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United States General Accounting Office
Washington, DC 20548

August 2, 2001

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
House of Representatives

Subject: Briefing Slides on Martin Frankel's Alleged \$200 Million Insurance
Scam

As you requested, this report transmits to you our briefing slides describing insurance regulatory oversight and information sharing in the matter of a highly publicized insurance investment scam exposed in May 1999. (See enclosure I.) These slides present the results of our report *Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight* (GAO/GGD-00-198, September 19, 2000). We used these or similar slides in, at last count, 15 briefings to various federal and state officials and national organizations. Enclosure II lists the various organizations and dates on which the presentations were made. These slides detail the alleged embezzlement of more than \$200 million in insurance company assets over nearly an 8-year period by Martin Frankel and associates. Mr. Frankel, a former securities broker who was barred from that industry in 1992, allegedly migrated to the insurance industry and continued to operate as a rogue by engaging in illegal activity. The specific objectives of these briefings were to (1) outline the alleged scam and (2) describe weaknesses in oversight and information sharing by insurance regulators.

Throughout the 1990s, Martin Frankel, with assistance from others, allegedly obtained secret control of entities in both the insurance and securities industries. He is alleged to have anonymously acquired and controlled insurance companies in several states and, despite being barred from the securities industry, to have exercised secret control over a small securities firm. Using the name of this securities firm, Mr. Frankel allegedly took custody of insurance company assets and provided false documents on investment activity to disguise his actual purpose. Instead of managing these assets in a prudent manner, he allegedly diverted them to other accounts he controlled and used them to support the ongoing scam and his lifestyle. The scam was finally exposed after insurance regulators in Mississippi took enforcement action against three of the Frankel-connected insurers by placing them under regulatory supervision.

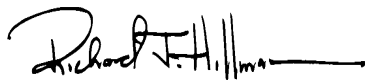
Weaknesses in key insurance regulatory oversight activities, extending over several years, contributed to delays in detecting the investment scam. We found inadequate tools and measures for assessing the appropriateness of insurance company purchasers, analyzing securities investments, evaluating the appropriateness of asset custodians, verifying insurers' assets, and sharing information within and outside the insurance industry. We also found

some weaknesses in support services provided by the National Association of Insurance Commissioners (NAIC), a voluntary association of state insurance regulators. NAIC weaknesses included weak interstate coordination and weak oversight of entities controlled by holding companies. We also found gaps in controls that would prevent migration of unscrupulous securities brokers to other financial services industries.

Our September 2000 report (see enclosure III) included recommendations to help prevent or detect similar investment scams in insurance companies by proposing the adoption of appropriate asset custody arrangements, improved asset verification procedures, and the sharing of confidential regulatory information across industries and agencies. The report also contained recommendations designed to broaden and help sustain cooperation among regulators of different financial sectors. Agencies responding to the report generally concurred with the report's findings, conclusions, and recommendations. We also suggested that Congress consider requesting periodic status reports on regulatory progress and plans in these areas. Such reports would enable Congress to monitor progress and would encourage states to adopt needed reforms.

We plan no additional distribution of this report. However, we will make the report available to interested parties on their request. If you or your staff have questions regarding this report, please contact me at (202) 512-8678 or Lawrence D. Cluff at (202) 512-8023. Key contributors to this report are acknowledged in enclosure IV.

Sincerely yours,

A handwritten signature in black ink that reads "Richard J. Hillman" followed by a horizontal line.

Richard J. Hillman
Director, Financial Markets
and Community Investment

Enclosures-4

Enclosure I

Briefing slides



Insurance Regulation: the need for Strengthened Oversight



**Thunor Trust
Liberty National**

Insurance Regulation: Scandal Highlights Need for Strengthened Oversight

- What happened?
- What are the regulatory weaknesses?
- What is being done to minimize future problems?

The \$200 Million Insurance Scandal

What happened?

Overview of the Scandal



What Happened: Major Events

1. 1985-1988: Mr. Frankel works in securities industry; is fired from two firms for differences with management and activities leading to an SEC investigation.
 2. December 1989: SEC begins investigation of Mr. Frankel for omissions and misstatements to investors about his investment practices.
 3. August 1992: Mr. Frankel settles with SEC and is permanently barred from the securities industry.
 4. August 1991: Liberty National Securities registers in Tennessee and is allegedly controlled by Mr. Frankel.
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What Happened: Major Events

5. September 1991: Mr. Frankel allegedly forms Thunor Trust using nominee grantors and files application and later buys a Tennessee insurance company.
6. February 1994-March 1995: Thunor Trust purchases four more insurance companies domiciled in Mississippi, Oklahoma, and Missouri.
7. February 1998: Thunor Trust purchases an insurance company domiciled in Alabama.
8. February 1999: Thunor Trust purchases an insurance company domiciled in Arkansas.

(continued)

Overview of the Scandal 1998 - 1999

9. Late 1998: Tennessee and Mississippi insurance regulators become suspicious of insurers' asset custody arrangements.
10. Early May 1999: Mr. Frankel flees the U.S.
11. September-October 1999: Mr. Frankel is arrested in Germany and indicted in federal court in Connecticut.

What Happened: The Scam

- Frankel gains secret control of a small securities firm and creates a phony trust to purchase an insurer.
- He converts insurer assets to cash--supposedly in custody of the securities firm for T-bond trading.
- Instead, he steals cash and launders through secret accounts.
- Hides theft with false trading records, a stream of trading “profits,” and complicity of co-conspirators controlling the insurance firm.

(continued)

What Happened: The Scam

- Ultimately, Frankel buys six more insurers and steals their assets, each time using previously stolen cash to buy the insurers, maintain the scheme, and support his lavish lifestyle.

The \$200 Million Multi-State Scam



The Conspirators

- **Frankel:** The alleged mastermind. Jailed in Germany in September 1999 and subsequently pleaded guilty to German tax evasion. Returned to U.S. in March 2001 to face federal charges of wire fraud, money laundering, securities fraud, racketeering, and conspiracy.
 - **Hackney:** Front for insurance activities. In September 2000, pleaded guilty to RICO conspiracy and money laundering. Forfeited assets obtained illegally.
 - **Guyer:** Front for securities activities. In September 2000, pleaded guilty to securities fraud and tax evasion.
 - Others have pleaded guilty or are under investigation.
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The \$200 Million Insurance Scandal

What were the regulatory weaknesses?

The Regulators

- Six state insurance regulators had primary jurisdiction over Frankel's various companies and used regulatory support services provided by NAIC.
- SEC, NASDR, and state securities regulators had jurisdiction of the securities firm.
- Scam went undetected by regulators for many years--Why?

Regulatory Weaknesses -- Summary

- Weaknesses throughout the insurance regulation process
 - inadequate oversight of changes in ownership
 - weaknesses in routine financial analyses
 - shortcomings in on-site examinations.
- Repeated instances of inadequate tools, policies, procedures, and information sharing.
- Underlying theme: insufficient professional skepticism.

Change in Ownership

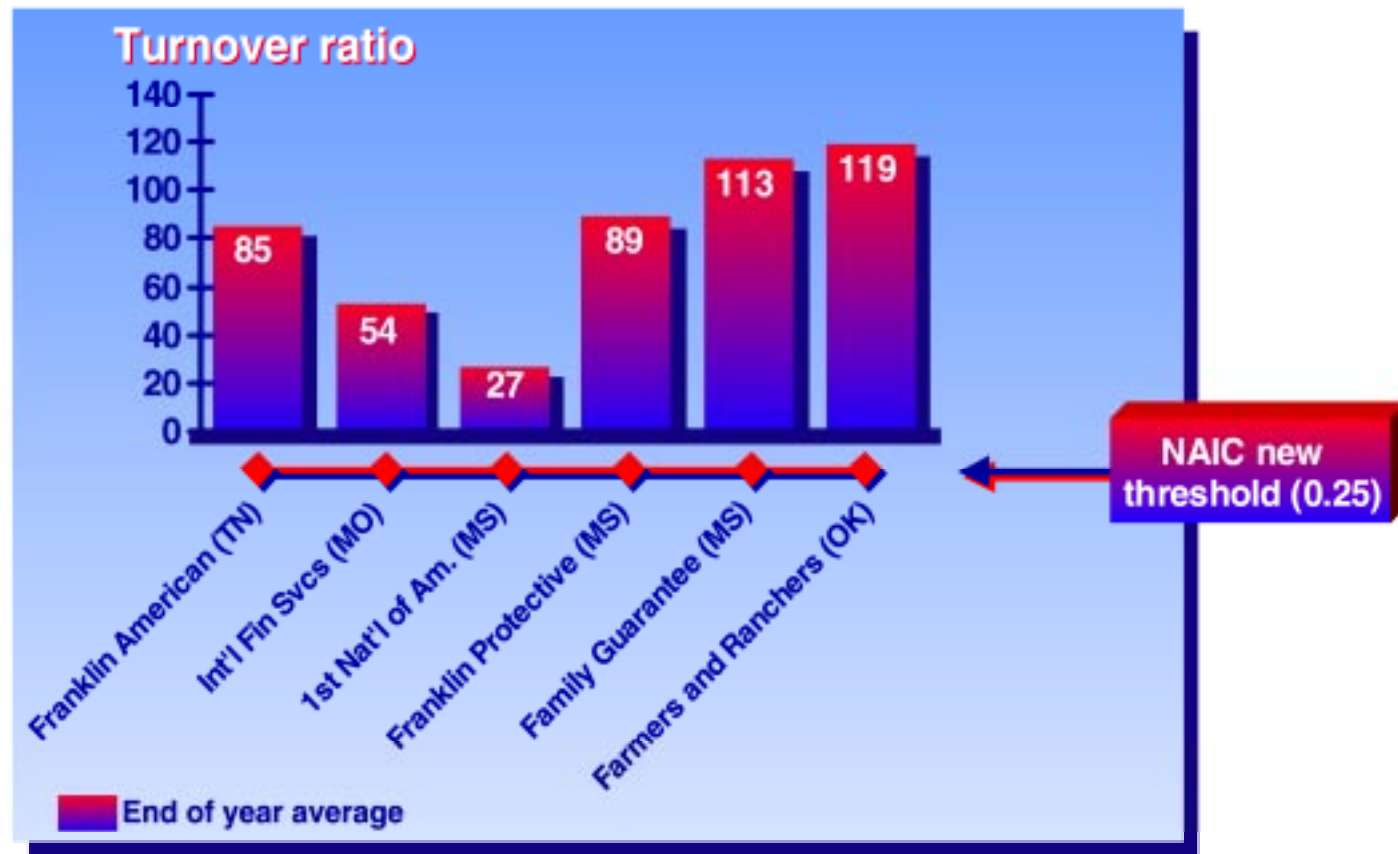
- Inadequate due diligence -- trust arrangement and unique investment strategy not questioned.
 - Trust named Mr. Hackney as irrevocable trustee.
 - Trust arrangement left supposed “grantors” with no control over their money.
 - Inadequate background checks -- e.g., no regulatory or criminal history checks.
 - Lack of coordination both intra- and inter- industry -- e.g., interstate coordination not timely.
 - Arkansas regulators were unaware of problems with Thunor Trust insurers found in other states.
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Weaknesses in Routine Financial Analyses

- Inadequate analysis of securities investments -- for example, missed asset turnover ratios.

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Frankel Case - Asset Turnover Ratios



Routine Financial Analyses

Ineffective mechanisms to safeguard and monitor assets held by other entities -- e.g., poor asset custodial policies and procedures.

- Missed or ignored disclosures on annual and quarterly statements that bonds were held by broker -- not by an authorized trust or depository.

Inadequate securities-related expertise and information gathering -- e.g., no communication with state securities regulators.

- State securities regulators across the hall had information about the real Liberty National Securities.
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Weaknesses in On-site Examinations

- Failure to detect misappropriation of assets -- for example, inadequate assessment of investment strategy.
 - Four full on-site examinations completed and one exam targeted on the investment strategy.
 - Examiners did not realize that the assets had been looted.

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Weaknesses in On-site Examinations

- Inadequate practices and procedures to verify the legitimacy of asset custodians -- for example, no independent verification.
 - No effort to identify and verify the legitimacy of the broker who supposedly had custody of the assets.

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Weaknesses in On-site Examinations

- Limited sharing of information and coordination among regulators. For example, no proactive alerts to other states.
 - When some states began to suspect a problem, their failure to communicate with other states led to an additional \$50 million in losses.

The \$200 Million Insurance Scandal

What is being done to minimize future problems?

What is Being Done to Minimize Future Problems?

- GAO recommendations
- Ongoing NAIC corrective actions/plans
- Congressional activity

Summary of GAO Recommendations

- State insurance regulators: Improve asset verification methods and information sharing.
- NAIC: Implement proposed corrective actions and strengthen accreditation program.
- SEC: Improve information sharing with insurance regulators and help prevent the migration of rogues.
- FBI and insurance regulators: Establish a means for conducting criminal checks on industry applicants.

Ongoing NAIC Corrective Actions/Plans Stemming From Frankel Matter

- Strengthen guidance for investment activities.
- Set threshold for flagging asset turnover ratio (> 0.25).
- Improve asset custodian interrogatories and review procedures.
- Design/implement Form A database.
- Require prior notification on significant reinsurance transactions.
- Improve timing of exams/greater use of targeted exams,
- Improve use of Part I accreditation in reviews.
- Develop proposed federal fingerprint legislation.

Congressional Activity

- March 6, 2001, hearing by House Financial Services Committee to begin considering:
 - Fingerprint checks in the insurance industry.
 - Improved efficiency in sharing of criminal and regulatory history information among regulators.
 - More efficient public access to data already in the public domain.

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Congressional Activity

H.R. 1408 introduced April 4, 2001

- Purposes: safeguard public from fraud, improve/streamline regulatory coordination, reduce duplicative information requests, help detect patterns of fraud, and take advantage of advanced data-sharing technology/internet.
- Create Antifraud Subcommittee to coordinate access and information sharing by regulators.
- Allow SEC to consider disciplinary actions by other regulators.

Enclosure II
Insurance Regulation: the Need for Strengthened Oversight

Table 1 shows the various organizations to which we have presented our briefing *Insurance Regulation: The Need for Strengthened Oversight*.

Table1: List of Organizations and Date Receiving GAO Briefing *Insurance Regulation: The Need for Strengthened Oversight*.

Organizations	Date
GAO Advanced Fraud Training	October 12, 2000
Women in Housing Finance	October 19, 2000
New York Insurance Department	December 12, 2000
Federal Bureau of Investigation-Economic Crimes Unit	December 13, 2000
North American States Securities Associations	January 22, 2001
New York Insurance Department Property and Casualty Division	January 22, 2001
Morgan Stanley	January 22, 2001
Connecticut Insurance Department	January 23, 2001
International Insurance Council	January 29, 2001
National Association of Insurance Commissioners Anti Fraud Taskforce	March 26, 2001
Tennessee Insurance Department	March 27, 2001
Tennessee State Auditors	March 27, 2001
Texas Insurance Department	April 25, 2001
Casualty Actuarial Society	May 8, 2001
Boston Federal Reserve Bank Risk Management Conference	May 11, 2001

Enclosure III

INSURANCE REGULATION: Scandal Highlights Need for Strengthened Regulatory Oversight

www.GAO.gov GAO/GGD-00-198

Enclosure IV

GAO Contacts and Staff Acknowledgments

GAO Contact

Lawrence D. Cluff (202-512-8023)

Acknowledgments

In addition to Mr. Cluff, James R. Black, Thomas H. Givens III, Rosemary Healy, Barry A. Kirby, Katherine Raheb, Paul G. Thompson, Karen C. Tremba, and Desiree W. Whipple made key contributions to this report.

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