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# Such a nice guy

## Lessons and learnings from financial services

Angelique Aksenoff

Individuals like Melissa Caddick, Melinda Scott and Bernie Madoff, when first exposed, initially elicit expressions of shocked disbelief; quickly replaced by outrage, overreaction and their categorisation as outliers.

However, fraud is surprisingly common and most fraudsters are friendly, seemingly generous and quite approachable.

Despite the evidence, people are often surprised to learn one of their employees, or one of their colleagues, had misappropriated funds to recoup a trading position, fund a gambling addiction, pay for living expenses, purchase luxuries they could not otherwise afford or, commonly, just because they could.

Financial advice is a credence good [a product for which the quality cannot be gauged by consumers, even after buyingpurchasing it]. Advisers, providing their clients with care and consideration, are explicitly trusted by those who rely on, and are vulnerable to, their adviser's ethics and good judgment. Trustworthiness is assumed, and trust easily granted, but, like most professions, there are some that abuse that trust.

### The psychology of fraud

Although many instances of fraud never make it to court, many judges have offered compelling assessments of fraudsters' motivations, characteristics, behaviours, investment choices and morality.

Following are excerpts from just a small number of recent cases the Commonwealth Director of Public Prosecutions (CDPP) has run successfully.

**Former Adelaide financial adviser sentenced to 10 years imprisonment after stealing client funds (2019–2020)**
***$4.8 million from 30 victims***

*"You had known most of your victims for many years and they trusted you completely. A number of them relied on your advice without question, and all the while you were systematically stealing their life savings from them.*

*"You have caused great suffering to many people. Yours is despicable offending and offending which only came to an end when you were caught. You did not voluntarily desist."*

**'Before we had plans, now we worry about survival'—Financial adviser found guilty of fraud (2019–2020)**
***$5.9 million from six couples***

*"[The] offending was a 'calculated and callous scheme of dishonesty' [and] involved a high level of planning, sophistication and persistence. Investors had been robbed of their retirement and Mr Jayaweera had committed a gross breach of trust.*

*"Judge Richards accepted that Mr Jayaweera did not use the defrauded money to fund a lavish lifestyle, but said this made the offending no less dishonest; Mr Jayaweera knew what was happening at all times, and when his victims began to suspect something was wrong, reassured them their money was safe."*

**Man who misappropriated retirement savings lost his moral compass (2020–2021)**
***$1.865 million from 10 clients***
*"[The accused's] actions were a cruel and deceitful betrayal leading to financial disaster for the victims involved.*

*"His Honour pointed out that the case highlighted the serious dangers of self-managed super funds, and the need for greater statutory regulation to minimise such fraud."*

**Former Townsville adviser jailed for stealing clients' funds (2020–2021)**
***$1,106,463 from 10 clients on 125 occasions***
*"I have seen this too often: after the first one, it becomes easier. It was sophisticated to the point that you diverted money into accounts other than your own, and I come to the conclusion that it was not just for need but there was some greed, because you bought a big boat and a car. I accept there was also need, but I cannot say it was all about that."*

## Practical wisdom

It is tempting to dismiss these cases as rare exceptions, but a review of CDPP prosecution statistics and referrals from partner agencies which included the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC), show a disturbing and not surprising upward trend in fraud.

The CDPP's *Annual Report 2019-20*, under the Commercial, Financial and Corruption portfolio, reported 106 referrals, with 282 matters on hand, with the top referring agencies including ASIC, the Australian Federal Police, the Australian Taxation Office and the ACCC, with ASIC being the largest source of referrals.

As other commentators have observed, a crisis can increases a person's propensity for fraud.

The UK's office for National Statistics identified that fraud offences increased by 21% in the two years after the GFC. In a crisis like COVID-19, incidents of fraud could increase by the same amount.

The data supports our thesis and undermines the practical value of unmonitored and unenforceable standards because the fraud is usually driven by need rather than greed; by necessity not opportunity.

Business owners are often surprised that employees can, and do, commit fraud despite oversight and controls. Often, it is the person they would least expect (or can least afford to lose).

What is interesting, is that the characteristics of the fraud perpetrators are often the exact characteristics employers looked for when hiring them. Doesn't every employer want staff who are outgoing, influential, clever and conscientious?

The actions of these types of employees will cast both a shadow and spotlight on the licensee, their risk framework and any monitoring and supervision capability. One persons' dishonesty can quickly compromise a licence and ability to continue providing financial services, honesty, fairly and efficiently—let alone, the reputational damage one employees actions can have on a business.

## Why do nice guys go bad?

In a research paper 'The psychology of fraud' published by the Australian Institute of Criminology, the authors Grace Duffield and Peter Grabosky argue that fraud, like many other crimes, can best be explained by three factors:

1. A supply of motivated offenders
2. The availability of suitable targets
3. The absence of capable guardians.

Licensees wondering about the likelihood of adviser misconduct should not underestimate their own contribution to the misconduct they might eventually uncover.

Licensees are guardians, and their advisers and clients rely on a licensee's capability. In monitoring and supervising these individuals, a licensee is ensuring their clients are protected from the dishonesty of these supposed 'good guys'.

So, the question licensees should ask themselves before ASIC or the courts do, is whether their compliance function is capable, competent and adequately resourced?

Duffield and Grabosky's article outlines some common motivating elements of fraud, including:

- explanations of financial strain
- a desire to possess what one cannot afford—'trying to keep up with the Joneses'
- ego in which there is a comparison with others who are better off, and a desire to match that standard in terms of lifestyle
- a threat of loss of something currently owned
- lifestyle choices, the most prominent of which is gambling
- ego and power over people as well as power over situations.

They conclude that the risk of fraud is both a product of personality and environment or situational variable.

Reflecting on personality in the first instance, the research acknowledged that financial strain features in almost every type of fraudulent activity. Further, it suggested that financial strain is a very subjective thing, with even the most affluent feeling economically deprived compared with what they perceive to be their relevant standard.

Fraud is sometimes a short-term solution to overcome a temporary loss, be it through trading, or business stress. However, other types of fraud may relate to ego/power.

For example, power over people as well as mastery over situations, while others are motivated by a desire to manipulate and make fools of their victims.

From previous cases run by the CDPP, some of the activities the convicted fraudsters were engaging in included:

- advising clients to establish self-managed superannuation funds, opening cash management accounts on their behalf and assuming near complete control of their financial affairs
- encouraging clients to invest in a scheme operated by the adviser's company

**The quote**

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- operating a Ponzi scheme under the guise of their business; misappropriating client funds for personal use, or to transfer to other clients; and purporting they were returns on amounts they had misappropriated earlier
- targeting victims who were financially unsophisticated and/or trusting clients
- stealing money to pay personal and business expenses, and cover the family's living expenses
- Forging victims' signatures or convincing victims to pre-sign withdrawal forms.

## Lessons for licensees

Leaving aside their historic aversion to compliance, the vast majority of advisers, in our experience, are honest, principled and ethical. Unfortunately, not every adviser is.

While it is dangerous to generalise from specifics, it is equally dangerous to dismiss exceptions or the possibility of misconduct. We have frequently written about individual preferences and construal elements, and while we remain convinced that individual preferences have less weight than environment and context, as licensees need to consider both the individual and the environment in which the individual operates:

- Have you created the culture and controls that resolve, or mitigate, the opportunities for successful fraud?
- Does your business and the way you manage risk and monitor and supervise your representatives give them the opportunity to commit fraud?
- Have you created a work environment with unrealistic performance goals that may motivate people to cut corners?
- Are you aware of personal factors that may be creating a pressure cooker environment, inducing them commit a crime?

In an April 2020 article 'Strain, coping and sustained fraud offending' published by the Australian Institute of Criminology, its authors Paul Andon and Clinton Free interviewed people convicted of serious fraud offences committed in the course of their employment or professional work. Fraud offending among the people interviewed took place over extended periods, often fluctuating in intensity.

In addition, the authors introduced the concept of the fraud triangle, which underpins strategies for workplace fraud prevention and detection strategies.

Unlike Duffield and Grabosky's thesis, the fraud triangle suggests that fraud is the result of the confluence of three conditions, namely:

- opportunity (e.g. weaknesses in, or ability to override, internal controls)
- motivating incentive or pressure (e.g. personal financial problems or unrealistic performance goals)
- a capacity to rationalise (e.g. from personal attributes or pressures).

In this study, serious fraud offenders reported feeling a range of positive and negative emotions during their offending. While all of them expressed feelings of satisfaction and thrill, all referred to strains in relation to their offending. That is, regret, guilt, shame, anxiety, and fear of being caught.

However, the 'strains in relation to their offending—regret, guilt, shame, anxiety and fear—did not prevent their misconduct'.

In fact, Assured Support's managing director Sean Graham argues that, from a practical perspective, the fraud triangle (and the escalating, embedded and patient nature of employee fraud) suggests that ethics exams and enhanced 'reference checking' are unlikely to prevent fraud. Instead, he suggests that licensees should:

- review their compliance arrangements/risk framework with a specific focus on exceptions and individual discretion
- review their balanced scorecard/incentive scheme both to identify systemic weaknesses and the (actual) strategies used by their high performers
- focus attention on their advisers' contraventions of internal policies and their real (rather than rhetoric) commitment to 'compliance' (acts, not words). Even without a conscious intention to commit fraud, small contraventions and compromises create the conditions for rationalising and justifying larger contraventions.

## What should you do if you suspect (or identify) fraud?

CPA Australia has published a useful guide, *Employee fraud: A guide to reducing the risk of employee fraud and what to do after the fraud is detected,* which outlines the following steps:

- **Stop the fraud from continuing**. Reduce access to electronic and other information or resources including blocking remote access. You may need to engage someone to undertake forensic IT on computer assets to recover anything that has been deleted from the hard disk. Identify other computers/equipment the employee may have used.
- **Collect the facts**. Before you approach the employee, collect as many facts as possible. Speak to their colleagues and ensure they can safely discuss what they know.
- **Discuss the issue with the employee**. you should be careful and approach these conversations with a clear head. You may wish to seek legal advice before having the conversation or have your lawyer present.
- **Report the fraud to the police (and ASIC)**—this step is after the fraud is detected or reasonably suspected. FS