

Wells Fargo Investors Stop Panicking, Learn to Live With Cap

By [Hannah Levitt](#)

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- ▶ Stock is outperforming as worries over Fed's sanction subside
- ▶ Analysts say its tarnished reputation may be the real drag

Wells Fargo Vigorously Competing for Loans, CFO Says

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Six months after the Federal Reserve put [Wells Fargo & Co.](#) on a strict diet -- no more growth until it cleans up its act -- shareholders are finding it's not so bad.

In May, the firm predicted the hit to profit will be [smaller](#) <https://www.bloomberg.com/news/articles/2018-05-10/wells-fargo-says-fed-asset-cap-isn-t-as-painful-as-it-thought> than it initially expected. In June, it announced an especially large jump <https://www.bloomberg.com/news/articles/2018-06-28/fed-test-forces-jpmorgan-goldman-four-rivals-to-temper-payouts> in dividends and stock buybacks to whittle its idle cash. And even after announcing a drop in lending last month that initially spooked investors, it said the move had more to do with [managing risks](#) <https://www.bloomberg.com/news/articles/2018-07-13/wells-fargo-breaks-from-herd-on-loans-saying-time-to-be>

prudent> -- then watched its shares advance.

Last week marked the half-year anniversary of the Fed's unprecedented sanction of a big U.S. bank, and if this were a medical checkup, the doctor would acknowledge it's doing better than initially feared. Since Wells Fargo's stock bottomed out in mid-April amid worries about the cap, it has gained 17 percent, the second-best performance in the KBW Bank Index of 24 major U.S. lenders. Again and again, executives insist they can handle the restriction.



Wells Fargo's stock has outperformed since a seven-month low in April

“The asset cap related to the Federal Reserve’s consent order has not impacted our ability to grow our core lending and deposit-taking businesses,” Chief Financial Officer John Shrewsberry told analysts last month on a conference call.

Reputation’s Drag

Perversely, one reason the cap isn’t so terrible, according to analysts, is that the bank’s businesses are being weighed down by another problem: A tarnished reputation.

Regulators barred Wells Fargo from growing total assets beyond their level at the end of 2017 because of a pattern of consumer abuses and other lapses -- a list that grew <https://www.bloomberg.com/news/articles/2018-08-03/wells-fargo-faces-u-s-probe-on-low-income-tax-credit-purchases> Friday when the firm said it may have improperly foreclosed on 400 home loans. The bank also said government agencies are examining how it negotiated and purchased some low-income housing tax credits. The order, Janet Yellen’s final act as the Fed’s chair, will remain

in place until executives shore up internal controls to authorities' satisfaction.

“Wells Fargo is not making it easy for the Federal Reserve to lift the asset growth cap,” Cowen & Co. analyst Jaret Seiberg wrote Monday in a note. “We don’t know how the Federal Reserve could lift the cap this year. And lifting it next year could become a problem if the Democrats retake the House in November as we expect.”

Even without the cap, customers are unsettled. Existing and potential clients may shy away from Wells Fargo’s commercial unit after it charged some companies higher fees than promised on foreign-exchange transactions. The firm took a \$171 million charge in the second quarter to make customers whole.

“FX trading was their big capital markets product,” Charles Peabody, an analyst at Portales Partners, said in an interview. “They’re clearly going to start to suffer on the investment banking and capital management front because corporate treasurers are going to be wary of doing business with them.”

Ad Campaign

Other businesses are contending with similar fallout from scandals.

“They are having trouble growing loans and growing the business anyway, and it’s not necessarily because of the cap,” Kyle Sanders, an analyst at Edward Jones, said in an interview. “They’re not having a lot of loans come through the pipeline, so they’re not really pushing up against this cap.”

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Wells Fargo has said it’s exercising some caution in hot lending markets such as commercial real estate and car financing to avoid getting burned. It’s also contending with the end of a mortgage-refinancing boom that helped drive past profits to records. To win back customer trust, it launched an ad campaign this year called “Re-Established,” reassuring the public that it’s addressing problems and

making things right.

One area the firm is targeting is credit-card lending, as it looks for higher-yielding assets to bolster profits under the cap. Though the bank holds more interest-bearing U.S. deposits than any other lender, and is the nation's top issuer of debit cards, it ranks seventh among credit-card issuers, according to industry publication Nilson Report.

In July, Wells Fargo launched a revamped Propel credit card targeting millennials hungry for rewards. Cards and retail services head Beverly Anderson has said another card in the same line will be revamped over the next couple years.

Read more: Wells Fargo bids for points pros with no-fee card revamp

<<https://www.bloomberg.com/news/articles/2018-06-25/wells-fargo-bids-for-points-pros-with-no-fee-credit-card-revamp>>

“You can probably get a 10 to 12 percent yield on a credit card loan versus probably 3 to 4 percent on a mortgage, so there is an opportunity there to grow that business,” Sanders said.

The focus on higher yielding business is a broad theme at the bank. Its net interest margin, the difference between what a bank charges borrowers and pays depositors, grew 9 basis points to 2.93 percent. A shift to higher-yielding assets boosted net interest income despite fewer loans overall, Peabody said.

Wells Fargo can continue to sell assets to pave the way for growth in higher-yielding categories. It sold its shareowner services business in the first quarter and a stake in a money manager, the Rock Creek Group, in the second quarter. The wholesale unit is considering a sale

<<https://www.bloomberg.com/news/articles/2018-07-26/wells-fargo-is-said-to-explore-sale-of-real-estate-unit-eastdil>> of commercial real estate broker Eastdil Secured, a person familiar with the matter said last month.

“You have a bunch of assets that are not very risky but not that profitable either, and those you can shed,”

Oppenheimer analyst Chris Kotowski said in an interview.
“It’s a question of how long you can do it.”

According to Peabody, the changes the bank can make to its asset mix are limited and the growth ban will have a greater impact the longer it is in place.

“My feeling is it’s going to have a bite by the fourth quarter, early next year, but in some respects I’m guessing,” Peabody said.

(Adds analyst comment in seventh paragraph.)