

# Institutional Account Risk

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FIRMA  
National Risk Management Training Conference  
**May 8<sup>th</sup>, 2019**  
**1:15pm – 2:15pm**

# “A Tale of Two Cities”

- What type of Risk(s) were involved?
- What were the “controls” in place?
  - Were these real controls or not?
  - How long was the particular activity?
- What was common about the characters in each story?
- How was risk uncovered?
- What was the conclusion?



# Tale #1 – “Should You Trust your Friends

- When: Summer 1992
- Where: Oklahoma City, OK
- Who: Cast of Characters
  - State Treasurer
  - Deputy State Treasurer
  - Outside Broker
  - Controller
  - Custodian



# Never looks good in the paper

- Excerpt from Tulsa World Newspaper, Feb. 1, 1994

OKLAHOMA CITY - A preliminary version of the state audit of questionable securities transactions by the state treasurer's office alleges a "scheme to plunder the assets of the state of Oklahoma," it was learned Monday.

The version of the audit report, which was obtained by the Tulsa World, alleges Planners Independent Management of San Diego reaped millions of dollars in excess profits from securities transactions approved by the treasurer's office, and says authorities ought to look at a variety of possible violations of law, including kickbacks and conspiracy to defraud the state.



# Be careful what you say!!

- New State Treasurer Comes into Office
  - Nov 9, 1990 – Tulsa World News
  - “Claudette Henry Says She’s **“Up for the Job”** of Treasurer (The transition from housewife to state treasurer may not be an easy one, but Treasurer-elect Claudette Henry said Thursday she is up for the job.)
  - “I just want to show the office can operate, and **can operate without corruption or graft.**”



# More Detail on Story.....

- Excerpt from Tulsa World Newspaper, 2/1/1994
  - “It appears that an undetermined number of individuals and firms were involved in a scheme to plunder the assets of the state of Oklahoma, through fraud, by falsely indicating a competitive bidding process was being conducted for the investment of the funds of the state of Oklahoma.”
- Who are these individuals?



# List of Characters

- State Treasurer – Claudette Henry
- Deputy Treasurer – Patricia Whitehead
- Outside Broker – Patrick Kuhse
- Connections – Who knows who?
  - Claudette and Patricia were lifelong friends
  - Patricia and Patrick worked together at brokerage firm prior to her appointment as Deputy Treasurer
    - Patrick spoke at FIRMA a few years ago on Ethics



# Transactions and Money

- State Treasurer's office paid in excess of \$6.3 million more for 101 transactions which should have cost approximately \$379,000
- Kuhse received \$4.3 million in commissions on these trades
- Whitehead received in excess of \$300,000 in kickbacks for placing \$1.6 billion in state securities trades through Kuhse



# So How did this happen

- Plain and simple – Collusion between Deputy Treasurer and Broker
  - Control should have been “best execution” with multiple brokers – multiple phone lines
  - Affirmation Process – PM and Broker
  - Custodial Reporting – Specifically Performance Reports
    - Meetings to discuss Benchmarks
    - Meeting between Custodian and Treasurer



# So how did this happen....

- Trust between Claudette and Patricia
- Avoidance of Benchmark selection by Patricia
- Various Optics were occurring
  - New Vehicle - Patricia
  - Home remodeling - Patricia
  - State Controller not receiving reports from Patricia



# Conclusion

- How was this fraud uncovered?
  - Custodian's push for a performance benchmark on the portfolio forced the discussion with Treasurer
  - Observations of behaviors of Deputy Treasurer
  - Discussions with State Controller – Concerns about attitude with Deputy Treasurer
- How could this have been prevented?
- Outcomes – Prison, Resignations, Fled Country



# Tale #2 – Local Police Pension Fund



- Background
  - Email request for a \$90,000 wire transfer
- Board Composition – Who sat on Board
  - Five member board: Actives, Retiree and Appointees
- When does Board meet and with whom?
  - Quarterly Basis with Investment Managers, Attorney, Board Clerk and Finance Director
- Board Meeting Agenda - Format/Structure



# Standard Operating Procedure

- Receipt of email (with LOI attached) instruction for wire transfer
- Confirm back with sender that it is legit via phone call
- Verify Letter of Instruction has been signed by authorized individuals
- Prepare to perform call back procedure to initiator on recorded line
- Once properly confirmed, release wire



# Any clues that this might be fraud?

- Email request came with attached signed letter on letterhead – however, not signed by authorized individual – CLUE #1
- Follow-up via email to initiator that proper authorized individual needs to sign letter
- Letter comes back next day with proper signature – keep in mind that this was a wire transfer request – Urgency?? CLUE #2
- Request looks odd, out of the ordinary – Not normal request – CLUE #3



# Any Clues.....?

- Phone call follow-up to initiator to confirm this is legit request
- Initiator confirms via phone, instructs that we process same day
- Call Back procedure goes into effect
  - Separate person at Bank calls back initiator per contact record in Trust System
  - Initiator verifies and confirms all required items on recorded line



# What Happens Next?

- Wire is released to reputable bank in Florida
- All procedures were followed, money was released, everything appears to be OK!
- Next couple of days, another email request comes through, same process as before – money to be sent to same entity, same receiving bank, almost the same dollar amount – BIG CLUE #4



# Investigation Begins

- Look up the receiving entity in Google
  - Find out that the entity address is a condo in Florida
  - Research entity to determine if legit corporation
    - Find out it is legit, but formed only 10 days prior to first wire according to State of Florida documents
- Call in internal Fraud investigator at Bank
- Contact Police Pension Fund
  - Police Chief contacted who also sits on the Board



# Who do you trust?

- Investigators visit bank from Police Department
  - One of the detectives is former Police Pension Fund Trustee and not happy with the Bank
  - Bank asked why we did not contact the President of the Board – Answer: He is a suspect!!
- Try to recall the funds from first wire
- During the investigation process – account at bank in Florida closed, money wired to a lesser known bank – FBI is notified by Police Department



# Who do you trust.....?

- Police Pension Fund President – not at all happy with bank – “Why did you not catch this?”
- Bank asks, “why did you approve the disbursement on the recorded line” –
- ANSWER - “ I am a BUSY man!!!”
- Bank did stop the second transaction and as a result, the fraudsters took funds from first fraud and fled – not found to this date



# Conclusion

- Police Pension Fund approaches Bank to ask for complete reimbursement
- Bank politely declines the request of their attorney – Pension Fund attorney is apologetic for even asking
- Police Pension Fund holds a meeting and votes to terminate Bank, but keeps the President on Board, even though he admitted to performing the Call Back



# “A Tale of Two Cities”

- What type of Risk(s) were involved?
  - Financial Risk, Reputational Risk
- What were the “controls” in place?
  - Performance Benchmarking – more of a detective control; Hiring practice – background checks; Call Back procedures
  - Were these real controls or not?
    - Overall YES – However, the controls were circumvented
  - How long was the particular activity?
    - Tale #1 – 2+ years
    - Tale #2 – 2 weeks



# “A Tale of Two Cities”

- What was common about characters in each story?
  - Element of overall Trust
- How was risk uncovered?
  - Independent third party outside of organizations involved
- What is the overall conclusion?
  - Trust your gut/instincts do serve you well
  - Don't be intimidated even by your clients
  - Follow your policies and procedures

