DML ASSOCIATES, LLC



ACFE Heartland Chapter

Think Like a Fraudster to Catch a Fraudster

July 20, 2021

Dennis M. Lormel
President & CEO
DML Associates, LLC



Getting Inside the Mind of a Fraudster

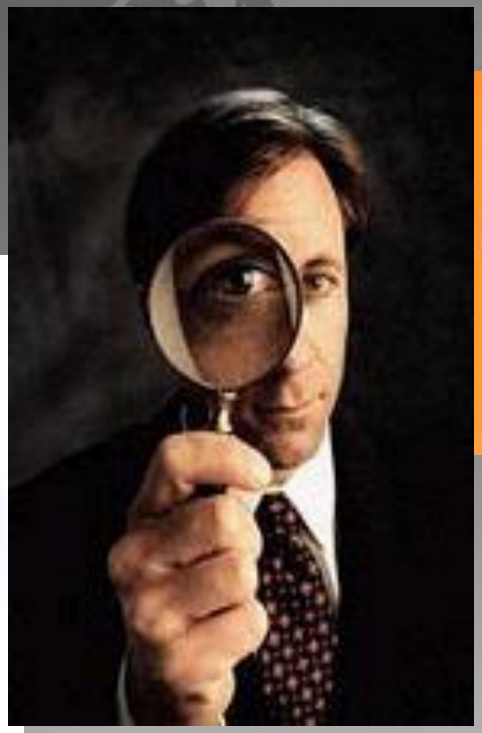
- Introduction
- Perspectives and Awareness
- Can You Think Like a Fraudster?
- Understanding the Fraud Crime Problem
- Comparing and Contrasting Fraud Schemes and Fraudsters
- Deconstructing a Fraudster
- Takeaways and Conclusion



Introduction









Vulnerability to Fraud

- In our personal and professional lives, we are susceptible to falling victim to fraud
  - Constant vulnerability
- Have you ever been a victim or attempted victim of fraud?
  - Yes and yes
- Can ignorance be bliss?
  - If it sounds to good to be true, ***it probably is***
  - "We have no fraud problem in this company"



- ***Understand how to be situationally aware of your vulnerability to fraud***

Trust

- Trust is the foundation for building personal and professional relationships
- Trust is also a fraudster's best friend
  - ***Trust facilitates opportunity***



- Differentiating between meaningful relationships and fraud requires understanding
- Understanding the motivation and rationalization used by fraudsters to justify their actions can be a critical component in predicating and recognizing fraudulent behavior



Five Elements of Fraud

- Integrity
- Opportunity
- Incentive / pressure
- Rationalization / attitude
- Capability
  - Opportunity influences integrity and capability
    - Control (limit) opportunity
    - Build perception of detection



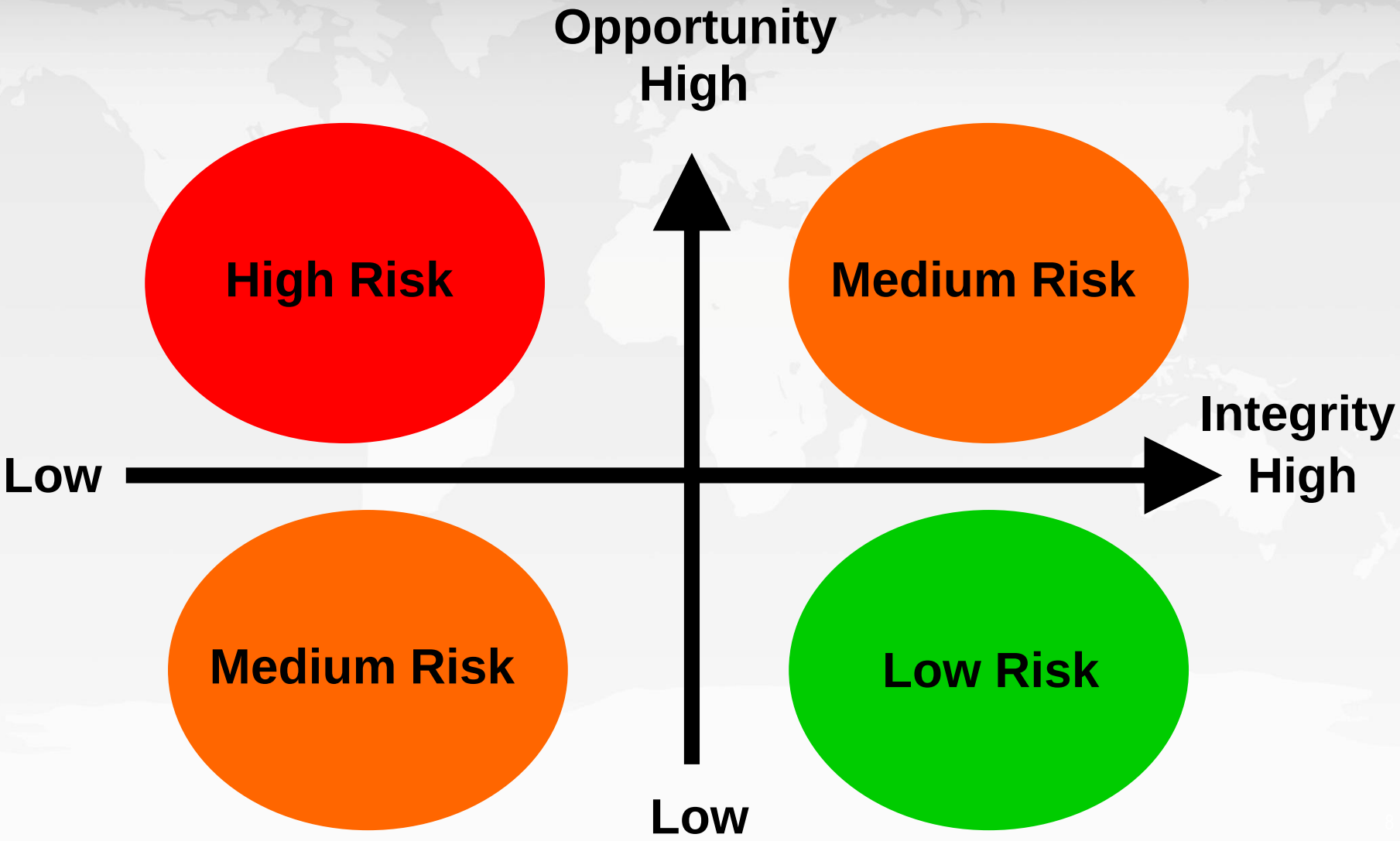


Controlling Opportunity

- Controls + monitoring = fraud deterrence
- Perception of detection
  - If an individual thinks that internal controls are in place that will detect any fraud they commit, they would not ***"cross the line of integrity"*** and commit fraud



Fraud Risk


Opportunity
High
High Risk
Medium Risk
Low
Integrity
High
Medium Risk
Low Risk
Low

Advantages of being a Fraudster

- Fraud detection reactive
- Criminals motivated by greed



- Fraudsters adept at exploiting systemic vulnerabilities
- Fraudsters understand how to use financial institutions to facilitate their illicit activity





Disadvantages of being a Fraudster

- Consequences

- Fraud will ultimately collapse under the weight of deception





Perspectives and Awareness













Perspectives

- Institutional
  - Board / executive management
  - General counsel / legal
  - Business / maximize profit
  - Compliance / limit risk
  - Internal audit / ensure process effectiveness
- Law enforcement
  - Prosecutors
  - Investigators
- Regulatory
  - Requirements
  - Expectations
- Fraudsters (facilitation / detection)
- Victims



Situational Awareness

- The importance of being aware of your surroundings
  - The same concept applies to physical security and AML compliance
- Best practices include:
  - Identify potential threats and dangerous situations
    - Is something out of the ordinary or unusual?
  - More mindset than skill
  - Recognize that threats exist
  - Take responsibility for your security
  - Trust your “gut” or intuition
- ***See something, say something***





Situational Awareness for Fraud

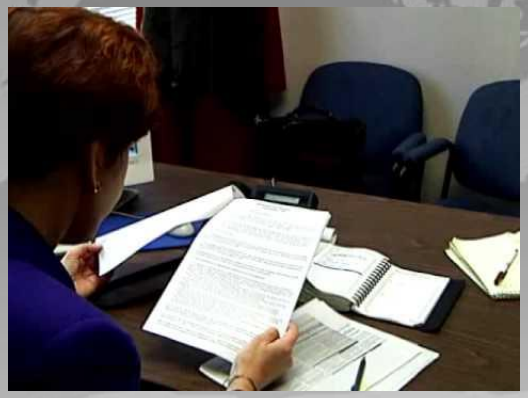
- The importance of being aware of your surroundings
  - Recognizing the weight of deceit
- Best practices include:
  - Identify potential fraud risks and scenarios
    - Is something out of the ordinary or unusual?
  - Understand the fraud crime problem and how fraudsters think
  - Recognize your constant vulnerability to fraud
  - Accept responsibility for your fraud vulnerability
  - Maintain objectivity
    - Trust / reasonableness / temptation
- ***See something, say something***
  - ***Reasonableness***





Can You Think Like a Fraudster?





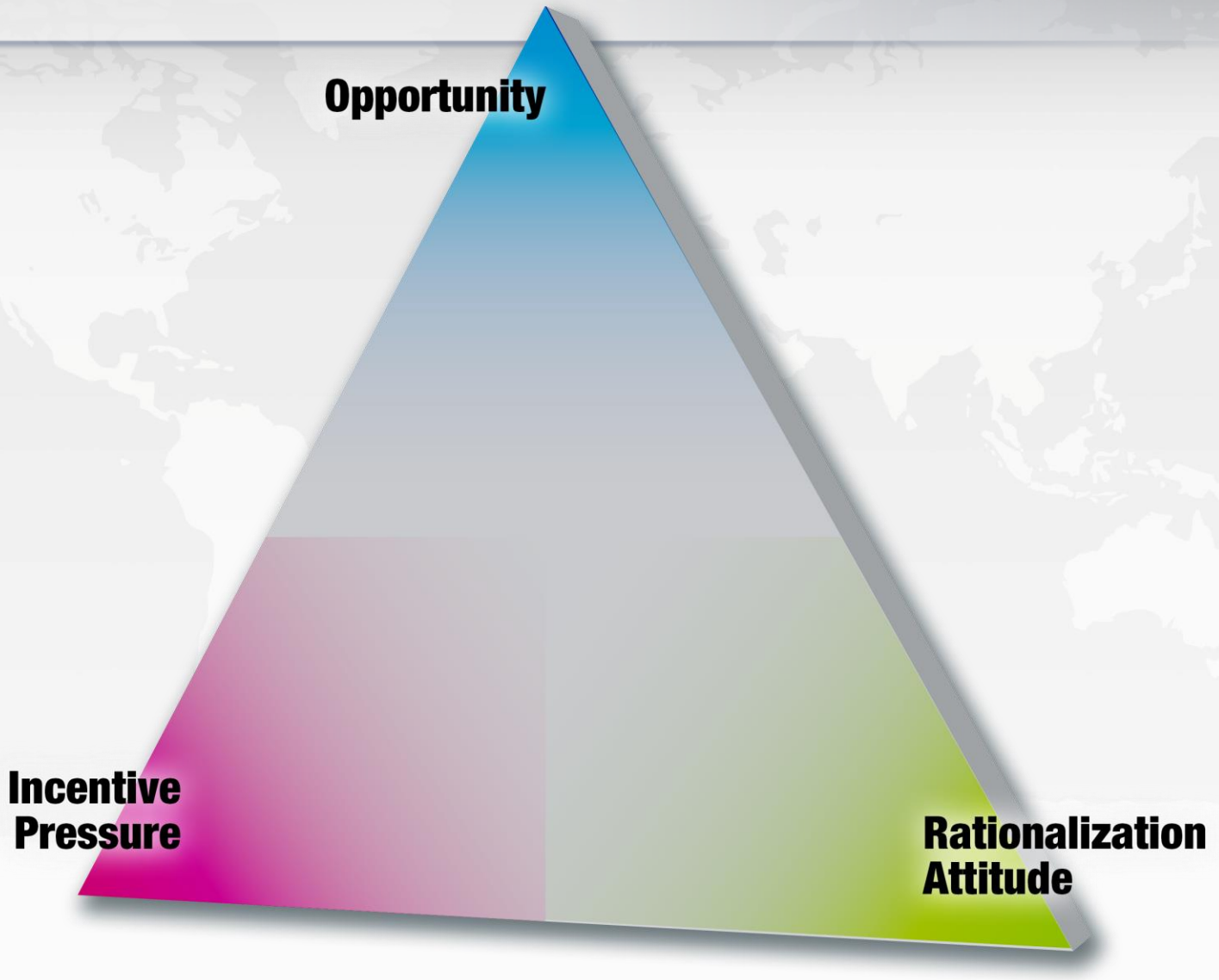
Fraudulent Mindset

- Can you think like a bad guy?
  - ***YES,*** we all can
  - The first step is to understand how five elements, or fraud traits, combine to influence an individual
    - Integrity
    - Opportunity
    - Incentive, motivation or pressure
    - Rationalization or attitude
    - Capability
  - The second step is to understand fraud on two levels
    - Generic
    - Specific

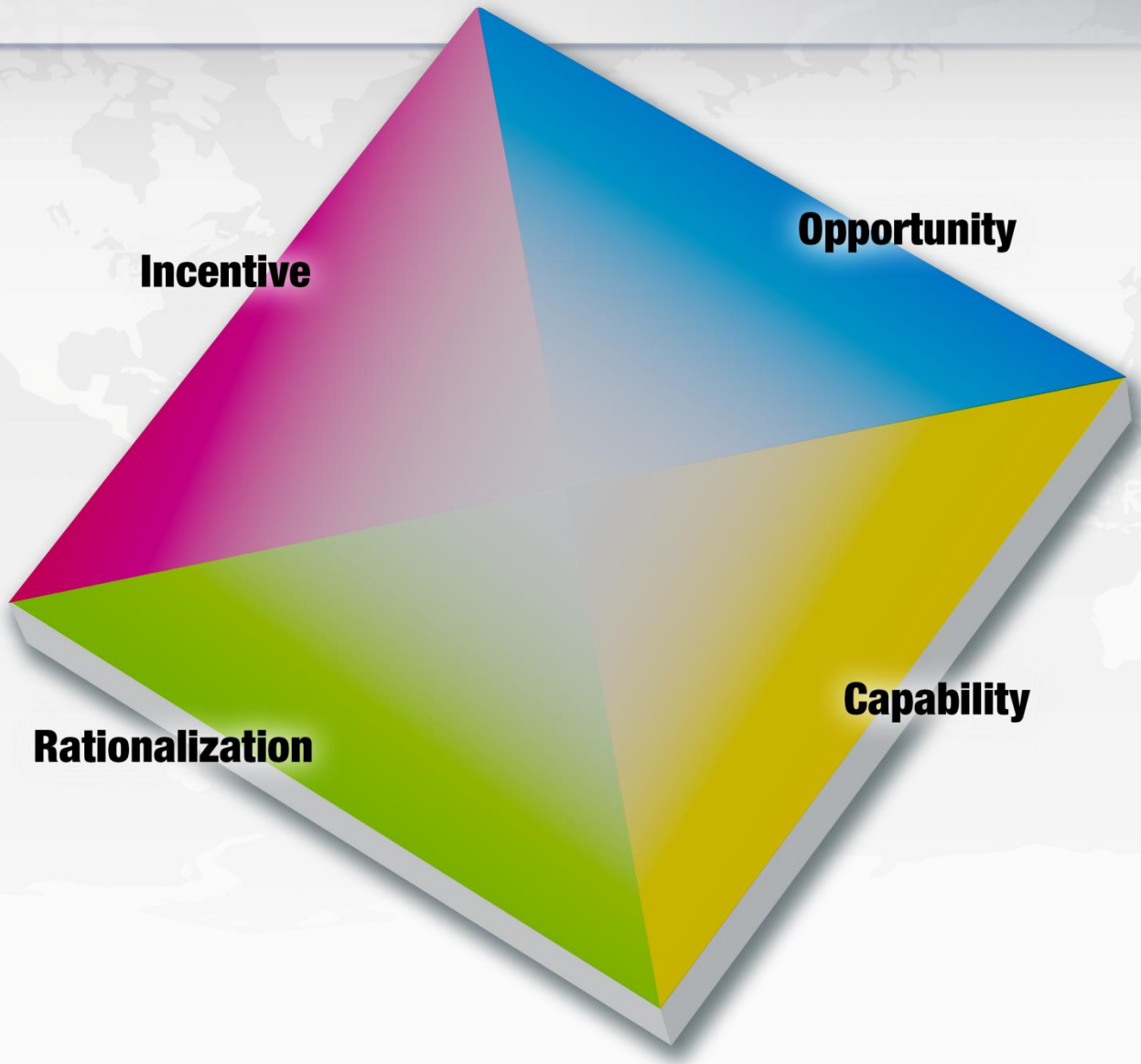




The Fraud Triangle

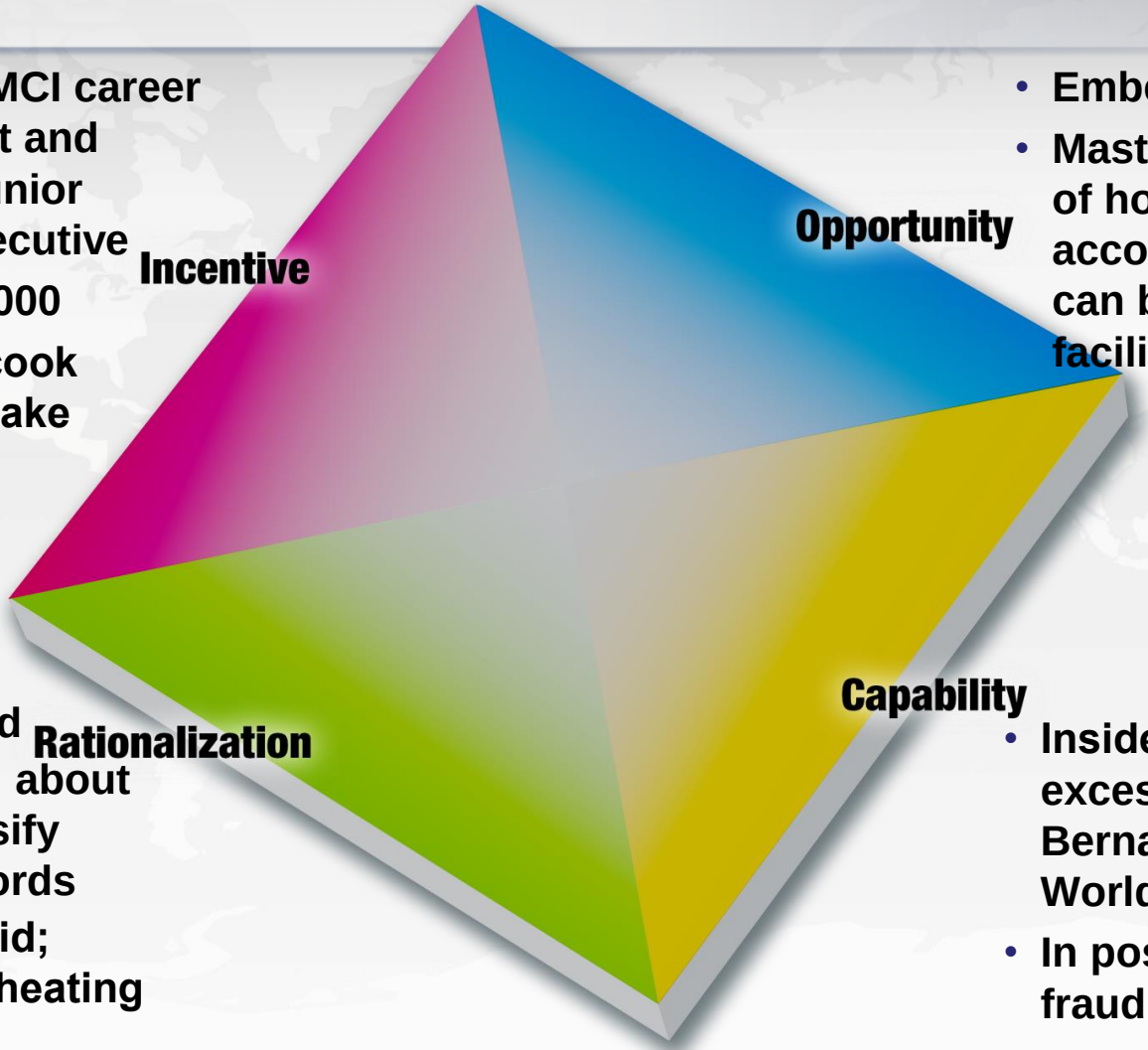


The Fraud Diamond



Stolen Without A Gun

- Started his MCI career as an honest and ambitious junior financial executive
- Earned $62,000
- Forced to “cook books” to make numbers



- Embezzled $6 million
- Masterful case study of how easily weak accounting controls can be exploited to facilitate fraud

- Became jaded and resentful about having to falsify financial records
- “I’m underpaid; everyone’s cheating

- Insider’s tale of greed, excess and fraud at Bernard Ebbers’ MCI Worldcom
- In position to execute fraud scheme

Walter Pavlo, Jr. found himself in situation where he succumbed to temptation of committing fraud

How Criminals Think About Money





- What does a criminal think about every day?
  - Not getting caught
  - Not having his assets confiscated
- Imagine:
  - All your money is illegal
  - And the government will seize it if they find it
    - How can you hide it?
    - How can you put it in the bank?
    - How can you transport / transfer it?
    - How can you support your family ?
    - How can you enjoy your wealth?

Mindset of a Fraudster

- Exploits opportunity to circumvent controls
- Rationalizes behavior
- Incentivized
- Hones skillsets (capability)
- Develops trust relationships
- Highly motivated
- Manipulative
- Effective communicator
- Self promoter
- Driven
- Focused
- Lacks empathy
- Greedy
- Arrogant
- Desires to avoid detection
- Has exit strategy
- Doesn't consider consequences



End Game

- Once you understand how to think like a bad guy, you better position yourself to identify fraud schemes
  - Breaking down spin and deception
- Good fraudsters have exit strategy
  - When scheme falters, exit strategy implemented
- Good guys need end game to prevent or disrupt exit strategy
- Two prominent end games
  - Private sector focus
  - Public sector focus





Understanding the Fraud Crime Problem









The Many Faces of Fraud

- ***Fraud is deception***
- Fraud knows no boundaries
- Fraud schemes range from simple to complex
- Evolution of fraud with the internet
  - Provides anonymity
- Fraudsters adept at exploiting systemic vulnerabilities
- Fraudsters understand how to use financial institutions to facilitate their illicit activity





Understand the Crime Problem

- Fraud should be assessed and understood from two perspectives
  - Generic
  - Specific



- Fraud schemes range from simple to complex
  - Common frauds
  - Major financial frauds
- The ability to be deceptive and avoid detection is a fraudster's primary key to success
- When investigators understand how fraudsters take advantage of generic and specific fraud schemes, they position themselves to more effectively and efficiently prepare and plan to compete against fraudsters

Steps to Enhance Understanding

- Training
  - Case studies / typologies
    - Break down fraud methodologies
    - Identify systemic vulnerabilities fraudsters exploit
- Investigative experience
- Investigative intuition
- Learn to think like a fraudster
  - Understand five elements of fraud
    - Integrity
    - Opportunity
    - Incentive or pressure
    - Rationalization or attitude
    - Capability



Areas of Criminal Exploitation

- Criminal Activity
  - ***Fraud***
  - Drug trafficking
  - Human smuggling / trafficking
  - Counterfeit goods / currency
  - Stolen goods
  - Violent crimes
  - Kidnapping
  - Extortion
  - Cyber fraud
  - Corruption
  - Terrorism
  - Other
  - ***Money laundering***

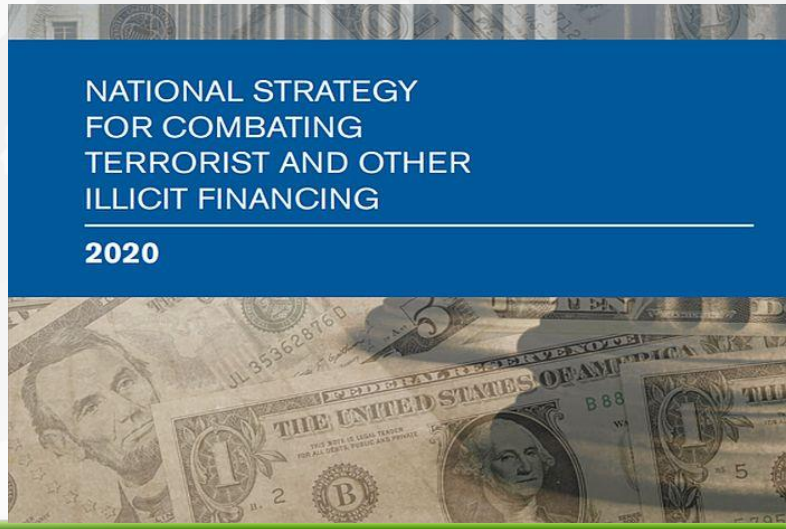




- Facilitation tools
  - Internet
  - Credit / debit cards
  - Stored value cards
  - NGOs / charities
  - Illegal money remitters
  - Informal value transfer systems
  - Shell companies
  - Off shore havens
  - Correspondent banking
  - Wire transfers
  - Electronic mechanisms
  - Other

2020 National Strategy for Combating Terrorist and Other Illicit Financing

- Most significant illicit financing threats facing the U.S.
  - Money laundering linked to:
    - Fraud (healthcare, tax refund, identity theft, bank, email compromise, elder, romance, and securities)
    - Cybercrimes and cyber-enabled financial crimes
    - Drug trafficking
    - Transnational organized crime
    - Human trafficking and smuggling
    - Corruption
  - Terrorist financing
  - WMD proliferation financing



2020 National Strategy for Combating Terrorist and Other Illicit Financing

- Recent trends in fraud
  - A wide variety of complex fraud schemes, including traditional types of fraud, persist and are increasingly internet-enabled
    - Business email compromise (BEC) schemes continue to top the list of cyber-enabled crime
    - Extortion letters, elder fraud, romance fraud, synthetic identity fraud, account takeovers, and mortgage and bank frauds are on the rise
    - Many fraud schemes, as well as drug and human trafficking, use a network of money mules who either unwittingly or knowingly deposit and layer funds on behalf of bad actors.
      - This allows criminals to distance themselves from victims and the source of funds
    - Criminals involved in healthcare fraud range from dishonest healthcare providers to organized crime groups
      - Migrating into perpetrating fraud schemes against Medicare and Medicaid

COVID-19 Fraud

- Over $3 trillion dollars in the U.S. and $15 trillion dollars globally in economic stimulus packages injected into the financial system
- Global pandemic to fraud pandemic (created a fraudsters playground)
- Same frauds, repurposed schemes
  - Five elements of fraud
    - Integrity, opportunity, incentive, rationalization, capability
    - Opportunity influences integrity and capability
  - COVID-19 fraud includes
    - SBA Payroll protection program (PPP) loan fraud
    - PPE price gouging, hording and counterfeit products
    - Scams to prevent, treat, diagnose, or cure COVID-19
    - Business email compromise
    - Investment, corporate and healthcare fraud
    - Internal / employee fraud



You Can't Fix Stupid

- ***Lack of capability + blinding greed = easy detection***
  - 2/05/2021, Oakland Woman Charged in Million Dollar Scheme to Defraud Pandemic Relief Program (PPP) For Struggling Businesses
    - Christina Burden submitted 11 loan applications attempting to obtain over $4.5 million in PPP forgivable loans through four different shell companies
    - Three loans funded for $1,143,191
    - Shell companies were recently formed
      - Did not appear to engage in any legitimate business nor have any employees
    - Loan applications contained false information and misleading statements, as well as doctored bank statements and fictitious tax forms



  - The PPP requires that its funds be used for legitimate business and payroll expenses
    - Bulk of loan money spent on personal indulgences including private jet travel, hotel stays, boat rentals, expensive automobiles, luxury goods purchased from Louis Vuitton, and Neiman Marcus, and specialty items purchased from Sunglass Hut and the San Francisco Giant Dugout Store

Fraud and Money Laundering

- Fraud and money laundering are interconnected
  - The proceeds of fraud and other predicate offenses need to be laundered
    - Gives appearance of legitimacy
    - Fraudsters must be able to move, store and spend the proceeds of their criminal activity in order to succeed
    - Greed factor is infectious







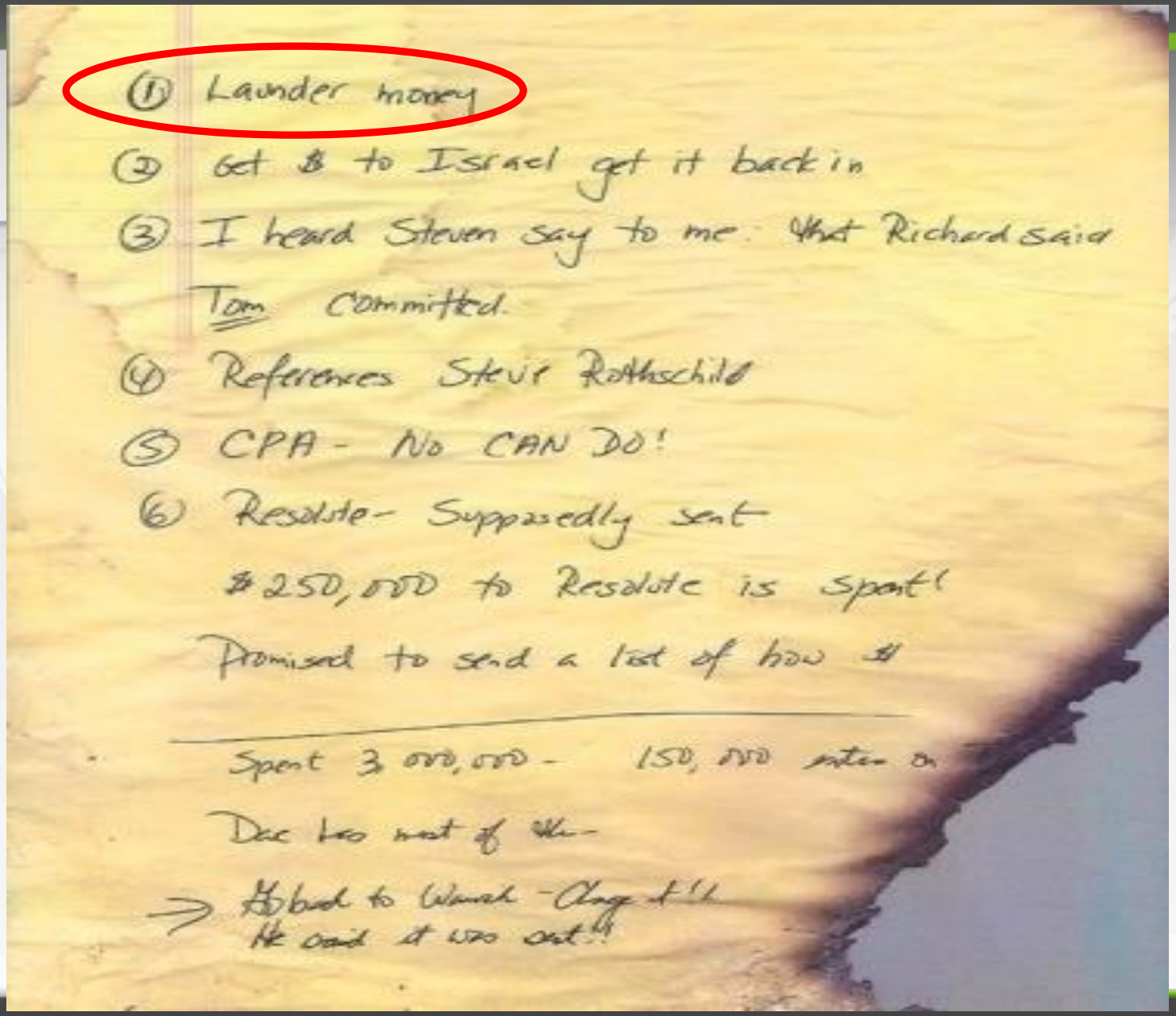
Frankel Case



- Martin Frankel
  - International con man
- Convicted and sentenced to 17 years in prison
- Embezzled $200 million from insurance companies in five states
  - Gained control of small insurance companies
  - Stole their assets
- Lived in two-mansion compound in wealthy Greenwich, Connecticut
  - Maintained lavish lifestyle



- Fled from U.S. leaving behind piles of smoldering documents
  - Authorities recovered to-do list
    - ***Item #1 – "launder money"***
- Arrested as fugitive in Germany


① Launder money
② Get $ to Israel get it back in
③ I heard Steven say to me: that Richard said
Tom committed.
④ References Stevie Rothschild
⑤ CPA - No CAN DO!
⑥ Resolute - Supposedly sent
$250,000 to Resolute is spent!
Promised to send a list of how $
Spent 3 000,000 - 150,000
Dec has most of the -
⇒ $ back to Wanek - Chase #1
He said it was out!

Multiple Consequences of Fraud

- Important to recognize and understand the multiple consequences of fraud
  - All actions or inaction have consequences
    - Victims
      - Financial loss / devastation
    - Financial institutions and other third parties
      - Facilitation tool v. detection mechanism
      - Financial risk
      - Reputations risk
      - Litigation risk
    - Fraudsters
      - Prosecution /restitution / asset forfeiture
      - Loss of family and loved ones

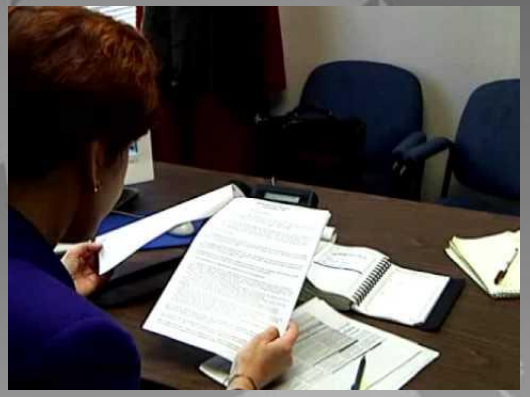




Comparing and Contrasting Fraud Schemes and Fraudsters







Areas of Exploitation

- Fraudulent Activity
  - Major financial frauds
  - Common fraud
- Associated criminal activity
  - Other criminal activity
  - ***Money laundering***
- Fraudsters and affiliations
  - Individuals
  - Groups of individuals
  - Organizations
    - Criminal and terrorist







Comparing and Contrasting Case Studies

- Rothstein Ponzi Scheme
  - Scott Rothstein
  - Fraud scheme
  - Back story
- Millones DTO
  - Angelo Millones
  - Drug trafficking organization
  - Back story
- Fat Leonard
  - Leonard Francis
  - Government fraud
  - Back story
- El Chapo
  - Joaquin Guzman
  - Sinaloa cartel leader
  - Back story
- 1MDB
  - Malaysian sovereign wealth fund
  - Foreign Corrupt Practices Act
  - Back story
- FIFA Scandal
  - International soccer executives
  - Corruption
  - Back story

- ***What are the commonalities shared by these different cases?***

Commonalities of Six Different Crime Problem Case Studies

- Need for steady flow of funds to sustain operations or activities
- Exploitation of systemic vulnerabilities (control weaknesses)
- Money laundering
- Fraud
- Corruption
- Avoiding transparency
  - Shell companies / front companies / nominees
- Correspondent banking
- Funds flow through U.S. banking system (U.S. jurisdiction)

Case Study Touch Points with Financial Integrity

- Predicate offenses
- Money laundering
- Consequences
- Financial system facilitation
- Correspondent banking
- Private banking
- Politically exposed persons
- TBML / BMPE
- Funnel accounts
- Beneficial ownership
- Informal value transfer systems (Hawala)
- FATF & International AML / CTF Standards
- USA PATRIOT Act
- Asset forfeiture
- Sanctions
- Risk factors / assessment
- Culture of compliance
- Customer due diligence
- Suspicious activity reporting
- Investigations
- Legal process
- Information sharing
- Legal Counsel
- Financial intelligence units
- Mutual legal assistance
- Others

Deconstructing a Fraudster







Deterring a Potential Fraudster

- Build perception of detection (minimize opportunity)
  - Strong internal controls
  - Consistent monitoring and assessment
  - In business environment, promote no tolerance policy for fraud
    - Tone at the top
  - Assess / test trust environment
  - Be vigilant



Deconstructing a Fraudster

- Starts with planning
- Exploit vulnerabilities of fraudster
  - Greed and arrogance can cloud focus
  - Lack of empathy
  - Lack of consideration for consequences
  - Communications (let fraudster talk)
    - Weight of fraud will collapse with ongoing spin and deception
  - Disrupt / prevent exit strategy
- Follow the money
- Persistence



Everyman Fraud



- Most common form of everyman fraud is embezzlement
- ***Quiet and costly epidemic***
- Generally, at time of onboarding the customer has not crossed the line of integrity and is honest
- At some point, after account opening, the customer crosses the line of integrity and engages in fraud or other criminality
  - Is your due diligence process up to the task of identifying suspicious activity
- Develop typologies through real case studies
  - Identify trends and patterns of activity by reviewing court filings and reviewing the statement of facts
  - FBI website a good source for case studies

Case Studies – Embezzlements

- Consequences of memorable embezzlement cases
  - Brokerage Firm / Purchasing Manager
    - Lifestyle change / sudden unexplained affluence
    - ***No separation of responsibilities***
    - Shell companies / falsified invoices
  - Bookkeeping Service / Senior Bookkeeper
    - Lifestyle change / boyfriend
    - ***No separation of responsibilities***
    - Falsification of receivable / payable ledgers / stolen checks
  - Washington, D.C. Law Firm / Partner
    - Gambling addiction
    - ***No separation of responsibilities***
    - Theft of checks / sudden disappearance



Recent FBI / DOJ Press Releases (+ 1)

- 7/16/2021, Chesterland Man Charged with COVID-19 Relief Fraud
- 7/15/2021, Former CEO And CFO Of Public Telecommunications Company Charged In Manhattan Federal Court With Scheme To Defraud Investors
- 7/15/2021, Former Unlicensed Investment Advisor Behind Ponzi Scheme Sentenced to Nine Years for Defrauding Clients out of More than $2 Million
- 7/15/2021, Columbus man who led online car scam sentenced to more than 14 years in prison
- 7/15/2021, Texas Man Pleads Guilty to $1.5 Million Investment Fraud Scheme
- ***The +1 (Debra Ann Jones)***
  - ***8/08/2018, Woman allegedly embezzles $225K to pay back previous $162K embezzlement***

Commonalities Among Fraudsters Charged in Recent FBI Investigations

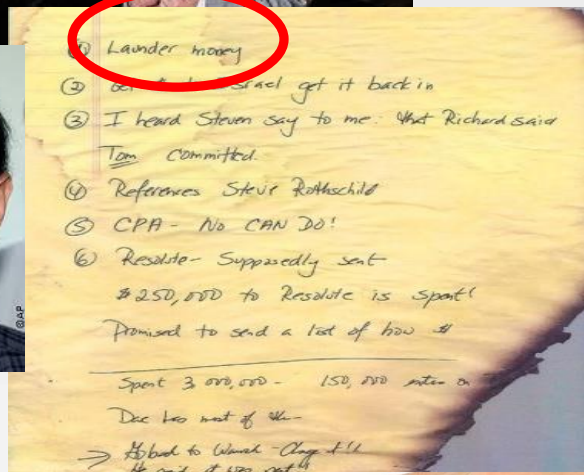
- Abuse of trust
- Exploitation of internal controls
- Would adequate controls have deterred the frauds?
  - Integrity / opportunity questions
- Skillsets / capability to commit the frauds
- Consequences
  - Did the fraudsters think about the consequences of being arrested and prosecuted?
  - Had the fraudsters understood the consequences they incurred, would they have been deterred?

Fraud Hall of Shame Inductees

- Madoff and the mini-Madoffs award
  - Scott Rothstein
    - Exit strategy / extradition research
- Corporate fraud award
  - Martin Frankel
    - To do list “launder money”
- Everyman fraud (embezzlement) award
  - Debra Ann Jones
    - Embezzled to pay back prior embezzlement
- COVID-19 fraud award
  - Christina Burden
    - 11 loan applications written in greed



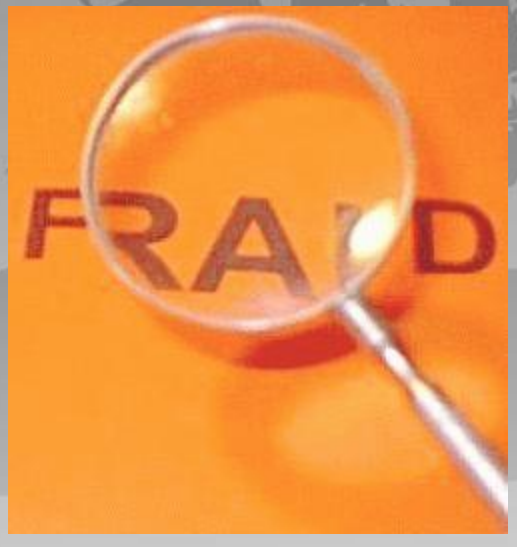






Investigating Fraud





Investigative Gamesmanship

- ***"I might be dumb but I'm not stupid"***
  - Dennis M. Lormel
- Many criminals engaged in fraud, financial crimes and other predicate offenses believe they are the smartest person in the room
  - Greed and arrogance
- Winning the game
  - Listening is an investigative attribute
  - Maintaining professional skepticism
    - Reasonableness of situation
    - Is there more to the case?







Team Sports







- Baseball, football, basketball, hockey, soccer, lacrosse
  - Different sports but objective the same
- One interesting commonality
  - Having most talented team does not always mean you win
  - Having best prepared team usually more advantageous
  - When game is on the line, preparation is likely to trump talent
    - Focus and discipline
    - Follow game plan and exploit adversary's vulnerabilities



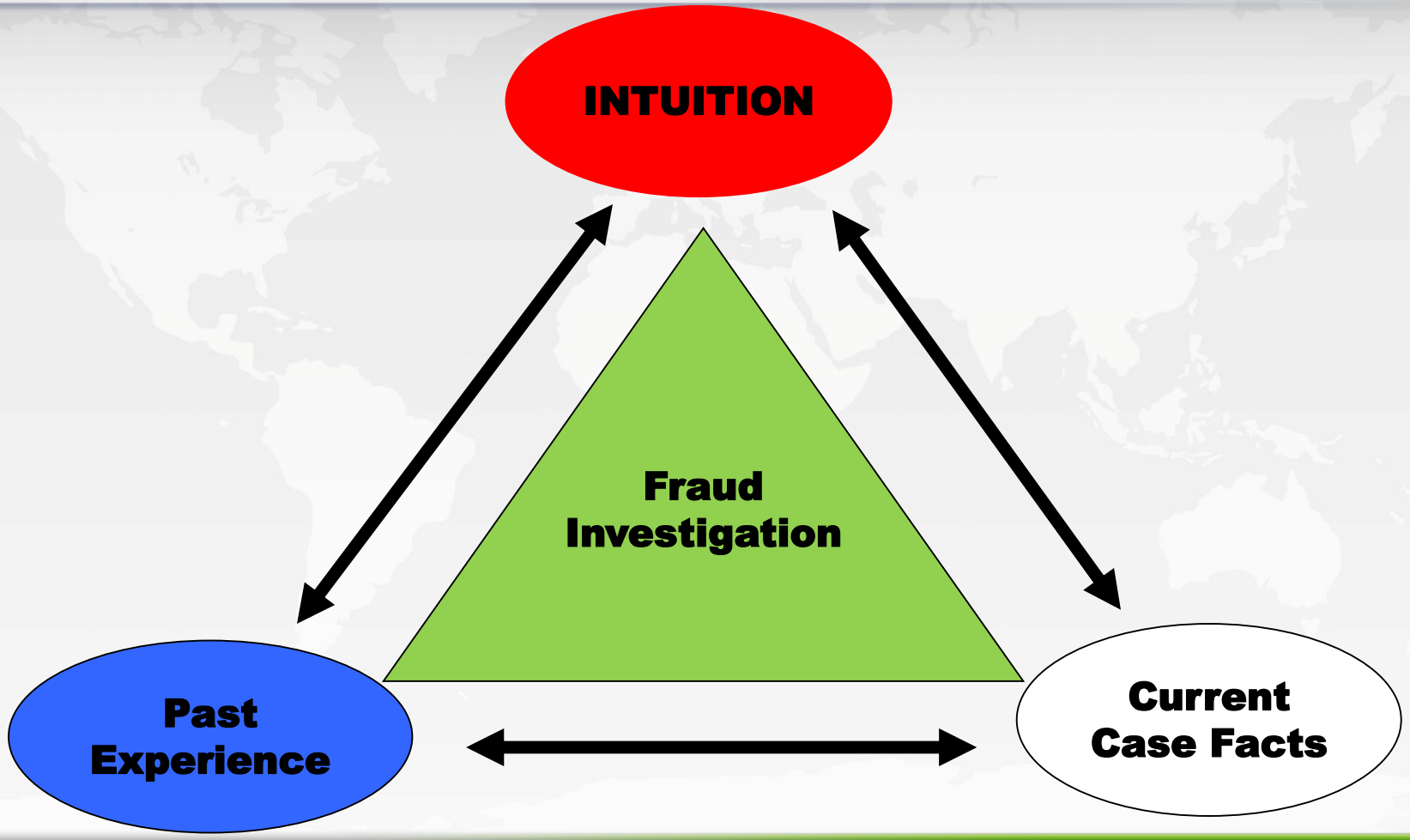




Fraud as Sporting Event

- Liken fraud to a sporting event
  - Fraudster v. investigator
    - Player who usually comes out on top is player better prepared to perform
- Fraudsters tend to be more talented
  - Proactive
  - Motivated by greed and arrogance
- When investigators take time to prepare and plan
  - More likely to exploit vulnerabilities of fraudsters
    - Greed and arrogance
    - Finance and communications
- Investigators must understand
  - Crime problem
  - How fraudsters operate (business model)
  - Game plan to exploit vulnerabilities of bad guys

Intuitive Investigation
The Triangle for Success



Investigating a Good Fraudster

- Upper hand
- Spin / deception
- Intimidation
- Persistence
- Analysis
  - Reasonableness
- Exit strategy



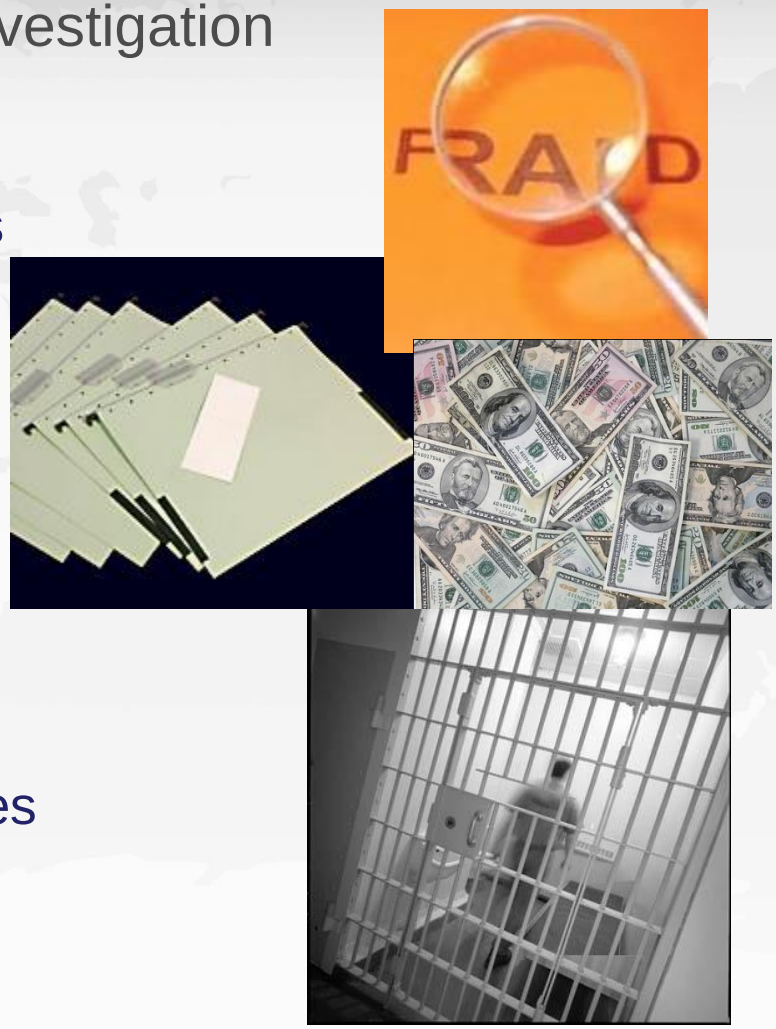






Ingredients for Successful Investigations

- Timely, consistent and thorough investigation
- The right investigative team
  - Individual experience and skill sets
  - Adequacy of resources
- ***Preparation and planning***
  - Maintain focus
  - Investigation tools/interviewing
- Following rules and regulations
  - Understand policies and procedures
- Confidentiality and objectivity
- Having an end game



Takeaways and Conclusion





Takeaways



- Trust
  - Foundation for meaningful relationships
  - A fraudster's best friend
- Opportunity
  - Perception of detection a significant fraud deterrent
  - Strong internal controls will limit opportunity of fraud
- Multiple consequences of fraud
  - Victims
  - Financial institutions and / or third parties
  - Fraudsters



Conclusion

- Understand fraud crime problem
  - Nexus between fraud and money laundering
- Understand mindset of fraudster
- Be situationally aware of fraud risk
  - Trust your instincts
- Contemplate end games and exit strategies
  - Understand perspectives
- Be vigilant
- Be safe
- ***Exploit vulnerabilities of bad guys***



Dennis M. Lormel



President & CEO
DML Associates, LLC

19309 Winmeade Drive
Lansdowne, VA 20176

571-333-0300
dlormel@dmlassociatesllc.com
www.dmlassociatesllc.com