



Reducing Vulnerability to Crime From Those You Trust: Strategies for the Wealthy

ACE Private Risk ServicesSM
White Paper

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Executive Summary

High net worth individuals confront exceptional risk challenges because of their relative wealth, lifestyle and public profile. Published research and anecdotal evidence indicate that the affluent are more vulnerable to a range of crimes perpetrated by financial advisers, contractors and domestic employees than average income earners. Such crimes include so-called Ponzi schemes, identity fraud, embezzlement, property theft, kidnapping and ransom, and child molestation, among others. These risks can be reduced through specialized background screening services, conducted by a security firm that specializes in vetting individuals. Nevertheless, no amount of background screening can eliminate all potential loss exposures. While standard insurance policies absorb some of these risks, high net worth individuals are advised to secure broader coverage with higher limits of financial protection. Such specialized insurance programs include the ACE Platinum Portfolio.SM

Loss of Trust

At a time when the global economic recession has elevated the public's anxiety, reading about the latest financial fraud affecting the life savings of so many people adds to the layers of insecurity. Ponzi schemes—a bogus investment operation in which investors are paid returns drawn from the monies raised from subsequent investors, rather than from actual earned profits—have been around for more than 100 years, but are now firmly solidified in the popular lexicon, thanks to recent significant and highly-publicized investment industry misappropriations. The perpetrators of these fraudulent schemes built fortunes based on their clients' unstinting trust in their investing track record and reputation. Few clients questioned the underpinnings of their all-too-consistent double-digit returns—until it was too late. While most financial advisers are men and women of high skill, integrity and unimpeachable character, these recent scams and several others give pause for consideration, especially among individuals of high net worth, whose status invites exposure to risks that are often unfamiliar to average income earners. Con artists solicit the affluent as clients because their accumulated or inherited wealth makes them lucrative targets.

Financial advisers aren't the only potential perpetrators of fraud and other crimes against high net worth individuals. Domestic employees, and even private contractors, also know where the money is. In fact, many affluent people have been the victims of unscrupulous contractors who steal their identities, abandon jobs midstream, perform shoddy work, burglarize homes and commit terrifying crimes against children, including kidnap for ransom scenarios. Scheming domestic employees have also pursued kidnap plots and stolen identities, committed property theft and embezzlement, and filed fraudulent lawsuits ripping at the seams of the defendant's reputation. The risks for high net worth individuals are real, costly and emotionally scarring. ACE Private Risk Services understands these unique risks, and has tailored its highest quality products and services to protect the most valued assets, family members and wealth of high net worth clients.

Financial Advisers

The term "Financial Adviser" is deceptively broad, encompassing an array of financial professionals who provide investment and other services. This group includes Certified Financial Planners, Chartered Financial Consultants, Portfolio Managers, Personal Financial Specialists, Money Managers and Investment Consultants, among others. Most people rely on the expertise, knowledge and trustworthiness of their financial advisers, yet they often know very little—if anything—about their background, skill or professional track record. Of the estimated quarter-million people calling themselves financial planners, only about 56,500 have earned the CFP (Certified Financial Planner) designation. Fewer still have earned the ChFC (Chartered Financial Consultant) designation.¹

Even if a financial planner has earned these and other professional designations, holding such designations does not preclude the possibility that the planner will commit fraud or offer grossly negligent investment advice. While most financial advisers are men and women of unimpeachable character and integrity, as recent events have shown, the few rotten apples can cause financial chaos and ruin. Numbers tell the tale, and in the case of abusive practices by financial advisers, the statistics are sobering:

- More than 25,000 complaints were filed by investors against their financial advisers from 2004 through 2008, resulting in more than 6,000 disciplinary actions by regulators, according to FINRA (Financial Industry Regulatory Authority).
- Complaints against financial planning consultants have risen by 50.4 percent from 2004 to 2008, the Council of Better Business Bureaus reported.
- A review of customer complaints and state enforcement actions in 20 states by the North American Securities Administrators Association and the Council of Better Business Bureaus uncovered more than \$90 million in fraud and abuse in the last three years by financial planners employing phony tax shelters, real estate partnerships, money market accounts and Ponzi schemes.ⁱⁱ
- Enforcement statistics compiled by the North American Securities Administrators Association involving NASAA members in the last three years indicates 8,365 enforcement actions, in which \$1.8 billion was ordered returned to investors.
- The median loss of frauds perpetrated against businesses and consumers in 2008 was \$175,000, while more than one-quarter of occupational frauds involved losses in excess of \$1 million, according to the Association of Certified Fraud Examiners.ⁱⁱⁱ

Corrupt financial advisers are skilled con artists who take great pains in targeting their marks. “They find ways, often ingenious ones, to develop a relationship with someone of means,” says Michael Guidry, founder, Chairman and CEO of The Guidry Group, an international security consulting firm that handles security problems for many of the world’s largest organizations. “Once they gain your trust, their cleverness extends to embezzlement and other financially motivated crimes. We had a wealthy client recently who was defrauded by a manager who had access to personal credit card and bank account information. He told the bank that the family wanted to enlarge their swimming pool and needed a loan for \$190,000. The bank cut the check without blinking, even though no such expansion was ever planned. Had the family conducted a background check on the manager before hiring him, they would have learned he had a criminal record for similar offenses in the past.”

Unfortunately, this example is not the exception. While multi-billion dollar swindles garner high profile media attention, local newspapers offer reports of many smaller frauds, such as:

- An Orange County, Calif. financial planner accused of stealing \$2.8 million from several elderly people
- A Quincy, Massachusetts financial adviser charged with stealing more than \$2 million from clients
- A Nashville financial planning firm accused by the Securities and Exchange Commission of defrauding clients out of more than \$6.5 million
- A New Orleans financial adviser charged with embezzling more than \$3 million from clients
- A New Jersey financial adviser indicted for stealing more than \$160 million from more than 370 investors
- And a Miami-based financial adviser convicted in March for stealing \$132 million from 577 people in an elaborate Ponzi scheme

As a recent *Forbes* magazine cover story on investment fraud stated, “There are all manner of sharpies you still need to be wary of.”^{iv}

Many high net worth individuals and the public at large have faith that financial regulators are equipped to halt financial frauds and related crimes such as unauthorized trading and stock churning (excessive buying and selling of securities), yet the unsettling truth is that it can take years to rein in untrustworthy advisers for their misdeeds — long after the damage can be undone.

Contractors

The wealthy also are targets of contractors, sub-contractors and other professions such as landscapers where employees work in or around the home and are frequently unsupervised. While most contractors are reliable and professional, tales are legion of others abandoning projects before completion (often with their fees paid in advance) or performing shoddy work. Since contractors and sub-contractors are on premises, they have potential access to personal records; may become aware of valuable artworks, jewelry worn by family members and other expensive objects within the home; receive temporary alarm codes or can assess the security system and disengage it; and are able to gain insight into a family's daily activities, such as the comings and goings of children. Consequently, the risk of identity theft, extortion, burglary and the kidnap and ransom or molestation of children is heightened.

Many homeowners fail to ask questions about the background of contractors and other hired professionals, relying largely on their references, which can be easily concocted or distorted. "More than 90 percent of Americans never run a background check on the individuals they hire, including people who will spend significant time in their homes, much of it unsupervised," Mr. Guidry says. "Few even check references. They're trusting to a fault."

While published research is slim on crimes perpetrated by contractors and related professions, two high profile cases illustrate why this should be a concern: A handyman who had worked on the roof of the home of a 14-year-old girl kidnapped her several months later and held her captive for many months; and a painting contractor in Montana planned to kidnap the young son of a famous comedian and talk show host for a \$5 million ransom, a plot later thwarted by the police. The foiled kidnapper was a convicted felon whose background was either ignored or undiscovered.

Numerous examples also abound of contractor fraud committed against homeowners whose premises were damaged by Hurricane Katrina in 2005. They include an elderly woman in Florida who received \$36,000 in insurance money that was stolen by the contractor hired to repair her house, and the scamming of seven homeowners in Houston by an unlicensed contractor who pleaded guilty in June to defrauding them out of more than \$140,000. In these cases and others, the homeowners did not check the background of the contractor, relying instead on references provided by the firm.

Domestic Employees

Domestic employees hired as nannies, butlers, chefs, housekeepers, gardeners, home health care workers, tutors and chauffeurs also present risk to high net worth individuals. While statistics are scant on the frequency of crimes committed by domestic employees—families often want to keep the information private—their gravity is sobering. They include property and identity theft, child abuse and kidnapping, embezzlement, extortion, and fraudulent sexual harassment, defamation, workers compensation and other lawsuits.

Domestic employees often have unfettered access to personal records that can be used to create fictitious credit cards and bank accounts, as well as knowledge of family activities and even the security code to the alarm system, given their typically close relationships with employers who trust them implicitly. Identity theft is a particular threat, and considered the fastest growing financial crime in the United States. According to the Federal Trade Commission (FTC), identity theft affected 10 million Americans in 2007, who collectively reported more than \$437 million in losses. Identity theft is the most common complaint the FTC reports, accounting for more than 40 percent of all complaints.

Another survey, by Javelin Strategy & Research Inc., indicates that crimes involving identity theft to obtain new credit cards alone were up seven percent from autumn 2007 to autumn 2008. “Victims spend an average of 60 hours recovering from the crime, stretched out over six months,” says Garrett Steen, Founder and President of RelyData, an identity protection service that helps people limit the damage caused by the fraudulent use of their identities.

Many cases of identity theft involve an acquaintance, as opposed to someone fishing around in the trash for personal information. According to the Identity Theft Resource Center, 18.4 percent of all reported identity thefts in the first six months of 2009 involved insiders, compared to 15 percent in 2008 and six percent in 2007. “Statistics indicate that the individuals committing identity theft typically know the person whose identity they have stolen,” says Mr. Steen. “One in ten people will experience an identity theft in the course of a year, typically in the form of unauthorized charges on their credit cards.”

The opening of a new credit card account by the fraudster causes the most financial pain, he adds. “Often, the new card will carry a low limit, which the perpetrator pays off monthly until the credit limit rises,” Mr. Steen says. “That’s when the person whose identity was stolen receives notice of tens of thousands of dollars in unpaid invoices.” He notes that the impact on the individual’s credit score is substantial and difficult to correct quickly.

Falling Through the Cracks

In-depth background screening is proven to reduce the risk associated with unscrupulous financial advisers, contractors and domestic employees. Unfortunately, many high net worth individuals rely solely on references and resumes as predictors of expertise, competency and honesty. This practice creates enormous risk, as the following studies illustrate:

- An astonishing 41 percent of employment, education and credential reference checks in the 2007 ADP Annual Screening Index reveal a difference of information between what the applicant provided and what the source reported cites.^v
- Two-thirds of all job applicants say they have “stretched the truth” about their experience, according to a study by bankrate.com.^{vi}
- One in four international credentials is fraudulent, according to the National Association of Professional Background Screeners.

The average cost to employers from such “bad hires” is significant—roughly 2.5 times the employee’s salary, according to a survey by Right Management, with 42 percent stating that this cost was at least three times the employee’s salary.^{vii} Had the employers in these instances conducted more comprehensive background screening, a significant return on the investment would have been realized—from \$5 to \$16 per dollar invested, according to the U.S. Small Business Administration. Background screening may not eliminate the risk of hiring an unscrupulous financial adviser, contractor or domestic employee, but foregoing such screening may produce severe consequences. Mr. Guidry points to the experience of a recent client. “We represented a well-known family with small children who had decided that during summer break they would hire a tutor to come to their country home and give lessons to the children,” he says. “The mother had a gut feeling that something ‘wasn’t right’ about the teacher, and she engaged us to perform a preliminary background check. We immediately learned that he was registered in several states as a known child predator.”

Preventing Loss with Background Screening

The background screening of financial advisers, contractors and domestic employees by a specialized security consulting firm such as The Guidry Group will significantly reduce the risk of hiring or retaining someone of criminal intent, thus minimizing potential financial and legal exposures. In a substantive background check, the stated qualifications and credentials provided by the job or service applicant are verified by a licensed security consulting firm leveraging private databases containing public records, thus separating verifiably competent professionals from inferior and possibly criminal ones.

Contrary to popular belief, there is no national database available to private employers to check an employment candidate's criminal records or false credentials. Still, high net worth individuals on their own can take steps to reduce the risk of hiring bad actors.

Preliminary Approaches

There are significant laws and regulations governing hiring practices and candidate privacy that may create liability for the individual undertaking more substantive background screening of job or service applicants. Nevertheless, some modest upfront work can whittle down the number of candidates. For example, the Web site of the Financial Industry Regulatory Agency (Finra.org) offers access to regulatory records on stockbrokers, investment advisers and their firms. The records state whether or not the agency has received any complaints, accusations of fraud or evidence of stock churning by financial advisers. Other Web sites, such as cfp.net and fpanet.org, provide information on a financial planner's education, work history and, if applicable, failure to comply with continuing education requirements. Relying on the recommendations of friends, family or fellow country club members about the expertise or reputation of a financial planner or investment adviser is ill advised, as is blithely believing in the promise of consistent double-digit returns.

In hiring domestic employees, good risk management dictates that emotions should never dissuade effective due diligence. "Checking references is a must," says Mr. Guidry. "We've also found it prudent to make a surprise visit to a potential employee's home, which can tell you a lot about a person." Another caveat: "The last thing you want to do is assume that the job recruiter has performed the screening—some do, many don't," he adds.

Similar regard should be given contractors. Smart tips include:

- Check for the name of the contractor in the Yellow Pages and on the Internet; no presence may indicate a fly-by-night operation.
- Do not hire a contractor if the company accepts only cash, insists the job be fully paid upfront or requests that the homeowner obtain the required permits, as this may be indicative of a substandard organization.
- Telephone the Better Business Bureau to determine whether or not a complaint has been lodged in the past against a contractor for job abandonment or inferior work.

Professional Background Checks

Once such preliminary background checking has concluded and candidates are pared down to two or three prospects, more thorough investigations by a professional security consulting firm are advised. In general, background screening companies look for red flags indicating potential problems on resumes and applications such as false or omitted information.

The Guidry Group, for instance, checks all employment references, confirming the places and dates of employment and examining the employee's performance, promptness and eligibility for rehire. Education and professional qualifications are similarly vetted, as is the person's credit history and driving record. A wide range of personal data is verified, such as date of birth, previous residences, Social Security number, professional certifications and civil and criminal records.

The firm also examines bankruptcy filings, Better Business Bureau complaints and sex offender registries. In addition to accessing public records from multiple private databases, The Guidry Group conducts deep Internet searches using a variety of public and proprietary search technologies. Most searches can go back at least seven years depending upon the jurisdictional system from which the prospective employee hails.

The Guidry Group has the knowledge and expertise to analyze extensive search data and will ensure that proper interviewing techniques are conducted, thus reducing potential employer liability from privacy and hiring regulations. The firm also will verify the credentials of individuals whose resumes contain references to international employment, and it will counsel clients on the most appropriate hires based on its assessment of security risks.

Background screening must not be a once-and-done exercise. "We counsel our clients to consider routine background checks every two years or more if security 'indicators' present themselves, since a person's emotional, psychological and financial state is never static," Mr. Guidry says.

He cites the case of a nanny who was employed by a wealthy family—a client—to care for their three small children. "The nanny had been with the family since she was 18 years old; she was now 25 and had become the equivalent of a close extended family member," Mr. Guidry says. "She was entrusted with the majority of their children's care, overseeing their daily activities and regularly driving them to their various events. Unbeknownst to the family, during her employ she had undergone an abortion and broken up with her longtime boyfriend, and had turned to drugs and alcohol for consolation. She requested at short notice a week's vacation. It was later determined that her 'vacation' was time spent in jail for driving under the influence of alcohol. She also had been driving the children for quite some time with a suspended driver's license. Periodic background checks would have unearthed this behavior."

Transferring Risk

The most sophisticated and thorough background screening does not eliminate the risk of loss—hence the need for insurance to absorb the exposures. Yet, standard insurance policies such as homeowners and automobile insurance provide only a limited measure of financial relief, probably not enough to absorb the breadth of risks and their potential financial severity. Fortunately, ACE Private Risk Services had developed specialized insurance policies and endorsements to standard policies that address much of this void.

The Portfolio Approach

Only a handful of insurance companies have the ability to underwrite and absorb the risks presented to high net worth individuals by crooked financial advisers, contractors and domestic employees. These insurers typically package together a range of different insurance policies and endorsements to the policies to offer comprehensive protection. ACE Private Risk Services, on the other hand, offers these coverages within a unique portfolio. Five separate insurance policies—homeowners, automobile, valuable collections, watercraft and umbrella—are combined in the ACE Platinum Portfolio. Imbedded in each of these "modules" are optional coverage features, such as an endorsement for Employment Practices Liability Insurance (EPLI) within the umbrella policy and Family Security Coverage within the homeowners policy.

The objective of the novel portfolio approach is to cover all the bases. A standard personal umbrella liability insurance policy, for example, does not transfer the risk of a fraudulent sexual harassment or job termination claim filed by an unscrupulous domestic employee. Purchasing the optional EPLI endorsement as part of the ACE Platinum Portfolio covers this loss exposure. Similarly, a standard homeowners insurance policy does not address expenses such as attorney fees related to the kidnapping of a child by a contractor or a domestic employee or the costs of resolving identity fraud perpetrated by a financial adviser, such as lost income resulting from time taken off from work to attend to the matter.

The ACE Platinum Portfolio for high net worth individuals also offers higher coverage limits than standard policies. The umbrella policy offers up to \$100 million in excess liability coverage for bodily injury, personal injury and property damage, in addition to paying for all legal defense costs and up to \$250,000 in public relations fees to protect a reputation under assault. The umbrella policy further offers up to \$250,000 to absorb costs related to the insured hiring private counsel to “shadow” ACE’s legal team.

The other modules within the portfolio offer additional risk protection, although none will replace funds stolen through Ponzi schemes and other investment fraud. The homeowner module covers up to \$100,000 in expenses incurred because of an identity fraud; up to \$100,000 to pay the cost of private investigators, attorneys, travel and lost income involved in a kidnap/ransom crime; and up to \$10,000 to cover the theft or unauthorized use of credit cards, the forgery of checks or negotiable instruments or the unauthorized use of computer equipment to conduct personal checking transactions with a bank.

The specialized program also has an optional endorsement that absorbs expenses related to incidents involving a home invasion, child abduction, carjacking, stalking and other criminal acts, including the expense of a reward for information on the crime. Another optional endorsement provides Not-For-Profit Directors and Officers Liability Insurance. Many wealthy individuals serve as unpaid board members of charitable organizations, and if these organizations are sued—perhaps by a contractor or staff—the board members may be personally liable. Although charities often have insurance for such occasions, the limits in the policy may not be sufficient. Domestic Workers Compensation Insurance also can be included within the portfolio as a separate policy.

Background Screening and Identity Restoration

ACE Private Risk Services offers more than just unique, customized risk transfer solutions. This product expertise complements its superior financial strength, consistent underwriting and global reach. The company provides the highest quality family asset protection to those with more to protect, tailored to their unique needs and situations. This promise is considered its highest priority.

Similarly, the ACE Platinum Portfolio is more than just a comprehensive risk transfer product. Policyholders can request basic background screening of financial advisers, contractors and domestic staff, conducted by The Guidry Group. This service is provided on a complimentary or reduced-fee basis, depending on the client’s annual policy premium amount. More in-depth background screening also can be performed for a nominal fee. To protect policyholders from the damage inflicted by the fraudulent use of their identities, the portfolio further offers the services of RelyData for free. RelyData’s rapid and effective identity restoration services help reduce the time to right the wrongs from 60 hours over six months to two hours over six weeks. The free service saves the insured the average \$1,200 in expenses incurred by individuals who undertake the effort on their own.

Conclusion

Given the serious financial, legal, reputational and other risks presented by financial advisers, contractors and domestic employees, high net worth individuals must take exceptional precautions. One of the more effective loss prevention strategies is the background screening of job or service applicants, which limits the possibility of retaining persons of criminal intent. Much of the remaining risk can be transferred to an insurance company that offers broad, portfolio-type protection geared to the unique needs of the affluent. The ACE Platinum Portfolio meets these requirements, while also providing free background screening and identity restoration services, making life less stressful and safer for those with the most to lose.

About the Author

Reducing Vulnerability to Crime From Those You Trust: Strategies for the Wealthy is a briefing paper sponsored and published by ACE Private Risk Services. Gary Raphael, senior vice president of claims and risk consulting at ACE Private Risk Services, was the author of the report and conducted the interviews. The research drew extensively from The Guidry Group, an international security consulting firm, and RelyData, an identity restoration service for victims of identity theft. Other research findings are derived from published sources in the public domain. Our thanks are due the interviewees for their time and insight.

Important Notice: This white paper contains only a general description of the insurance coverages provided by the ACE Platinum Portfolio. Coverage terms are subject to change and can vary by state. The white paper does not include all of the benefits and limitations found in the policy. The insurance policy itself, not this white paper, will form the contract between the policyholder and the insurance company.

- i <http://articles.moneycentral.msn.com/RetirementandWills/CreateaPlan/8ThingsYourFinancialPlannerWontTellYou.aspx>

- ii http://www.texasinvestored.org/fraudabuse_planningindustry.php

- iii www.acfe.com/documents/2008-rttn.pdf

- iv <http://www.forbes.com/forbes/2009/0608/042-fraud-madoff-kroll-checking-out-financial-advisor.html>

- v <http://www.adp.com/media/press-releases/2008-news-releases/adp-annual-pre-employment-screening-index.aspx>

- vi www.peoplecheck.biz/.../Do a thorough background check on.pdf

- vii <http://phx.corporate-ir.net/phoenix.zhtml?c=65255&p=irol-newsArticle&ID=849080&highlight=>

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