



HELLS BELLS AT WELLS

Back in 2009 Warren Buffett gave an interview to Fortune magazine explaining why Wells Fargo was his favourite bank. I want to highlight a couple of his comments because I think they are particularly interesting in the light of what we now know was going on at the bank:

Fortune: How is Wells Fargo unique? *Warren Buffett: It's sort of hard to imagine a business that large being unique. You'd think they'd need to be like any other bank by the time they got to that size. Those guys have gone their own way. That doesn't mean that everything they've done has been right. But they've never felt compelled to do anything because other banks were doing it, and that's how banks get in trouble, when they say, "Everybody else is doing it, why shouldn't I?"*

How is Wells differentiated from the banks you own and the ones you don't? *Wells just has a whole different attitude. That's why Kovacevich calls them retail stores. He doesn't even like the word banking. I mean, he is looking to have a maximum enduring relationship with many, many millions of people. Tens of millions. And at the base of it involves getting money in very cheap. When you do that that's a helluva start in the business. The difference between getting your money at 1-1/2 % and 2-1/2% on a trillion-dollar asset base is \$10 billion a year. It's hard to overemphasize that. He thinks more like Sam Walton than he thinks like J.P. Morgan. I'm talking about the individual there. He's a retailer. He's not trying to influence Washington or be the most important guy on the scene or anything like that. He's just trying to do business with millions of people every day and make a few bucks off of them.*

In other words Warren said that Wells was always prepared to be different and Warren gave a good chunk of the credit for this uniqueness to the then Chief Executive Dick Kovacevich. At the time this article came out Warren was aware that a new Chief Executive was about to take over. This is what he had to say about John Stumpf:

How confident will you be in Wells when Kovacevich retires? *Well, John [Stumpf] is in charge. Dick is a terrific help to John. I play bridge with John on the Internet. He plays under the name of HTUR. His wife's name is Ruth. My bridge partner, who I probably play bridge with four times a week, developed online banking for Wells. A woman named Sharon Osberg. And she's worked with those people. And she told me about John Stumpf ten years ago. I've had some insight through her on these people. But the real insight you get about a banker is how they bank. You've got to see what they do and*

what they don't do. Their speeches don't make any difference. It's what they do and what they don't do. And what Wells didn't do is what defines their greatness.

How is John's bridge game? *John is a very good bridge player. But he doesn't play as much as I do. I play all the time. He's smart. He's a different personality than Dick. Dick is a real sales person. They both subscribe to the same principles of banking. They just don't think you have to do things that the other guy is doing.*

In other words Warren first heard about John Stumpf as far back as 1999, at some stage they ended up playing Bridge together and by 2009 Warren thought he knew him well enough to say that he would continue doing the thing that makes Wells Fargo unique, he would maintain the tradition of being prepared to be different.

I now want to move forward to a talk given by John Stumpf at a conference in 2013. At the conference John was asked about his relationship with Warren and according to SeekingAlpha (www.SeekingAlpha.com) this is what he had to say:

John Stumpf *Well first of all – Warren is a friend, I actually went out to his 50th annual meeting in Omaha, a couple of weeks ago. I have not been before and...*

Unidentified Analyst *You took the sales force...*

John Stumpf *We took the sales force – and to have him as our largest shareholder, this is the best of the best the world's ever known and for him to be pushing towards 10% ownership in the company valuing his share at \$28 billion is such a privilege to earn his confidence.*

A couple – a couple of things about him, he is very long-term in his thinking and he knows us as well or better than we know ourselves. He reads everything that we produce, I call him one day on something or he called me, he said you know I was reading your 10-Q this weekend. Just a second, what the – and I said you're on Page 37. I said wow, don't you watch football on Saturdays? So here you have this guy who is incredibly detailed and understands the issues, but yet when you talk with him, he is talking about the morale of the team and what you are seeing in this industry, how do you think about this five and ten and 20 years forward.

Here we have John Stumpf saying that he is a friend of Warren and he also says that it is a privilege to have earned his confidence. He also says that he knows Warren emphasises the long term and that to achieve good results in the long term it is important to have good team morale.

I now want to jump forward to more recent times and to what we now know about what it was really like at Wells Fargo.

Here is how Fortune magazine described the scandal:

The Wells Fargo scandal was far different. Instead of a select few doing bad things, the unethical behavior was widespread at the bank, with thousands of employees engaged in secretly creating new bank and credit-card accounts for customers without their knowledge, resulting in overdraft and other fees. So far, 5,300 Wells Fargo employees have been fired over the issue.

According to John Maxfield at the Motley Fool “One employee was even fired after sending an email to John Stumpf about the creation of fake accounts.”

We now know that John Stumpf was at the head of a bank where morale was destroyed by short term performance pressures. (The very opposite of what Warren would expect)

In my opinion, John Stumpf should have paid a higher price than just losing his job and giving up part of his pay. The evidence of what was going on began to appear in 2013 and he just didn't react fast enough.

John Stumpf said he was a friend of Warren and Warren said he trusted John and yet this scandal occurred.

I presume John must have known a couple of Warren's most famous quotes and yet he still didn't follow them:

“I want them [the CEOs] to judge every action by how it would appear on the front page of their local newspaper, written by a smart but semi-unfriendly reporter, who really understood it, to be read by their families, their neighbours, their friends. And it has to pass that test”

It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently.”

This brings me to the main lesson I have learned from this sorry saga and it is the reality of how little we know about what is going on inside the companies in which we invest. If the pressure is so great on John Stumpf that he ends up allowing problems to fester well then I really have to be cautious about how good my judgement will be about the actions of any of the CEOs of companies in which I have invested.

In other words, if even Warren Buffett was caught out by this it highlights to me the importance of diversification. I have followed a rough rule of thumb of never putting more than 5% into any one holding in my portfolio and I normally start selling if performance results in a holding going above 6%. This rough rule gives a minimum of 20 holdings in the portfolio but I have generally had between 30 and 40. I have toyed with the idea of allowing position sizes to be bigger (see Opinion Piece 51 Jan.10) but I never followed through and

now I am more convinced than ever that my investment philosophy will be to keep a level of diversification that should prevent me from being badly stung by any future equivalent John Stumpf.

Finally, as far as I can see from doing a quick search, Charlie Munger has not given his perspective on recent events and given that he is always a bit blunter than Warren I do hope he shares his thoughts sooner rather than later.