

# News from CFALA

## For Immediate Release

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## Detecting Deception Is Increasingly Important In the Investment Arena, QVerity CEO Explains

LOS ANGELES – In an age when fraud is costing investors billions of dollars, investment professionals can better serve their employers and clients by learning how to spot and interpret deceptive behaviors, former Central Intelligence Agency Officer Phil Houston told members of CFALA's Applied Behavioral Finance Group at recent luncheon presentation.

Houston, whose 25-year CIA career was highlighted by his service as a senior member of the agency's Office of Security, is now CEO of QVerity, a privately-held company based in Greenville, NC, that provides behavioral analysis, training, screening and consulting services for private- and public-sector clients worldwide. QVerity's objective is to provide exclusive analysis that yields competitive advantage and high-value insights for its clients.

"It's always been important to try to know when people are being deceitful, but what we are seeing today is that people are aware that there is much more deception and dishonesty out there than they ever imagined," Houston said in an interview. "A prime example is the Madoff case, where investors who seemed to be very knowledgeable and savvy all of sudden appear to get duped. It's making people more cynical and more wary."

Even though they know they should be careful, investment professionals aren't always able to protect themselves, Houston noted.

"When deception occurs, people sometimes spot it but they don't really understand what they're seeing," he said. "They're not sure how to interpret what they're seeing, and they often interpret what they've seen with a bias toward what their desired outcome is. For example, let's say you have a long position in a company. Well, you don't want that company to have trouble, and if we hear rumblings that the company may be in trouble, that can be threatening to our viewpoint. So instead, we look for something that supports our position. As human being, we have to force ourselves to be objective – it's not something that comes naturally to most of us."

Houston conducted thousands of interviews and interrogations for the CIA and other federal agencies, both as an investigator and as a polygraph examiner. He is credited with developing a detection of deception methodology currently employed throughout the U.S. intelligence and federal law enforcement communities. Many of those techniques are now utilized by QVerity on behalf of its clients, who include hedge funds, institutional firms, and private equity companies, among others. QVerity's techniques have been used to identify areas of concern that corporate executives have attempted to conceal and/or downplay during their pitch to potential investors. Some of these issues have included fraudulent accounting, hidden internal personnel or operational problems, and overly aggressive forecasts.

"We help people become more sensitive to potential problems that deception might pose to an investment position, and we also help sensitize them to potential opportunities." He said. "Our goal is to help them incorporate deception detection into their investment strategy and help them increase their conviction about pulling the trigger on an individual stock or idea."

The ability to spot deception can help investment professionals in a variety of ways, Houston said.

"One way detection of deception helps us is that it can act as an early warning system," he said. "We can use it to spot an issue and thus save money that otherwise might have been put at risk. Another way, if we are able to spot deception ahead of time, ahead of the Street, is to use that to make money by shorting. So you can use deception detection defensively – to avoid something – or offensively, in terms of idea generation.

"Detecting deception can also be helpful in indicating the scope of a problem. Let's say you're an analyst and you're asking questions about something specific to a company's operations. And let's say the CEO is answering with a lot of what we call 'convincing statements' rather than facts. A 'convincing statement' might be something like, 'We've been in this business for more than 25 years and I think we have a good handle on what we're doing.' If the CEO spends a lot of time responding that way, it may be an indication that there really is a problem and that you need to dig deeper."

Sometimes the unintended deceptive indicators are written rather than spoken.

"Let's say you have a company that's responding to a problem and they put out a press release intended to minimize the seriousness of the issue," Houston said. "The more they strategize that release, the easier our job is, because by the time the release comes out every word in there is in there for a reason. We know that the release has been vetted by top management, the lawyers, the accountants, the ops people – everybody. So if some of the words are associated with deceptive behaviors, it tells us something, because we know those words were very carefully chosen, chosen for a reason."

While people sometimes display what Houston calls “deceptive non-verbals,” he doesn’t find so-called “body language” interpretations to be very useful.

“A lot of ‘body language experts’ focus on things like a person who looks away when they’re talking to you, or fidgets, or is sitting with what they’ll call a ‘closed posture,’” he said. “Well, the person may be doing all of that, but what does it really tell me? Our models and techniques, things we developed in the agency, combine a variety of behaviors, verbal and nonverbal, that go way beyond ‘body language.’”

Houston notes that the clients QVerity trains don’t become “human lie detectors.”

“Analysis of human beings, whether it’s medical or behavioral, is an imperfect science,” he said. “What we can do is enhance our skills. The skills of deception detection can serve as a compass, to help guide us through analysis and investigation, and tell us where we need to drill down. We can’t get rid of our inherent bias towards a desired outcome, but we can manage it. That’s what we help our clients to do.”

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