioners alike for its industry-leading coverage
- Provides thousands of real-life case studies based on external risk loss events

IBM® Algo FIRST® highlights operational risk events, control breakdowns and management responses to help financial institutions prevent losses before they occur. Subscribers can proactively apply lessons learned from almost 15,000 real-life case studies to help minimize their risk exposure and enhance internal controls. The Algo FIRST database is constantly expanding.

Recent additions include a rules and regulation hierarchy to assist in better understanding the outcomes of regulatory violations in the industry and scaling information for the banking and insurance industries. Recent financial services loss events include insider trading, fraud, natural disasters, regulatory violations, liquidity risk and transactional and business risk.

One of the industry's most respected external risk loss databases

The financial community has never been under more pressure to understand its overall exposure to risk. Increased market volatility, along with shareholder demands for greater accountability, is fueling the need to identify, measure and manage risk across the enterprise. While risk has always been a part of the financial services industry, managing exposure in today's climate of complex, global transactions, in addition to intense regulatory oversight, has become an even greater challenge.

One important strategy for managing risk is to learn from the experience of others. The Algo FIRST database is designed to assist risk professionals with their analysis of large loss events by providing real-life case studies that include key triggers, contributory factors and management responses. The Algo FIRST database offers financial institutions a distinct perspective on operational risk events, along with discussions of associated control breakdowns and lessons learned, to help prevent similar mishaps within their own firms.

One of the industry's only research tools that puts real-life case studies within an operational risk framework, Algo FIRST is an ideal supplement to internal data for self-assessment and scenario modeling. Charts and graphs, free-text search, in-depth case studies, and essential content for self-assessment programs help ensure that Algo FIRST is an invaluable resource for financial services organizations.

The IBM Algo FIRST database is sold as a data subscription. Because it is a cloud-based solution, it does not require installed software.

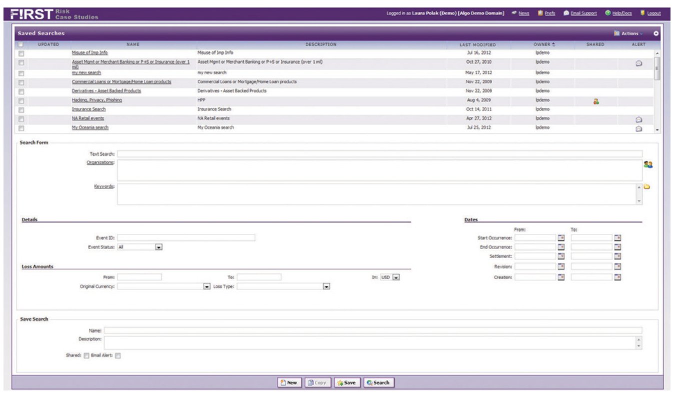

Figure 1: Screen capture of the Algo FIRST home page

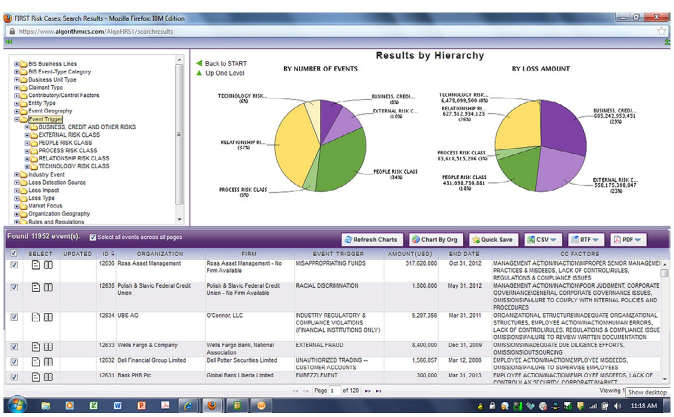

Figure 2: Screen capture of Algo FIRST query results

Algo FIRST database sample case study

Wells Fargo & Company (excerpt from Event #15467)

In our sample case, an incentive program designed to motivate employees went drastically wrong. On September 8, 2016, Wells Fargo Bank agreed to pay USD 187.5 million to settle allegations by federal and state regulators that the bank improperly opened unauthorized deposit and credit card accounts.

The Consumer Financial Protection Bureau (CFPB) alleged that since January 2011, Wells Fargo employees—spurred by sales targets and compensation incentives—had boosted sales figures by secretly opening accounts and funding them by transferring funds from consumers' authorized accounts without the customers' knowledge or consent, often racking up fees or other charges.

According to the bank's own analysis, Wells Fargo employees opened more than two million deposit and credit card accounts that may not have been authorized by consumers. Wells Fargo agreed to pay restitution of about USD 2.5 million to affected customers and a USD 100 million penalty to the CFPB. It also agreed to pay an additional USD 35 million penalty to the Office of the Comptroller of the Currency (OCC) in Washington DC and another USD 50 million to the City and County of Los Angeles.

Wells Fargo said it would eliminate all product sales goals in its retail banking, effective January 1, 2017, and instructed call center workers to temporarily halt the cross-selling of financial products. It also disclosed that more than 5,300 employees had been fired, but declined to say where any senior executives would face any sanctions or reprimands.

Wells Fargo Bank, which is headquartered in San Francisco, is one of the largest banks in the United States and offers many consumer financial products and services, including savings and checking accounts, credit cards, debit and ATM cards, and online-banking services. According to the CFPB, Wells Fargo has sought to distinguish itself in the marketplace as a leader in cross selling such products and services to existing customers.

The CFPB alleged that starting in January 2011, Wells Fargo employees began to enroll consumers in the products and services without their knowledge or consent, to obtain financial compensation for meeting sales targets. According to the bank's own analysis, Wells Fargo employees opened about 1.5 million deposit accounts and 565,000 credit card accounts that may not have been authorized by consumers. The analysis also found that roughly 85,000 of those deposit accounts incurred USD 2 million in fees and 14,000 of the credit card accounts incurred USD 403,145 in fees.

Investigators further discovered that Wells Fargo employees requested and issued debit cards without consumers' knowledge or consent, going so far as to create personal identification numbers (PINs) without telling customers they were doing so. In addition, Wells Fargo employees allegedly created phony email addresses, such as "noname@wellsfargo.com" and "1234@wellsfargo.com" when they enrolled consumers in online banking services without permission.

In the practice known at Wells Fargo as "pinning," an employee could obtain a debit card number and personally set the PIN, often to 0000, without customer authorization. Pinning permits the employee to enroll a customer in online banking, for which the employee would receive a sales credit. The employee would then input the phony email address to validate the transaction as completed.

Wells Fargo's high-pressure sales tactics were first disclosed in a December 2013 Los Angeles Times article that found employees had forged signatures, falsified phone numbers, and opened customer accounts without their knowledge or consent. The Los Angeles City Attorney sued the bank in May 2015 alleging the sales tactics created a "fee-generating machine" that led employees to open unauthorized accounts to meet sales targets.

As a sign of a lack of internal controls, the CFPB noted that Wells Fargo's compensation incentive programs encouraged employees to sign up existing clients for deposit accounts, credit cards, debit cards, and online banking, but failed to monitor the implementation of these programs with adequate care.

One red flag that was missed, according to a report by Bloomberg View columnist Matt Levine on September 10, 2016, was that sales targets imposed by Wells Fargo on its employees were often not attainable because "there simply are not enough customers who enter a branch on daily basis for employees to meet their quotas through traditional means."

As part of its corrective actions, on September 8, 2016, Wells Fargo agreed to pay USD 185 million in fines to settle with the CFPB, the OCC, and the Office of the Los Angeles City Attorney. The bank also agreed to pay restitution of about USD 2.5 million to affected customers and to hire an independent consultant to conduct a thorough review of its procedures.

Wells Fargo issued a statement saying the bank "is committed to putting our customers' interests first 100 percent of the time, and we regret and take responsibility for any instances where customers may have received a product that they did not request." The bank also said that it refunded money to customers if there was even the slightest possibility they were charged improperly because of unauthorized accounts.

In its management response, Wells Fargo added that it had fired at least 5,300 employees who were involved in the improper sales practices. A spokesperson for Wells Fargo told the New York Times (September 9, 2016) that employees who were terminated included managers as well as other workers but declined to say whether any senior executives were reprimanded or terminated. About 10 percent of the terminated employees were managers.

Responding to news of the settlement, on September 13, 2016, Wells Fargo announced that it would eliminate all product sales goals in its retail banking, effective January 1, 2017. "We are eliminating product sales goals because we want to make certain our customers have full confidence that our retail bankers are always focused on the best interests of customers," said Chief Executive John Stumpf.

At an investor conference, Chief Financial Officer John Shrewsberry said that Wells Fargo spends about USD 50 million a year for "enhanced training, monitoring and controls." The Wall Street Journal (September 13, 2016) reported that Mr. Shrewsberry referenced "a mystery-shopping program where a third party would go to different bank branches to try to suss out bad behavior."

This was the largest fine the CFPB has imposed against any financial institution and the largest fine in the history of the Los Angeles City Attorney's office. CFPB Director Richard Cordray said that the CFPB's action "should serve notice to the entire industry that financial incentive programs, if not monitored carefully, carry serious risks that can have serious legal consequences."

Kevin Barker, an analyst for investment bank Piper Jaffray, told Reuters News (September 8, 2016) that he did not think the crackdown on Wells Fargo will have much of an impact on others in the industry. "I think this is unique to Wells Fargo and their particular situation and how hard they push on cross-sell," Mr. Barker said.

Allen Tischler, an analyst for Moody's, told Bloomberg News (September 12, 2016) that "the regulators' findings are consequential for a bank such as Wells Fargo, which historically has had strong customer satisfaction scores and a reputation for sound risk management." Mr. Tischler also said, "We do expect some immediate damage to Wells Fargo's reputation from this embarrassing episode."

On September 12, 2016, the Senate Banking Committee's Republican majority said that it planned to hold hearings into the bank's sales practices. A spokesperson for the committee said that CEO John Stumpf is among executives who've been asked to appear.

Moody's Investors Service said on September 12, 2016 that the revelations of employee misconduct are "highly disturbing" and could hurt holders of the bank's debt. The credit ratings agency said in a report that Wells Fargo encouraged "pervasive inappropriate practices" and results of examinations by the federal regulators are credit negative.

Mike Mayo, an analyst for investment bank CLSA, wrote in a note to clients that the fines "probably should lead to a pay clawback" from Carrie Tolstedt, the Wells Fargo executive who was in charge of community banking until the bank announced her retirement in July 2016. Mr. Mayo said that "these issues should have been caught sooner and dealt with more forcefully."

According to Fortune (September 12, 2016), Ms. Tolstedt was leaving Wells Fargo with USD 124.6 million in pay and other benefits. A spokesperson for Wells Fargo told Fortune that the timing of her exit was the result of a "personal decision to retire after 27 years" with the bank. The spokesperson declined to comment on whether Wells Fargo was considering clawing back any portion of the executive's pay package.

The New York Times (September 13, 2016) noted that in a November 2015 interview with the San Francisco Chronicle, Mr. Stumpf had said: "I don't want anyone ever offering a product to someone when they don't know what the benefit is, or the customer doesn't understand, or doesn't want it, or doesn't need it." The newspaper noted that there was "a disconnect between whatever Mr. Stumpf was telling the public and what was actually going on at Wells Fargo."

On October 12, 2016, Wells Fargo announced that Mr. Stumpf had informed the board that he would retire as chairman and CEO of the company, effective immediately. The board elected Tim Sloan, its president and chief operating officer, as the new CEO of the company, and lead director Stephen Sanger as the board's non-executive chairman.

Key benefits and features

Provides a better understanding of potential exposures

Case studies can be shared among departments, providing valuable content for use in management reports, committee or board presentations or discussions, internal newsletters, self-assessment workshops, and scenario-based models. Charts and graphs allow for better understanding of loss breakdowns, while the internet-based subscription helps ensures that users in the organization can have ready access to Algo FIRST without additional infrastructure cost.

Helps minimize risk exposure

By proactively applying lessons learned, financial institutions can improve internal controls, reduce investment risk, and create better understanding around new product research processes before losses or exposures occur.

Enhances trend analysis

Firms gain the ability to examine commonalities among a series of events and to track emerging patterns. By benchmarking internal loss history against the event experience of peers, organizations can use Algo FIRST to help improve their competitive insights.

Helps reduce investment risk

Improve new product research processes by identifying potential risk exposure by product type, so that the appropriate control measures can be put in place. Management can also reference Fitch ratings or Scaling data, linked to the timing of events, to see if there are contextual references of how events might have impacted the cost of capital.

Increases access to relevant insights

IBM operational risk research analysts have a background in financial analysis. This experience helps ensure that they understand which loss event details are relevant to financial institutions and that these insights are passed along to subscribers.

Allows for easier data export

Users can create customized searches and then download information in CSV, RTF or PDF formats for use in other internal documents or knowledge-based systems. For those who want to integrate FIRST into systems by using automation or filtering routines, Algo FIRST is available in two data add-on formats:

- An XML version that you can use to incorporate Algo FIRST data through direct feed into internal or external operational risk, compliance, enterprise risk or other knowledge-based systems
- A FastMap version that you can use to incorporate Algo FIRST data through direct feed into the IBM OpenPages® Operational Risk Management module
- A Services Directory Integrator (SDI) version that you can use to incorporate Algo FIRST data using the SDI ETL tool into the IBM OpenPages Operational Risk Management module

In-depth case studies

Loss events are detailed with analyses of key factors, including control breakdowns, regulatory rule violation information, management responses to events, graphs and charts, and industry lessons learned. Special coverage is provided for catastrophic (tail) events, which are detailed with timelines to allow for day-by-day or hour-by-hour analysis of breakdowns that led to loss.

Extensive search functions

Free-text and hierarchical searches allow for user identification of events by natural language or keyword node terms. The powerful search engine of Algo FIRST enables users to combine search concepts or search by several factors, including product type, geography, loss type, event trigger and control breakdowns. Basel II categorizations and Boolean search are also supported in the advanced search function of Algo FIRST.

Access to online newsletter

Algo FIRST Database subscribers also receive a monthly newsletter. This monthly online publication is designed to raise awareness of topical issues that can impact daily business operations. This newsletter also provides excerpts from relevant case studies to highlight how Algo FIRST informs your risk program.

About IBM Analytics

IBM Analytics software delivers data-driven insights that help organizations work smarter and outperform their peers. This comprehensive portfolio includes solutions for business intelligence, predictive analytics and decision management, performance management, and risk management.

Analytics solutions enable companies to identify and visualize trends and patterns in areas such as customer analytics, which can have a profound effect on business performance. They can compare scenarios, anticipate potential threats and opportunities, better plan, budget and forecast resources, balance risks against expected returns and work to meet regulatory requirements. By making analytics widely available, organizations can align tactical and strategic decision-making to achieve business goals. For further information, visit ibm.com/analytics.

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