

CLOs: Fight Fraud With Better Analytics



Law360, New York (November 13, 2014, 12:40 PM ET) -- Private- and public-sector use of data analytics has been a hot topic for several years. Of the many uses of analytics in the business world today, several may fall under the purview of chief legal officers. For example, operational or performance analytics can help legal departments evaluate spending, a well-established practice that helps control costs by revealing the financial impact of case-management choices, outside counsel selection, and other cost and spending decisions.

Computer assisted review, known as predictive coding, is a text analytics technique used for document review that is gaining rapid acceptance in the profession and in the courts. Other analytical applications gaining momentum include tools for contract management, both within the legal department and throughout the enterprise, and quantitative case prediction tools that help attorneys assess the likelihood of favorable and unfavorable litigation outcomes.

A very important, emerging application, which typically doesn't reside in the legal department but concerns CLOs nonetheless, is enterprise fraud and misuse management (EFM). CLOs play a pivotal role in meeting legal and regulatory mandates of the organization and thus are an important voice in shaping an organization's EFM strategy, implementation and operation. In preparing for this role, CLOs can benefit from understanding the types of analytics that can be applied to EFM, the key dimensions of analytics effectiveness, and the ways in which they can contribute to EFM deployment.

The Role of Analytics in EFM

An EFM platform is an advanced technology framework that can help improve an organization's internal controls regime and may have potential to improve the bottom line by managing and mitigating fraud, waste and misuse. Analytics conducted within an EFM framework facilitates the transition from backward-looking to real-time and even predictive views of activities across an organization. EFM analytics systems can process enormous volumes of structured numerical data around transactions and integrate that data with other information sources, including unstructured data, text-based fields such as names or comments, geospatial data, or even "voiceprints" pulled from telephone conversation recordings. EFM solutions can innovatively collect and integrate information from outside the enterprise such as public records, social media, government data, and other online media sources.

Both private- and public-sector organizations are tapping the power of EFM analytics. Businesses are employing powerful new analytics-based solutions to unearth fraud, waste and misuse among employees and third parties and to test compliance with mandates such as the Foreign Corrupt Practices Act, which prohibits bribery of public officials. Government agencies such as the Centers for Medicare and Medicaid Services, U.S. Securities and Exchange Commission and Department of Defense are

aggressively using analytics to combat costly abuses of taxpayer money, investment fraud and terrorist activities. In short, an effective EFM framework provides a structure for improved compliance, reduced costs associated with inappropriate activities, and lower risks of reputational damage.

EFM Analytics Tools

As important contributors to EFM program development and oversight, CLOs can benefit from awareness of the analytics methods available for combating fraud, waste and misuse. Data analytics helps uncover patterns and can provide insights from voluminous and heterogeneous data leading to faster, more accurate decision-making. Analytics can help CLOs, compliance officers and operations leaders focus their attention on data sets that are likely to reveal fraud such as anomalies, outliers and missing items.

Analytic methods for detecting fraud, waste and misuse include:

- Visual analytics. Both novices and experts can use data visualization techniques to explore and analyze patterns, relationships and anomalies in data. The ability to see connections between entities and individuals can reveal levels of relationships not readily apparent in a spreadsheet, as well as highlight abnormal patterns.
- Transactional data analytics. Visual analytics facilitates transactional analytics — the detailed examination of general ledgers, accounts payable, and other transaction records to detect potentially fraudulent activity. Transaction analytics can be either rules-based or risk-based.
- Text analytics. Unstructured data can be analyzed for patterns or indicators that can be used on their own or within a risk-based or predictive model. Analytical techniques can include simple keyword searches and text clustering. Sentiment, context or even patterns of deception can be analyzed using text analytics.
- Link analysis. Various relationships can be identified, including between entities, employee to employee, employee to vendor, and vendor to vendor. Link analysis can extend beyond first-level relationships to uncover multilevel relationships not readily apparent through simple queries.
- Predictive analytics. Supervised and unsupervised machine learning can be used to "teach" analytics tools to identify trends, patterns and anomalies with a higher likelihood of fraud based on past findings.
- Social network analytics. Examination of emails, instant messages and other communication methods can help determine who is talking with whom and what is being discussed. Individual relationships between people suspected of fraudulent behavior can be identified through social media engagement in forums such as Facebook and Twitter.

Boost Your EFM IQ

Major technology vendors today offer EFM systems that can receive data streams, proactively monitor for fraud, report out to investigators, and automatically stop transactions, among other things. Organizational leaders, including CLOs involved in EFM, need powerful tools to help make sense of the

vast amounts of data that their organization accumulates and integrate relevant external data. What differentiates EFM platforms from previous generations of analytic tools is that they simultaneously shift paradigms around four dimensions:

- Time — advanced tools and platforms help organizations take a proactive stance rather than a reactive one. They can process data at high speeds, often as it is streaming, rather than providing backward-looking analyses of historical data.
- Aperture of analysis — advanced tools look across the enterprise, not within individual organizational silos, to capture patterns that might go unnoticed by a narrower view. These tools can monitor data from both enterprise resource planning (ERP) and operational systems to help identify potential fraud indicators — such as anomalous or clustered transactions — across the organization as a whole.
- Breadth of data — the nature of what constitutes data is changing as new tools bring order to unstructured information sources such as text and Website activity, device geo-location sensors, and even sounds. Emerging sources include phone conversations, using caller ID information plus speech patterns and voiceprint analysis.
- Sophistication of analysis — the analytical and reporting models embedded within the tools are becoming more responsive. Machines can learn from transaction patterns and incorporate new anecdotal evidence as fraud schemes evolve. Banks, for example, are striving for predictive models that can self-calibrate to match ever-changing online fraud schemes, rather than manually refreshing models based on outdated rules.[1]

Your Role in EFM Analytics

CLOs have a dual interest in the deployment of EFM analytics. As head of the legal function, they of course want to thwart illegal activity involving the organization. At the same time, opportunities may exist to leverage such an EFM platform's capabilities to address other legal and organizational requirements. CLOs can contribute to EFM analytics implementation in several ways, including:

- Building the business case. CLOs routinely collaborate with their compliance and audit counterparts to meet regulatory requirements and stem fraud, waste and misuse. Involving legal in EFM analytics deployment from the outset can help keep the initiative on track. For example, CLOs can champion an institutional commitment to gathering the data critical to the analytics effort, help gain buy-in from the leaders of business units who can support or derail EFM deployment, and inform the board of directors and senior management team of EFM program development. The credibility informed CLOs bring to an EFM deployment is substantial and important.
- Addressing the people and process aspects. Technology enables data analytics, but it takes the right people to make it useful. CLOs can promote the need for involvement by both data scientists, who write the algorithms and predictive models, and subject matter specialists, who understand the business dimensions and implications of the initiative. CLOs can also stress the need to explore how regulatory requirements and fraud, waste and misuse threats affect processes across the organization and work hand in hand with the compliance team to address such issues.

- Promoting organizational integration. Fraud, waste and misuse management is only one of many areas in which organizations are applying data analytics. With disparate initiatives underway, the potential grows for siloed solutions to emerge with their own, possibly redundant, tools and systems. The CLO can be a strong advocate for communication and coordination between different segments of the organization to simultaneously avoid reinventing the wheel and encourage different groups to share analytics resources and capabilities. Such an integrated approach has the potential for better insights across the entire enterprise, as well as positive return-on-investment and operational performance improvement.

Embarking on the EFM Analytics Journey

EFM analytics can be a powerful tool to help identify, deter and prevent fraud. But implementing it is not a trivial undertaking. Some organizations may be ready and willing to plunge into a comprehensive deployment. Others may choose an incremental approach, undertaking pilot programs using specific tools such as data mining in combination with link analysis to find relationships of interest. Either way, CLOs can play an instrumental role in capturing and leveraging the value of the organization's investment in analytics.

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[1] Forrester, Big Data in Fraud Management: Variety Leads to Value and Improved Customer Experience, Andras Cser, Oct.16, 2013.
