In God We Trust — Everyone Else We Audit

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mong old-school Nashville bankers, “In God we trust, everyone else we audit,” is a familiar quote that purportedly originated with Sam Fleming, the venerated chief executive officer of Third National Bank for many, many years. Mr. Fleming’s philosophy on trust helped make Third National Bank a financial powerhouse and the city of Nashville a financial center in the southeastern United States. In uncertain times, people often look to the past for guidance. Forecasting the future seems mostly a waste of time, and it is comforting somehow to know that others have faced uncertainty and survived or even prospered.

Since the October 2008 issue of The Tennessee Banker, which included an article on “Bank Fraud,” misplaced trust has become a topic of international concern, not only in the financial services sector, but across industry lines. The national headlines are filled with reports of fraud in unprecedented proportions, with the Madoff case topping the list. Madoff has been labeled a case of “affinity fraud” because so many of the victims were Jewish. People invested with Madoff because they either trusted him or they trusted the people who trusted him. In fact, investors considered themselves “lucky” to be able to invest with Madoff. They were completely surprised to learn that the entire venture was one massive con. And those investors were not the only victims. At the end of the day, a $50 billion fraud hurts the entire financial services industry, and every American taxpayer can be included among the victims of one of the most common confidence games going — the ever-popular Ponzi scheme.

Although there are many variations, the basic pyramid or Ponzi scheme is simple. New investor money is used to pay returns to earlier investors. Often these returns are generous, even spectacular. This creates the impression that the investment is successful, often highly so. The original investors are thrilled. The con artist is a genius. Later investors are confident that they, too, will receive great returns. All investors believe their money is safe because they trust the person investing their money. They gladly recommend the investment to friends and family who are sucked in based on the original investors’ glowing testimonials. And then, as the saying goes, “You can’t fool all of the people all of the time.” Inevitably, the flow of new investors dries up, and the scheme collapses when there is no new money to pay investor “returns.”

Some years ago, the wife of Tennessee Tech’s football coach absconded with millions through a Ponzi scheme that involved issuing fake CDs. She paid a pretty good rate until her supply of new customers ran out. Recent variations operate under the guise of foreign currency exchange trading. Madoff claimed to be trading in stock options. This is not something that just happens in New York — it happens here, too, and it can happen to you.

As the result of the publicity surrounding cases like Madoff, many bankers and investors find themselves re-evaluating trusted relationships. This is not necessarily a bad thing, but it can be an uncomfortable position to be in. No one wants to believe that someone we trust has betrayed that relationship, but the undeniable truth is, it happens. And in tough economic times, unfortunately it happens a lot. Frequently, members of a particular group are targeted by one of their own. This can be a family member, a neighbor, a church member, or a business colleague. Any group or community can be a target, and the results can be devastating both emotionally and financially. There are reported cases involving Baptist church members, Mormons, and Native Americans, just to name a few. The reality is, no one is immune. Our affiliations, our trust in others make us vulnerable.

What is the solution? How do you protect your bank, your customers, and yourself from being victimized? And how do you do all this without damaging the very valuable relationships you have that merit your trust?

The answer lies in examining and verifying information provided by those you trust. Sometimes this can be a hard thing to do, especially when there is a family or other close personal relationship involved. To question or verify information provided by a friend, colleague, or family member may seem rude and can be viewed as the equivalent of questioning someone’s integrity. That is one of the worst personal offenses one can commit. “Are you calling me a liar?” may be the unspoken response. Those are fighting words. And yet the alternative can create a huge financial exposure. Those of us whose job it is to handle other people’s money cannot ignore this exposure. Our job is to question and verify. Other people depend on us and pay us to do that very thing.

Regardless of the specifics, at the root of every fraud is the element of misplaced trust. This is true of bank fraud, affinity fraud, internet fraud, identity theft, Ponzi or pyramid schemes, and 419 Nigerian scams. In every case, the perpetrator convinces someone that he can be trusted. Trusted without the need for examination or verification. Even people who are financially sophisticated

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and very successful can be the victims of fraud through misplaced trust. Everyone has personal relationships, and affinity fraud is a crime in which your personal relationships are used against you. People let down their guard when they are around people they like and are comfortable with.

While there is no such thing as a risk-free investment or a risk-free bank, there are steps you can take to minimize fraud exposure. Here are some guidelines to avoid misplacing your trust and becoming a victim of affinity fraud:

1. Don’t rely solely on testimonials or personal recommendations. While these opinions may be utterly sincere, in a typical Ponzi or pyramid scheme, early investors are paid returns from the investments of those who get in later. Take into account the experience and expertise of the person giving the recommendation.

2. Verify the information you are given. Get it in writing, and if there is some reason it can’t be reduced to writing, find out why not. If there are inconsistencies in the information, keep asking questions until those are resolved. Check out registrations and licenses with government agencies whenever possible. Don’t be pressured into making a quick decision before you have time to verify the information. There is no substitute for doing your homework.

3. Get independent professional advice. No one can be an expert on everything. Be sure that the advice you get is based on experience or expertise. Above all, make sure that the advice you are given is candid and independent. The key here is to have an expert who doesn’t have a financial interest in the outcome review the information.

Finally, the best advice is always to trust your instincts. If something is telling you things are not quite right, that something is too good to be true, it probably is.