GESTÃO FINANCEIRA II
CORPORATE FINANCE II
ADVANCED CORPORATE FINANCE

Problem Set 1

Licenciatura – Undergraduate Course

1st Semester 2022 - 2023

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Chapter 1, 13 & 16

1. Consider the following piece of news about the recent scandal of fake accounts at one of the largest listed banks in the US (Wells Fargo):

Wells Fargo Forced To Pay $3 Billion For The Bank's Fake Account Scandal

Wells Fargo, the fourth largest bank in the United States, agreed on Friday to pay $3 billion to settle its long-running civil and criminal probes into the heinous accusations of rampant fraudulent sales practices.

The San Francisco-based bank announced that it will pay the substantial financial penalty to both the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC). Roughly $500 million of the fine will be allocated to the SEC. The regulator will use the funds from the settlement to offer some restitution to the defrauded customers.

The problems began when Wells Fargo executives pressured rank-and-file bank personnel to aggressively cross-sell products to enhance sales and revenue to meet certain quotas. Deception reared its ugly head when Wells Fargo employees then created millions of savings and checking accounts for customers without their knowledge or approval.

To reach the sales goals set forth by the company, bank branch staff resorted to inappropriate activities. They started using their own contact information on forms to prevent customers from discovering the scam. Employees were accused of creating fraudulent checking and savings accounts by moving money out of existing accounts into the new ones. This was made possible by "pinning"—a process in which the customers PIN number was set to "0000," so that bankers could readily control their clients' accounts and keep them in the dark.

Eventually, many of the bank's customers noticed and questioned the fees on accounts they didn't request or realize that they owned. The avalanche of complaints drew the attention of regulatory agencies. The fraud started to gain wider attention in 2016 when a group of government regulatory agencies fined the company a combined $185 million. Wells Fargo subsequently dealt with civil and criminal lawsuits and paid out over $2.7 billion, not including the recent penalties. John Stumpf, Wells Fargo's chief executive at the height of the scandal, was forced to resign.

The bank now admits, according to DOJ officials, that it pressured employees to meet "unrealistic sales goals that led to thousands of employees opening millions of accounts for customers under false pretenses or without customer consent often by misusing customers' identities."

In a statement, Andrew Murray, U.S. Attorney for the Western District of North Carolina, said, "Today's announcement should serve as a stark reminder that no institution is too big, too powerful or too well-known to be held accountable and face enforcement action for its wrongdoings."

U.S. Attorney Nick Hanna added, "Simply put, Wells Fargo traded its hard-earned reputation for short-term profits, and harmed untold numbers of customers along the way."

Last month, the Office of the Comptroller of the Currency (OCC) charged former Wells Fargo executives for their roles in the sales scandal. The OCC also barred former CEO Stumpf from ever working at a bank again and ordered that he pay $17.5 million for his role in the scandal.

Wells Fargo claims that it has enacted measures with the goal of earning back the trust and confidence of its stakeholders, including clients, employees, investors and regulators. The bank intends to cease sales goals for its products and services, change the company's compensation structure, so that it's tied to the best interests of its customers, and strengthen oversight of the large organization.

Wells Fargo CEO Charlie Scharf publicly addressed the settlement in a statement, “The conduct at the core of today's settlements—and the past culture that gave rise to it—are reprehensible and wholly inconsistent with the values on which Wells Fargo is built.” Scharf said, “Our customers, shareholders and employees deserved more from the leadership of this company.”

Dick Bove, a veteran Wall Street research analyst, believes that the bank faces a challenging future. Bove wrote, “The turnaround of Wells Fargo is likely to take a minimum of three to five years. There are much better investments. Sell.” Bove maintains that about 20,000 employees—representing 10% of the workforce— may be downsized. Wells Fargo’s wealth management brokerage division saw a huge decline in its ranks. The brokers believe that the negative publicity surrounding the scandal has hurt its business and they’ve moved onto other companies.

A group of people may benefit from this fiasco. Compliance, legal, risk, audit and related professionals will see more job openings due to the settlement. The bank, pledging to increase its oversight, will most likely need people with a fresh perspective to join the bank to ensure this type of scandal doesn’t occur again.

Jack Kelly Feb 24, 2020 – Forbes

a) What is your opinion about the action of Wells Fargo executives? Is this way of making money beneficial to the Bank's shareholders? Explain.

b) Wells Fargo shareholders have suffered huge losses. How? Why do you think that happens?

2. On the website https://finance.yahoo.com/ extract the monthly adjusted closing prices of the last five years for the Wells Fargo stock and S&P 500 index.

   a) Present a scatter plot between the Wells Fargo stock monthly returns and the S&P 500 index monthly returns.

   b) Based on these data, present the values of the parameters of the market model, i.e., Alpha and Beta.

   c) What is the abnormal return on Wells Fargo shares in September 2022?

   d) Look at the closing prices of the Wells Fargo shares in the days prior to August the 4^{th}. You see that the "Close" is different from the "Adjusted Close". Why?

   e) Wells Fargo also buys back its own shares. Should you also see an adjustment in stock prices because of that?

3. Considering what you have learned about the different forms of market efficiency, for each of the situations described below, indicate which of the efficiency forms is violated. Justify.

   a) ABC Ltd released its earnings well above expectations. The ABC stock price increases only after a week, when a financial analyst revises its recommendation to “buy”.

   b) Mr. Pinto can get large average abnormal gains by doing day trading. In his words: “I simply look at charts, buy low and sell high”.

c) The shares of the company Infex Inc, started trading Ex-Div this morning. The opening price is the same as the closing price of the previous day.

d) Mr. Costa is the CEO of a well-known football club which is listed on the stock exchange. He frequently trades his club's shares on the stock market. He makes huge gains.

e) Shares of small companies tend to close Monday's stock exchange session in the same direction as the previous Friday.

4. In your own words, explain the Wall Street saying: "Markets have no memory".