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LABOR UNION INSURANCE ACTIVITIES OF JOSEPH HAUSER AND HIS ASSOCIATES

REPORT

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MADE BY ITS

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

together with

ADDITIONAL AND SEPARATE VIEWS

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NOVEMBER 26 (legislative day, NOVEMBER 15), 1979.—Ordered to be printed

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Mr. NUNN, from the Committee on Governmental Affairs, submitted the following

REPORT

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ADDITIONAL AND SEPARATE VIEWS

I. SUMMARY, FINDINGS, AND CONCLUSIONS

A. GENERAL

Few things are more important to the well-being and financial security of the millions of labor union members and their families throughout the Nation than the proper administration of their employee welfare as well as pension plans. Employee welfare benefit plans finance the health care, disability benefits, life insurance, and other benefit programs needed to help union members and their dependents cope with many of the difficulties of life. They are funded by or on behalf of union members from earnings set aside and placed in trust to be safeguarded and administered for the sole benefit of plan participants and their beneficiaries.[1]

[1] The Department of Labor advised that, as of 1976, there were over 1.2 million employee benefit plans covering 45 million participants. Of these plans, about 4,000 had 39 million of the participants and the remainder of the plans had fewer than 100 participants each. The General Accounting Office reported in October 1978 that there were about 500,000 private pension plans having about 57 million participants and having about $280 billion in assets. The GAO figures are exclusive of employee welfare benefit plans. In this regard, the Department of Labor has advised that meaningful data on the assets of welfare plans is not available because most plans commit most of their funds to the purchase of term life and other insurance products having no cash asset values.

This report is the result of a detailed and lengthy inquiry by the Permanent Subcommittee on Investigations into the sale of life, health, accident, and other insurance programs to 20 jointly-managed labor union health and welfare plans throughout the country during the period 1973–76. The investigation officially began in September 1976 and led to 11 days of hearings in October and November 1977. The Subcommittee has continued to monitor various criminal and civil actions which stemmed either in whole or in part from the information adduced during the investigation.

The insurance contracts which were the subject of the investigation were solicited and obtained by insurance companies either controlled by or associated with Joseph Hauser who has since been convicted of felony violations in connection with these activities. Hauser had previously been convicted of criminal violation in the promotion of health plans to union employee plans.

The Subcommittee's investigation shows that of some $39 million in union insurance premiums obtained by the Hauser companies, $11 million was diverted to other firms in the form of questionable commissions and commission advances, worthless and questionable investments, conversions to cash, and the payment of personal expenses and legal fees. As a result, the Hauser companies were forced into receivership or bankruptcy resulting in losses of millions of dollars to a number of union trust funds and their members.

Hauser's most significant victim was the Teamsters Central States, Southeast and Southwest Areas Health and Welfare Fund ("Teamsters Fund"). The Teamsters Fund suffered a loss of some $7 million which it now is endeavoring to recover through legal action. Major losses totalling over $1 million also were incurred by several Florida Laborers' Union health and welfare funds.

In addition, thousands of individual policy holders suffered significant financial losses and great personal hardship when their insurance companies failed in the wake of Hauser's scheme. For example, approximately 20,000 policy holders of Hauser's Farmers National Life Insurance Company had their insurance cancelled and lost the cash surrender values of their policies or unpaid claims. Also, about two-thirds of Farmers policy holders were either uninsurable or of such an age or employment level that they had great difficulty obtaining insurance coverage except at very high prices.

The sale of these insurance plans to the various union trust funds occurred when Hauser was under investigation by the California Attorney General in connection with a scheme to promote the sale of prepaid health insurance plans to union and other groups. Early in 1974, while the California Attorney General's investigation was underway, Hauser's key California association, a firm known as National Prepaid Health Plans, declared bankruptcy, leaving more than $2 million in debts and unpaid union and other medical claims.

Despite his troubles in California and a subsequent criminal investigation by Federal authorities,[2] Hauser was able to acquire and main-

[2] As a result of his activities in California, Hauser was convicted in March 1977 of four counts of an eight-count, March 1975 indictment charging violations of 18 U.S.C. § 1954 (Offer, Acceptance and Solicitation to Influence Operations of an Employee Benefit Plan). The offenses involved bribes or attempts to bribe union officials to do business with Hauser's now defunct California firm, National Prepaid Health Plans, Hauser was sentenced to two and one-half years in prison, a $46,000 fine, and four years probation. On Mar. 21, 1979 the Court of Appeals for the Ninth Circuit affirmed his conviction. Hauser is seeking Supreme Court review of his conviction.

tain control of Farmers National Life Insurance Company, a small, financially-troubled insurance company in Florida, and Family Provider Life Insurance Company, the dormant Arizona-based subsidiary of Farmers National. Soon after acquiring the Florida company, Hauser concealed his ownership and control of it. Primarily through those companies, Hauser carried out an even broader insurance sales scheme targeted principally at union health and welfare trust funds—first in Florida, then Indiana, Massachusetts, and Arizona. The scheme culminated on April 30, 1976, with a $23 million group life insurance contract with the Teamsters Fund. The Hauser operation collapsed shortly after the Teamsters award.

When the Hauser group had exhausted the labor union business available to it in States where its own insurance companies were licensed to do business, it entered into a type of reinsurance agreement known in the industry as a "fronting" arrangement with Old Security Life Insurance Company of Kansas City, Missouri. Old Security was licensed to do business in States where Hauser's smaller, relatively obscure companies were not. Under this fronting agreement, the Hauser group would sell insurance to labor union trust funds using Old Security's policies but reinsuring all or most of the risks into one of the Hauser-controlled companies. Most of the premiums would be passed on to the Hauser companies. Old Security received a percentage of the premiums as its profit, but did not maintain reserves or perform any other significant functions in connection with servicing of the policies. Although Old Security acted merely as a "front" for the Hauser group, it also went into receivership after the collapse of Hauser's schemes since it was liable as primary obligor on the policies sold to the funds.

Prior to Hauser's acquisition of Farmers National and the fronting arrangement with Old Security, neither Old Security, Farmers National, nor Family Provider had significant insurance business with labor union employee funds. Much of Hauser's success was attributable to Hauser's gaining entree to the funds by cultivating fund trustees and labor union leaders, or persons influential with those officials, including an insurance consultant to trustees, attorneys to funds, and relatives of union leaders. In many instances, Hauser offered financial inducements to these influential persons, including gratuities to some trustees, finders' fees to certain attorneys, commissions and other payments to relatives of union officials, and assistance to an insurance consultant in obtaining new union fund clients. The Hauser group typically submitted the lowest bid, in some instances with the assistance of inside information.

Once the insurance contracts had been awarded to the Hauser companies, Hauser and his associates converted large amounts of the premiums to their own use before the claims built up. As the claims mounted against the premiums which had been diverted to other uses, a portion of the premiums from newly acquired labor union business was used to pay the outstanding claims against old business. As a result, new business had to be generated constantly to bring in new premium dollars to pay claims against the earlier contracts. In this respect, the Hauser operation resembled a "Ponzi Scheme," or never-ending chain.

A Federal grand jury in Phoenix, Arizona returned a multicount indictment in June, 1978 against Hauser and three of his associates, including Bernard Rubin, a Florida union official and fund trustee who had been previously convicted of embezzling union and employee plan funds. The indictment charged the defendants with conspiracy to conduct a racketeer-influenced and corrupt organization in connection with activities in Florida, Massachusetts, Arizona and the Teamster Fund in Illinois (18 U.S.C. §§ 1962(d), 1962(c), and 1963). The indictment also charged Hauser and certain of his associates with interstate transportation and the receipt and disposal of large sums of money received from Laborers and Teamsters trust funds, knowing them to have been stolen and unlawfully converted (18 U.S.C. §§ 2314 and 2315). The indictment (Appendix C) is based, in large part, on matters explored during the Subcommittee's public hearings. On February 5, 1979, Hauser pleaded guilty to three counts of the indictment. Rubin pleaded guilty to a single count on December 4, 1978. Sentencing of Hauser and Rubin has been deferred pending the outcome of the trial on the remaining defendant, George Ralph Herrera.[3]

The activities of Hauser and his associates have also resulted in a number of civil suits, including an action filed on August 2, 1976 by the Teamsters Fund trustees;[4] an action filed on September 24, 1976 by the Securities and Exchange Commission in connection with Hauser's use of misappropriated Teamster Fund insurance premiums to take over National American Life Insurance Company;[5] and another by the Secretary of Labor on February 16, 1979 in connection with Hauser's Florida operations.[6]

In each major phase of their operation—Florida, Indiana, Massachusetts, Arizona, and the Teamsters Central States Fund—Hauser and his associates acquired business from labor union trust funds in substantial part through the influence of persons close to the unions involved. The following detailed findings demonstrate how this method was used in each case.

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[3] Hauser, Rubin and Herrera appeared at the Subcommittee's hearing in response to subpenas. Citing their privilege under the Fifth Amendment to the Constitution, they declined to answer any questions concerning their activities on the ground that their answers may tend to incriminate them.

[4] *Central States, Southeast and Southwest Areas Health and Welfare Fund et al.* v. *Old Security Life Insurance Company, et al.*, C.A. No. 76–C–2904, U.S. District Court for the Northern District of Illinois. A related action filed on May 1, 1978, by two beneficiaries of the Teamsters Fund names the present and former Fund trustees, among others as defendants and charges them with breach of fiduciary duty and fraud. *Carpenter and Adcock* v. *Fitzsimmons, et al.*, C.A. No. 78–C–1672. U.S. District Court for the Northern District of Illinois. In August 1979, the Fund trustees submitted a proposed partial monetary settlement of $2.9 million for court approval. The settlement was opposed by the plaintiff Fund beneficiaries because it does not provide enforceable procedures to protect future operations of the Fund. (Appendixes D–1 and D–2.) Subsequently, the plaintiff Fund beneficiaries and trustees reached agreement which was preliminarily approved by the Court in October, 1979. The agreement included the $2.9 million payment and protection procedures to be negotiated, with any differences to be resolved by the Court.

[5] *Securities and Exchange Commission* v. *National Pacific Corp., et al.*, C.A. No. 76–1784, U.S. District Court for the District of Columbia. The SEC obtained consent orders which among other things, enjoined Hauser, his associates and companies from violating the securities laws; barred Hauser from association with a public company for 10 years; and appointed a receiver for National American Life. Also, the SEC and the receiver obtained the return of a substantial amount of the funds Hauser misappropriated and a judgment against Hauser and certain of his associates in the amount of $3.9 million.

[6] *Marshall* v. *Trica io, et al.*, C.A. No. 79–914, U.S. District Court for the Southern District of Florida. This action is still in the pre-trial stage. See Appendix E for a letter to the Subcommittee from the Secretary of Labor discussing this suit and other enforcement actions in the Hauser case.

B. FLORIDA

In October, 1973, Hauser acquired a controlling interest in Farmers National Life Insurance Company, a small and financially troubled Florida firm, along with its dormant subsidiary, Family Provider Life Insurance Company of Phoenix, Arizona. He managed to do so despite information received by the Florida State Department of Insurance questioning his "integrity, competency, and experience" and a recommendation by two Department officials that his application to acquire controlling interest be denied.

To represent him in the acquisition of Farmers National, Hauser hired the law firm of Ciravalo and Feldman of Miami. The then Florida State Insurance Commissioner, Thomas D. O'Malley, who approved Hauser's acquisition of Farmers National, had been a partner in this firm before he took office.[7] The application for acquisition was approved by O'Malley, despite the recommendation of two insurance department officials to the contrary.

Shortly after his acquisition of Farmers National, Hauser took steps to conceal his control of the firm by creating a holding company and placing his shares of stock in the names of two other men—his brother-in-law, Harold Bernstein, and the man he had hired as president of Farmers National, Brian Kavanagh.

Once he had gained control of Farmers National and concealed his interest in the firm, Hauser set about acquiring insurance business from certain labor union trust funds in Florida, especially the Laborers and other construction unions. To gain access to these unions, Hauser paid $2,500 a month to Seymour A. Gopman, the attorney for many of the unions involved.[8] In return, Gopman introduced him to important union officials. Through Gopman, Hauser established a "very special relationship" with Bernard G. Rubin, the president of the Southeast Florida Laborers' unions in the Miami area and a trustee of a number of the employee benefit plans to which Hauser eventually sold insurance contracts. Rubin became a familiar figure in the office of Farmers National and involved himself in the day-to-day affairs of the company. At the time Hauser was soliciting business from the Laborers' funds, a Hauser-controlled company leased an expensive sports car for Rubin's use and provided employment for Rubin's son. Another Hauser company purchased an expensive pleasure boat for use by Sal Tricario, another Laborers' officer and a trustee of a union employee fund which placed its insurance program with Hauser's company.[9]

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[7] On Dec. 18, 1975, O'Malley was indicted by a Florida Federal Grand Jury for mail fraud and other criminal violations. On Jan. 18, 1979, he was convicted of, among other things, charges that he deprived the people of Florida the right to his impartial services because he was receiving payments from law partners for the sale of his partnership interest and that the source of such payments were fees obtained by his former law partners for representing clients before O'Malley. Hauser was not charged in these proceedings.

[8] On Apr. 7, 1978, Gopman pleaded guilty to four counts of an October 1977 indictment charging him with filing a false tax return, embezzlement of employee benefit plan funds, and receiving kickbacks from Sage Corporation in connection with certain loans by an employee benefit plan to Sage Corporation and its affiliates. These matters were not the focus of the Subcommittee's investigation: however, the Subcommittee did examine certain mortgage transactions between Sage Corporation and the Hauser group.

[9] The complaint in *Marshall* v. *Tricario* alleges, among other things, that Tricario breached his fiduciary duty to Laborers Local 767 Health and Welfare Trust Fund by accepting use of a boat from the Hauser group in exchange for his support of the Fund's purchase of life insurance from Hauser's company (Appendix E–1). Tricario appeared at the Subcommittee's hearings in response to a subpoena, but declined to answer any questions concerning his activities citing his Fifth Amendment privilege.

The Subcommittee finds that the acceptance of gratuities from Hauser by Rubin and Tricario was incompatible with their positions as employee benefit plan fiduciaries. The Subcommittee also finds Gopman's acceptance of compensation from Hauser for providing access to his client employee benefit plans constitutes a serious conflict of interest. The record also indicates that Rubin, Tricario, and Gopman, were instrumental in the Hauser group's success in selling insurance to the funds with which they were associated.

In July 1975, during the time that Hauser was soliciting insurance business from the Laborers' Union funds, Rubin was indicted in an action before the U.S. District Court for the Southern District of Florida for embezzling approximately $400,000 from unions and union trust funds. Immediately after the indictment, the Justice Department petitioned the Court, pursuant to 18 U.S.C. § 1963,[10] to place all of the unions and trust funds of which Rubin had control under a trusteeship in order to protect their remaining assets. The Department of Labor was requested by the Justice Department to act as trustee. The Labor Department initially agreed to do so, but later withdrew its agreement and said it would oppose the motion on the grounds that there was no statutory authority or precedent for such action, and that it would take too much manpower. Marty Steinberg,[11] the Miami Strike Force prosecuting attorney, explained to the Labor Department that he was not asking for a full trusteeship but for a monitor who would oversee the disbursements of union and welfare funds. However, the Labor Department did not cooperate, and the court subsequently denied the motion.

On October 22, 1975, Rubin was convicted and sentenced to 5 years in prison and fined $50,000. Following his conviction, the District Court issued an order requiring Rubin to forfeit all union and employee benefit plan positions. The sentence and forfeiture were stayed pending appeal by the Court of Appeals for the Fifth Circuit.

Also, following the conviction, the Department of Justice made another unsuccessful motion seeking the appointment of an independent monitor to review dispositions of union and employee fund assets. Since the Department of Labor had again declined to perform this function, the Department of Justice was not in a position to implement such an appointment even if the Court had granted the motion. The motion papers submitted by the Department of Justice also pointed out that the Laborers' International Union had failed to take action to protect the union or employee funds.

Rubin was not removed from his positions with unions and union employee funds until an October 1977 bond revocation proceeding at which the Department of Justice submitted evidence that Rubin had embezzled an additional $2 million from those unions and trust funds after his conviction.[12] It was only after the revelation of these further

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[10] 18 U.S.C. § 1963 is the forfeiture provision applicable to persons found guilty of a pattern of racketeering activity under 18 U.S.C. § 1962. Subsection (b) of section 1963 provides that, in any action brought by the United States under this section, the district courts of the United States shall have jurisdiction to enter restraining orders, prohibitions, or take such other actions as they deem proper.

[11] Marty Steinberg is now Chief Counsel to the Subcommittee. He was appointed to that position in July 1979.

[12] Rubin agreed to divest himself of these positions in lieu of withdrawal of bond pending appeal. The Court of Appeals for the Fifth Circuit affirmed Rubin's conviction in September 1977 (559 F.2d 975). On Mar. 15, 1975, after a remand by the Supreme Court, the Court of Appeals affirmed again, while reversing on two counts out of 103 (591 F.2d 283). On July 5, 1975, Rubin filed a petition for Supreme Court review, which is still pending. Rubin remained free on bail during these further appeal proceedings.

embezzlements that the Laborers' International Union imposed a trusteeship over the unions in which Rubin held positions and initiated investigations of those unions and union employee trust funds.

The Department of Labor has advised the Subcommittee that it does not believe that it was authorized under the Labor-Management Reporting and Disclosure Act (LMRDA) to assume a trusteeship of the unions whose funds Rubin embezzled in violation of Title V of that Act. The Department said it had no civil enforcement authority under Title V and that the ban on union office holding by Rubin under Section 504 of the Act does not apply until the exhaustion of all appeals.

The Department of Labor said it had no authority prior to January 1, 1975, to assume a trusteeship or monitorship for Rubin's misconduct involving employee benefit plan assets. The Department said its authority to seek civil remedies under ERISA for the protection of such employee plans (LMRDA covers only labor union organizations) pertains only to fiduciary misconduct occurring after January 1, 1975.

While the Department does not have specific civil authority under Title V of the LMRDA, its explanation ignores the fact that the trusteeship was sought by the Department of Justice under 18 U.S.C. § 1963. The order of the court directing a trusteeship would have given the Department its authority.

In any event, since some of the misconduct of Rubin occurred after January 1, 1975, the Department could have invoked its civil authority under ERISA to protect the employee benefit plans, but it did not do so.

The Subcommittee finds that the Labor Department and the Laborers' International Union failed to act in a timely fashion to protect union and trust fund assets from further looting by Bernard Rubin after he had been convicted for embezzlement of approximately $400,000 from these same funds. The Court of Appeals decision to grant a stay of the District Court's order requiring Rubin to forfeit his union and welfare plan positions, following his conviction, appears to have been within the discretion of the Court. However, the granting of the stay created a substantial risk that the union and plan's assets would not be adequately protected from repetition of the kind of conduct for which Rubin was convicted and indeed which occurred to a much greater extent after his conviction.

The lucrative nature of the labor union trust fund business is illustrated by the rapid increase in premiums received by Farmers National. In 1973, the year prior to Hauser's take-over, the total premiums received by the company amounted to about $1 million. Under Hauser's aegis, premiums increased to more than $4.5 million in 1974—primarily because of the new business generated from labor unions and employee welfare plans in Florida, most of them affiliated with the Laborers' and other building trades unions.

One reason that these premiums increased so rapidly was that the union trust funds purchased individual whole life insurance policies, which included an investment or cash value feature. These policies cost more than group term life insurance policies, which provide the same amount of insurance, but do not carry the investment feature. In addition to the higher cost to the union members, about 6,000 of the 13,000 Farmers National whole life policies issued to the members during 1974 lapsed in 1975 due to the high turnover in the construction industry—resulting in the loss of cash values to the members. In other words, nearly half the members' higher premiums were wasted. The higher premiums for whole life, as opposed to lower premiums for group term life, cost the Florida Laborers' Union trust funds an estimated $1 million extra in premiums costs per year.[13]

Florida law requires that insurance companies keep enough reserves to meet claims demands. Farmers National violated that law, enabling Hauser and his associates to divert and convert to their own use a large portion of the union premiums moneys. They arranged for the payment of high commissions and commission advances to insurance agencies which were owned or controlled by Hauser. In 1974 and 1975, two of Hauser's agencies were paid almost $2.5 million in commissions and commission advances by Farmers National. The Florida Department of Insurance was unable to obtain documentation justifying the payments. These payments had no relationship to any premium income generated by the two agencies. The creation of insurance agencies and the payment of commissions and commission advances was to be a prominent feature in Hauser's *modus operandi* when he expanded his scheme outside Florida.

In addition to these payments, Hauser and his associates withdrew more than $775,000 in cash and paid out almost $200,000 of insurance company funds for apparently personal expenses. In 1974 and 1975 these expenditures came almost exclusively out of the premiums paid by the Florida labor union trust funds to Farmers National. As noted above, the Florida funds have sustained losses in excess of $1 million on insurance contracts sold by Hauser's company.

Hauser's operation in Florida was typical of the labor union insurance fraud schemes that have been encountered by the Department of Justice. In a July 1978 article[14] in the Journal of Pension Planning and Compliance, then Attorney in Charge of the Buffalo, New York Strike Force of the Department of Justice, Marty Steinberg, noted that these schemes generally involved: (1) Contracts by the insurance fraud artist with an "initiator," who is usually willing, in exchange for gratuities or a kickback, to provide assistance in securing approval of the insurance program by the board of trustees; (2) the sale of high cost whole life policies; (3) exorbitant commissions; (4) shell companies which transfer premium payments in a maze of financial transactions which hide substantial sums of money; (5) lack of any method to guarantee the availability of funds to beneficiaries; and (6) bankruptcy and final dissolution within a short period of time.

C. INDIANA

In 1975, Hauser and his associates expanded their labor union insurance business beyond Florida and into the more unionized Northeast-

[13] See pp. 57, 58 of this report which refer to similar type abuses uncovered by the Subcommittee in the investigation of Louis C. Ostrer. The Secretary of Labor has filed a civil action against Ostrer and others with respect to some of the matters covered by the Subcommittee's Ostrer inquiry. See discussion of this civil action in the Secretary's letter to the Subcommittee which is in appendix E.

[14] "Proposals to Assist in Ending the Abuse of Employee Welfare and Pension Benefit Plans."

ern and Midwestern States. They did so in order to increase their cash flow to offset the money which they had taken out of Farmers National and to meet claims obligations on the Florida business.

In October 1975, Old Security Life Insurance Company, a front for Hauser and Farmers National, was awarded a large group insurance contract by the Indiana State District Council of Laborers and Hod Carriers Welfare Fund. Farmers National was licensed to do business only in Alabama, Florida, Georgia, South Carolina, Tennessee and Arizona. Old Security was licensed in every State except New York. Farmers National carried on the business using Old Security merely as a facade. The policies were entirely reinsured by Farmers National. Then Farmers National failed and was unable to meet the claims on outstanding insurance. Old Security was unable to satisfy its primary obligation on policies ceded to Farmers National since it had received only 2 percent of the premiums. Consequently, Old Security eventually was driven into receivership (see pp. 31, 32 of this report for discussion of Reinsurance).

As they had done in Florida, Hauser and his associates again relied on inside contracts to obtain business in Indiana. Since their target was an affiliate of the Laborers' International Union, they cultivated Paul Fosco, grandson of the Laborers' International Union president, Peter Fosco, and son of current president, Angelo Fosco. Early in 1975, Farmers National established Paul Fosco in the insurance business as the P. F. Insurance Agency in Chicago and agreed to cover Fosco's salary and the agency's expenses during 1975. As an added inducement, Hauser also agreed to pay Paul Fosco's agency an override on all insurance sold by Farmers National anywhere in the country. Hauser paid about $260,000 to P. F. Insurance Agency, including $50,000 in 1974 before Fosco was licensed to sell insurance. Fosco participated in only one insurance contract sale—the one to the Indiana Fund. The payments to Fosco had no correlation to the amount of insurance business generated by the agency.[15]

Paul Fosco used his Laborers' Union connection, including his lifelong friendship with Charles Morris, secretary-treasurer and trustee of the Indiana State Council of Laborers' and Hod Carriers Welfare Fund, to help bring about the rebidding of that Fund's insurance program. The new bids were solicited by Morris without the trustees' approval. Through the influence of Paul Fosco and Morris. Hauser's associates prepared the bid specifications and designated the companies that were invited to bid, including Old Security. The specifications requested bids on group permanent life, as well as the existing cost-plus program. The evidence shows that the specifications were tailored to Old Security's existing group permanent plan. In fact, only Old Security submitted a bid on the group permanent plan.

The Subcommittee finds that Morris' unilateral action in causing the rebidding of the Fund's insurance program and permitting interested parties to prepare bid specifications fell short of the standards which an employee benefit plan should expect of its trustees.

During Hauser's efforts to secure the Indiana Laborer's Fund business, he and his associates developed a questionable relationship with

[15] Paul Fosco appeared to testify at the Subcommittee's hearing in response to a subpoena. Citing his Fifth Amendment privilege, Fosco declined to answer any questions.

the Tolley International Corporation, which at the time was serving as insurance consultant to the Laborers' Fund. At the outset, the decision to rebid the Indiana insurance program and the actual solicitation of bids were undertaken without the advice of Tolley International. When the resulting bids, including Old Security's proposal for group permanent life coverage, were submitted to Tolley International for analysis, Tolley International noted in a June 11, 1975 letter to the trustees that Old Security's proposal entailed an annual premium far in excess of the premium being paid under the Fund's existing cost plus, term life policies, and it cautioned the trustees against approving such a costly program. That advice was rendered before Tolley International's Executive Vice President, Len Teeuws, visited Farmers National's headquarters in Miami and held discussions with the Hauser group. After that visit by Teeuws, Tolley International reversed its position and recommended that favorable consideration be given to Old Security's high cost group permanent life insurance proposal. On the basis of Tolley International's advice, the Fund's trustees initially approved the Old Security permanent life proposal. After the Fund's legal counsel raised a question about the fact that only Old Security bid on the group permanent proposal, Tolley International was asked to prepare an analysis of the competitiveness of the bid. Tolley International subsequently submitted a report, dated September 17, 1975, to the Fund stating its opinion that the Old Security group permanent proposal was competitive. The evidence indicates that Tolley's analysis was based substantially upon an analysis prepared by Hauser associate, John Boden. After the Fund's legal counsel continued to raise objections, the Fund trustees voted to rescind the group permanent award and to award the cost plus proposal to Old Security which was the low bidder.

Internal documents obtained under subpena from Tolley International's files strongly indicate that Tolley International's reversal was linked to its expectation that Hauser, as well as Paul Fosco and others influential with the Laborers' International Union, would be helpful in obtaining for Tolley International other consulting contracts with Laborers' Union health and welfare plans, including the Health and Welfare Fund of the Massachusetts Laborers' District Council.

Tolley International was aware of a reinsurance arrangement between Old Security and Farmers National as reflected in Tolley's July 23 bid analysis which noted that "Old Security would cede a *portion* of the premium and underwriting responsibilities to Farmers who would handle all administrative responsibilities between the companies and the Fund." (Italic added.)

Tolley International's July 23 report of its bid analysis also stated its opinion that Old Security and Farmers National "were financially large enough to handle the underwriting" of the Fund's insurance program. Attached to the analysis was financial data showing the combined or consolidated assets of Old Security's holding company ($418 million) and the assets of Farmers National ($5 million). At a later meeting of the trustees, Len Teeuws of Tolley advised the trustees that "he would feel secure with Old Security as the insurance carrier."

The Tolley International report concerning the reinsurance arrangement and the financial condition of Old Security and Farmers National was materially incomplete and misleading. In fact, Old Security was merely fronting for Farmers National to which Old Security ceded 100 percent of the coverage and gave control over substantially all of the premiums to Farmers. Tolley's reference to "a portion" of the premium and underwriting being ceded to Farmers National did not inform the trustees of the significant risks in the contract since the Fund would be relying in substantial part upon Farmers National financial standing. In this regard, the data contained in Tolley International's bid analysis showed that the Fund's annual premium was approximately equal to Farmers National's assets. Moreover, the inclusion in Tolley's July 23 report of consolidated financial information for Old Security's holding company created a misleading implication that the full financial strength of the holding company stood behind the Old Security commitment.[16] There is no evidence of any such guarantee. Also in contrast to its July 23 report, Tolley International's June 11 report showed only Old Security's assets which were $23 million, as compared with the holding company's consolidated assets of $418 million. Thus the annual premium would constitute about 20 percent of Old Security's assets.[17]

Len Teeuws of Tolley International testified that he did not know the terms of the reinsurance agreement and had not made any inquiry concerning them and that it was not the normal industry practice to do so because Old Security remained liable for all risks. The failure to adduce these clearly relevant details has the same impact as a knowing failure to disclose them; namely, that the Fund is deprived of information important to its assessment of the bid. Also, the subsequent demise of Old Security and Farmers gives little reason for employee benefit plans or insurance consultants to take comfort in industry practices which are incompatible with the protection of such plans and their beneficiaries.

As to Tolley International's use of Old Security's consolidated financial statements, the Subcommittee did not explore whether Tolley intended to mislead the Fund. Whatever Tolley International's intentions, the impact was misleading.

The Subcommittee finds that the foregoing conduct by Tolley International fell well short of the standards of independence and care an employee benefit plan should expect of its insurance consultant.

As compensation for its consulting services to the Fund, Tolley International received a commission from Old Security consisting of a percentage of premiums. It appears that the receipt of this compensation was disclosed to and approved by the Fund trustees. *However, the Subcommittee finds that such a compensation arrangement creates an irreconcilable conflict of interest. Since the compensation is based on a percentage of premiums, it does not necessarily bear any direct relationship to the true value of the consultant's serv-*

[16] In the case of the Arizona Laborers Health and Welfare Fund, the Fund specifically asked Old Security if its parent would agree to hold the Fund harmless if Old Security failed in its commitment to the Fund and was advised by Old Security that it was precluded by law from making any such agreement. Tolley International was not the consultant to the Arizona Fund, but presumably the same information was available to it had it asked.

[17] The risk involved in an insurance company committing such a sizable portion of its resources to a single contract is reflected in the declinations of some major insurance companies—with assets ranging from about $250 million to $15 billion—to bid on the Teamsters Fund's contract involving a $23 million annual premium. The declination letters cited the exposure to risk involved.

ices and creates an incentive to recommend either more insurance or higher premium cost insurance than may be appropriate. As a result, Tolley International stood to gain a higher consulting fee if the Fund had approved its recommendation for higher premium group permanent insurance.

Based upon the testimony of Len Teeuws and other information in the record, it appears to be a common practice for employee benefit plan insurance consultants to receive their compensation from insurance companies. Also, the Department of Labor appears to have exempted this practice from the prohibited transactions provisions of ERISA.

The Subcommittee finds that this practice and the exemption impair the independence of insurance consultants to employee benefit plans.

D. MASSACHUSETTS

During the same period in 1975 that Hauser and his associates were acquiring the insurance business of the Indiana Laborers' Fund, they used similar tactics to obtain an insurance contract with the Massachusetts Laborers' Health and Welfare Fund. As had occurred in Indiana, the Tolley International Corporation came on the scene as a consultant to the Massachusetts Laborers' District Council and the Fund and promoted Hauser's interests.

In Massachusetts, the Hauser group first sought out Joseph Vaccaro, who was in the construction business and who knew many important officials of the Laborers Union because of his position on the Labor Management Committee that negotiated contracts on behalf of management with the Laborers Union. As he had done with Paul Fosco, Hauser set up Vaccaro in his own insurance agency. Hauser promised him a salary of $75,000 a year plus expenses, as well as the use of a leased Cadillac automobile. While Vaccaro was instrumental in bringing Hauser's proposals to the attention of the Fund trustees, the payment of his salary and expenses had no relation to the amount of new insurance business his agency generated. The award by the Massachusetts Fund to Old Security was the only insurance business in which Vaccaro was involved. The records of his agency did not identify payment of $127,000 he received from Hauser as being related to specific insurance business.

In promoting Hauser's sale of insurance to the fund, Vaccaro obtained the approval of Arthur E. Coia, regional vice president of the Laborers' International for the New England area, to contact Joseph Merloni, president of the Massachusetts Laborers' District Council. Merloni and his wife were then treated by Hauser to an all-expense-paid trip to Florida, where they visited the headquarters of Farmers National. After this trip, Merloni actively sponsored the adoption by the Fund trustees of Old Security's group permanent life insurance plan being promoted by Hauser and his associates. Both Vaccaro and Merloni were instrumental in getting the Fund trustees to place the Fund's insurance out for rebidding and to include expensive group permanent life in the specifications.

On May 9, 1975, bids were solicited from a number of major insurance companies recommended by the Fund's insurance consultant, the Martin Segal Company. At Merloni's request, Old Security and three other firms were added to the list.

The bids were opened on June 6, 1975. At a trustees meeting held July 10, 1975, the Segal Company presented a report showing that the group permanent life insurance plan of Old Security would cause a deficit to the Fund for the next year and also pointing out there were unanswered questions concerning the Old Security bid. In spite of this, a vote was taken to award the contract to Old Security for group permanent. Five trustees (four union and one employer) voted to approve it, and three employer trustees voted against. However, the award was defeated because it did not receive the required six votes from the eight trustees.

The next trustees meeting was held August 7, 1975. In the meantime, the Segal Company wrote Old Security and raised a number of questions including one as to whether the total coverage would in any way be reinsured. Old Security's answer failed to disclose that 100 percent of the coverage would be reinsured with Farmers National under a fronting agreement.

At the August 7, 1975, meeting, the union trustees received a telegram from Peter Fosco, General President of the Laborers' International Union, stating that "we do not believe that it is appropriate and consistent with fiduciary duties for a fund" to buy group permanent or other similar types of ordinary life insurance "because of their high cost, low value ratio and other serious drawbacks." The Martin Segal Company also presented a report critical of the Old Security group permanent proposal which noted, among other things, the "excessive cost" of the alleged cash value benefit of permanent life policies and that Segal was not aware of any large multi-employer welfare fund that uses such policies. Although he was not a trustee, Merloni recommended to the trustees that the Tolley International Corporation be brought in as an outside consultant. The trustees approved this recommendation.

At the next trustees meeting on September 21, 1975, Len Teeuws of Tolly International, as he had done in Indiana, presented a report to the Massachusetts trustees which was favorable to the Old Security group permanent life proposal. Tolley's report cited as one of the advantages of the permanent life proposal that cash values would be generated for beneficiaries. However, no consideration was given in the report (nor do the minutes of the trustees meeting reflect any consideration in Teeuws' oral presentation) to the potential adverse impact of employee turnover on administrative costs and the attainment of cash values. Also, the report did not disclose the existence of the reinsurance arrangement between Old Security and Farmers of which Teeuws knew or should have known.

Once again, a motion was made to accept the Old Security group permanent life proposal. The four union trustees again voted unanimously in favor of accepting it, but the motion failed when two management trustees voted against it and one abstained. Six votes of the eight trustees were required to approve it.

Had it not been for the opposition of the Segal Company, the telegram from then General President Peter Fosco and the requirement for approval of six out of the eight trustees, the expensive group permanent life insurance plan of Old Security probably would have been approved for the Fund.

Len Teeuws said the Tolley International bid analysis submitted to the Massachusetts Fund actually was prepared for the Massachusetts Laborers District Council. He said he did not receive compensation from either the District Council or the Massachusetts Fund. Tolley International was induced to provide an analysis on the basis of an expectation that Arthur E. Coia, Paul Fosco and the latter's father, Angelo Fosco, would use their influence in the Laborers' International Union to replace the Segal Company as consultant with Tolley International. The expectation was based on discussions Len Teeuws had with Mike Capurso, a Hauser associate, and Arthur E. Coia, Paul Fosco and Merloni. On August 14, 1975, Teeuws wrote to his superior, Russell Tolley, that "a great deal of potential profit to our corporation hinges on what occurs in Boston." Tolley International also knew that Coia and Merloni supported the Old Security permanent life proposal. Teeuws permitted Hauser's associates to participate in the drafting of its analysis of the permanent life proposals which were very favorable to the Old Security bid. Indeed, John Boden, a Hauser employee, testified that he prepared the analysis. Teeuws also discussed the report prior to presenting it to the trustees with Coia, his son Arthur A. Coia, Merloni, and Hauser's associates, Boden and Roger Carney. Also, Tolley International had a commission arrangement with Old Security with respect to its consulting services to the Indiana Laborers' Fund.

The trustees considered the Tolley International analysis to represent the firm's impartial analysis. Had the trustees known all the facts concerning Tolley International's relationships with Old Security and Hauser and its understanding that Laborers International Officials would support replacing the Segal Company with Tolley International, they would have had strong reason to question whether Tolley International was acting as an advocate rather than an independent consultant.

On October 30, 1975, the trustees voted unanimously to accept Old Security's low bid for the more conventional and less costly group term life insurance and other health and accident coverages. Prior to the award, the Segal Company consultant pointed out that the difference in retention between Old Security and the existing carrier was "minimal." Also, co-counsel to the Fund pointed out that the choice to be made was a "policy decision for the trustees," based on all the factors presented by the consultants. One of the factors cited was that Old Security's total health and welfare business the previous year was less than the annual premium of the Fund. This appears to have been a suggestion to the trustees that they consider the risk to the Fund of dealing with Old Security which had limited experience in writing health and welfare business. Of course, the Fund would actually incur greater risk because of Old Security's fronting arrangement with Farmers National in this regard. The trustees and the Segal Company consultant seemed unaware of the existence of Old Security's reinsurance arrangement with Farmers National prior to making the award.

From about the fall of 1975 to the summer of 1976, the Hauser group engaged in a number of transactions which further demonstrate his *modus operandi* of cultivating persons who could assist him in gaining entree to Laborers Union employee trust funds. In the fall of 1975, Hauser asked the younger Mr. Coia if he could recommend someone with insurance expertise whom Hauser could hire. Arthur A. Coia recommended Vincent Vallero, who was hired by Hauser after a January 1976 meeting of Hauser, Vallero and Coia in Coia's office. In early 1976, Hauser stated he told Coia and his law partner, Albert Lepore, that he wanted to set up an insurance agency in Providence. Lepore served as counsel to the Rhode Island Laborers' Heavy Construction Fund which later awarded an insurance contract to Old Security. Northwest Insurance Agency, Inc., was formed by Lepore in March, 1976. There is no evidence of direct stock ownership interest by Arthur A. Coia in Northeast, although there is evidence of his involvement in the business, including his receipt of a $50,000 check in July 1976 from a Hauser insurance company which was endorsed by Arthur A. Coia over to Lepore for Northeast-related expenses. A total of $110,000 was received from Hauser companies by Northeast Insurance Agency between April and July of 1976. The records of Northeast Insurance contained no written agreement as to commissions or other payments nor any documentation which identified any of the payments to Northeast as commissions or fees on any specific insurance contracts.

E. ARIZONA

In soliciting labor union insurance business in Arizona, Hauser and his associates once again relied on contacts with persons of influence—in this case, two men who served as trustees on two union health and welfare funds. Carrying on these contacts was a close Hauser associate, George R. Herrera, who had performed a variety of tasks for Hauser over the years, including a stint as his bodyguard. Although not a licensed insurance agent, Herrera operated a Hauser-related insurance agency which received large commission advances that had no relation to any insurance business produced by Herrera or the agency.

The two trustees who promoted Hauser's interests in Arizona were William Soltero of Phoenix and Fred Brown of Tuscon. Both had known Hauser and Herrera for four years, and Soltero had had a variety of business relationships with Herrera. Soltero was business manager and secretary-treasurer of Local 383 of the Construction, Production, Maintenance and Laborers' Industrial Union as well as a trustee of the local's health and welfare fund. Both Soltero and Brown were trustees of the health and welfare trust fund of the much larger Local 395 of the Arizona Laborers, Teamsters and Cement Masons Union. The two men played prominent roles in awarding the insurance contracts of the two funds to Old Security, which again was acting as a front for Hauser's insurance companies.

Late in 1975, the trustees of the Local 395 fund decided to rebid their insurance business after their carrier of long standing announced a premium increase. Their insurance consultant, the Martin Segal Company, sent invitations to 23 firms, which did not include Old Security, Farmers National or Family Provider. The latter was Farmers National's dormant Arizona subsidiary, which Hauser and his associates planned to activate in order to win this new business and to retain the 2 percent of the premium that Old Security would otherwise receive under their fronting arrangements.

After the bid deadline had passed and at Herrera's request, Soltero and Brown asked Segal to send bid specifications to five other companies, including Old Security and Farmers National. Both firms responded with bids. In addition, Family Provider submitted an unsolicited bid. The Hauser group actually prepared all three of these bids. Of all bids received, Old Security was the lowest on premium and Family Provider was lowest on retention.

At a trustees meeting on December 23, 1975, two management trustees raised objections to the three late bids on grounds that they were untimely, that the companies' assets were insufficient to sustain the risks, and that the proposals would not cover pre-existing hospitalizations. Soltero and Brown encouraged the gathering of more information that would clarify the companies' financial status and their bids. Nevertheless, the trustees, including Soltero and Brown, voted to award the contract to the Union Labor Life Insurance Company, which had the lowest bid received before the bid deadline.

Learning of this decision, Hauser objected personally to Soltero and Brown, and on December 29, 1975, the two men notified the attorney for the trustees that Old Security's assets were more than had been reported by the Segal Company and that Old Security's bid had been misinterpreted. Herrera also visited the attorney and placed a call during that meeting to John Boden who was asked to clarify Old Security's bid. Boden was not an official of Old Security; rather, he was employed by Hauser's companies. As a result of these efforts, the trustees decided to resolicit bids from those initially replying and from Old Security, thereby specifically excluding Farmers National and Family Provider from consideration.

On February 2, 1976, the trustees awarded the insurance contract to Old Security, which was the lowest bidder. Ironically, this award to Old Security actually resulted in what the trustees had attempted to avoid; that is, not to give their business to the two Hauser firms. Because of the fronting arrangement with Old Security, Hauser and his associates obtained the business anyway.

Shortly thereafter, the Local 383 Health and Welfare Fund awarded its insurance program to Old Security after rejecting lower unsolicited bids from Farmers National and Family Provider. Again, through the fronting arrangement, Farmers National and Family Provider obtained the business despite the trustees' intent to do business with a more substantial carrier.

F. TEAMSTERS CENTRAL STATES FUND

The Hauser group's most ambitious project was the life insurance program of the huge Chicago-based Teamsters Fund. The Fund's life insurance policy is one of the largest single group term policy of its kind in the country, providing $2.6 billion in force insurance for 180,000 Teamster members, with annual premiums of more than $23 million.

Despite competition from some of the giants of the insurance industry, including the Prudential Life Insurance Company of America, the Plan's trustees awarded the contract on April 30, 1976, to Old

Security, which was acting as a front for Hauser's dormant Family Provider Life Insurance Company. Within two weeks, Hauser's associates converted more than $1 million of Teamsters Fund premiums to their own use. Shortly thereafter, the Hauser operation collapsed, resulting in a loss of approximately $7 million to the Teamster Plan.

As in two previous cases, Tolley International played an important role in the award, this time as insurance consultant to the Teamsters Fund. The Hauser group also obtained the assistance of persons who were in a position to influence the leadership of the Teamsters Union and the Fund. The most important of these persons was former Attorney General Richard Kleindienst,[18] who knew and had direct access to Frank Fitzsimmons, the General President of the Teamsters International Union and a Fund trustee.

The Subcommittee finds that the award of the $23 million Teamsters Fund insurance contract to Old Security was the result of several contributing factors:

(a) *the questionable and undisclosed relationship between Tolley International and the Hauser group;*

(b) *a failure on the part of Tolley International and Fund trustees and other Fund officials to assure that the contract was awarded strictly on the basis of sealed, timely bids and in strict conformity with the bid specifications and procedures;*

(c) *a failure on the part of the Fund's trustees to heed the recommendation by the Fund's Executive Director that the contract be awarded to the Prudential Life Insurance Company;*

(d) *Hauser's agreement with Allen Dorfman to permit Dorfman's Amalgamated Insurance Agency to process claims under the Old Security contract and the willigness of the Fund trustees to accept Amalgamated as the claims processor; and*

(e) *efforts exerted by Kleindienst on behalf of the Hauser group in return for a substantial fee.*

1. Conduct of Tolley International

The first knowledge that Hauser and his associates had concerning the details about the Teamsters Fund to solicit new bids on its insurance contract came from Len Teeuws of Tolley International during a meeting in Miami in December 1975. Tolley International had been serving as the Fund insurance consultant since about 1972. By the time of the December 1975 meeting, Tolley International already was involved with Hauser's group in promoting insurance contracts with the Laborers Union in Indiana and Massachusetts. Teeuws told Hauser's associates that he would be preparing the bidding specifications for the Teamsters Fund, and that if the Hauser group could submit a competitive bid, it would have a good chance of winning the award. Hauser associate John Boden testified that Teeuws also told them that a retention [19] rate of 3 percent would be competitive.[20] In his testimony before the Subcommittee, Teeuws could not recall the

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[18] Kleindienst resigned as Attorney General on May 24, 1973. In May 1974, Kleindienst pleaded guilty to a charge that he violated 2 U.S.C. § 192 by having refused to testify fully and accurately to certain questions put to him in his Senate confirmation hearing about the ITT affair.

[19] The retention rate is the portion of the premium which the insurance carrier keeps for state and federal taxes, contingency reserves, acquisition costs, commissions (if any) and profit. The remainder of the premium belongs to the policyholder which the carrier uses to pay benefits and to set up reserves for incurred, but unreported claims.

[20] Boden testified before the Subcommittee under a grant of immunity conferred by order of the U.S. District Court for the District of Columbia pursuant to 18 U.S.C. §§ 6002 and 6005.

particulars of what was discussed at this Miami meeting, but that, in any event, it would not have been uncommon for him to have discussed competitive retention rates with prospective bidders. He also stated that he would not consider it improper if he had advised Hauser's associates of what retention would be competitive.

The weight of the evidence supports Boden's testimony that Teeuws told Hauser's associates that the 3 percent retention rate would be competitive. Boden testified this information was very helpful to the Hauser group in formulating its bid which provided for a 3 percent retention. The communication of this information in an informal manner, as opposed to the formal written invitation to bid, creates (1) a substantial risk that it will not be made equally available to all prospective bidders and (2) obvious opportunities for fraud and abuse. Teeuws' testimony displays a lack of sensitivity to this risk. Other than Teeuws' general and unsupported assertions that he discussed retention rate "at all times" with insurance companies, there is no evidence indicating that Tolley International made equal disclosure of the "competitive rate" to other bidding insurance companies.

Tolley International prepared a list of bidders which included Hauser's fronting company, Old Security, among some of the larger and best known insurance carriers in the nation.

The bid specifications provided that the successful bidder would be required to process the claims under the contract. This provision was included because the Fund's Executive Director, Daniel Shannon, wanted to remove the claims processing function from Amalgamated Insurance Agency, which was controlled by Allen M. Dorfman. Shannon cited a number of factors for his position, including difficulties the Fund had encountered obtaining information from Amalgamated; subservience of the Fund to Amalgamated, which he believed exercised too much control over the claims program; Amalgamated's unauthorized use of the list of Fund participants in soliciting purchases of add-on insurance; and Dorfman's 1972 conviction of an offense relating to a Teamsters Pension Fund transaction.

The specifications did not ask bidders to disclose whether they intended to reinsure any portion of the business with another company.

The bids were solicited on January 14, 1976, with bids to be postmarked not later than midnight February 13, 1976. The bids were not kept sealed or opened at a conventional "bid opening" after the bidding deadline. Instead they were copied on receipt at the Fund's offices apparently without retaining or noting postmarkings, and then forwarded on to Tolley International for analysis. After the bidding deadline, Old Security submitted an amended proposal offering to reduce its bid by an unspecified amount if the claims processing function was handled by the Fund instead of by Old Security, as required in the bidding specifications. There is no evidence that any other bidder was informed of this amendment or afforded an opportunity to match this change in Old Security's bid. This amendment figured prominently in Tolley International's analysis of the bids and the ultimate award of the business to Old Security.

Tolley International's analysis of the bids, submitted to the trustees on March 1, 1976, made no clear recommendation as to which bidder should be awarded the contract. However, it did identify alternatives available to the trustees, depending on the length of time the Fund was to remain insured by the successful bidder. If the trustees intended to remain insured for less than a 3-year period, Tolley recommended that "consideration should be given to the low retention charges," pointing out that Old Security had the lowest net retention. Tolley further recommended that, if the trustees intended to remain insured for a period longer than 2 years, "consideration should be given to the Prudential * * * proposal which results in credits to the Fund from interest on reserves." Tolley pointed out Old Security's offer to negotiate an unspecified reduction in its bid if the Fund were to process its own claims, but it did not bring to the trustees attention that the specifications required bidders to handle processing or whether all bidders were given an opportunity to make the same offer that Old Security did.

The recommendation contained in Tolley International's analysis of bids, stated that Prudential would not credit the Fund with interest on reserves until the third year. Old Security did not offer to credit the interest on reserves. However, testimony by Franklin Dana, an actuary from the United States General Accounting Office (GAO), pointed out that Prudential offered to credit interest in the first and second years as well and that this was evident in certain tables included in Tolley's own analysis. If taken into account, these interest credits would have reduced Prudential's retention by $17,830, making its net retention lower than that of Old Security in the first year as well as in subsequent years. The GAO actuary also pointed out that, in contrast to Tolley's treatment of the Prudential's offer to credit interest, its analysis of the late Travelers bid (which was rejected because it was late) took into account interest credits that the insurer offered to pay.

Teeuws did not provide a satisfactory explanation as to why he only pointed out to the trustees the interest credit benefits offered by Prudential in the third and remaining years when it was clear from the data included in his analysis that such credits were also offered in the first and second years and, if taken into account would have made the net retention cost to the Fund of the Prudential bid lower than Old Security's bid.

In accepting and giving emphasis in its analysis to Old Security's variance from the bidding specification, Tolley International paved the way for another late amendment to its bid—2 days before the award. This amendment specified the amount by which Old Security would reduce its bid if relieved of claims processing, thereby permitting the continued performance of such services by Allen Dorfman's Amalgamated Insurance Agency.

The analysis of bids by Tolley International contained no disclosure of any reinsurance arrangements on the part of any of the bidders. Based on its previous dealings with Old Security and the Hauser group in Indiana and Massachusetts, Tolley International at least should have known that Old Security was merely fronting for Family Provider Life Insurance Company, a reinsurance carrier not qualified to bid directly or to reinsure the bulk of the risk on the Teamsters Fund contract.

Tolley International later provided the Fund financial information concerning Old Security which showed the consolidated assets of "Old Security Holding Company" as exceeding $450 million. The assets of Old Security itself, however, were a little more than the $23 million annual premium provided in the Teamsters Fund contract.[21] Tolley's own bid analysis report contained letters from some insurance companies, with assets exceeding Old Security by many hundreds of millions of dollars, in which they notified the Fund that they would not bid on the contract because it would expose them to too great a risk.

While Tolley International provided this misleading financial information and vouched for Old Security at the April 30, 1976 trustees meeting, its analysis did not address the relative financial strength, reputation and ability to perform of the bidding companies. In this regard, Len Teeuws of Tolley International was aware that Old Security was primarily involved in the writing of credit life insurance, but did not bring this fact to the attention of the trustees.

As previously noted, Tolley International had an understanding that the Hauser group would assist Tolley in replacing the Segal Company as consultant to the labor union funds with which Hauser had influential contacts. Tolley International did not bring this important information bearing on its independence to the attention of the Fund's trustees. Tolley International's relationship with the Hauser group constituted a conflict of interest which should have been disclosed to the Fund.

In a letter to the trustees dated April 5, 1976, Fund Executive Director Daniel Shannon recommended that the contract be awarded to Prudential because "it appears to combine a low retention with a superior reputation and the financial stability to handle our account." [22] The meeting agenda attached to the letter said Tolley International recommended the Prudential bid as "the most attractive bid." A later meeting agenda dated April 23 reported the same Tolley recommendations. Teeuws testified that he had not made this recommendation. However, Richard Heeren, Shannon's assistant, testified that Teeuws had made such a recommendation.

2. Kleindienst's contacts with Frank Fitzsimmons

Word of Shannon's preference, which appears to have been conveyed to the Hauser group by Teeuws of Tolley International, led to an effort by Hauser to bring outside influence to bear on Frank E. Fitzsimmons, a Fund trustee and general president of the Teamsters International Union, in order to obtain his support for the Old Security bid.[23] In carrying out this effort, Hauser first contacted two Washington, D.C. public relations executives, I. Irving Davidson and Thomas

[21] As noted above (pp. 10, 11), similar misleading consolidated financial information was provided as a written bid analysis submitted by Tolley International to the Indiana Laborers Fund.

[22] Prudential had assets at the time of about $40 billion, which was more than 1,500 times greater than Old Security's assets.

[23] Hauser attempted to influence Fitzsimmons much earlier through Terrance O'Sullivan, a former Laborers Union official, who was acquainted with Fitzsimmons. Fitzsimmons testified that, in early 1976, or possibly late 1975 O'Sullivan contacted him and told him that he had an insurance program he wanted Fitzsimmons to look at. Fitzsimmons said he referred O'Sullivan to the Fund's office in Chicago, did not contact the Fund on his behalf and did not even know the company he was representing.

D. Webb, Jr., the latter of whom was a friend of Fitzsimmons. Hauser offered to pay them a fee for their help if Old Security won the award. In turn, Webb suggested that a better approach to Fitzsimmons would be through Richard G. Kleindienst, the former Attorney General of the United States, who was closer to Fitzsimmons and who would have more "clout" with the Teamsters president.[24] Accordingly, Webb contacted Kleindienst and offered to split a $250,000 fee [25] with him if he could be helpful in obtaining Fitzsimmons' support of Old Security.

Kleindienst testified that he had at least two series of contacts with Fitzsimmons in April 1976 prior to the award. The first series involved two telephone conversations, one initiated by Kleindienst on about April 5 and the other by Fitzsimmons on or about April 6. A similar series occurred in the latter part of the month, one initiated by Kleindienst on April 23 and one by Fitzsimmons on April 26.[26]

Kleindienst recalls the April 5 call to Fitzsimmons as his first contact resulting from his conversation with Thomas Webb. Kleindienst said that he told Fitzsimmons he represented Old Security and understood it was the low bidder and was deemed qualified to do this business by the Fund's insurance consultant. He asked that Fitzsimmons check it out and said he would appreciate any help Fitzsimmons could give with this matter. He said Fitzsimmons called him back the next day (April 6) and said that he looked into the Old Security matter, it is a company that is apparently qualified to write the business and that it had a "good chance" of getting the business and that he would keep in touch about it.

Kleindienst's contacts with Fitzsimmons on the latter part of the month were prompted by a call he received from Webb advising that things were "off the track" insofar as Old Security getting the bid was concerned. Kleindienst said he called Fitzsimmons to ask him to look into the matter and let him know if there was a problem. Kleindienst recalls receiving a call back from Fitzsimmons in which Fitzsimmons said that everything was going to be all right, but that it will take 3 or 4 days. Telephone call records of Kleindienst's law firm indicate that on April 22 and April 23, Kleindienst received calls from Webb; that on April 23, Kleindienst called Fitzsimmons; and that on April 26, Kleindienst received a call from Fitzsimmons.

Fitzsimmons testified that he had no recollection of having any contacts with Kleindienst in April 1976, prior to the award. He did recall that he called Kleindienst after the trustees' decision to award the contract to Old Security to tell him of the award. Fitzsimmons also recalled receiving a telephone call from Kleindienst, which he placed in February 1976. He said Kleindienst told him that he represented Old Security which was bidding on the Teamsters Fund insurance business and asked if he (Fitzsimmons) would be of any help. Fitzsimmons said that, if Old Security was sound and viable and its bid was

[24] Prior to seeking Kleindienst's assistance, Webb had contacted Fitzsimmons. Webb could not recall the date of the call. Fitzsimmons said he did not recall having received such a call. The weight of the evidence indicates that such a call took place (see pp. 131, 132 of this report).

[25] Webb and Davidson testified that the amount of the fee was not established at that time but that Kleindienst would work out the amount of the fee.

[26] Kleindienst indicated that there may have been a third series in the latter part of the month. There are also some indications that some contacts between Kleindienst and Fitzsimmons may have taken place before April 5.

competitive, its bid would be given as much consideration by the trustees as any other bid. In contrast to his prior routine referral of Terrance O'Sullivan's inquiry to the Fund offices, Fitzsimmons said he checked with Executive Director Shannon to see if Old Security was on the bid list and then called Kleindienst back. Fitzsimmons denied he provided Kleindienst any assistance or that he ever told Kleindienst that Old Security was the low bidder or otherwise gave him assurances that Old Security's chances of receiving the award were good.

The persuasive weight of the evidence is that there were at least two series of contacts between Kleindienst and Fitzsimmons in April 1976. In this regard, Fitzsimmons in his testimony pointed out that, in April and in the three to four preceding months, he was preoccupied with intensive labor negotiations and, thus, could not recall precise dates of meetings and phone calls and other details of events leading to the award of the insurance contract to Old Security. Whatever Fitzsimmons communicated to Kleindienst in those April conversations, it is clear that Kleindienst found basis for optimism. As Kleindienst testified:

> He always gave an indication to me there didn't appear to be any problems so far as the Old Security bid was concerned.
>
> * * * * *
>
> * * * I was optimistic. I relayed that optimism to my wife, to my secretary, to my law partners, and also the fee that I thought we could anticipate as a result of our optimism (p. 1039).[27]

It is doubtful that, given his financial stake in a favorable outcome and his experience and sophistication, that Kleindienst could have taken any comfort (much less become optimistic) if Fitzsimmons merely told him that the Old Security bid would receive as much consideration as any other bid.

On April 12, 1976, after his contacts with Kleindienst on April 5 and 6, and following Executive Director Shannon's letter of April 5 to the trustees recommending that the Prudential bid be accepted and noting that this was also Tolley International's advice, Fitzsimmons and then co-trustee William Presser[28] met with Shannon in Miami. At this meeting, the bid from the existing insurer Republic Life was discussed and ruled out. It also appears that, at this meeting, Fitzsimmons indicated to Shannon that, since Old Security's bid appeared to be the low bid on a short-term basis, one of the options for the Fund was to place the contract with Old Security for 1 year subject to possible later renegotiation of the contract along the lines proposed by Prudential with respect to crediting the Fund with interest on reserves.

The evidence in the record indicates that Fitzsimmon's interest in pursuing the purportedly lower Old Security bid for the short-term occurred after Kleindienst's contacts and was apparently triggered by those contacts. As later events show, the Prudential recommendation did not advance any further after April 12. Under the circumstances,

[27] Unless otherwise noted, page references are to the Subcommittee's printed hearings.
[28] Presser resigned as a trustee in October 1976.

Kleindienst's contacts with Fitzsimmons must be viewed as a significant contributing factor to the process leading to the award to Old Security.

Shannon sent the April 5 recommendation in order to secure the approval of the trustees (which would be ratified at a later formal meeting) so his staff could start the necessary transition process, since the Republic Life contract was scheduled to expire after April 30. Two employer trustees, Jack Sheetz and John Spickerman, communicated their approval of the Prudential bid to Shannon. However, action could not be taken unless two employee (i.e., union) trustees also approved. After the meeting with Fitzsimmons in Miami, Shannon told Len Teeuws of Tolley that the employee trustees were giving serious consideration to Old Security. On April 23, Shannon, still hoping that his recommendation to accept the Prudential bid would be adopted, sent out another meeting agenda letter to the trustees containing his recommendation and reporting the same recommendation by Tolley International. However, the failure of the other trustees to respond favorably to this recommendation, and the conversation Shannon had with Fitzsimmons in Miami, suggested to Shannon and Heeren that the Prudential recommendation was not making any headway and, by inference, the chances for Old Security were improving. Teeuws of Tolley International was aware of these developments.

Three days before the contract was awarded to Old Security, Kleindienst had a telephone conversation with Allen Dorfman of the Amalgamated Insurance Agency. Under Amalgamated's contract with the Fund, which ran to February 28, 1979, Amalgamated was receiving a fixed monthly payment of more than $480,000 to process their existing life and health insurance policies with Republic Life and any claims services requested by the Fund. As noted above, the specifications prepared by Tolley International required the bidding insurer which received the award to perform processing functions, which would have resulted in a substantial reduction in the use of Amalgamated's services.

Kleindienst testified that Dorfman told him that his agency had been processing claims for previous carriers under the Teamsters Fund insurance policy and that his company was already set up to do the work more efficiently and cheaper than anybody else including Old Security. Kleindienst said he told Dorfman that the matter would have to be settled between Dorfman and Old Security. Over the objections of Irving Davidson who advised Hauser not to speak to Dorfman,[29] Kleindienst urged Hauser to call Dorfman and meet with him the next day. Hauser followed his advice.

Boden testified that Kleindienst had a telephone conversation with Dorfman in his presence and that following the call, Kleindienst told him that Dorfman would process the claims for $96,000 [30] and that he (Kleindienst) could now tell him that Old Security would get the business. Boden also said that Kleindienst told him that Dorfman wanted an agreement whereby it could sell add-on insurance policies to Teamsters Fund participants on an individual basis. Kleindienst

[29] Kleindienst denies there was any disagreement.
[30] The $96,000 figure roughly corresponds to the amount by which Old Security later reduced its retention, which is discussed below.

denied making any statement that Old Security would get the business and had no recollection of having discussed specific sums of money or any agreement concerning add-on insurance.

Kleindienst said his advice that Hauser contact Dorfman was based upon Dorfman's statement that Amalgamated was already set up to process the Fund's claims more efficiently and his (Kleindienst's) understanding that Dorfman and Fitzsimmons were very friendly and that Hauser's meeting with Dorfman would not hurt. Kleindienst had no recollection that Fitzsimmons suggested contacting Dorfman. Fitzsimmons denied he told Kleindienst to contact Dorfman concerning the award or that he discussed the award with Dorfman.

On April 28, Hauser traveled to Chicago. Boden testified that Hauser called him from Chicago that day to tell him that Old Security would get the business, but that Brian Kavanagh and Roger Carney would have to meet with Amalgamated. The evidence shows that Kavanagh and Carney met with Sol Schwartz of Amalgamated on April 29. Richard Halford of Old Security testified that in late April he received a phone call, probably from Carney, requesting that Amalgamated serve as claims processor and Old Security agree to a reduction of the retention from 3 percent to 2.6 percent, with the Fund paying Amalgamated directly for its services. Halford agreed.

On April 29, over Halford's signature, Old Security sent the Fund trustees a telegram formally making a late amendment to its prior late offer to reduce its bid, specifying the amount by which it would lower its retention if it were relieved of claims processing (i.e., from 3 percent to 2.6 percent). The circumstantial evidence suggests that the reduction in retention was negotiated by Hauser's associates with Amalgamated [31] which had neither actual nor apparent authority to act on behalf of the Fund. Tolley International's bid analysis noted that Old Security "would negotiate a reduction in the retention" if relieved of the claims processing function (p. 738). There is no evidence of any negotiations between the Fund and Old Security on this matter. Fund Executive Director Shannon and his assistant Heeren did not know of the pre-April 30 contracts between Amalgamated and Old Security representatives until after the award and then objected to them as violations of Fund policy.

3. The Award to Old Security

On the next day, April 30, 1976, the Fund's trustees voted to award the insurance contract to Old Security. The agreement between Hauser and Dorfman apparently paved the way for the award to Old Security. The minutes of the meeting show that Tolley International recommended to the trustees that Old Security be selected on a short-term basis and that the Fund could reevaluate its experience with Old Security after one year and make a decision how to proceed in the future. This was essentially the same suggestion Fitzsimmons made in his April 12 meeting with Shannon and Presser.

Hauser associate, John Boden testified that Len Teeuws of Tolley International told him that Tolley could not make a clear recommen-

[31] The Subcommittee's records as to the details of the negotiations is incomplete since at the Subcommittee's hearings Dorfman refused to answer questions about his conduct in the Old Security matter, citing his Constitutional right under the Fifth Amendment not to incriminate himself. Dorfman's testimony is discussed further below.

dation in favor of Old Security because he did not want to oppose what he then perceived as his client's preference (i.e., Shannon's) for Prudential. Between April 5 and the trustees meeting of April 30, the situation was turned around and Teeuws became aware the Prudential recommendation had not advanced and that the Old Security proposal was receiving the serious consideration by the employee trustees, including Fitzsimmons.

There was no discussion at the April 30 trustee meeting concerning the discrepancy between Tolley International's recommendation at the meeting and the April 5 and 23 agendas reporting a recommendation of the Prudential bid by Tolley International. Nor did the trustees inquire as to whether all bidders were given an opportunity to reduce their retention if relieved of the claims processing function. There is no indication that any inquiry was made as to the nature of any negotiations upon which Old Security's reduced retention was based. Also, Shannon remained silent at the trustees meeting and did not advance his own recommendation (which he had communicated to the trustees in two previous meeting agendas) or challenge Tolley International's apparent change in position.[32]

4. Payment of the Kleindienst Fee

Following the award of the contract to Old Security, Hauser paid Kleindienst's law firm $250,000 for services rendered prior to April 30, 1976—the date of the award. His firm paid half of the fee to Webb and Davidson. Kleindienst acknowledged that he did not provide any legal services for this fee.[33] Neither Webb, a non-practicing attorney, nor Davidson a non-attorney, furnished any legal services. That this extraordinary payment was made solely to buy Kleindienst's access and influence with Fitzsimmons is clear. That Kleindienst—trading on his prominence as a former Attorney General of the United States and his personal relationship with Fitzsimmons—was willing to sell his influence also is clear.

Although Old Security represented, in response to the specifications issued by the Fund, that no commission or finder's fee would be paid in connection with the underwriting of the policy offered to the Fund, Old Security's reinsurance partner, Family Provider, paid such a commission or fee to Kleindienst, Webb and Davidson. The basic purpose of the specifications was to enable the trustees to ascertain any sales related expenses and prevent the Fund from incurring them.[34] The Fund has its own consultant and staff to evaluate insurance proposals, and, thus, would not benefit from any sales effort (as might be true in the case of sales of individual policies). Because of the substantial profitability to an insurance company of placing business with employee benefit plans, such plans have sufficient bargaining

[32] In explanation of his silence, Shannon testified that he thought he might have been out of order to speak out since the Fund had hired Tolley to give its advice. He also noted that he had previously made his position clear and thought he would be beating a dead horse. However, Shannon did acknowledge that, on the basis of hindsight, he should have spoken up.

[33] In his testimony, Kleindienst stated that ". . . up to the award of this bid, I would say that I did not provide any legal services, I think in all fairness you would have to say that" (p. 1048).

[34] In this connection, specifications prepared by the Segal Company on behalf of the Arizona Funds, also called for disclosure of commissions and whether they were included in the retention. (Appendix A-31) Commissions also appear to have been a matter considered by the trustees of the Indiana and Massachusetts Funds (pp. 408, 415, 506, 508).

leverage to cause insurance companies to waive such fees and reduce costs that otherwise would be passed on to the Fund. This is evidenced by the fact that only one bidder indicated that it would pay a commission ($1,250 which would be paid in the first year or over a ten year period). The Fund's effort to avoid incurring costs reflecting payments of commissions and finders' fees was a proper implementation of the prudent man standard for fiduciaries under ERISA.

Had Hauser disclosed the nature and purpose of the fee arrangement with Kleindienst, et al., it would have alerted the trustees to Hauser's relationship to Old Security and that unnecessary expenses were being incurred. Also, the unusual size of the fee ($250,000) relative to the Old Security's annual profit ($24,150) [35] would have tipped the trustees off to the fact that Hauser was not engaged in a bona fide insurance business. Of course, as the record shows, Hauser caused the fee to be paid out of the first Teamster Fund premium payments, which constituted a misappropriation of the reserves Family Provider was required to maintain under the insurance policy.

Fees of the nature paid to Kleindienst, Webb and Davidson, also raise questions under State insurance laws. The Director of Insurance of Arizona, in the capacity of receiver for Family Provider Insurance Company, filed a civil action against Webb, Davidson and Kleindienst, and Kleindienst's former partners in the law firm of Morgan, Welch and McNelis, seeking recovery of the $250,000 fee (*Trimble* v. *Kleindienst, et al.*, Civil Action No. 77–2152, U.S. District Court for the District of Columbia.) The complaint alleges that the services rendered by Kliendienst and his law partners, Webb and Davidson, conferred no benefit upon Family Provider or Old Security, and that receipt of such fee constitutes, among other things, unjust enrichment. As part of a settlement in January 1979, Morgan, Welch and McNelis returned $66,000 to the receiver. As part of another settlement in June 1979, Kleindienst, Webb and Davidson each agreed to return $50,000. Also in June, a default judgment was rendered against Hauser in the amount of $1.4 million. (Appendix F.)

5. Influence of Allen Dorfman

The history of Dorfman's dealings with the Teamsters and their employee benefit plans has been marked by controversy. Despite a criminal conviction and his unauthorized involvement in the Old Security award, Dorfman has maintained a highly profitable business relationship with the Teamsters Health and Welfare Fund.

On February 29, 1972, Dorfman was convicted of accepting a $55,000 kickback which he received while a consultant of the Teamsters Pension Fund in connection with a loan by the Pension Fund,[36] of which Frank Fitzsimmons was a trustee. Fitzsimmons felt that Dorfman, his friend for over 20 years, was not guilty. He called it a "trumped up charge." However, Fitzsimmons said that, since the court convicted him, there was "no other way to do it but to remove him as consultant as far as the Pension Fund was concerned."

[35] Old Security's bid stated that out of the $724,500 annual retention, $78,488 was for insurance company administration charges, $621,862 for premium taxes, and $24,150 for profits (p. 711).

[36] Dorfman's conviction was affirmed, *United States* v. *Dorfman*, 470 F. 2d 246 (2d Cir. 1972), *cert. dismissed*, 411 U.S. 923 (1973). Dorfman was released from prison on December 17, 1973, after serving about eight and one-half months of a one-year sentence.

Fitzsimmons was also a trustee of the Teamsters Health and Welfare Fund.[37] But no effort was made by Fitzsimmons or the Fund to remove Dorfman's Amalgamated Insurance Agency as insurance claims processing agent for that Fund. When asked to justify the inconsistency in positions with respect to Dorfman, Fitzsimmons said "it is like a horse that will bite one person but won't bite another one." (Pp. 1140–1141, 1145–1147.)

Fitzsimmons' explanation demonstrates a marked insensitivity to his obligation to protect the Health and Welfare Fund from the risk of abuse attendant to retention of the services of a person who violated a position of trust and confidence with the sister Pension Fund.

The influence of Dorfman over the Teamsters Central States Health and Welfare Fund at the time of the insurance award to Old Security appears to have been as pervasive as it was 20 years ago when his activities were first exposed by the Senate Select Committee on Improper Activities in the Labor or Management Field. This is evidenced, in part, by the fact that Kleindienst, in his efforts to bring about the award to Old Security, advised the Hauser group to reach an understanding with Amalgamated with respect to servicing claims for Old Security. As previously noted, the continuation of the services of Amalgamated was contrary to the advice of the Fund's Executive Director, Daniel Shannon. Hence, the bid specifications required the new contractor to process all claims rather than have them handled by Amalgamated. Thus, agreement by Hauser to continue the Dorfman agency appears to have been a condition to Old Security receiving the award. In this connection, by letter agreement dated April 30, 1976, between Central States Fund and Amalgamated, signed on behalf of the Fund by trustees Jack A. Sheetz and William Presser[38] the Fund designated Amalgamated as claims paying agency of the Fund for the 10 year period from June 1, 1976 through May 31, 1986. Despite the fact that the letter agreement states that it is based upon a resolution of the trustees, there is no evidence of any such prior action by the trustees. Although it was purportedly signed April 30, 1976, Sheetz said in an affidavit that he did not see the letter contract or sign it until June 7, 1976 when Presser handed it to him.[39] The minutes of a meeting of the trustees on June 8, 1976, stated that "The Trustees' attention was brought to the fact that considerations should be given to the extension of the Amalgamated Insurance Agency contract."

As a result of such consideration, the trustees instructed counsel to draft an amendment to the current Amalgamated Agreement (dated January 31, 1976), stipulating an extension of 7 years (or ten in total) with the price to be negotiated yearly during each of the 7 last

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[37] Fitzsimmons resigned as a trustee on the Teamsters Health and Welfare Fund in April 1977.

[38] In 1971, Presser pleaded guilty to eight counts of an indictment charging him with violations of 29 U.S.C. § 186(b) (Unlawful Receipt of Payments by Labor Organization Official). In 1960, Presser was convicted of obstructing an investigation of the Senate Select Committee on Improper Practices in the Labor or Management Field by mutilating and concealing subpoenaed records. He was also convicted in the same year of contempt of Congress for refusing to answer questions posed by that Committee.

[39] Presser was present at Fitzsimmons meeting with Shannon on April 12, 1976 in Miami in which Fitzsimmons indicated interest in the Old Security bid. Presser declined to be interviewed during the Subcommittee staff's investigation and was not called to testify at the Subcommittee's public hearings.

years. This action was taken without consideration of alternatives such as the solicitation of competitive bids or the performance of the claims processing function internally by the Fund.[40] After adverse publicity concerning the extension of the Amalgamated contract, and receiving advice from counsel that the April 30 contract was unenforceable because the price was not specified, the trustees voted unanimously on August 2, 1976, to rescind the June 8 extension. On September 7, 1976, the Fund received a legal opinion that its August 2 rescission was proper, since the actions of Sheetz and Presser and the June 8 action of the full board of trustees constituted breaches of fiduciary duty under ERISA. The opinion further noted that rule of prudence under ERISA dictated that an intensive search be instituted of service organizations—and possibly competitive bids be obtained—before such a contract is let by the Fund.

On July 19, 1977, the Funds new board of trustees, which was appointed after a Federal joint task force investigation forced the resignation of the former trustees (including Fitzsimmons, Presser, and Spickerman), voted an additional 10-year extension of the Fund's agreement with Amalgamated, despite Shannon's recommendation to the contrary. The Fund's attorney stated that this action constituted only an agreement in principle to extend Amalgamated, pending resolution of certain matters in controversy.

Dorfman appeared at the Subcommittee's hearings in response to a subpena. However, citing his Fifth Amendment privilege against self-incrimination, he declined to answer any questions about his involvement in the Old Security award, including whether an agreement was reached on the occasion of his conversation with Kleindienst whereby Amalgamated would process claims for $96,000; and whether it was a condition of the Teamsters Fund award that Old Security allow Amalgamated to process claims and sell add-on insurance to Teamsters Fund participants. Dorfman also declined to respond to a question asking him to justify the $22 million Amalgamated had received since 1970 for processing claims.

The Subcommittee's November 1977 public hearings established that Dorfman violated fund policy by his contacts with the Hauser group prior to the April 30 award; that Shannon consistently opposed continuation of the Fund's relationship with Dorfman's Amalgamated; and that Dorfman refused to account for his role in the Old Security award or as the Fund's claims processor. Nevertheless, on January 31, 1979, the Fund's board of trustees executed a 3-year contract with Amalgamated. The award was made following the receipt of three bids after soliciting bids from Amalgamated and six insurance companies. The Fund found Amalgamated was the low bidder. The award is the subject of pending civil action instituted by the Department of Labor against the Fund trustees which attacks, among other things, the competitive bid procedures followed by the Fund. The Department was unsuccessful in obtaining a preliminary injuction to prevent execution of the contract. (See pp. 152–153 of this report for further discussion of the litigation.)

[40] Shannon and Heeren testified that they estimated that the Fund would be able to process claims by $2 to $3 million per year less than the $6 million charged by Amalgamated. Shannon said the Fund could have undertaken the performance of that function by the time the Amagamated contract terminated in February 1979.

Whatever the legal merits of the Department of Labor's pending civil case, Dorfman's 1972 conviction and the record of the Subcommittee's hearings demonstrate that, to paraphrase former trustee Frank Fitzsimmons, there is a palpable risk that the horse that has bitten once, will bite again. *In the view of the Subcommittee, the decision of the Fund's trustees to continue to do business with Dorfman constituted a highly questionable business judgment.*

6. Misappropriation of $1.5 million Teamsters Fund Insurance Premiums

A few days after the award, the Teamsters Fund paid Old Security the required deposit and premium payment which amounted to over $3.4 million. The day after the deposit of these payments in an account established for Old Security and Family Provider at the Continental Illinois Bank of Chicago, $1.5 million was transferred by wire to a Family Provider account in Phoenix, Arizona. Family Provider then transferred the money to accounts controlled by the Hauser group, including Great Pacific Corporation, Family Provider's parent company. The $1.5 million transfer constituted an unauthorized, improper appropriation of Teamsters insurance premiums.

Of this $1.5 million, $200,000 was used to cover a $250,000 check from Great Pacific (Family Provider's parent) to Kleindienst's law firm for his pre-April 30 services in connection with the Teamsters Fund award to Old Security. His law firm also represented Great Pacific in connection with its unsuccessful efforts to acquire a Great American Life Insurance Company of New Jersey and a successful attempt to acquire National American Life Insurance Company (NALICO) of Louisiana.

Also, $1.1 million of Teamsters premiums was paid by Great Pacific to American Financial Corporation, owner of Great American, in connection with an agreement to acquire Great American. This was part of a down payment and held in escrow at the Provident Bank in Cincinnati, Ohio, a subsidiary of American Financial.

During the attempt to acquire the New Jersey company, the Arizona Insurance Department learned about the $1.5 million transfer since it was to be part of the down payment for the purchase price. The $1.5 million constituted an illegal dividend under Arizona law and the Arizona Director of Insurance ordered Great Pacific to return it to Family Provider. To demonstrate compliance with the order, Kleindienst, acting as counsel to Hauser's Great Pacific Corporation, asked Provident Bank and Diplomat Bank to confirm in writing that $1.8 million was deposited to the account of Family Provider, which they did. Boden testified that Kleindienst requested that the banks confirm that the deposits were unencumbered. The Diplomat Bank confirmed that the $700,000 deposit was unencumbered. However, the Provident Bank did not state whether or not the $1.1 million deposit was encumbered. In fact, these funds at Provident National Bank were encumbered under the aforementioned escrow arrangement. Kleindienst testified that he had no knowledge of this encumbrance until Boden testified about it in the Subcommittee's hearings.

At a May 24, 1976 public hearing held by the Arizona Director of Insurance, Boden falsely represented that the funds at the Provident

Bank were not encumbered. At the same hearing, Kleindienst made a commitment that Family Provider would not make any dividend without the prior consent of the Director of Insurance. In reliance upon Boden's representation and Kleindienst's commitment, the Director of Insurance took no adverse action and vacated the proceeding.

In violation of the commitment, Hauser diverted funds from the Diplomat Bank account to Great Pacific for his own personal expenses. On June 9, 1976, after the New Jersey Department of Insurance denied the Hauser group application to acquire the New Jersey company, Hauser caused the $1.1 million in the Provident Bank account to be transferred to Great Pacific.

The Hauser group sought to acquire NALICO because Louisiana's insurance laws did not require the State regulatory body to approve the purchase. Hauser formed a new company, National Pacific Corporation, to carry out the purchase. On June 14, 1976, the settlement of the NALICO purchase took place, at which the Hauser group made a $2 million down payment. Of that amount, $1.8 million came in the form of a check from National Pacific and the source of the money was the funds that had been improperly diverted from Family Provider's accounts to Great Pacific.

Hauser associate John Boden testified that Kleindienst knew that the $1.8 million came out of the Family Provider account. Kleindienst denied he had any such knowledge.

In *Trimble* v. *Kleindienst, et al.*, the Arizona Director of Insurance alleged, among other things, that Hauser and the other defendants, including Kleindienst, Webb, and Davidson, conspired to defraud Family Provider of the Teamster Fund insurance premiums. An issue arose during discovery in that case as to whether Kleindienst obtained knowledge of the encumbrance on Family Provider funds from James Evans (an attorney and agent of American Financial Corporation, parent of Provident Bank) prior to the aforementioned hearing before the Arizona Director of Insurance. In his deposition, Evans could not recall having told Kleindienst that those funds were encumbered. The notes of former Subcommittee investigator W. Donald Gray indicate that Evans told him in an interview that he (Evans) had informed Kleindienst of the encumbrance prior to the hearing by the Director of Insurance. These notes were brought to the attention of the District Court after Trimble obtained access to them pursuant to a Rule XXX resolution—S. Res. 138. Before Evans could be deposed further and the issue resolved, the case was settled (Appendix F).[41]

Old Security was aware of the $1.5 million diversion of the Teamsters Fund premiums from the Continental Illinois account from the day it occurred (May 11, 1976). Old Security agreed to receive as a replacement copies of mortgages with a face value of $2.2 million without obtaining title insurance or a title search. In fact, these instruments were the worthless Golden Horn mortgages (see pp. 75–77 of this report).

As a consequence of the $1.5 million unauthorized transfer of the Teamsters Fund premiums, a continuing dispute with the Hauser

[41] In this connection, see p. 160 of this report for discussion of *Trimble* v. *Evans, et al.*, an action in which the Director of Insurance alleged that Evans, American Financial, and Donald Klekamp, another American Financial attorney, committed fraud by their failure to disclose the encumbrances.

group over control of the reserves, and adverse publicity, Old Security decided to discontinue its involvement with the Teamsters Fund contract and the reinsurance arrangement with Family Provider and Farmers National. In July 1976, Old Security entered into an agreement with NALICO, Hauser's Louisiana company, whereby NALICO assumed Old Security's position in the reinsurance agreements with Family Provider and Farmers National. As part of this assumption agreement, Old Security turned over to NALICO about $2.5 million representing the remainder of the reserves on the Teamsters Fund business, the worthless mortgages held in lieu of the $1.5 million which had been previously diverted, and Old Security's 20 percent share of the profit under the reinsurance agreement, which came to $1.4 million. These transactions took place despite the fact that the Hauser group had sought and were denied permission from the Teamsters Fund to transfer the Old Security insurance contract to NALICO.[42]

The Subcommittee finds that the foregoing conduct by Old Security constituted a gross disregard of the interests of the Teamsters Fund.

The record of the Teamsters case is the most demonstrative example of the weakness in insurance regulation, and the susceptibility of employee benefit plans to insurance related fraudulent schemes. This scandal should stand as a warning to those charged with the stewardship of other employee benefit plans throughout the country to exercise particular caution when considering insurance proposals and other transactions involving significant commitments of plan assets.

G. REINSURANCE

Reinsurance is a common and legitimate practice in the insurance industry. Under such arrangements, the company actually issuing a policy (the ceding company) limits its exposure by reinsuring a portion of its risk with the other party to the agreement (the assuming carrier), which received a commensurate share of any profit. The assuming carrier agrees to reimburse the ceding company for part of any loss sustained under the latter's policy in accordance with the terms of the agreement. Generally, reinsurance is beneficial to both the insurance industry and the consumer. By enabling insurers to spread their risks, consumers are often able to purchase insurance protection that might otherwise not be available to them. Nevertheless, the Hauser group and their reinsurance partner, Old Security, abused the reinsurance concept—to the substantial detriment of the union health and welfare plans with which they did business.

To obtain the insurance contracts of the Indiana and Massachusetts Laborers' health and welfare plans, Farmers National and Old Security entered into a reinsurance agreement known in the industry as a fronting arrangement. Under the agreement, Old Security issued the insurance policies and then reinsured 100 percent of the risk into Farmers National. In return, Old Security received 2 percent of the premiums; Farmers National, the remaining 98 percent. Farmers National collected the premiums, paid all claims, kept the reserves, and

[42] Shannon testified that, in late June, Kleindienst called him and asked if Old Security's business could be transferred to NALICO. Shannon objected as did Fitzsimmons a few days later in a conversation with Kleindienst.

controlled all the money except for Old Security's 2 percent. Acting as agents for Old Security, Farmers National representatives (actually members of the Hauser group) solicited the business, prepared the bid specifications, and conducted the negotiations. For 2 percent "off the top," Old Security permitted Farmers National to use its good name, reputation, and policy forms to do general union insurance business in States where Farmers National itself was not licensed or qualified to write insurance directly.

Rather than risk having attention drawn to the financial difficulties of Farmers National during its solicitation of the Teamsters Central States Fund business, the Hauser group obtained a separate reinsurance agreement with Old Security, this time using Family Provider as the assuming company. Unlike its earlier agreements with Farmers National, Old Security agreed to share the profits and liabilities with Family Provider on a 20 percent–80 percent basis, respectively. Family Provider was given sole responsibility for the underwriting, policy issuance, administration, premium billing and collection, and the payment of 80 percent of all claims and judgments for damage under policies covered by the agreement. In the case of the Teamster contract, the agreement permitted 80 percent of the risk and nearly full administration of a $23 million insurance program to be committed to the care of Family Provider, a virtual nonentity in the insurance industry.

The Subcommittee finds that Old Security failed to conduct anything approaching an adequate background investigation of Farmers National or of Family Provider prior to entering into the reinsurance agreements. There is no indication in the record that any inquiry was made either to the Florida Department of Insurance or to the Arizona State insurance authorities to ascertain the financial status or problems or the ownership of either company. Instead, Old Security relied solely on routine financial statements filed by the companies and an evaluation of the president of Farmers National based on telephone conversations with unidentified industry contacts. Despite substantial financial risks entailed in dealing with Hauser's marginal insurance companies Old Security permitted those companies to have access and control over millions of dollars of employee plan insurance premiums without safeguards to assure that adequate reserves were maintained and that expenditures were made for proper purposes.

The Hauser group's use of reinsurance fronting arrangements to obtain the union trust fund contracts raises grave questions concerning current industry reinsurance policies and practices, the adequacy of present State laws and regulations governing the insurance industry, and the effectiveness of present Federal statutes in combatting abuses of labor-management health and welfare insurance programs.

H. DEPARTMENT OF LABOR'S ENFORCEMENT OF CRIMINAL AND CIVIL STATUTES RELATING TO LABOR ORGANIZATIONS AND EMPLOYEE BENEFIT PLANS

As an outgrowth of its November 1977 hearings on the Hauser case, the Subcommittee initiated an inquiry into the effectiveness of the Labor Department's investigations of criminal statutes pertaining to labor organizations (Labor Management Reporting and Disclosure

Act) and pension and welfare benefit plans (Employee Retirement Income Security Act and certain provisions of Title 18 of the U.S. Code applicable to such plans). On November 29, 1977, the Subcommittee asked the General Accounting Office to determine whether the Department's present organizational structure, procedures, and manpower are sufficient to carry out its responsibilities to detect and investigate violations of these statutes. Also, as part of this inquiry, the Subcommittee held hearings on April 24 and 25, 1978 concerning the extent and quality of the Department of Labor's commitment to the President's Organized Crime Program and the pursuit of labor-management racketeering cases. The GAO's report, dated September 28, 1978, and the Subcommittee's April 1978 hearings disclosed the existence of serious deficiencies in the Department's criminal and civil enforcement program.

The GAO found that most of the Labor Department's efforts and priorities in 1977 dealt with other than criminal violations; that most of the effort under ERISA was devoted to activities other than enforcement of either the criminal or civil provisions of ERISA; and that the Department used its national office computerized reporting process and desk audit system to achieve voluntary compliance with the laws.

GAO also found the following weaknesses in the investigations and audits of labor organizations and employee benefit plans:

Lack of coordination in investigations of criminal and civil violations under both LMRDA and ERISA.

Lack of formal procedures for notifying the Department of Justice of cases under investigation.

Little investigative effort by area offices to follow up on reasons for deficient reports submitted by unions and employee benefit plans.

Lack of sufficient field audit work at labor organizations and benefit plans.

Insufficient staff to enforce both laws and little formal training provided to area office investigative and audit staffs.

In its dealings with the Department of Labor, the Department of Justice has encountered most of the deficiencies cited by the GAO. See letter of June 18, 1979, from Assistant Attorney General for Administration, Kevin Rooney, to Comptroller General Staats. (Appendix J.)

The GAO recommended that:

1. The Secretary of Labor determine the additional resources needed to effectively enforce the criminal and civil provisions of LMRDA and ERISA and provide this information to Congress.

2. The Secretary direct the Labor Management Services Administration (LSMA) to (a) strengthen area office audit activity by increasing the number of on-site field audits of labor organizations and employee benefit plans and assure that consistent, high-quality audits are made; (b) improve the timeliness of area offices' investigations of cases with potential for criminal violations; (c) establish procedures to require direct, continuous coordination between criminal and civil LMRDA and ERISA investigative activities at area offices; (d) establish procedures to notify the Department of Justice of its investigative activities to avoid duplicative efforts; (e) review the training of

LMSA area office field staff to ensure that the auditors and compliance officers receive the training needed to carry out their duties.

In a statement on the floor of the Senate on October 14, 1978, Senator Sam Nunn, Chairman, urged that the Secretary of Labor give careful consideration to the GAO report.

At the Subcommittee's April 1978 hearings, several representatives of the Justice Department and its various Organized Crime Strike Forces testified that since 1970 the Labor Department had steadily diminished its commitment of manpower to the strike forces to the point where the Labor Department proposed to cease all active participation in labor-management racketeering cases. The strike force attorneys described the labor racketeering situation today as bad or worse than it was 20 years ago when labor rackets hearings were held under the chairmanship of the late Senator John McClellan.

Following the April 1978 hearings, the Labor Department reassessed its position and made a commitment to assign a total of 90 persons to support organized crime strike forces. The Subcommittee is encouraged that the Labor Department has substantially fulfilled its manpower commitment to the organized crime program. By October 1978, 51 of the 90 positions were filled or committed. As of August 20, 1979, 81 of the 90 positions were filled and personnel actions were pending or about to be initiated to fill the remaining 9 investigator jobs.

In contrast, the Department of Labor's response to the GAO's report is disappointing. The response is contained in a letter of May 14, 1979, from Secretary of Labor Marshall to Comptroller General Staats, a copy of which was transmitted by letter of July 24, 1979, from Secretary Marshall to Senator Ribicoff, Chiarman of the Committee on Governmental Affairs. (Appendix J.)

The Secretary stated that he is committed to "aggressive programs" to enforce the provisions of both LMRDA and ERISA for which the Department of Labor has the responsibility. The Secretary pointed out that, within the last year, the Department had implemented a "comprehensive training program" for staff involved in enforcement of ERISA and that it will be instituting "on the job training" in audit procedures and analysis for LMRDA compliance officers. The Secretary also stated that, in response to a suggestion in the GAO report, the Department of Labor is engaged in a joint "long-term" effort with the Internal Revenue Service to conduct a series of statistically selected compliance examinations that are intended to furnish measures of compliance by employee benefit plans.

Otherwise, the Secretary did not acknowledge any deficiencies in the Department's enforcement programs or address GAO's specific findings of deficiencies and recommendations for corrective action. The Secretary basically rejected the idea of stepping up the field audit program as too costly in light of availability of resources. The Secretary stated:

> As I testified before the Subcommittee on April 25, 1978, I have serious doubts about the efficacy of simply throwing additional staff at these problems.

The GAO found that, in fiscal year 1977, the Department's LMSA staff spent only 1 percent of its man-days on field audits of labor organizations and only 3 percent of its man-days on field audits of pension and welfare plans. The Department has a long way to go before it can be said to be "throwing additional staff" into field audit activity.

The Secretary said that the Department's actions "should be focused on root causes and on denying those who would misuse their positions of trust in a union or employee benefit plan the opportunity to do so, by the judicious use of appropriate civil and/or criminal remedies." However, the Secretary made no specific commitment as to how this policy can or would be implemented, stating only that:

> When the current backlog of union member complaints under LMRDA is sufficiently reduced, we could then divert some of our resources to the field audits recommended by * * * (the GAO) report.

The Subcommittee is very concerned by the Secretary's rejection of the GAO's finding that the Department of Labor is primarily responsible for detecting and investigating criminal as well as civil violations in connection with the operations of employee benefit plans covered by ERISA. The Secretary stated that ERISA is primarily a civil statute with limited criminal provisions relating to reporting. He suggested that since certain criminal laws relating to employee benefit plans are not in ERISA (such as 18 U.S.C. § 664 which prohibits embezzlement of plan assets), the Department has no responsibility to investigate such violations. He further suggested that the GAO's "misunderstanding [of the Department's criminal responsibilities] in turn may lead to a more general misevaluation of the Department's vigor in execution of its functions." This lack of vigor was underscored in the GAO report which found that, in 1977, none of the national office audits of ERISA plans resulted in detection of criminal violations.

The Subcommittee finds that the Department of Labor takes an unduly narrow view of its responsibility to detect and investigate violations of Title 18 criminal provisions relating to ERISA plans.[43] The Subcommittee believes that the interdepartmental memorandum of understanding which gives primary responsibility to the Department of Justice for investigating Title 18 violations is a reasonable allocation of resources. However, as then Deputy Attorney General, now Attorney General, Benjamin Civiletti, pointed out in a letter of May 19, 1978, to the Subcommittee, the Department of Justice does not have the investigative resources or expertise to assume the monitoring function of the Department of Labor which is key to the detection of criminal violations.[44]

In order to have an effective criminal enforcement program, it is necessary for the Department of Labor to have a comprehensive program to detect potential violations and to make appropriate preliminary inquiries prior to referring cases to the Department of Justice for further criminal investigation. Without this initial iniqury process by the Department of Labor it is inevitable that many criminal as well as civil violations will go undetected. The proper utilization of an effective

[43] See also 18 U.S.C. § 1027 which prohibits false statements and concealment of material facts in reports required by ERISA; and 18 U.S.C. § 1954 which prohibits kickbacks and other illegal payments to influence plan actions.

[44] The exchange of correspondence between the Attorney General and the Subcommittee is in Appendix K.

audit system by the Department of Labor, as recommended by the GAO report, will go a long way to correct serious problems in the detection of potential criminal violations.

The Secretary pointed out that the Department of Labor's civil ERISA enforcement program is concentrating on violations of fiduciary duties and noted that it was successful in restoring $45 million in plan assets in fiscal year 1978. However, *the Subcommittee still has serious reservations concerning the adequacy of the Department of Labor's civil enforcement program.* As previously noted, the Department of Labor instituted only one civil action under ERISA arising out of Joseph Hauser's activities, which was filed on February 16, 1979. In contrast, pursuant to the SEC's responsibilities under the securities laws, the SEC instituted timely and effective enforcement action against Hauser and his associates on September 24, 1976. Also, the Department of Justice obtained an indictment of Hauser in June 1978, as well as an earlier one in March 1975, both of which led to convictions. The Department of Labor presently has less than 20 attorneys to handle the civil litigation and related legal enforcement functions under ERISA. This appears to constitute significant understaffing given the magnitude of the task at hand, and further supports the GAO's finding of manpower deficiencies in the Department's enforcement program.

In conclusion, *the Subcommittee finds that the Department of Labor's response to the GAO report fails to evidence the needed commitment to vigorous enforcement of the criminal and civil laws relating to labor unions and employee benefit plans.*

II. Recommendations

A. Employee Retirement Income Security Act (ERISA)

Every union member in the country is entitled to demand the highest standards of professionalism and care from those entrusted with responsibility for the administration of their health and welfare plans. Anything less than complete fidelity to safeguarding and advancing the interests of participants and beneficiaries is a disservice to rank and file union members, and a serious breach of trust on the part of the responsible trustees and administrators.

Prior to the adoption of the Employee Retirement Income Security Act of 1974 (ERISA), the protection afforded by Federal law to employee benefit plans was limited to the disclosure requirements under the Welfare and Pension Plan Disclosure Act and criminal penalties for false statements in reports under that Act (18 U.S.C. § 1027), embezzlement or conversion of plan assets (U.S.C. § 664), and payments to plan trustees, officers, employees, and consultants which are made for the purpose of influencing plan decisions (18 U.S.C. § 1954). Otherwise the conduct of the business of these plans was substantially unregulated by Federal law and subject to significant abuses.

In order to remedy this situation, Congress enacted ERISA, which was designed to protect the interests of participants in employee benefit plans and their beneficiaries by, among other things, establishing standards of conduct, responsibility, and obligations for plan fiduciaries and by providing for appropriate remedies, sanctions, and access to the Federal courts.[1]

The fundamental obligations imposed on fiduciaries embody a carefully tailored law of trusts, including the requirements of undivided loyalty and the prudent man rule.[2] ERISA supplements these basic standards by expressly prohibiting a fiduciary from dealing with a plan for his own interest, engaging in transactions involving a conflict of his interest with that of the plan, or receiving any consideration for his own account from any party dealing with such plan in connection with a transaction involving plan assets.[3]

Also, ERISA prohibits a fiduciary from causing a plan to engage in a transaction if he knows or should know that such transaction would constitute a direct or indirect transaction with a "party in

[1] ERISA § 2(b), 29 U.S.C. § 1001(b).

[2] ERISA § 404(a), 29 U.S.C. § 1104(a). The prudent man rule requires that a fiduciary discharge his duties with respect to a plan "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

As will be discussed later, ERISA disqualifies from serving as a plan fiduciary persons convicted on certain crimes (ERISA § 411, 29 U.S.C. § 1111) and authorizes civil actions to remove plan officials who breach their fiduciary duties (ERISA § 409, 29 U.S.C. § 1109).

[3] ERISA § 406(b), 29 U.S.C. § 1106(b).

interest".[4] A party in interest includes those who are fiduciaries and several other persons who may be in a position, directly or indirectly, to influence the management of fund assets such as employers and labor organizations whose employees or members are covered by the plan, persons furnishing service to such plan, counsel to the plan, and officers, directors, employees, and/or relatives and other affiliates of certain of the foregoing.[5] A fiduciary must act with prudence in investigating whether a party-in-interest relationship exists.[6] ERISA also provides statutory and administrative exemptions from these prohibitions.[7]

ERISA was in effect during most of the period of Joseph Hauser's activities in connection with the sale of insurance to employee benefit plans. The record of the Subcommittee investigation shows the vulnerability of employee benefit plans to insurance related fraudulent schemes. This vulnerability stems in large part from serious weaknesses in the regulation of insurance which the Subcommittee believes requires corrective action.

The Subcommittee hearing record also shows the *modus operandi* of the perpetrator of a fraud—Hauser's cultivation of influence through payments and other inducements and his exploitation of less than vigilant businessmen and plan fiduciaries. The Subcommittee believes that this kind of conduct can be deterred by improved disclosure which would permit the detection of such payments; clarification as to what persons serving employee benefit plans are fiduciaries under ERISA and the nature of the responsibilities of plan fiduciaries; strengthened sanctions and remedies for misconduct; and improvements in the Department of Labor's enforcement program.

The foregoing and other problems are addressed in the Subcommittee's recommendations which follow.

B. INSURANCE REGULATION

Historically, the licensing of insurance companies and regulation of the insurance business has been reserved to the States. This means that there are 50 sets of laws and regulations governing the industry throughout the Nation. There are wide variations among the States in their legal requirements for licensing and regulating insurance companies and in the effectiveness of State enforcement activity. These variations were an important factor in the success of the Hauser operation. For example, in Florida, Hauser was able to obtain approval to acquire a controlling interest in Farmers National Life Insurance Company shortly after an application to acquire control of a California company was rejected because of questions concerning Hauser's "integrity, competency, and experience." Similarly, due to Arizona's low capitalization requirements, Hauser was able to activate Family Provider Life Insurance Company, a previously dormant shell company with only $250,000 in capital and one employee, and then position the firm to reinsure 80 percent of the $23 million premium Teamster

[4] ERISA § 406(a), 29 U.S.C. § 1106(a).
[5] ERISA § 3(14), 29 U.S.C. § 1002(14).
[6] See Conference Report on ERISA, S. Rept. 93–1090, 93d Congress, 2d session, p. 307, in which the Conference Committee noted that the extent of investigation required would depend upon the significance of the transaction.
[7] ERISA § 408, 29 U.S.C. § 1108.

insurance contract. In addition, despite his background in California and Farmers National's problems with the Florida Department of Insurance, Hauser was able to purchase control of a Louisiana-based insurance company without having to obtain State approval.

The present State insurance regulatory network does not provide adequate protection to employee benefit plans. Frequently, these plans, as well as the operations of insurance companies, extend beyond the confines of a single State. The jurisdictional problems that face State insurance authorities were well-described in the testimony of Governor Bruce E. Babbitt of Arizona (see pp. 163–166 of this report).[8]

Significant differences exist in State laws and regulations pertaining to reinsurance agreements, particularly the kind of "fronting" arrangement used by Old Security Life Insurance Company and the Hauser companies. Some States simply prohibit fronting without defining it. Others prohibit fronting for the purpose of evading State licensing law. Some States prohibit reinsurance with an unlicensed insurer of all, substantially all, some given percentage of all, a particular class of business, or of a particular policy or group of policies. A number of States permit the reinsuring of all or part of any risk with an insurer not licensed in the State, but require that the unlicensed insurer meet the same capital requirements as a licensed insurer. Other States require the prior written approval of the insurance commissioner for any reinsurance with a company not licensed in the State. One State apparently provides that the reserves on any business reinsured with an unlicensed insurer be placed in escrow. The State of New York has proposed a regulation which would require advance official approval of any agreement under which a company proposes to reinsure with an unlicensed carrier any business in excess of its established retention or aggregating 25 percent or more of a specific policy or of a group or class of policies.

The abuse of reinsurance and inadequate State regulation played a key role in Hauser's fraudulent scheme. In a letter to the Subcommittee, the Securities and Exchange Commission said that it brought enforcement cases against insurance companies involving fraudulent use of reinsurance arrangements to conceal underreserved deficiencies or to transfer over-valued assets from company to company.[9] The SEC noted that its enforcement activities with respect to insurance companies, which include Hauser's Family Provider Life Insurance Company and National American Life Insurance Company:[10]

> * * * indicate the rather amazing speed at which determined persons appear to be able to utilize the assets of insurance companies for their personal gain[,] * * *.
>
> *   *   *   *   *
>
> * * * the growing complexity of possible misconduct in this area, and the difficulties faced by State regulators, with their limited jurisdiction and resources, in attempting to deal with

[8] At the time of his testimony, Governor Babbitt was the Attorney General of Arizona.

[9] Letter of Sept. 19, 1978, to the Subcommittee from Harold M. Williams, Chairman of the SEC. (Appendix G.) The Subcommittee wishes to acknowledge the cooperation of the SEC which made its investigation files relating to Hauser's activities available to the Subcommittee.

[10] See pp. 161–162 of this report for discussion of the enforcement action taken by the SEC against Hauser.

the varieties of problems presented by multistate insurance companies. * * *

James Hanna of the Florida Department of Insurance also testified before the Subcommittee about jurisdictional problems encountered in regulating the multistate insurance carrier. He also pointed out problems in obtaining cooperation from Federal authorities in investigating Hauser's activities.

ERISA pre-empted State regulation of employee benefit plans.[11] However, ERISA reflects the basic policy of the McCarran-Ferguson Act and generally leaves the regulation of insurance to the States, despite the fact that insurance contracts are a major investment medium for employee welfare and pension plans.[12]

It is of paramount importance to the national policy of protecting employee benefit plans that such plans deal only with financially responsible insurance companies controlled by honest management. The Hauser case shows that reliance on existing State regulation provides little protection against a recurrence of the type of scheme carried out by the Hauser group.

The Subcommittee is also concerned about the pattern of payments by Hauser in connection with insurance awards by employee benefit plans. Many of these payments were purported commissions paid by Hauser insurance companies to agencies controlled by Hauser. These disbursements ranged from those that were of questionable business purpose to outright conversions.

Other payments were made and inducements offered by Hauser to various persons who were in positions to influence the award of employee benefit contracts. Some of the recipients were fiduciaries, such as Bernard Rubin, a trustee of certain Florida employee plans which purchased insurance contracts from Farmers National, a Hauser company. Other recipients, while not fiduciaries, had contacts with persons who were in influential positions. The persons receiving these purported commissions or other fees performed functions of no benefit to the employee plans and of no or at least questionable economic benefit to the insurance companies that incurred the expenses.

This case demonstrates that the schemes of operators, such as Hauser, are facilitated by (1) the relative ease with which diversions of assets of business entities and payments for influence can be disguised as commissions, fees and other ostensibly bona fide transactions; and (2) the difficulty in documenting after the fact the nature of such transactions and recovering funds that have been improperly diverted.

In formulating recommendations to deal with the foregoing insurance related problems, the Subcommittee has attempted to strike a balance between the policy of the McCarran-Ferguson Act to leave insurance regulation primarily to the States, and the national interest in protecting beneficiaries of employee benefit plans. Thus, proposals calling for Federal legislation affecting insurance are limited to those necessary to provide effective protection of employee benefit plans. Otherwise, the Subcommittee proposals urge the States to take effective

[11] ERISA § 514(a), 29 U.S.C. § 1144(a).
[12] ERISA § 514(b), 29 U.S.C. § 1144(b) states that ERISA shall not be construed to exempt any person from State insurance laws, but provides that employee benefit plans shall not be deemed to be insurance companies.

action to strengthen general insurance regulation. In this connection, it should be emphasized that employee benefit plans were not the only victims of Hauser's activities. Many individual and other policyholders lost their coverage and investment in the insurance companies looted by Hauser.

1. Minimum Standards for Insurance Companies Doing Business With Employee Benefit Plans

The Subcommittee recommends that Congress enact legislation amending ERISA, which would direct the Secretary of Labor to establish minimum standards that insurance companies would be required to meet before an employee benefit plan could deal with such companies. These standards should cover licensing, capitalization, reserving and other financial requirements. Since the employee benefit plans vary in size, the minimum standards on financial criteria would have to take these variations into account. Specific standards should prohibit the use of fronting reinsurance arrangements which would evade the minimum standards, and specify protective measures on legitimate reinsurance arrangements, such as controls regarding access to and accountability for premium payments and reserves. The standards should also restrict transactions between insurance companies and their officers, directors and other affiliates.

The standards should take into consideration the history of civil and criminal violations of State insurance statutes or other laws by insurance companies and the principals of such companies. Disclosure of such violations as well as any material investigations by State or Federal authorities should be required.

The better State practice should serve as a useful guide in formulating minimum standards. If necessary, a Federal standard could exceed or supplement State law. The Subcommittee believes that proposed Federal standards generally should not create conflicts with State regulatory requirements.

Legislation should require that an insurance company doing business with an employee benefit plan certify that it has met each of the minimum standards. Legislation should also provide that willful miscertifications or misstatements be subject to criminal penalties [13] and civil remedies.

The foregoing proposal is consistent with ERISA's basic purpose of protecting employee benefit plans by imposing standards of conduct on persons who control the disposition of plan assets. In this connection, insurance company liabilities under ERISA for breach of fiduciary responsibilities are presently limited by an exemption. The exemption provides that an insurance company is not considered to hold plan assets solely because the plan purchases a guaranteed benefits

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[13] With respect to criminal penalties, the proposed legislation should make it clear that the insurance company certifications and representations required by this proposal would be subject to 18 U.S.C. § 1027, which provides in pertinent part:

"Whoever, in any document required by title I of . . . [ERISA] to be published, or kept as part of the records of any employee welfare benefit plan or any employee pension plan, or certified to the administrator of any such plan, makes any false statement or representation of fact, knowing it to be false, or knowingly conceals, covers up, or fails to describe any fact the disclosure of which is required by such title or is necessary to verify, explain, clarify or check for accuracy and completeness any report required by such title to be published or any information required by such title to be certified, shall be fined not more than $10,000, or imprisoned not more than five years, or both."

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policy from it.[14] This exception reflects State insurance practice which treats the proceeds of the sale of such a policy as part of the general assets of the insurance company and accords the policyholders rights available under the policy contract and otherwise under State law. The minimum standards approach would not disturb this practice, but would provide a measure of Federal protection for employee benefit plans against abuses stemming from the deficiencies in State regulation.

As the label "minimum standards" suggests, it is not designed to relieve plan fiduciaries of their responsibilities to evaluate the financial condition, reinsurance arrangements, or other aspects of an insurance proposal. (See recommendations below concerning Disclosure of Payments and Fees and "Prudent man" guidelines under ERISA.)

2. Disclosure of Payments and Fees

The Subcommittee recommends that the Congress pass legislation which would direct the Secretary of Labor to adopt regulations which (1) would require insurance companies which offer to sell insurance contracts to employee benefit plans to disclose all commissions, finder's fees and other payments made or proposed to be made in connection with such sale; and (2) would require insurance companies to make and keep accurate records of all payments and commissions in connection with the sale of insurance contracts to employee plans. This legislation should also make it a crime to willfully make false and misleading statements [15] or otherwise violate such regulations and provide appropriate civil remedies for violations.

The foregoing recommendations would provide employee plan fiduciaries information which would enable them to discharge their duty to prevent plans from incurring costs reflecting payments made in connection with the sale of insurance to plans which are of little or no economic benefit to the plans. The required disclosures would also permit plan fiduciaries to determine whether any payments are being made to parties in interest and, thus, serve as a useful supplement to the prohibited transactions provisions of ERISA.[16]

3. Financial Statements and Reporting by Insurance Companies

An insurance company is exempt from the financial reporting and certain other provisions of the Securities Exchange Act of 1934 (Exchange Act) if its domiciliary state requires it to file an annual "convention" (financial) statement on a form prescribed by the National Association of Insurance Commissioners (NAIC) and if the State

[14] ERISA § 401(b)(2), 29 U.S.C. § 1102(b)(2). This exemption does not apply to assets placed in a separate account maintained by an insurance company under a policy providing benefits in accordance with the investment performance of such account.

[15] See footnote 13 on p. 41 of this report concerning the criminal penalty provided under 18 U.S.C. § 1027 for false statements and concealment of facts in documents required under ERISA.

[16] ERISA presently requires an employee benefit plan which purchase benefits from insurance companies to include in its annual report a statement from the insurance company disclosing among other things commissions and fees to brokers, agents and other persons. ERISA § 103(e), 29 U.S.C. § 1023(e). The Subcommittee's recommendation would extend this disclosure requirement to the time that the plan considering an insurance proposal. In this connection, see recommendations on pp. 48–51 of this report which would require parties in interest to disclose receipt of consideration from persons offering or selling property or services to a plan.

regulates proxies and insider trading in a manner comparable to SEC regulation.[17]

However, the NAIC convention statement requires neither an independent audit nor periodic reporting as is mandatory for other corporate issuers. In contrast, holding companies with insurance subsidiaries are not eligible for this exemption. The requirement for financial statements audited by independent accountants and periodic reporting enhances the reliability of financial information and provides protection against fraud. Accordingly, the Subcommittee recommends that Section 12(g)(2)(G) of the Exchange Act be amended to impose this requirement on insurance companies.

The SEC also suggests the establishment of a central repository for audited insurance company convention statements to enable State regulatory authorities and the public to have access to this information. The Subcommittee endorses this proposal and recommends that Congress implement it through legislation.

4. State Regulation

The record of this case shows how unscrupulous operators can exploit the variations in insurance regulation among the States. The record demonstrates the jurisdictional problems an insurance department in one State faces when it must go to another State to investigate or seek enforcement of orders protecting assets or other relief. The inadequacies of State regulation have an adverse impact on investors in insurance companies, their policyholders, and commerce generally.

The Subcommittee recommends that the States take steps to strengthen their respective insurance laws and regulations relating to licensing, capitalization, and reserve requirements and reinsurance, and the investigatory and enforcement powers of their insurance departments. Licensing procedures should require State approval of transfers of control and thorough background checks to assure that dishonest and other unreliable persons are excluded from managing and controlling insurance companies. The use of reinsurance as a fronting device to circumvent State insurance laws should be prohibited. There should also be effective regulation to prevent overreaching of insurance companies in transactions with their management and other affiliated persons. This should include restrictions on loans by insurers to their officers and other controlling persons and on commission and fee arrangements by insurers with firms affiliated with its controlling persons.

5. Interstate Cooperation

The Subcommittee recommends that the States enter interstate compacts which would enable them to obtain prompt enforcement of their subpenas, injunctions and other orders relating to their domestic insurers doing business in other jurisdictions and which would require the exchange of data obtained in investigations and other information among State insurance departments. The Subcommittee recommends that Congress pass legislation giving advance approval to such interstate compacts.

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[17] Section 12(g)(2)(g) of the Exchange Act, 15 U.S.C. 78 *l* (g)(2).

6. Federal-State Cooperation

The Subcommittee recommends that the Departments of Labor and Justice and the SEC establish procedures which provide for the prompt reporting to the appropriate State insurance authorities of information evidencing possible violations of State laws and regulations. The Subcommittee recommended that State insurance departments establish procedures for reporting to the appropriate Federal agencies of possible violations of Federal statutes and regulations. It is suggested that a group consisting of representatives of the interested Federal agencies work with the NAIC or other representatives of the States to develop mutually acceptable procedures.

C. FIDUCIARIES UNDER ERISA

As noted above, ERISA lays down rules governing the conduct of fiduciaries of employee benefit plans. Under the act, "fiduciary" is defined as any person who exercises any discretionary authority or control respecting the management of a plan or disposition of its assets; renders investment advice for a fee or other compensation, or has authority or responsibility to do so; or has any discretionary authority or responsibility in the administration of the plan.[18] Under this definition, a "fiduciary" would clearly include persons named as fiduciaries in the instrument creating a plan, trustees, investment managers, administrators, and officers and directors of a plan.[19] The definition of fiduciary specifically covers any person designated by a named fiduciary to carry out non-trustee fiduciary functions.[20]

A number of individuals and companies were shown by the Subcommittee's investigation to have played important roles in connection with the award of employee benefit plan insurance contracts to the Hauser group. They included an insurance consultant to various plans and an attorney to a plan.[21] Whether or not they were fiduciaries under existing law and regulations can be determined only through an examination of the particular functions they performed. In this connection, the Conference Report on ERISA (p. 323) stated that:

> While the ordinary functions of consultants and advisers to employee benefit plans (other than investment advisers) may not be considered as fiduciary functions, it must be recognized that there will be situations where consultants and advisers may because of their special expertise, in effect, be exercising discretionary authority or control with respect to the management or administration of such plan or some authority or control regarding its assets. In such cases, they are to be regarded as having assumed fiduciary obligations within the meaning of the applicable definition.

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[18] ERISA § 3(21), 29 U.S.C. § 1002(21).

[10] ERISA § 402(a), 29 U.S.C. § 1102(a); ERISA § 403, 29 U.S.C. § 1103; ERISA § 3(38); 29 U.S.C. § 1002(38); ERISA § 3(14)(A), 29 U.S.C. § 1002(14)(A); ERISA § 3(21), 29 U.S.C. § 1002(21). See also, Conference Report on ERISA, p. 323.

[20] ERISA § 3(21), 29 U.S.C. § 1001(21); ERISA § 405(c)(1)(B), 29 U.S.C. § 1105(c)(1)(B).

[20] See pp. 48–49 of this report for a discussion of conflicts of interest arising from receipt of compensation by attorneys and other parties in interest who may not be fiduciaries to a plan.

1. Insurance Consultants

During the course of its investigation, the Subcommittee wrote to the Secretary of Labor seeking an opinion as to whether and under what circumstances an actuarial or insurance consultants might be considered a fiduciary under ERISA. In response, the Secretary advised that actuaries and certain other professionals performing their usual professional functions would not ordinarily be considered fiduciaries and that whether their services brought them within ERISA's definition of fiduciary must be determined by the factual situation involved on a case-by-case basis.[22]

Len Teeuws of Tolley International indicated that he did not believe insurance consultants were fiduciaries under ERISA, but that he favored clarification of their status by treating them as fiduciaries. The record of this case demonstrates that "industry standards" applicable to insurance consultants fall far short of the standard of conduct required of fiduciaries under ERISA.

The interests of employee benefit plans cannot be protected when plan trustees make decisions in substantial reliance upon expert evaluations by insurance consultants who fail to conform their conduct to the fiduciary standards of ERISA. Because of their special expertise, independent insurance consultants have considerable influence on employee plan decisions and, in effect, exercise discretionary control within the meaning of the guidelines suggested in the Conference Report on ERISA (p. 323). There is no need to await further retrospective analyses of individual fact situations. Insurance consultants who are selected by plans to evaluate proposals must know that they are fiduciaries before they render advice to employee benefit plans, not after a court has adjudicated them a fiduciary in litigation with respect to losses incurred by such plans occasioned by their failure to adhere to fiduciary standards.

Accordingly, the Subcommittee recommends that the Department of Labor issue interpretive regulations which would specify that consultants selected by employee benefit plans to evaluate insurance matters are fiduciaries under ERISA whenever they render advice or related services that will be relied upon by the plan or otherwise be a significant factor in any decision or action by the plan.

2. Conflict of Interest

As previously noted, ERISA prohibits a fiduciary from receiving any consideration for his own account from any party dealing with the employee benefit plan in connection with a transaction involving the assets of the plan. These provisions are designed to prevent kickbacks and to prevent fiduciaries from exercising their fiduciary responsibilities when they have interests which may conflict with the interests of the plans.[23]

However, the Department of Labor has issued an administrative exemption [24] which permits a "pension consultant" [25] to receive a "sales

[22] The exchange of correspondence with the Secretary of Labor is in Appendix M.

[23] See Conference Report on ERISA, p. 309 and ERISA Regulations, 29 C.F.R. § 2550.408 b–2(e)(1).

[24] The Department's exemptive authority is in ERISA § 408(a), 29 U.S.C. § 1108.

[25] The term "pension consultant" is not defined. However, the exemption appears to be intended to cover insurance consultants to employee welfare benefit plans as well as to pension plans.

commission" from an insurance company in connection with the purchase of an insurance contract with plan assets.[26] Certain conditions must be met to qualify for the exemption, including a requirement that the transaction be on terms "at least as favorable to the plan as an arm's length transaction with an unrelated party" and a requirement that the consultant obtain the advance approval of a distinterested fiduciary after furnishing disclosure of the sales commission on the recommended contract—expressed as a percentage of gross annual premium payments for the first year and each succeeding renewal year—and disclosure of the consultant's affiliation with the insurance company recommended.

Although this method of compensation appears to be common in the insurance industry, it significantly impairs the independence of insurance consultants [27] and, as a practical matter, permits insurance companies rather than employee plan trustees to set the amount of compensation of consultants. The value to a plan of a consultant's professional services is basically a reflection of his skill and the amount of time and degree of difficulty involved in his assignments, which do not necessarily bear any direct relationship to the size of the premium involved in the insurance contract awarded. Compensation based upon a percentage of the premium provides incentives to consultants to recommend more insurance or forms of insurance with higher premiums (e.g. group whole life) than is truly necessary or appropriate for employee plan beneficiaries.

The exemption granted by the Department of Labor sanctioning this practice derogates from the objective of ERISA to assure that persons serving a plan in a fiduciary capacity discharge their duties to a plan "solely in the interest of participants and beneficiaries" and for the "exclusive purpose of providing benefits to participants and beneficiaries." [28] The Subcommittee believes that this practice constitutes an irreconcilable conflict of interest. The conditions for the exemption do not obviate the conflict of interest; they merely place the onus on plan trustees and other fiduciaries to evaluate whether the method of compensation may have an impact on his professional judgment as to matters on which such trustees and other fiduciaries have little or no expertise. Therefore, the Subcommittee recommends that the Department of Labor repeal the exemption from the prohibited transaction provisions of ERISA for receipt by an insurance consultant to an employee plan of compensation from insurance companies in connection with the purchase of an insurance contract with plan assets.

3. Guidelines for Determining Who Are Fiduciaries

It has been more than 4 years since the enactment of ERISA. By now, the Department of Labor should have gained enough experience with the roles of accountants, attorneys, real estate consultants, in-

[26] Prohibited Transaction Exemption 77–9; 42 Fed. Reg. 32395 (June 24, 1977) and 44 Fed. Reg. 1479 (January 5, 1979).

[27] Len Teeuws of Tolley International pointed out in his testimony that insurance consultants are subjected to intense lobbying or marketing efforts from insurance companies eager to sell to employee benefit plans and that he would be "delighted if this practice would end" (p. 947). Certainly this method of compensation makes it difficult for a consultant to maintain complete objectivity.

[28] ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1).

surance consultants, and other persons who provide professional or other specialized services to employee benefit plans to determine the extent to which these persons are fiduciaries to the plans they serve. Therefore, the Subcommittee recommends that the Secretary of Labor issue interpretive guidelines which identify with greater specificity the circumstances under which persons providing professional or other specialized services to employee benefit plans are fiduciaries under ERISA. Such guidelines would serve to alert persons dealing with benefit plans as to when their activities make them fiduciaries and of their obligations to conform their conduct to ERISA standards.

D. PROHIBITED SELF-DEALING AND CONFLICT OF INTEREST TRANSACTIONS UNDER ERISA

The Subcommittee's investigation also raised questions concerning the adequacy of the Prohibited Transactions provisions of ERISA which are designed to obviate conflicts of interest in the administration of employee welfare benefit plans.[29] As previously noted, these provisions prohibit or limit certain types of transactions between a plan and fiduciaries or other parties in interest. One such prohibited transaction is the furnishing of goods, services, or facilities between the plan and a party in interest.[30] This provision would appear to bar a party in interest from serving as insurance agent or broker for a company doing business with a welfare benefit plan, unless exempt under Section 408(b)(2) of the Act, 29 U.S.C. § 1108(b)(2) or by the administrative exemptive provisions. Section 408(b)(2) exempts "contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan if no more than reasonable compensation is paid therefor."

1. Relatives of Union Officials as Parties In Interest

The definition of "party in interest" [31] includes any fiduciary, counsel or employee of a plan, a person providing services to a plan, an employer any of whose employees are covered by a plan, an employee organization or union whose members are covered by the plan, certain controlling persons of an employer or employee organization, an officer, director or employee of the plan or of any of the above. It also includes a relative [32] of any of the above, except an employee organization and the officers, directors and employees mentioned. It appears that relatives of union officers, who are not trustees or fiduciaries of a plan, are not considered parties in interest to the plan; therefore, they apparently are not subject to the Prohibited Transactions provisions of ERISA.

The record of this case shows that the son of an official of the Laborers' International Union acted as broker in connection with the sale by the Hauser group of an insurance contract to the Indiana Laborers' Fund. The Hauser group financed the establishment of that

[29] While the investigation dealt with employee welfare benefit plans, the questions raised and recommendations would also apply to pension plans.
[30] ERISA § 406(a)(1)(C), 29 U.S.C. § 1106(a)(1)(C).
[31] ERISA § 3(14), 29 U.S.C. § 1002(14).
[32] The term "relative" means a "spouse, ancestor, lineal descendant, or spouse of a lineal descendant." ERISA § 3(15), 29 U.S.C. § 1002(15).

relative's insurance agency and made commission payments to that agency. Hauser entered this business relationship with this person precisely because he had contacts with union and plan officials. Since a relative of a non-fiduciary union official is not a party in interest, this transaction apparently did not come within the proscriptions of ERISA. The record shows that the services performed by the union relative were of little or no value to the Fund, which had its own insurance consultant.

In view of the substantial influence that relatives of union officials may potentially wield over union related employee benefit plans, the Subcommittee recommends that the Congress consider amending ERISA to include relatives of non-fiduciary union officers as "parties in interest" with respect to any employee benefit plan which covers members of such union and, thereby, subject them to the Prohibited Transactions Provisions of the Act.

2. *Receipt of Compensation by Parties in Interest*

In its investigation the Subcommittee found that Hauser paid Seymour Gopman, counsel for many of the Florida union employee benefit plans which awarded insurance contracts to Hauser's insurance company, $11,500 for introducing Hauser to officials of the plans. Since Gopman stated that he was placed on the board of directors of Hauser's holding company "to look after the interests of the labor unions." He also advised one of the funds (Laborers Local 666) that Farmer's National was financially stable and able to handle its insurance program. Thus, it appears that he may have exercised sufficient discretionary authority to have acted as a fiduciary with respect to the insurance awards. However, the investigation did not adduce sufficient proof to make a conclusive determination.[33] Receipt of such compensation by a fiduciary is prohibited by Section 406(b)(3) of ERISA.[34]

In any event, counsel to an employee benefit plan is a party in interest [35] and, thus, it would appear that a Gopman-type transaction would come within the Prohibited Transaction provisions as a "direct or indirect * * * furnishing of goods, services, or facilities between the plan and a party in interest [or] transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan." [36] In this regard, access to officials of an employee benefit plan is an asset of the plan and is not something that counsel to a plan has the right to sell whether or not he is a fiduciary. There is clearly no basis for concluding that

[33] In this connection, the Secretary of Labor has filed a civil action against Gopman alleging that he was fiduciary with respect to Laborers Local 767 Health and Welfare Trust Fund and breached his fiduciary duty by dealing with fund assets for his own account and imprudent conduct. (Appendix E.) However, the complaint makes no reference to the payment of any introduction fee by Hauser.

[34] This prohibition did not become effective until January 1, 1975. Gopman said that he received all compensation from Hauser in 1974.

Also, receipt of an "introduction fee" by counsel to an employee benefit plan for his influence in affecting an insurance award by the plan may constitute a criminal offense under 18 U.S.C. § 1954, which was in effect prior to the adoption of ERISA. Section 1954 makes it a crime for specified persons who are in a position to influence such a plan (including counsel to a plan) to receive or agree to receive or solicit any fee, kickback, commission, gift, loan, money or thing of value because of or with the intent to be influenced with respect to, any of his decisions, actions, or other duties relating to any question or matter concerning such plan. The section does not prohibit bona fide compensation or payments for goods or services furnished or performed in the regular course of the duties of the recipients.

[35] ERISA § 3(14)(A), 29 U.S.C. § 1002(14)(A).

[36] ERISA § 406(a)(1)(C) and (D); 29 U.S.C. § 1106(a)(1)(C) and (D).

Gopman transaction would be exempt under Section 408(b)(2) as necessary for the operation of the plan. Accordingly, the Subcommittee recommends that the Department of Labor adopt interpretive regulations making it clear that so-called introduction fees paid to parties in interest, including counsel to a plan and any other non-fiduciary parties in interest, constitute prohibited transactions.

Section 406 (a) of ERISA imposes an obligation on plan fiduciaries to prevent the plan from engaging in a transaction which he knows or should know constitutes a party in interest transaction. The prohibition does not specifically apply to a party in interest who is not a fiduciary. However, the Secretary of Labor is authorized under Section 502(i) of ERISA (29 U.S.C. § 1132(i)) to assess a civil monetary penalty against a party in interest (including a non-fiduciary party in interest) which engages in a transaction prohibited by Section 406.[37] Thus, by implication, a party in interest is under a personal duty to refrain from engaging in prohibited transactions and would appear to be a proper subject of injunctive and other equitable relief under Section 502(a) of the Act (29 U.S.C. § 1132). The Subcommittee recommends that ERISA be amended to make it clear that a non-fiduciary party interest who knows (or should know) that he has engaged in a prohibited transaction is also a proper subject of an action seeking injunctive and other equitable relief.

ERISA does not impose a specific duty on the part of either fiduciary or non-fiduciary parties in interest to disclose to a plan that they are engaging in transactions that are or may be violations of ERISA. The Subcommittee recommends that Congress amend ERISA to impose on parties in interest a specific duty to disclose to plan administrators their financial interests in any party dealing with the plan and any arrangements whereby such party in interest will receive compensation or other payments, including loans, for his own account from a party dealing with a plan.

The proposed disclosure requirements should be patterned after the provisions of the Labor Management Reporting and Disclosure Act (LMRDA) which require union organizations, employers and union officers to file annual reports with the Department of Labor disclosing questionable payments and financial interests.[38] For example, officers and non-clerical employees of labor organizations are required to disclose their and their families' (1) financial interests in employers and enterprises which do business with employers and labor organizations, and (2) payments they and their families receive from any employer or labor relations consultant to an employer (29 U.S.C. § 432). Similarly, employers must report direct and indirect payments to union organizations and union officers and employees. The purpose of these reporting requirements was described in Senate Report No. 187, 86th Congress, First Session (1959), p. 5:

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[37] The amount of the penalty may not exceed 5 percent of the amount involved and, if the transaction is not corrected, the Secretary of Labor is authorized to impose a penalty of up to 100 percent of the amount involved. In the case of pension and certain other plans "qualified" under the Internal Revenue Code, provision is made for the imposition of a similar penalty in the form of an excise tax. (See Section 4975 of the Internal Revenue Code.)

[38] (29 U.S.C. § 431–433.) These reports are public information under 29 U.S.C. § 435. Also, 29 U.S.C. § 439 provides criminal penalties for failure to file these reports and for false statements and concealment of material facts in such reports.

> * * * [O]nly full disclosure will enable the persons whose rights are affected, the public, and the Government to determine whether the arrangements or activities are justifiable, ethical, and legal.

This rationale is equally applicable to employee benefit plans.

In order to permit flexibility to take into account the broad reach of the definition of party in interest,[39] the Subcommittee recommends that legislation direct the Secretary of Labor to adopt regulations to implement the disclosure proposal. The regulations should be designed to obtain only information as to business relationships and financial interests which are material to the detection or assessment of potentially unlawful or questionable transactions. In this regard, the regulations should be tailored to the responsibilities of the positions held by persons who are parties in interest. For example, counsel, insurance consultants and other professionals which serve a plan should disclose the names of their clients which have material business dealings with the plan and any personal business relationships or financial interests in a party which deals with the plan.

It is further recommended that the information disclosed pursuant to these regulations be filed with the Department of Labor as required under LMRDA, or be included in the annual reports required by ERISA of employee benefit plans.[40] Violations of these disclosure requirements should be subject to criminal penalties under 18 U.S.C. § 1027 [41] and to injunctive and other civil remedies.

The recommended disclosure requirements would alert employee benefit plan officials to potential conflicts of interest and other questionable transactions. Such disclosures could also serve as supplements to existing provisions concerning prohibited transactions. They would provide a mechanism to alert plans, their fiduciaries, and the Department of Labor as to the existence of possible prohibited transactions and breaches of fiduciary duty.

The proposed recommendation contemplates disclosure of some payments which might be criminal under 18 U.S.C. § 1954 which prohibits payments to (and receipt by) employee plan fiduciaries and certain other parties in interest because of or with the intent to influence (or be influenced with respect to) actions and decisions of the plan. A person who willfully fails to report such a payment may have a complete defense to prosecution for such failure to asserting his Fifth Amendment privilege against self-incrimination; however, the privilege against self-incrimination would not preclude prosecution for filing a report which contains false information or conceals material facts. See *United States* v. *McCarthy*, 298 F. Supp. 561 (S.D.N.Y. 1969), *aff'd* 422 F. 2nd 160 (2d Cir. 1970), *appeal dismissed*, 398 U.S. 946.

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[39] In some instances a firm dealing with the plan may itself be a "party in interest," thus making officers, directors, and controlling persons of that firm parties in interest. The Subcommittee's proposal is not intended to require regular officers, directors, and controlling persons to disclose bona fide compensation for their services to such firm. Disclosure requirements should not apply to clerical employees. Also, persons who are parties in interest solely by virtue of being relatives of fiduciaries, service providers, etc., may include their disclosures in the reports of their fiduciary or service provider relatives.

[40] ERISA § 103, 29 U.S.C § 1023. These reports are available to plan participants.

[41] See discussion of this provision in footnote 13 on p. 41 of this report.

The preceding recommendation is designed to facilitate detection of questionable, improper, and prohibited transactions by requiring annual reporting by parties in interest. The Subcommittee also recommends that Congress amend ERISA to require the Department of Labor to adopt rules requiring employee benefit plan fiduciaries to obtain written certified disclosures from parties dealing with the plan ("dealing party") prior to entering any material transaction with the dealing party. The disclosures should cover any payments made or to be made in connection with the proposed transactions to any fiduciary or other party in interest and any financial interest which any fiduciary or other party in interest may have in the dealing party. The legislation should make it clear that the required disclosures would be subject to the criminal penalties of 18 U.S.C. § 1027 for false statements and concealment of material facts.

E. JOINTLY MANAGED TRUST FUNDS

The Subcommittee also is concerned that the present structure of many employee benefit trust funds jointly managed by employer and employee representatives does not adequately protect against potential conflicts of interest. The provisions of the Taft-Hartley Act relating to such trust funds require that employees and employers be equally represented in the administration of such funds "together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon * * *".[42] However, the Subcommittee has found in the course of its investigations that there are seldom any "neutral" trustees, and that frequently the union and management trustees are the same individuals who must face each other periodically over the collective bargaining table.

In reviewing the process by which the trustees of various funds decided to award their insurance contracts to the Hauser group, it appears that one or more of the union trustees tended to dominate the proceedings. Although management trustees sometimes raised questions concerning the proposals by the Hauser companies or about the companies themselves, in a number of instances they acquiesced in what the union trustees wanted to do. This raised the question of whether or not the fact that the management trustees would have to face the labor trustees across the bargaining table at some future date may have affected their actions as trustees.

To minimize this potential conflict of interest in the jointly managed trust funds, the Subcommittee recommends that the Congress amend the Taft-Hartley Act to require the inclusion of independent neutral trustees. The Subcommittee also recommends that the Congress extend the "sunshine" or open meetings principle to jointly managed trust funds by requiring that all meetings of the trustees be open to participants in the fund. It is further recommended that a verbatim record be kept of the proceedings and made available for review by any participant in the fund and members of the public as are reports required by the Labor Management Reporting and Disclosure Act (29 U.S.C. § 435).

[42] 29 U.S.C. § 186(c)(5)(B).

F. SANCTIONS AND REMEDIES AGAINST UNIONS AND EMPLOYEE BENEFIT PLAN OFFICIALS WHO ABUSE THEIR POSITIONS OF TRUST

In its investigation, the Subcommittee learned that Bernard Rubin continued to serve as a trustee of local labor organizations of the International Laborers' Union and related employee benefit plans after he was convicted of several counts of violating the racketeering statutes and embezzling the funds of these organizations. Following the conviction of Rubin, the Court of Appeals granted a stay of the District Court's order under 18 U.S.C. § 1963 requiring Rubin to forfeit his plan and union positions. The Department of Justice uncovered evidence that Rubin continued to embezzle union and union employee plan funds between the time of his conviction and his removal two years later from his fiduciary positions pursuant to a court order setting conditions on his bond pending appeal.

1. *Forfeiture of Positions*

A union or employee plan official who is convicted of racketeering violations involving embezzlement of the assets of such entities or other misconduct affecting those entities (e.g., kickbacks and fraud) should not be permitted to exercise control over the plan. If he is ordered to forfeit his positions with those entities and the order is stayed pending appeal he should at least be suspended from performing any functions until the appeal is decided. Accordingly, the Subcommittee recommends that legislation be adopted which would provide for such suspension.[43]

2. *Disqualification*

Both the Labor Management Reporting and Disclosure Act (LMRDA) and ERISA prohibit a person convicted of certain crimes from serving as a trustee, officer, employee, or consultant to labor organizations (LMRDA, 29 U.S.C. § 504) and employe benefit plans (ERISA 29 U.S.C. § 1111).[44] However, the disqualification does not take effect upon conviction by a trial court, but only after such judgment has been sustained on appeal. Thus, a union or employee plan official convicted of embezzling union or plan funds would not be disqualified from holding those positions pending appeal. Many appeals take years to reach their ultimate conclusion, years in which officials like Rubin can further deplete the union and trust fund assets.

The Subcommittee believes that a union or plan official who is convicted by a trial court of a crime involving a breach of his position of trust with a union or employee plan, should be suspended from performing any official functions pending appeal. The considerations forming the basis of the preceding recommendation with respect to forfeitures for racketeering violations apply with equal

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[43] See discussion below of recommendation for suspension following conviction under other criminal statutes. The Subcommittee assumes that the U.S. Courts of Appeal would take appropriate steps to assure that appeals of cases where such suspensions apply will be decided on an expedited basis.

[44] The forfeiture under the racketeering provisions of 18 U.S.C. § 1963 may be invoked only upon a showing of a "pattern of racketeering activity"; i.e. at least two acts of "racketeering activity" which is defined to include crimes which directly affect labor organizations and employee benefit plans such as embezzlement and illegal payments for influence. In contrast, the disqualification provisions of LMRDA and ERISA apply in the case of conviction of any one of the disqualifying crimes.

force in such a case. Accordingly, the Subcommittee recommends enactment of legislation providing for such a suspension.

In examining the disqualification provisions of LMRDA and ERISA, the Subcommittee found that the list of disqualifying crimes under ERISA are much broader than those under LMRDA. For example, ERISA enumerates fraud, including mail and wire fraud; illegal payments to officials of employee benefit plans (18 U.S.C. § 1954); perjury; obstruction of justice (18 U.S.C. §§ 1503, 1505, 1506); interference with commerce by threats or violence; attempts to commit any of the enumerated crimes or any crime in which any of the foregoing is an element. However, the foregoing are not included in the list of disqualifying crimes under LMRDA. Thus, the Subcommittee recommends that LMRDA be amended to bring it into conformity with the corresponding disqualification provisions of ERISA.

As noted above, Allen Dorfman's Amalgamated Insurance Agency continued to act as the insurance claims processing agent of the Teamsters Health and Welfare Fund even after his removal as consultant to the Teamsters Pension Fund following his 1972 conviction for accepting a kickback in connection with a Pension Fund transaction. The trustees of the Health and Welfare Fund could have invoked the prudent man rule and terminated its relationship with Amalgamated, but it did not do so.

The automatic disqualification provision of ERISA (29 U.S.C. § 1111) does not specifically bar a corporation, which is controlled by or employs a disqualified person, from serving an employee benefit plan as a consultant, agent, or other capacity.[45] The Subcommittee considers this a loophole which should be closed by legislation extending the coverage of the provision to corporations and other entities controlled by disqualified persons or which employ disqualified persons.[46] The legislation should provide that, before this disqualification could be imposed, the affected entity must be given an opportunity to obtain an exemption from the U.S. Board of Parole if it can be demonstrated that the disqualified employee or control person will not take part in any aspect of the entity's dealings with the plan.[47]

The Subcommittee further recommends that a similar loophole in the disqualification provision for labor organizations under LMRDA (29 U.S.C. § 504) also be closed by similar legislation.

3. Preconviction Remedies

The disqualification provisions of LMRDA and ERISA apply only after conviction of the specified crimes. In contrast, the Government may invoke 18 U.S.C. § 1963 to obtain a protective order or equitable relief to prevent a union or plan official under indictment for a pattern of racketeering activity for misuse of the assets of such entity from misusing such assets pending trial. This authority permits the Depart-

[45] The disqualification is limited to 5 years following final conviction or the end of imprisonment whichever is later.

[46] It may be possible to invoke the disqualification provision against a corporation on the theory that is the alter ego of the disqualified individual. However, it would be a difficult burden to sustain such a theory and, in any event, it probably could not be used to reach situations in which a corporation merely employs a disqualified individual.

[47] The ERISA presently provides that a corporation or partnership which is convicted of a disqualifying crime may not be disqualified unless the Board of Parole determines, after notice and an opportunity for hearing, that service to the plan would be inconsistent with the intention of this section.

ment of Justice to take action independently of the Department of Labor, which may not be able to effectively pursue regular civil remedies because the evidence of the misconduct was developed by a Grand Jury and, thus, not available for civil enforcement purposes.[48]

Comparable pre-conviction is not provided under non-racketeering criminal statutes relating to embezzlement and other misuses of union and plan assets. Thus, the Subcommittee recommends that these criminal statutes be amended to authorize the Department of Justice to seek appropriate pre-conviction restraints on union and plan officials under indictment for crime involving misuse of union and employee benefit plan assets (29 U.S.C. § 501 and 18 U.S.C. § 664).

4. Civil Remedies Against Union Officials

ERISA provides civil remedies enforceable by the Department of Labor to remove plan fiduciaries who have breached their fiduciary duties, obtain money judgments and to obtain other equitable or remedial relief.[49] The provision for "equitable and other remedial relief" is broad enough to authorize the Secretary of Labor to seek and, if the circumstances warrant, a court to impose a trusteeship or monitorship to protect or seek the return of fund assets. However, similar protections are not afforded under LMRDA.

LMRDA provides no authority for civil enforcement by the Government of the provisions of Title V of the LMRDA, which impose fiduciary obligations on labor union officers and employees and other representatives (29 U.S.C. § 501) and provides for other safeguards relating to bonding of union officer employees (29 U.S.C. § 502), loans to officers and employees of unions (29 U.S.C. § 503), and the disqualification of persons convicted of crimes from serving as union officers (29 U.S.C. § 504). The Subcommittee believes that this is a serious deficiency and, therefore, recommends that LMRDA be amended to provide the Government authority to bring civil actions for remedial and other equitable relief against persons violating their fiduciary duties to labor organizations and other duties under Title V of the LMRDA. This will bring into conformity with the corresponding civil enforcement provisions of ERISA.

G. "PRUDENT MAN" GUIDELINES UNDER ERISA

This case shows the need for vigilance by employee benefit plan trustees and other fiduciaries with primary management responsibility in protecting the plan against overreaching by operators such as Hauser and his associates. As previously noted, ERISA provides that a fiduciary shall discharge his duties with the care, skill, prudence and diligence that a "prudent man" would use. The record of this case, together with the experience gained from administering ERISA, should give the Department of Labor an adequate basis to define minimum standards that fiduciaries must meet in order to comply with the prudent man rule. Accordingly, the Subcommittee recommends that the Department formulate and issue appropriate interpretive regulations setting forth such standards.

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[48] See Rule 6(e) of the Federal Rules of Criminal Procedure.

[49] ERISA § 409, 29 U.S.C. § 1109; and ERISA § 502(a), 29 U.S.C. 1132(a). ERISA also authorizes a civil action for removal of a person who serves in violation of the disqualification of Section 411 of ERISA, 29 U.S.C. § 1111.

The proposed regulations should specify the steps trustees should take to investigate the backgrounds of persons furnishing services to the plan in order to determine their reliability, potential conflicts of interest they may have, and their status as fiduciaries. Such inquiry should adduce information which would permit plan trustees to determine whether to retain the services of consultants and other persons who have special expertise.

The proposed regulations should also require trustees to make inquiries into bidding insurance companies in order to determine the reputation of their management and the financial responsibility of such companies, including reinsurance, finder's fee and commission arrangements. The nature and extent of such inquiry would be less burdensome if the Subcommittee's recommendations for minimum standards for insurance companies doing business with employee benefit plans and other insurance related proposals were adopted.

The proposed regulations should further require plan trustees to adopt written procedures designed to prevent and detect overreaching of and fraud on the plan and breaches of fiduciary duty and "prohibited transactions." The procedures should set forth the details of the plan's internal control and accountability system and provide for documentation and audit of compliance with plan procedures, including the basis of decisions involving dispositions of plan assets as well as the nature and results of the inquiries into persons providing services to the plan and bidding insurance companies. The regulations should also require adoption of competitive bidding procedures for purchases of insurance and other appropriate transactions and emphasize the need for plan trustees to be watchful for deviations from established procedures and other irregularities.[50]

The above proposals for "prudent man" guidelines are intended to complement the Subcommittee's other recommendations which are designed to remedy significant weaknesses in insurance regulation and current Federal laws which protect employee benefit plans. Implementation of these other recommendations should make it significantly more difficult for a Hauser-type scheme to achieve success. However, employee benefit plans would still remain attractive targets for unscrupulous operators who promote similar or novel schemes. Thus, the ultimate responsibility for protecting the interests of employee benefit plans must remain with the trustees and other fiduciaries of such plans. This case shows that they cannot necessarily take comfort in "industry practices," but rather must discharge their duties with a healthy skepticism. To that end, the recommended prudent man guidelines would heighten the awareness of persons vested with responsibility for management of such plans as to what is required of them as fiduciaries.

H. IMPROVEMENTS IN THE DEPARTMENT OF LABOR'S ENFORCEMENT PROGRAM

As previously noted, the Department of Labor has filled 82 of the 90 positions it promised about a year ago to assign to the Department of

[50] The Department of Labor recently adopted a regulation which sets forth guidelines on the investment of plan assets under the "prudence" rule (29 C.F.R. § 2550 404a–1). The matters to be dealt with in the prudent man guidelines recommended by the Subcommittee are not covered by the Department's regulation. For example the Department's regulation deals only with investments and thus does not cover background inquiries, internal control, and procedures to prevent fraud and ERISA violations.

Justice's Organized Crime Strike Forces. The Subcommittee recommends that the Department promptly fill the remaining positions and continue its commitment to support the organized crime program. Also, the Department is directed to submit to the Subcommittee within 60 days a report on the status of its commitment. The report should also contain a summary of the strike force investigations in which Department personnel have participated and the outcome of such investigations, including the results of any prosecutions.

The Department of Labor has suggested that it has no responsibility to detect and investigate violations of criminal laws relating to employee benefit plans in Title 18 of the U.S. Code because they are not technically part of ERISA. The provisions include prohibitions against embezzlement (18 U.S.C. § 664), kickbacks (18 U.S.C. § 1954), and false statements in reports under ERISA (18 U.S.C. § 1027). The Subcommittee recommends that Congress amend ERISA to make it clear that the Department of Labor's investigative responsibility extends to such crimes.

The Subcommittee further recommends that the Department of Labor reassess its position with respect to the September 28, 1978 GAO report which found several serious shortcomings in the Department's enforcement program. The Department is directed to submit to the Subcommittee within 60 days a detailed report of the results of its reassessment of each GAO finding and recommendation. In this connection, the Subcommittee cannot emphasize too strongly the need for the Department of Labor to carry out a vigorous criminal and civil enforcement program. The GAO report and the comments of the Department of Justice make it clear that, in order to achieve this objective, the Department of Labor needs more qualified manpower than has been requested by the Department of Labor and the Office of Management and Budget and approved by Congress. Thus, the Subcommittee recommends that Congress carefully consider Department of Labor budget requests for enforcement personnel to assure that personnel needs are adequate to the task. A complete accounting of its personnel needs in the Department's report to the Subcommittee will obviously assist the Congress. The Department of Labor's report should also contain its legislative recommendations to correct any deficiencies in its jurisdiction or investigative tools which prevent it from dealing effectively with abuses affecting labor organizations and employee benefit plans.

The Department is also directed to submit within 60 days a statement as to what action it will take in response to each of the Subcommittee's preceding recommendations for the adoption of regulations and guidelines (see Sections B-6, C, and G).

III. Details of the Evidence

A. THE INVESTIGATION

Under section 3, paragraph 2 of Senate Resolution 370, 95th Congress, 2nd Session, and similar resolutions of preceding Congresses, the Permanent Subcommittee on Investigations has been authorized to investigate improper practices and activities in the labor-management field detrimental to the interests of the public, employers, or employees. Pursuant to this authority, and the Subcommittee's rules of procedure, the Subcommittee in early 1976 unanimously authorized the staff to undertake preliminary inquiries into problems in the labor-management area. Subsequently, attention was focused on problems besetting labor union insurance programs.

As part of its work in this area, the Subcommittee, in June 1976, issued a committee print entitled "Staff Study of the Severance Pay-Life Insurance Plan of Teamsters Local 295." That study dealt with a highly questionable life insurance plan which was promoted and sold to the Local 295 Severance Trust Fund by one Louis C. Ostrer and his associates. The effect of that plan was to extract high insurance premiums and excessive commissions from the Severance Pay Trust Fund through the sale of individual whole-life policies to union members rather than a more conventional and much less costly group-term life policy. Following the issuance of that staff study, the staff continued its investigation of the activities of Ostrer and his associates. In March of 1977 the Subcommittee held a public hearing and released a committee print entitled "Supplemental Staff Study of Union Severance Pay-Life Insurance Plans adopted by Union Locals," which showed that the same type of plan had been sold to 11 other union trust funds in six states, and that commissions amounting to as much as 90 percent of the first year premiums had been paid to the plan's promoters.

During the course of the Subcommittee's investigation into the activities of Ostrer and his associates, the staff identified another group, headed by a man named Joseph Hauser,[1] that had sold thousands of whole life and other insurance policies to some of the same Florida union trust funds and individuals as had the Ostrer group.

In accordance with the Subcommittee's rules of procedure, an inquiry into the activities of Hauser and his associates was authorized by the Subcommittee on September 16, 1976, and reauthorized on July 12, 1977.

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[1] In December 1978, the Secretary of Labor instituted a civil action against Ostrer and the trustees of Southeast Florida Laborers' District Council Pay Trust Fund alleging that they breached their fiduciary duties by causing the Fund to expend excessive and unwarranted sums in connection with the funding of health benefits resulting in a loss of $300,000. *Marshall* v. *Rubin, et al.*, C.A. No. 78–5749 (U.S. District Court, Southern District of Florida). See discussion of that action in the letter from the Secretary of Labor to the Subcommittee which is in Appendix E. Former Fund trustee and defendant Bernard Rubin was also an import figure in Hauser's activities. (See discussion below.)

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The immediate objectives of the investigation were to determine the reasons for the phenomenal success of the Hauser-affiliated companies in obtaining labor union trust fund insurance contracts in competition with many of the largest and best known insurance companies in the country; whether there were improprieties on the part of fund trustees or others in the awarding of such contracts to the Hauser group; and whether, how, and the extent to which Hauser and his associates had converted labor union trust funds to their own use.

The ultimate purpose of the investigation was to determine whether the improprieties identified had been made possible by deficiencies in Federal and State laws, or in the administration and enforcement of such laws, and if so, to formulate appropriate recommendations for legislative or administrative remedies.

Due to the highly complex and widespread nature of the Hauser operation, the number and volume of complicated financial transactions involved, and the intricacies of the programs and bidding processes involved in the awarding of labor union insurance contracts, a full year was required to complete the investigation. It involved the issuance of almost 100 subpenas and the review and analysis of voluminous records and files. It also required extensive field work including interviews with numerous prospective witnesses.

As a result of the information obtained during the investigation, the Subcommittee held 11 days of public hearings on October 10–12, 17–19, 28 and 31, and November 1, 2 and 4, 1977. Twenty-seven witnesses were examined under oath, including several members of the staff who had participated in the investigation, and additional evidence was received in the form of exhibits and sworn affidavits. The printed hearing record covers 1,209 pages.

The members of the Subcommittee staff who participated in this investigation were: W. Donald Gray, LaVern Duffy, John J. Walsh, William Anderson, and Ray Madden of the Majority Staff; Robert Nichols, a Congressional Fellow on loan to the Subcommittee from the Equal Employment Opportunity Commission; and Jonathan Cottin, Howard Marks, and Joseph J. Block of the Minority Staff. The Subcommittee was also assisted by Joseph Unger, Herbert Harris, and Franklin Dana of the General Accounting Office who were assigned to work with the regular Subcommittee staff and made significant contributions to the investigation. The investigation was under the overall supervision of former Chief Counsel Owen J. Malone and former Chief Counsel to the Minority Stuart M. Statler. This report was written under the supervision of LaVern J. Duffy, General Counsel to the Subcommittee.

Following is a detailed summary of the evidence obtained by the Subcommittee during the investigation.

B. OVERVIEW OF THE HAUSER OPERATION

There were some similarities between the operations of the Louis Ostrer and Joseph Hauser groups, notably in their attempts to influence labor leaders to purchase high-premium whole-life or permanent type insurance for their groups, rather than the more conventional and less costly group-term life. However, Hauser's operation was much larger, more sophisticated and significantly more complex than Ostrer's.

The Ostrer group sold only one product, individual whole-life insurance policies, to a specialized type of fund, severance pay trust funds. The Hauser group [2] dealt with the unions' general health and welfare funds. If Hauser and his associates could not sell a fund whole-life insurance, they would sell it group-term life, as well as health, accident, and disability insurance.

While the Ostrer group was largely dependent for income on commissions from the insurance companies with which they placed the insurance they sold, the Hauser group acquired and ran its own insurance companies. Thus, the Hauser group had access to and use of the full premium payments from the business they generated, including the reserves for future claims.

The normal insurance company uses most of the premiums to pay claims and to set up reserves which are placed in qualified investments. In contrast, the *modus operandi* of Hauser and his associates was to channel large labor union trust fund insurance premiums into their insurance companies and then to convert large amounts of these union premium monies to their own use before the claims caught up. As claims mounted against the premiums which had been diverted to other uses, a portion of the premiums from newly acquired labor union business would be used to pay the claims against old business. As a result, new business had to be generated constantly to bring in new premium dollars to pay claims, the reserves for which had been diverted to other uses. In this respect, the Hauser operation resembled a "Ponzi Scheme," or never-ending chain in which the later victims generally suffer the greatest loss. In this case, the last purchaser of insurance from the Hauser group was the Teamsters Fund which also suffered the largest single loss—$7 million.

Moreover, when the Hauser group had largely exhausted the labor union business available to it in States where its own insurance companies were licensed to do business, it entered into a type of reinsurance agreement, known in the insurance industry as a "fronting" agreement, with a company licensed in other States. The Hauser group would then sell insurance to labor union trust funds in those States, using the policies of the fronting company, but reinsuring all or most of the risks into one of the Hauser-controlled companies. Most of the premiums would also be passed on to the Hauser company.

The Subcommittee's investigation showed that during the 3 years of its existence, the Hauser operation enjoyed phenomenal success in securing insurance business from labor union trust funds.

For example, during the period 1973–1976, the Hauser affiliated insurance companies collected over $39 million in insurance premiums from 20 labor union trust funds headquartered in 8 States (pp. 13–14, Exhibit 1A).[3] At the time of the Subcommittee's investigation, only $25.6 million had been paid out in claims against the $39 million collected in premiums, leaving over $13 million—or approximately

[2] The term "Hauser group" refers to Joseph Hauser, the insurance companies and other firms which he controlled and the officers, directors, and the employees of those firms.

[3] Unless otherwise indicated, page and exhibit numbers cited in this report refer to pages in the printed hearing record and exhibits printed or indexed in the hearing record. Citations to Appendices refer to documents which were not included in the hearing record, but which are made a part of this report.

one-third of the total premiums—unaccounted for. More recent information indicates that actual losses resulting from Hauser's activities totals at least $8 million, which includes the $7 million Teamsters Fund loss and over a $1 million loss sustainted by several Florida Laborers' health and welfare funds.[4] Teamsters Fund trustees and certain Fund beneficiaries have instituted civil actions seeking the recovery of the loss.[5] The Secretary of Labor has instituted one action against Hauser and certain of his affiliated firms and the current and former trustees of Florida Laborers' Local 767 Health and Welfare Fund alleging that Hauser induced fund trustees to breach their fiduciary duties in expending excessive amounts of plan assets for individual whole life insurance policies. The Secretary of Labor is also preparing to institute legal action or considering possible legal action with respect to a number of the Florida funds.[6]

Due to the enormous number of claims and other transactions involved, and the non-availability of many records, the Subcommittee did not attempt to verify the accuracy and validity of the claims figures which were provided by the trust funds, nor was the Subcommittee able to trace every dollar of the remaining premium payments. However, on the basis of the bank accounts and other records which the Subcommittee was able to obtain and analyze, approximately $11,700,000 in diversions and questionable expenditures by Hauser and his associates from the union trust fund premium moneys were identified. This amount constituted about 30 percent of the total premiums paid by the union trust funds. Details of these diversions and questionable payments were included in Exhibits 2A through 2H of the hearing record (pp. 16–33).

These exhibits showed $775,402 in conversions to cash by Hauser and his associates, including a number of individual transactions ranging from $50,000 to $200,000; $3,334,629 in payments to other enterprises controlled directly by Hauser and/or his associates; $199,932 for payment of what appeared to be personal expenses; and $354,122 for commissions, fees, or other payments to insurance agencies and other enterprises most of which, while not directly controlled by Hauser and his associates, were established at Hauser's behest, and funded almost entirely by payments from the Hauser affiliated insurance companies. A number of these agencies were owned by relatives or associates of labor union officials associated with trust funds that placed their insurance with the Hauser companies. In addition, some $5,792,463 was placed in investments which were at best questionable and at worst, worthless and possibly fraudulent; $713,058 was paid out in legal fees, many of which appeared to be extraordinarily high, and frequently were made to firms which were representing Hauser or his associates in their personal legal difficulties or in other matters unrelated to the normal operations of the insurance companies. Finally, there was $555,319 in miscellaneous disbursements which bore no

[4] Well over $20 million of the aforementioned $39 million in premium payments to the Hauser affiliated insurance companies were made by the Teamsters and Florida funds.

[5] Copies of the Complaints in these actions and certain other court papers are in Appendix D.

[6] See correspondence from the Secretary of Labor in appendix E. The Secretary notes that several cases are still under investigation and that the results of other investigations failed to uncover losses to funds in Indiana, Arizona, Rhode Island and Hawaii.

apparent relationship to the normal business operations of the insurance companies.

While some of these payments could conceivably have been related to normal and legitimate operations of the insurance companies, in many instances they clearly were not. For example, Hauser wrote a check for $1.1 million to a Swiss Corporation, Zeevco A. G., which had no apparent relationship to the operations of the insurance companies identified in the Subcommittee investigation and which was never satisfactorily explained. A court-appointed receiver for Hauser's National American Life Insurance Company recovered about $832,000 of the $1.1 million. Hauser finally made restitution of another $146,000 only after having been held in contempt for failure to comply with a Federal court order.

In other instances, payments which are normally considered quite legitimate for an insurance company were questionable for other reasons. For example, many of the commission payments made to insurance agencies appeared to bear no relationship to the volume of, or particular blocs of, business generated by those agencies. (See e.g., pp. 26–27, 84–85, 358, 369–370, 512, 516, 518.) To the extent that such commission payments exceeded the amounts which would be due under the terms of agency agreements, they were carried on the books as "commission advances." The largest share of such commission payments and advances was made to companies controlled directly or indirectly by Hauser. While some portion of these payments might be considered legitimate, there was either no or inadequate documentation as to business purpose. Overall, these questionable payments were nothing short of disastrous from an insurance underwriting point of view. All of the insurance companies involved are now in receivership.[7]

The Subcommittee's investigation shows that most of the labor union insurance business of the Hauser affiliated companies, other than the whole-life policies, was written on a "cost-plus" basis. This means that the premiums paid by the union trust funds to the insurance companies were limited to the amount of the anticipated claims, based on past experience, plus a so-called "retention" fee to cover the insurance company's expenses and profit. In most cases "retention fees" amounted to 4 percent or less of the anticipated claims. Thus, this was very low margin business. The retention for expenses and profit could not possibly support the diversions of premium dollars identified by the Subcommittee's inquiry.

This "cost-plus" feature of an insurance contract normally allows the insuring company to operate on such a thin margin because the company does not have to assume the risk that the actual claims will exceed the anticipated claims. If this occurs, the labor union trust fund must pay the difference at the end of the policy year. On the other hand, if the actual annual claims are less than the anticipated claims, the labor union trust fund is due a refund of the difference.

The Subcommittee's investigation and hearings show that the Hauser group followed a general pattern in obtaining labor union

[7] Farmers National Life Insurance Co. of Florida is now in liquidation proceedings. Farmers National policy holders, many of whom had become uninsurable, lost their insurance coverage and cash values. Old Security Life Insurance Company and Family Provider are also in liquidation proceedings. Although it suffered substantial losses and still has major claims outstanding against it (most importantly, a claim by the Teamsters Fund), National American Life Insurance Company of Louisiana has been reorganized with no termination of life insurance coverage for its policy holders.

trust fund insurance business. The group's method was to cultivate relationships with labor union officials, members of their families, and other persons close to them in order to gain access to the business. In some instances, the group obtained assistance from fund trustees, an insurance consultant, and an attorney to certain funds. The Hauser group frequently offered economic incentives to these persons, which included the payment of gratuities to some fund trustees and union officials and payment of a finder's fee to a fund attorney. In other instances, the Hauser group established and underwrote the expenses of insurance agencies for relatives of or persons having contacts with union leaders and agreed to pay commissions and/or premium overrides to such agencies. Hauser also offered to use his union contacts to assist an insurance consultant in acquiring other union employee fund clients.

In substantial part through these persons, the Hauser group was able to bring about the rebidding of the union employee benefit plans' insurance program, and/or see to it that one or more of Hauser's companies and/or their reinsurance partner, the Old Security Life Insurance Company, was included on the list of companies invited to bid. The Hauser group frequently exerted influence to have the invitations for bids include a request for proposals on the expensive permanent or whole life insurance being promoted by the Hauser group.

The Hauser group usually submitted the lowest bid. In some instances, operating through their inside contacts, the Hauser group even prepared or helped prepare the bidding specifications and the list of bidders used by the trust fund involved or, after invitations were issued, the Hauser group received information and advice from inside some of the plans involved.

In a number of instances, the Hauser group brought influence to bear on the plan trustees to approve group permanent life insurance as part of their insurance program and to accept their group permanent bid. Where this did not succeed, the Hauser group influenced the trustees to award it contracts for other forms of insurance such as group term life, and health, accident and disability coverage.

The Subcommittee's investigation and hearings explored in great detail how this general pattern was followed with respect to particular labor union groups.

The Hauser operation involved three more or less distinct phases. The first involved the sale of insurance to labor union groups primarily within the State of Florida and surrounding States where Hauser's Florida-domiciled insurance company was licensed to do business. Phase two involved expansion into other States through the use of a reinsurance fronting agreement with Old Security Life Insurance Company of Kansas City, Missouri, a non-Hauser owned insurance company licensed to do business in 49 States. Through this device the Hauser group was, in effect, able to write labor union group insurance contracts in States where the Hauser-owned companies were not licensed to do business. The third phase of the Hauser operation involved a concentrated and ultimately successful effort to obtain the life insurance contract of the Teamsters Central States, Southeast, and Southwest Areas Health and Welfare Fund, reputedly the largest such contract in the country.

Succeeding sections of this report deal with each of these phases of the Hauser operation.

C. PHASE ONE—FLORIDA

The Florida phase of the Hauser operation began in October 1973 when the Equitable Health Corporation of America, a California company, made application to the Florida Department of Insurance to purchase a controlling interest in Farmers National Life Insurance Company, a small Florida based carrier. According to a January 1973 prospectus filed by Equitable with the Securities and Exchange Commission, Joseph Hauser was a founder and principal organizer of the company, owned 64,800 shares of its stock, participated in its management decisions, and could be deemed a control person of the company (Appendix A–1).

From 1971 until he became active in the insurance business in Florida, Hauser had been involved in the sale of prepaid health plans to unions and other groups in California. His key company in California, a non-profit concern known as National Prepaid Health Plans (NPHP), was highly successful in securing union business but had difficulty in servicing and paying its claims. In January 1974 the California Attorney General issued an order alleging that NPHP had failed to maintain required reserves and net worth, had failed to file quarterly and annual financial data, and had failed to pay any claims. One of the reasons cited by the Attorney General for NPHP's problems was the fact that it had paid more than 35 percent of its premiums to Equitable Health Corporation, a profit-making concern, for administrative services. The Attorney General termed this amount "excessive" and ordered NPHP to cease operations until the situation was corrected. Two weeks later, NPHP filed for bankruptcy, leaving debts of more than $2 million, including $1.5 million of unpaid medical claims.

At the time Hauser acquired control of Farmers National, the Justice Department's Organized Crime Strike Force in Los Angeles was also investigating his California activities, including allegations that he bribed labor union officials in order to have his prepaid health plan adopted by their unions.

As a result of that investigation, Hauser was indicted in March, 1975 and on March 18, 1977, Hauser was convicted in the U.S. District Court for the Central District of California on four counts of the eight-count indictment charging violations of 18 U.S.C. § 1954 (Offer, Acceptance and Solicitation to Influence Operations of an Employee Benefit Plan). The offenses of which Hauser was convicted involved bribes, or attempts to bribe, the trustees of union trust funds and/or other union officials to do business with his California prepaid health plans. He was sentenced to a total of 2½ years imprisonment, fined $46,000, and placed on probation for 4 years (Exhibits 4A and 4B). The Court of Appeals for the Ninth Circuit affirmed the conviction on March 21, 1979. Hauser has filed a petition with the Supreme Court asking it to review that decision.

By the time Hauser was convicted in the California case, he had already completed the insurance operation in Florida and other States which is the subject of this report—an operation that resulted in the loss of additional millions of dollars of labor union trust funds and later led to Hauser's indictment in June 1978 and conviction in February 1979.

1. Acquisition of Farmers National Life Insurance Company

As previously noted, when Hauser moved his base of operations to Florida, he used Equitable Health Corporation to acquire working control of the Farmers National Life Insurance Company. According to the testimony of James Hanna, Director, Division of Insurance Company Regulation of the Florida Insurance Department, who was the official responsible for reviewing Equitable's application to acquire control of Farmers, the acquisition was personally approved by then Florida Insurance Commissioner Thomas D. O'Malley. O'Malley took this action despite information received from the California Department of Insurance questioning Hauser's "integrity, competency, and experience," and recommendations from Hanna and the Department's chief examiner that it not be approved (pp. 77–79; exhibits 5A, 5B and 5C). The Hauser interests were represented in this matter by O'Malley's former law firm, Ciravolo and Feldman of Miami, Florida. In an affidavit given to the Subcommittee, Seymour Gopman, counsel to several Florida Laborers' funds, stated that he referred Hauser to this law firm because it was "public knowledge" that O'Malley had been a law partner of Ciravolo before he became Insurance Commissioner so that it was "commonly believed that the law firm had clout with the insurance department" (p. 188).[8]

Hanna testified that, subsequent to O'Malley's approval of Hauser's acquisition, he had reason to believe that the Hauser group had, in effect, used Farmers National's own assets to acquire the company by selling part of the company's bond portfolio after the acquisition and using the proceeds to pay off loans they had obtained to purchase their stock in the company. Hanna further testified that he had been unable to confirm this belief because the Santiago Bank in Tustin, California, which handled the disposition of the Farmers' bonds, would not provide information concerning the transactions (pp. 80, 122). According to the Equitable prospectus mentioned previously, John C. Barta, a vice president and director of Equitable, was also a founder and director of the Santiago Bank. This was only one of a number of instances in which State officials testified that they had been unable to obtain necessary information about the Hauser insurance operation from institutions in other States.

Hanna's belief that the Hauser group had in fact used Farmers National's own assets to purchase control of the company was essentially substantiated by the Subcommittee's investigation (pp. 185–187; exhibits 18–23).

[8] In this connection, O'Malley was later impeached by the Florida House of Representatives and resigned from office before he could be tried by the Florida Senate. The impeachment proceeding included charges that O'Malley received an excessive amount of money on the sale of his interest in his law firm to his former partners. On Dec. 18, 1975, O'Malley was indicted by a Florida Federal Grand Jury for mail fraud and other criminal violations. On Jan. 18, 1979, he was convicted of, among other things, charges that he deprived the people of Florida the right to his impartial services because he was receiving payments from law partners for the sale of his partnership interest and that the source of such payments were fees obtained by his former law partners for representing clients before O'Malley. Hauser was not charged in these proceedings.

2. Concealment of Hauser's Control of Farmers National

Shortly after Equitable Health Corporation acquired control of Farmers National, Hauser took steps which concealed his control of the insurance company. A holding company, Farmers Financial Corporation, was formed and in March 1974 acquired Equitable's controlling interest in Farmers National. Simultaneously, Hauser brought in an experienced actuary, Brian Kavanagh, to become president of both Farmers National and the holding company, Farmers Financial. Kavanagh in turn hired two other experienced insurance men, John Boden and Roger Carney, as vice presidents of Farmers National.

Hauser's name did not appear as a stockholder of record, officer, or director of Farmers Financial, and also disappeared from the list of officers and directors of Farmers National. However, John Boden, a former close associate of Hauser and a high ranking officer of several of the Hauser controlled companies, after being granted immunity by the Subcommittee pursuant to 18 U.S.C. §§ 6002 and 6005, testified that Hauser maintained effective control of both the holding company and the insurance company through 42 percent of the Farmers Financial stock held in the name of Brian Kavanagh and 25 percent held in the name of Hauser's brother-in-law, Harold Bernstein. Boden, a former executive vice president of Farmers National and an officer and director of Farmers Financial testified that:

> * * * throughout the entire time I was associated with the holding company * * * there was never any doubt that Hauser had complete control over the firm. He made all major decisions either alone or together with Brian Kavanagh, me, or other individual directors.
>
> In fact, the board of directors seldom held a formal meeting. If a decision required written minutes or board resolutions, these were drawn up without any actual meeting taking place and often after the action had taken place.
>
> The same is true for Farmers National Life Insurance Co., Joseph Hauser had actual, if not official, control over all the activities of the company. * * * (P. 144.)

According to Boden, Farmers Financial Corporation was established as a holding company for Farmers Life to conceal Hauser's real control of the insurance company and to show a different group of shareholders from that of Equitable, presumably because of Equitable's problems in California (p. 144). Also, the move allowed Hauser greater freedom to engage in financial transactions with Farmers National, through his other companies than he would have had had he remained an officer or shareholder of the insurance company. Records obtained from the Florida Insurance Department show that, on February 18, 1974, the Department of Insurance had disapproved a request by Farmers National to purchase a condominium and lease it to the Frank L. Kendall Insurance Agency, a California firm, in part because Hauser was both a director of Farmers National and an officer of Kendall (Appendix A–2). As shown in succeeding sections of this report, after disguising his control of Farmers National, Hauser engaged in numerous financial transactions with that company which were invariably to his own personal advantage.

In his testimony before the Subcommittee, John Boden stated:

> When I joined Farmers National Life Insurance Co. in Florida, I found that the company had recently written a substantial amount of new business. Hauser and Kavanagh told me that they had "very special relationships" with labor unions in Florida, Indiana, Massachusetts, and California and would soon write an even more substantial amount of new business for these groups. * * * (P. 143.)

3. Obtaining Labor Union Insurance Business in Florida

The Subcommittee's investigation shows that early in 1974, shortly after the Hauser group acquired control of Farmers National Life, there was a large influx of new business to the company, almost exclusively from labor union trust funds in South Florida. The unions involved were all in the building trades and affiliated with the Laborers, Carpenters and Plumbers international unions. Included were the Broward County Carpenters Local 103 Health and Welfare Fund; Dade County Laborers Health and Welfare Fund (Locals 478 and 635); Laborers Local 666 Health and Welfare Fund; Plumbers and Pipefitters Local 719 Health and Welfare Fund; Laborers Local 767 Health and Welfare Fund, and Laborers Local 938 Health and Welfare Fund.

The total premiums paid to Farmers National by these six trust funds during 1974 amounted to over $5 million (pp. 13–14). According to the testimony of James Hanna the total of all premiums collected by Farmers National during the year preceding Hauser's takeover was only $1,000,000 (p. 81). Moreover, a large portion of this new business was in the form of high premium, high profit, individual whole-life insurance policies on the lives of union members. The purchase of this type of insurance by labor union trust funds was criticized in the two previously mentioned staff reports of the Subcommittee dealing with the activities of Louis C. Ostrer and his associates.

According to Hanna's testimony, during 1974 Farmers National generated over 13,000 new whole-life policies from union benefit plans representing $65,300,000 in insurance coverage, and 46 times more new business than the company obtained during 1973 (p. 81).

The Subcommittee's investigation showed that Hauser had taken steps to obtain this Florida labor union insurance business even before acquiring control of Farmers National.

Seymour Gopman, an attorney from Miami Beach who for many years had been retained by Laborers' Union trust funds which placed their insurance with Farmers National in 1974, gave the Subcommittee a sworn affidavit (pp. 187–189) in which he stated that a client, whom he declined to identify, introduced him to Joseph Hauser in 1973, prior to Hauser's acquisition of Farmers National.[9]

According to the Gopman affidavit, Hauser told him that he wanted to set up labor union insurance operations in Florida similar to those he had in California, and asked Gopman to assist him by introducing him to labor union officials. An agreement was reached whereby

[9] As previously noted (pp. 63, 64), Hauser also sought Gopman's assistance in obtaining the Florida Insurance Department's approval of his purchase of Farmers National and, in response, Gopman referred Hauser to the then Florida Insurance Commissioner's former law firm.

Gopman would receive $2,500 per month from Hauser for his help. According to Gopman he received a total of $11,500 under this agreement, all during 1974.

Gopman stated that late in 1973 he introduced Hauser to Bernard G. Rubin, a powerful figure in the Laborers' Union in Southeast Florida and a trustee of several of its union employee welfare benefit plans.

According to Gopman, in January 1974 he and Rubin traveled to California for a 3-day weekend, as the guests of Hauser, to look over Hauser's California operation. They stayed at the Beverly Hills Hotel. Hauser paid all expenses. Following this visit, there were further meetings and discussions between Gopman, Rubin, Hauser and a firm known as Florida Administrators, a consultant to Laborers Health and Welfare Funds. Hauser then made a presentation of his health, accident and individual whole life insurance package to the Laborers Union, which they later approved. All told, four of the union employee health and welfare funds, which Gopman said he had represented, purchased insurance from Hauser's Farmers Life (pp. 13, 187, exhibit 1A).

4. The Hauser-Rubin Relationship

John Boden identified Bernard Rubin as Hauser's principal contact in the Florida Laborers' Union. Rubin had long been a prominent leader of the Laborers' Union in South Florida. At the time of his involvement with Hauser he held the following Laborers' Union positions: Special International Representative, Laborers' International Union of North America; President, Southeast Florida Laborers' District Council; Business Manager, Laborers' Local No. 478; President, Laborers Local 666, Trustee, Laborers Local 293 Health and Welfare Fund; Trustee, Laborers Local 767 Health and Welfare Fund; Trustee, Laborers' Health and Welfare Fund of Dade County, Florida; Trustee, Laborers' Local 666 Health and Welfare Fund; Trustee, Southeast Florida Laborers' District Council Dental, Vision and Preventive Care Trust Fund; and Trustee, Laborers Education and Training Trust Fund; Trustee District Council Pension Plan.

Because most of the Florida Laborers' insurance business was obtained by Farmers National before he joined the company in July, 1974, Boden had no knowledge of what Rubin may have done to assist the company in obtaining the Laborers' business, or of any remuneration to Rubin or any other Laborers' Union official related to Farmers National obtaining the Laborers' business (pp. 146, 153). It is clear, however, that soon after Hauser was introduced to Rubin by Seymour Gopman, the attorney for the Laborers' Unions, and the January, 1974 visit with Hauser in California, health and welfare plans of a number of South Florida Laborers', Carpenters, and Plumbers unions awarded insurance contracts to Farmers National that included Hauser's controversial and costly group permanent life insurance program. The minutes of a February 19, 1974 meeting at which the health and welfare plan trustees for Laborers' Union 666 awarded their business to the Hauser group show that Gopman, the plan's attorney whom Hauser promised to pay $2,500 a month to help get Hauser's operation started in Florida, advised the trustees that Hauser's company, Farmers National, was financially stable and able to handle their insurance program (Appendix A–3).

In his affidavit, Gopman said that he was placed on the board of directors of Farmers National's holding company "to look after the interests of the labor unions" (p. 189).

The Secretary of Labor has filed a civil action against Gopman alleging that Gopman breached his fiduciary duty to Laborers Local 767 Health and Welfare Fund by dealing with fund assets for his own account and by engaging in imprudent conduct. *Marshall* v. *Tricario et al.* (Appendix E).[10]

According to John Boden, Hauser and Rubin had "a very special relationship" (p. 153). Boden testified that after he joined Farmers National in July, 1974, Rubin was a frequent visitor to the company's offices; that he met with Hauser and/or other company officials several times a week; that he anticipated—as would an officer or director—in discussions of general corporate affairs, company problems, problems the company was having with the Florida Insurance authorities, marketing problems, including discussions as to how Farmers National could obtain additional union trust fund business in Massachusetts and Indiana; and that Rubin provided advice concerning how new union business might be obtained, whom to talk to, and who had the most influence. According to Boden, Rubin continued to participate in the company's affairs following his indictment and conviction in 1975 on numerous charges of embezzling union funds (pp. 155–157). (See pp. 69–71 of this report for discussion of Rubin's conviction.)

Boden also described how Rubin benefited from his relationship with Hauser. He said an associate of Rubin's, a Jerry Olin, was put on the payroll of Farmers Financial Corporation, the holding company, as the highest paid of Hauser's executives despite the fact according to Boden, Olin merely put in his time at the office and made no contribution to the company. Asked by Senator Nunn if he had complained about this Boden said he had taken the matter up with Hauser and that "Hauser said he didn't want him around either but he was only there because of Bernie Rubin" (p. 157).

In addition, Boden testified that during the latter half of 1974, Rubin used a Porche sports car that had been leased for him by Hauser's insurance agency, the National Financial Agency, and by Any, Inc., another Hauser affiliate, and that Rubin's son and daughter were given jobs and received salaries from Farmers National (pp. 146, 157).

5. The Hauser-Tricario Relationship

Sal Tricario is Business Agent of Laborers Local 767, a South Florida union. He also has been a trustee of the Local 767 Health and Welfare Fund. Boden testified that Tricario also had a special rela-

[10] On Apr. 7, 1978, Gopman pleaded guilty to four counts of an October 1977 indictment charging him with filing a false tax return, embezzlement of employee benefit plan funds and receiving fees, kickbacks, and other things of value from Sage Corporation in connection with $1.5 million in loans by an employee benefit plan and Sage Corporation. These matters were not the focus of the Subcommittee's investigation, although Sage Corporation did engage in certain mortgage transactions with the Hauser group which were examined by the Subcommittee (pp. 75–77 of this report for discussion of Golden Horn Mortgages). Gopman received a 4 year prison sentence and a $40,000 fine.

tionship with Hauser and was a frequent visitor in Hauser's office. Farmers National received a contract for Local 767's health and welfare plan insurance program in March, 1974. According to Boden, Hauser subsequently used money from Farmers National to purchase an expensive boat for Tricario's use.

The boat was not registered in Tricario's name, but according to Boden it was regularly moored at Tricario's home and treated by Tricario as his own (pp. 146, 158).

Affidavits and documentary evidence obtained by the Subcommittee show that on July 12, 1974, Tricario ordered a 36 foot Hatteras Sports Fisherman at a net cost of $56,160 with a $5,000 cash down payment. Acccording to an affidavit submitted by Roy Clark, the boat salesman, Tricario described the boat as a bonus or gift and stated that he did not want his name on any of the documents (pp. 192–193). Accordingly, Tricario was given a John Doe receipt for $5,000 and the purchase order was written in the name of ANY, Inc., a Hauser company located at the same address as Farmers National Life. Subsequently, two of Hauser's employees, Peter Wagner and Linda Johnson, gave the dealer a $5,000 check from ANY, Inc., signed by J. S. Hauser and Tricario's $5,000 was returned to him. When the boat was delivered the balance was paid by a check signed by Brian Kavanagh, the President of Farmers National, and drawn on another Hauser company, National Financial Agency, to which the boat was registered. However, the mooring address was Tricario's residence. Hauser sold the boat in 1976. The purchaser, a Mel Adler, stated in a deposition that he had difficulty in retrieving the boat from Tricario and that afterwards he received a number of anonymous, threatening calls warning him to return the boat to Hauser and indicating that Bernie Rubin owned a half interest in it (pp. 189–204; exhibits 24–35).

Both Tricario and Rubin were called as witnesses to testify concerning their roles in the awarding of Laborers Union trust fund insurance contracts to Farmers National Life and their relationship to Hauser. However, both invoked their Fifth Amendment Constitutional right against self-incrimination in response to all questions (pp. 204–206; 257–259).

On February 16, 1979, the Secretary of Labor filed a civil action against Tricario and others. The complaint alleges, among other things, that Tricario breached his fiduciary duty to Laborers' Local 767 Health and Welfare Fund by causing the Fund to pay excessive and unwarranted sums in connection with insurance contracts purchased from Farmers National and by accepting use of the boat from the Hauser group in exchange for his support of the Fund's purchase of insurance from Hauser's company (Appendix E).

6. Rubin's Conviction

During the course of its investigation, the Subcommittee found that Rubin had been indicted on July 8, 1975, and convicted on October 22, 1975 in the U.S. District Court, Southern District of Florida, for embezzling approximately $400,000 from unions and union trust funds of which he was an officer. He was sentenced to 5 years in prison and fined $50,000 (exhibits 109, 111).

Following Rubin's conviction, the U.S. District Court on January 20, 1976, ordered Rubin to forfeit his right to hold any office in the union and forfeit any right to act as trustee in any of the particular trust funds involved. However, the forfeiture order was stayed by the U.S. Fifth Circuit Court of Appeals after Rubin appealed his conviction to that Court (exhibit 117).

On September 12, 1977, the Department of Justice had initiated an application to the District Court to revoke Rubin's bond, pending appeal, based on evidence indicating continued embezzlements amounting to about $2 million which occurred after the date of his conviction (pp. 311–312, 315). Some of the moneys embezzled by Rubin were used in connection with dealings with Hauser, Farmers Life and Sage Corporation that were the subject of the Subcommittee's inquiry (p. 323). A hearing on that application was concluded on October 5, 1977 with the entry of a bond condition order agreed to by Rubin, divesting Rubin of all union and trust fund positions, and restraining him from influencing, in any manner, or receiving anything of value from, any union or trust fund (exhibits 118–121).[11]

In the December 1975 proceedings before the District Court concerning the forfeiture of Rubin's positions with the Laborers' International local unions and employee funds, the Department of Justice pointed out that the International Union had not acted in any manner to protect these unions or funds (exhibit 110). No subsequent action was taken until after the Department instituted the aforementioned bond revocation proceeding. In this regard, on October 4, 1977, the Laborers' International Union imposed a trusteeship over Southeast Florida Laborers' District Council and Laborers' Local 666, organizations in which Rubin held office. The International also directed that an audit and investigation be made of those organizations and of all Laborers' trust funds in Southern Florida (pp. 242–244).

Finally, the Subcommittee received testimony from Marty Steinberg, then a special attorney with the Department of Justice's Organized Crime and Racketeering Strike Force in Miami, who handled the Rubin case, that immediately after Rubin's indictment, in July 1975, his office had decided to petition the court to place all of the unions and trust funds of which Rubin was an officer under a trusteeship, in order to protect their remaining assets. According to Steinberg, a request was made to the Miami office of the Department of Labor for that Department to serve as trustee, and he received word back that this request had been approved by the Department of Labor in Washington.

A motion was filed on July 10, 1975. However, according to Steinberg, he was later informed by the Solicitor's Office of the Department of Labor in Washington that the Department would no longer accept the trusteeship and would oppose the motion on the grounds that there was no precedent for such action and that it would take too much manpower. According to Steinberg, he advised the Court of the change in the position of the Department of Labor and, within

[11] Rubin agreed to divest himself of these positions in lieu of withdrawal of bond pending appeal. On Sept. 22, 1977, the Court of Appeals for the Fifth Circuit affirmed Rubin's October 1975 conviction (559 F.2d 975). On Mar. 15, 1975, after a remand by the Supreme Court, the Court of Appeals again affirmed, while reversing on two counts (591 F.2d 283). On July 5, 1975, Rubin filed a petition for Supreme Court review, which is still pending.

a week, the Court denied the motion for trusteeship (pp. 301–304).[12]

On October 21, 1977, the Subcommittee sent Steinberg's testimony to the Department of Labor for comment. Secretary Marshall's response of November 2, 1977, takes the position that the Department of Labor had neither the statutory authority nor the resources to serve as trustee and assert that a request to serve as trustee was neither received nor approved by any responsible official of the Department of Labor.

Secretary Marshall's letter was sent to the Department of Justice for review and comment on December 14, 1977. The response from the Department of Justice, dated February 6, 1978, was signed by John C. Keeney, Deputy Assistant Attorney General, Criminal Division, points out that the Department of Labor did not need statutory authority to seek a trusteeship since the Department of Justice has such authority under 18 U.S.C. § 1963 (b) and was merely seeking the assistance of the Department of Labor to serve as trustee or monitor. The letter also offers further details from Steinberg and his associates concerning their efforts to secure the cooperation of the Department of Labor.[13]

Information filed with the Court in connection with the Rubin bond revocation proceeding, which finally resulted in Rubin's being divested of all his union and trust fund positions (exhibit 121) shows quite clearly that the alleged continuing embezzlements and misuse of some $1,500,000 of union trust fund moneys involved in his dealings with Joseph Hauser, Farmers National Life, the Sage Corporation and certain of the transactions involved in the Subcommittee's investigation.

For his part in Hauser's labor union insurance scheme, Rubin was indicted on June 15, 1978, along with Hauser by the Grand Jury of the U.S. District Court for the District of Arizona. On December 4, 1978, Rubin entered a guilty plea to one count of a multicount indictment. The count to which he pleaded charged him with engaging in a racketeering enterprise with Hauser and his associates which illegally misapplied the funds of union employee plans utilizing Farmers National and other Houser companies (18 U.S.C. §§ 1961, 1962 (c), (1963) (Appendix C). In the same proceeding, Hauser also pleaded guilty on February 5, 1979 to three counts of the indictment. Sentencing of Rubin and Hauser has been deferred pending the conclusion of the trials of the two remaining defendants.

7. Losses by Florida Labor Union Trust Funds

At the time of the Subcommittee investigation, the Florida labor union trust funds had paid almost $14,000,000 in premiums to Farmers National and had collected less than $10,000,000 in claims for a net loss of over $4,000,000 (exhibit 1). Results of investigations into several of these funds completed by the Department of Labor show that losses will exceed $1 million (Appendix E).

One reason that the premiums exceeded the claims paid was that, as previously noted, these groups purchased individual whole life

[12] Following Rubin's conviction, the Department of Justice made another unsuccessful motion seeking the appointment of an independent monitor to review dispositions of union and employee fund assets. Since the Department of Labor had again declined to perform this function, the Department of Justice was not in a position as a practical matter to implement such an appointment even if the Court had granted the motion.

[13] The entire exchange of correspondence is contained in Appendix B.

insurance policies which included an investment, or cash value, feature. The disadvantages of this type of insurance for labor union groups has been pointed out in the Subcommittee's previous reports and hearings dealing with the activities of Louis C. Ostrer and his associates. They include high premiums, first year commissions of up to 90 percent of the premium, and loss of the cash surrender value if the policy is terminated within the first 3 years.

These disadvantages were reiterated in the testimony of Hauser associates John Boden and James Hanna of the Florida Insurance Department with respect to the Florida Labor Union Trust Fund insurance programs. For example, a study conducted for the Florida Department of Insurance showed that the cost to the Florida labor union members was very high in terms of premiums and commissions. Hanna estimated the premiums to be 50 to 60 percent higher than they would have been for group term life. Boden estimated that the purchase of individual whole life policies, by the Florida Labor Union Trust Funds cost them approximately $1,000,000 per year extra. Moreover, due to the high turnover in the construction industry, 6,000 of the 13,000 Farmers National policies issued to these members during 1974 lapsed in 1975 and the cash value was thus lost. In 1975 Farmers National converted the remaining individual whole life insurance policies to a group permanent master policy issued to the fund trustees, without making any corresponding adjustment in the premiums—which should have been much lower—and also failed to put aside sufficient reserves to back the policies. Hanna further testified that he believed the main reason for converting the individual whole life policies to group permanent life was to lower the reserve requirements (pp. 82–88, 122–123, 147, 159–160, 162). As shown in the next section of this report, the reserves were inadequate primarily because Hauser and his associates were draining money out of the company almost as fast as it came in.

Even Seymour Gopman, who was responsible for introducing Hauser to Florida labor union leaders, acknowledged that Hauser did not live up to his promises and obligations. In his affidavit to the Subcommittee, Gopman stated:

> * * * Hauser promised that the individual whole life insurance policies would be delivered and would provide for substantial cash surrender values, but Hauser never came through with his promise to deliver the policies. * * *
>
> *   *   *   *   *
>
> * * * It was only because of vigorous efforts by Florida Administrators in pressing for the payment of claims that losses to union members because of non-payment of claims was held to a minimum before Farmers National Life failed (pp. 188–189).

8. Diversion of Labor Union Trust Fund Insurance Premiums

Insurance companies are required by law to set aside in cash and/or acceptable investments a portion of the premium moneys they receive as reserves to pay future claims. Naturally, the reserve requirements for whole life or permanent insurance of the type purchased by the Florida groups are higher than for term insurance due to the investment or cash value feature.

The minutes of several of the Florida trust funds which placed their insurance with Farmers National show that the Fund Trustees were assured by their counsel, Seymour Gopman, that they were protected by legal documents guaranteeing the establishment of reserves to pay claims in case the insurance carrier was unable to do so (Appendix A–3, 4, 5). The Subcommittee's investigation showed that whatever legal documents Gopman was referring to were either nonexistent or ineffective; that adequate reserves were not maintained by Farmers National, and that in fact, Hauser and his associates diverted and converted to their own use a large portion of the union premium moneys.

Initially, this was accomplished largely through the payment of high commissions and other fees to insurance agencies controlled by Hauser. One of these agencies, the Frank L. Kendall Agency, a California-based firm, was designated the exclusive general agent of Farmers National for labor union business in Dade and Broward Counties in Florida. The Kendall Agency was the largest shareholder in Equitable Health Corporation and had been collecting commissions on the prepaid health plans with which Equitable was associated in California (Appendix A–1). Documents filed with the Biscayne Bank in Miami, where Kendall opened an account on June 13, 1974, listed Hauser as president; his associate, Melvin Wyman, as vice president; and Hauser's personal secretary, Linda Johnson, as the corporate secretary. Hauser and Johnson were the signatories on the account (Appendix A–6).

After the Florida Department of Insurance questioned dealings between Farmers National and Kendall, due to Hauser's dual role in the two companies, Kendall's agency agreement was shifted to National Financial Agency (NFA), a Florida-based insurance agency created by Hauser. According to the Florida Department, Hauser owned 72 percent of NFA; the remainder was owned by Wyman and Kavanagh (p. 88).

The Subcommittee's investigation shows that during 1974 and 1975 Kendall and NFA were paid almost $2,500,000 in commissions and commission advances by Farmers National. Hanna testified that despite repeated demands, the Florida Department of Insurance had been unable to obtain documentation justifying the payments to Kendall and NFA (pp. 87–89). John Boden confirmed Hanna's suspicion that the commission payments and advances to Kendall and NFA bore no relationship to any premium income generated by these agencies (pp. 148–149, 164–165).

According to Boden's testimony:

> * * * Although many of these payments were labeled "advance commission payments" on Farmers' books, they really bore no relationship at all to insurance business written by Farmers Life. The checks were written at the direction of Joseph Hauser and the circumstances of their writing were similar to those I described earlier.
>
> Hauser would give instructions that money be sent to National Financial Agency and the Farmers' checks would then be prepared and signed. It was only later, when Farmers Life

had to prepare a financial statement and justify these payments that agency contracts were drafted and signed to make these payments coincide with the commissions on the labor group insurance policies. These agency contracts were drawn up after the payments had been made and only for the purpose of accounting for the payments to Hauser's firm (p. 148).

In addition to the commissions paid to Kendall and NFA, over $600,000 owed to Farmers National by the National Ben Franklin Life Insurance Company for business ceded to them under a reinsurance agreement was diverted to National Financial Agency as a "finder's fee" (pp. 89–90, 148–149). Further, Farmers also invested over $820,000 in Kendall and NFA debentures which were worthless (p. 92).

Besides the payments made to Kendall, NFA and other Hauser affiliated companies, as previously noted, Hauser and his associates withdrew over $775,000 in cash and paid out almost $200,000 of insurance company funds for apparently personal expenses. During 1974 and 1975 these expenditures came almost exclusively out of the premiums paid by Florida labor union trust funds to Farmers National.

Hanna listed the following as typical of the costly personal expenses paid for Hauser:

(a) On January 31, 1976, Farmers Life paid a $641.95 bar bill at the Washington Country Club, Gaithersburg, Md.

(b) During 1975 and 1976, Farmers Life paid $1,404 a month for a penthouse apartment at the Hotel Mutiny, Sailboat Bay, Coconut Grove, Fla. The expenditure was charged to a traveling expense account.

(c) On May 8, 1974, Farmers Life paid Joe Hauser's hotel bill for $2,594.61 at the Seville Hotel, Miami, Fla. Hauser stayed in a $112.36 a day suite from February 4 to March 1, 1974.

(d) Farmers Life paid rent and other charges, as indicated below, for an apartment at the Carriage House in Miami, Fla.:

April 16, 1974	$2,000.00
April 1974	3,250.00
May 1, 1974	6,500.00
May 28, 1974	6,500.00
June 21, 1974	1,884.82
July 9, 1974	1,300.00
July 18, 1974	6,550.90
September 3, 1974	2,600.00
November 4, 1974	2,600.00

(e) On January 26, 1976, Farmers Life paid $1,228.75 by check to Better Services, Cadillac Limousine, Inc. of Chicago, Ill.

(f) On April 19, 1976, Farmers Life paid $5,000 by check to Beverly Hilton Hotel in California (p. 96).

Hauser and his associates accomplished their largest diversions of the Florida labor union trust fund premium moneys through worthless or phony investments of the claims reserves. According to the testimony of Hanna:

Farmers used this influx of union premium money to finance a wide variety of "cosmetic" investment schemes which really masked a systematic looting of the assets of the corporation by Hauser and his associates.

The purchase by Farmers of worthless and fraudulent mortgages, debentures and other securities depleted this company's assets, significantly intensified the company's financial troubles, constituted serious abuse of other stockowners and policyholders, and finally resulted in the firm's total collapse in late 1976. * * * (p. 91).

9. The Golden Horn Mortgages

The most notable transactions, which the Subcommittee investigated in great detail, involved two mortgages on the recreational facilities at the Golden Horn Condominiums in Hallandale, Florida, and resulted in the loss by Farmers National of over $2 million, most of which came from labor union trust funds in Florida and elsewhere.

Ironically, according to the testimony of John Boden, these transactions were undertaken by Hauser and his associates in an effort to prepare for an examination by the Florida Department of Insurance anticipated at the end of 1975 which they feared might put Farmers National out of business. Due to the constant depletion of the company's assets, Farmers did not at this time have sufficient good assets to withstand an Insurance Department examination. Although they had survived an examination at the end of 1974, Hauser and his associates expected a much more stringent examination following the departure by impeachment and resignation of Thomas D. O'Malley as Florida's Insurance Commissioner. Therefore, Hauser, Kavanagh and others decided to look for mortgages which they could purchase for less than face value but which under the Florida insurance code could be carried as assets at their face value. The purpose was to quickly improve the financial picture of the company. The plan was to locate such mortgages; acquire them through National Financial Agency; and then contribute them to Farmers National in order to shore up the insurance company's assets (pp. 149–150).

John Boden testified that late in 1975 Bernard Rubin introduced Hauser, Kavanagh and Boden to George Wuagneux, President of the SAGE Corporation, Hallendale, Fla. The Sage Corporation was a construction company and among other enterprises, it has built two condominiums in Hallendale—Golden Horn North and Golden Horn South (p. 150). As is common in Florida, while the titles to the condominium buildings were passed to the tenants association, the title to certain recreational facilities attached to the buildings, (the swimming pool, the recreation room, etc.) was retained and leased to the tenants association for an annual rental.

Title to the Golden Horn North recreational facilities was vested in Stephen Weiss, trustee, for himself, George Wuagneux and others. Title to the Golden Horn South recreational facilities was vested in George Wuagneux, trustee for Stephen Weiss and others. Stephen Weiss is a former business associate of George Wuagneux in Sage Corporation but they had been estranged since 1972 and in 1975 had been in litigation for several years on a number of matters including the leases for the recreational facilities.

Wuagneux, who also appeared as a witness, testified that he was introduced to Hauser by Grady Breed of the Broward County Carpenters Union and that he had never met Boden. Wuagneux testified that he did know Rubin, but that Rubin was not present at his initial meeting with Hauser. However, he did acknowledge that on another occasion he and Hauser met Rubin at a lunch (pp. 265–272, 274–276).

The monthly rental under the Golden Horn North condominium lease was $3,600; for Golden Horn South $4,800 or an annual income from both leases of $100,800.

Sometime in late 1975 Joseph Hauser and George Wuagneux negotiated an agreement whereby Hauser's National Financial Agency agreed to loan George Wuagneux $2.2 million to be secured by mortgages on the two recreation facility leases.

It should be noted that the annual income from these leases did not justify a loan of this size; Wuagneux did not have authority to execute such mortgages without the consent of Stephen Weiss and the other beneficiaries; and, lastly, the leases were already encumbered.

Nevertheless, George Waugneux had his attorney draw up two mortgages, two promissory notes and two assignments encumbering these leases for a total of $2.2 million (exhibits 39, 40). Wuagneux signed one mortgage and note as trustee without the consent of the beneficiaries in violation of the Trust Agreement. On the other mortgage and note, he signed the name of Stephen Weiss without the knowledge or consent of Weiss. Stephen Weiss testified before the Subcommittee to this effect (pp. 331–332).

No money actually changed hands until late in January 1976. At that time, Joseph Hauser and George Wuagneux entered into additional agreements which had the effect of washing out or reversing the previous loan and mortgage agreement between George Wuagneux and Hauser's National Financial Agency.

Under this arrangement, the following took place:

1. Hauser's National Financial Agency gave Wuagneux $600,000 in cash and a promissory note for $1.6 million.
2. Wuagneux's Sage Corporation borrowed $1.1 million in cash from Hauser's Farmers National Life Insurance Company.
3. Wuagneux used $600,000 of the cash received from Hauser's Farmers Life to pay off the mortgages to Hauser's National Financial Agency.
4. Wuagneux's Sage Corporation made a loan of $550,000 to Hauser's National Financial Agency which was secured by a debenture for $1.1 million National Financial Agency to Sage.

Details concerning this highly complicated maneuver are set out in pp. 218–224 of the hearing record. In summary, the result was that $2.2 million of the assets of the Farmers National had been drained out. Wuagneux received approximately $600,000 of these funds and the balance went back into the control of Hauser to be used by him in other transactions for his benefit. In return, Farmers National had two worthless and fraudulent mortgages with a face amount of $2.2 million.

Despite the fact that these mortgages were fraudulent and worthless, that the actual transfer of money did not take place until some time in January 1976, and that the mortgages were shown as satisfied almost simultaneously with their execution, these mortgages were included in the December 31, 1975 annual statement of Farmers National at a value of $2.2 million thereby falsely inflating the assets of the company by that amount (exhibit 46).

10. Conclusion of Florida Phase

As previously noted, John Boden testified that by the end of 1975 Farmers National was in very bad financial condition due to the continuous draining of the company's assets by Hauser and his associates. An audit by the Florida Department of Insurance was anticipated at the end of 1975. The Golden Horn mortgage transactions were an attempt to puff up the financial status of the company, but as explained above the net result of those transactions was a further deterioration of the company's financial position.

Anticipating that the Florida Department might disqualify Farmers Life from continuing in business, Hauser had made alternative arrangements to continue his operation. According to John Boden (pp. 344–345), in order to deal with this possibility, Hauser proposed that an entirely new corporation be created with which Hauser would not be formally identified as a controlling person. The new entity was to be a holding company which would locate and purchase other insurance companies domiciled outside of Florida and licensed to do business in States other than those in which Farmers National was licensed and would also be able to transfer Farmers National existing business if the Florida Department acted to close Farmers National down.

The plan was initiated in November 1975 with the "purchase" of Family Provider Life Insurance Company, a dormant, wholly-owned subsidiary of Farmers National, by Great Pacific Corporation, an Arizona company formed to serve as the holding company in carrying out Hauser's plan. The Subcommittee's investigation shows that this was an insider transaction and a sham purchase which resulted in further depletion of Farmers National's assets. It was accomplished in the following manner:

The new holding company, Great Pacific, was created as a wholly-owned subsidiary of Actuarial Consultants, a small company nominally owned by John Boden. Farmers National paid Actuarial a fictitious $50,000 consulting fee, which Actuarial used to capitalize Great Pacific. Great Pacific then acquired Family Provider by paying the $50,000 back to Farmers as a down payment and giving a $200,000 note for the balance, which was never paid. Great Pacific then acquired all the stock of Actuarial Consultants, and became the parent rather than a subsidiary of that corporation. Consistent with Hauser's design to separate his name from the new company, all of Great Pacific's stock was recorded in John Boden' name. However, Boden had an oral agreement with Hauser under which Hauser could acquire 80 percent of the stock at a future date, either directly or through a trust. Eighty percent of the stock was subsequently transferred to Hauser in early 1976 (pp. 52–53, 92–93, 344–345).

Thus, Hauser created a new holding company equipped with an existing insurance company ready to do business. According to Hanna, the book value of Family Provider was about $750,000 and Farmers

National's assets were thus further depleted by that amount. However, Family Provider was in substance a "shell" corporation. It was licensed to do business only in Arizona, and had essentially only one employee—John Boden, who was the president of the corporation. Boden's wife was secretary-treasurer and a director. The other directors were two friends of Boden's from Los Angeles. According to Boden, all decisions for both Great Pacific and Family Provider were made by Hauser, Kavanagh, Wyman and himself (p. 346). Because Family Provider was a shell, most of the premium moneys and claims, including those from outside Florida, continued to be funneled through Farmers National and its subsidiary, Nationwide Administrators.

The Florida Department of Insurance began its strict examination of Farmers National early in 1976 and finally placed the company into receivership late that year. Just as the examination was beginning, according to the testimony of Hanna:

> * * * Farmers Life quickly sold 52 issues of the 83 non-affiliated corporate bond issues it held in its portfolio. A summary of the sales indicated that the book value of these bonds at the time of their sale was over $480,000 but they were sold at far less than their value.
>
> In fact, the sale resulted in a loss of over $128,000 to the company. Apparently, Hauser and his associates were forced to liquidate these bonds quickly to try to keep their various fraudulent schemes afloat (p. 93).

As will be shown in succeeding sections of this report, Hauser's operation was not terminated by the problems raised for Farmers National by the Florida authorities. Hauser and his associates took steps not only to keep the operation afloat, but in fact to greatly increase its business with labor union trust funds beyond the State of Florida.

D. PHASE TWO—EXPANSION OF HAUSER OPERATION BEYOND FLORIDA

The Subcommittee's investigation shows that throughout 1975 Hauser and his associates engaged in efforts to expand their labor union business beyond Florida and into the more heavily unionized Northeastern and Midwestern States. This move was necessary to increase their cash flow in order to compensate for the money which they had taken out of Farmers National and to satisfy claims obligations on the Florida business. However, because Farmers National was licensed only in 5 Southeastern States (Alabama, Florida, Georgia, South Carolina and Tennessee) and in Arizona, and Family Provider was licensed only in Arizona, a means had to be found to secure business in other States.

1. Fronting Arrangement with Old Security Life

The device selected was a "fronting arrangement" involving a reinsurance agreement between Farmers National and Old Security Life Insurance Company, an established company based in Kansas City, Missouri, licensed to write insurance in all States except New York.

Reinsurance is a common and legitimate practice in the insurance industry, under which the company issuing a policy limits its exposure by reinsuring a portion of the risk with a second company which receives a commensurate share of any profit. However, under a "fronting" type reinsurance agreement, which is illegal in some States, the company issuing the policy reinsures all, or almost all, of the risk in return for a ceding fee.

Under the terms of its agreement with Farmers National, Old Security issued policies to labor union groups in States where Farmers National was not licensed to do business directly and reinsured 100 percent of the risk into Farmers National. Old Security received 2 percent of the premiums and Farmers National received the remaining 98 percent. The purpose and effect of the agreement, known in the insurance industry as a "fronting arrangement," was to enable Farmers to do business in States where they were not licensed.

In the words of John Boden, "Old Security allowed Farmers to use its name, reputation, and financial status in return for 2 percent of the premium." "However," Boden continued, "the reinsurance agreement * * * had some very severe flaws, from Old Security's viewpoint and from the policyholders' viewpoint," which he described as follows:

> First, while it is true that under its agreement with Farmers Life, Old Security was directly responsible to the policyholder for 100 percent of the liability, the problem was that from the outset of the arrangement Farmers Life did not have sufficient good assets to cover the liabilities. The same was true with respect to another reinsurance agreement between old Security and Family Provider Life Insurance Co. which I will discuss later in my statement.
>
> The part of the premiums that were to be held as reserves were invested in assets of questionable value. This meant that Family Provider Life was in no position to assume the reinsurance obligation by its agreement with Old Security.
>
> Second, under its reinsurance agreements with Farmers Life and Family Provider, Old Security did not have control over the part of the premiums that had to be set aside in order to build up the reserves needed to cover the risks for which they were responsible. The way was open for Farmers Life and Family Provider to gain access to the premiums and to divert them to Hauser.
>
> And, third, under these agreements Old Security accepted risks on which they did no actual underwriting. They assumed that Farmers Life and Family Provider would look after their interests in this regard. By this I mean before any insurance company accepts any risk they analyze the risk and put a price on it.
>
> Old Security never did this in relation to any of the insurance business we wrote using their policies. For example, one policy they accepted without any analysis was the *Central States Teamster* case which has approximately $23 million in premiums and an approximate risk of $2 billion. This one policy more than doubled Old Security's total life insurance risk (pp. 338–339).

This points up one of the most intriguing questions to arise out of the Subcommittee's investigation: Why would Old Security enter into such a reinsurance agreement with a company such as Farmers National, which was so obviously disadvantageous to the best interest of Old Security?

The agreement was drafted by Richard K. Halford, a senior vice president of Old Security and an acknowledged expert on reinsurance, and was reviewed by the company's general counsel (pp. 349, 557, 567–568).

The Subcommittee's investigation did not uncover any evidence of improper payments to anyone at Old Security. Moreover, Boden, who is intimately familiar with the arrangement, testified that he was unaware of any such payments (p. 350).

Halford, who also appeared as a witness, testified under oath that neither he nor, to his knowledge, anyone else at Old Security received any payment or anything else of value from Hauser or anyone associated with him (p. 588).

Both Boden and Halford testified that the Hauser group's first contact with Old Security was made by Mike Capurso, a former regional manager for Equity Funding Company who had gone to work for Hauser early in 1975 (pp. 337–338). Halford testified that Capurso, whom he did not know, had been referred to him by another of Old Security's reinsurers, but he could not recall which one. Capurso invited Halford to come to Miami as the guest of Farmers National to discuss the possibility of Old Security's reinsuring the Farmers' Florida labor union business. Halford accepted the invitation and visited Farmers on January 30, 1975. He testified that although he was favorably impressed while at Farmers, he declined the reinsurance offer largely because it would require a large cash outlay by Old Security (pp. 562–564).

When Halford was asked what induced Old Security to subsequently enter into the fronting agreement on the business outside of Florida, he answered succinctly, "profit." He further explained that the agreement did not involve any cash outlay by Old Security, and meant a 2 percent profit for Old Security on the gross premiums. Questioned concerning the care with which Old Security weighed its risks against the percentage of premium profit anticipated under the agreement, Halford testified that before concluding the agreement Old Security assessed the actuarial risk involved but not the possibility that someone would walk off with the money. In his words:

> * * * if there had been any thought on our part at all, we were doing business with less than honest people, we would have never considered this type of an agreement (p. 580).

Under questioning, Halford indicated that the only checking he did on Farmers National before entering into the reinsurance agreement was to look at their entry in a standard reference book known as Best Insurance Reports; to review biographical data on Brian Kavanagh of Farmers and Lee Eldridge, the president and controller of Farmers, and to make some inquiries of people in the industry whose names he could not recall, concerning their reputations. He also reviewed copies of quarterly financial statements given to him by Farmers National, which they said they had filed with the Florida Department of Insurance. According to Halford the financial statements showed a capitalization of $850,000 but he could not recall what they showed about Farmers' total assets (pp. 562–563, 565, 581).

Halford testified that the checking procedure he went through was the normal practice for his company and the insurance industry in general. He stated that insurance companies are not investigators and do not have that capability. Instead, he said:

> * * * We rely very strongly on the fact that the State Insurance Departments are charged with regulation of that company.
>
> If the company is a problem company, is a company that shouldn't be doing business, we are relying on the State in effect to say no, you can't do business, to issue a cease and desist, or to make public that information (pp. 565–566).

However, Halford acknowledged that he did not make any inquiry of the Florida Department of Insurance concerning Farmers National, either before Old Security entered into the reinsurance agreement or at a later date when the attorney for the management trustees of one of the Arizona Laborers funds called and questioned him about problems Farmers was having with the Florida Department of Insurance and about Hauser's involvement with Farmers National. According to Halford's testimony, he then called Kavanagh rather than the Florida Department of Insurance, and was assured that Farmers' problems had been resolved and that Hauser was not associated with the company, except as an agent who had produced some business in Florida but was not connected with the Arizona account. Halford then passed these assurances on to the Arizona attorney (pp. 573–578).

Halford disagreed with Boden's testimony that Old Security did not perform underwriting analyses on the business secured by Farmers National under the reinsurance agreement, to make sure that it was actuarially sound. Halford testified that Old Security did review the bids and were aware of the actuarial risks and liabilities involved (pp. 569, 580–581, 585–586).

Halford did not disagree with Boden's testimony that the reinsurance agreement was written in such a manner that careful reading and analysis were required to detect that it was in fact a fronting agreement, but he maintained that this was not done to obscure or to mislead State insurance departments (pp. 338, 349, 351–352). He said the agreement was based on a format which had been developed by Old Security over a period of years and offered in evidence a marked-up copy of Old Security's reinsurance agreement with Colony Charter Life Insurance Company of Los Angeles which became the Farmers National reinsurance agreement (pp. 568–571, exhibits 198–199).

Examination of the agreements shows that a provision of the Colony Charter agreement specifying that the reserves be placed in an escrow account, as required by the California Insurance law, had been deleted from the Farmers National agreement. When asked why this provision has been deleted from the Farmers National agreement, Halford stated that under this agreement Old Security was to have had actual physical possession of the reserves. However, he acknowledged that this turned out not to be the case, and that Old Security did not receive any information from Farmers National regarding premiums and reserves until June 1976, when Old Security was already in the process of trying to terminate the agreement (pp. 570–571).

Halford also acknowledged that the premiums on this business were sent directly to Farmers National and were placed in Old Security bank accounts on which Farmers National had drawing rights (pp. 571–572, 582–583). The Subcommittee's investigation shows that the monthly statements and cancelled checks for these accounts were sent directly to Farmers National and were not forwarded to Old Security.

In view of this situation, the size of the liabilities assumed by Old Security under the agreement, and the relative paucity of information which they had about Farmers National, Halford was asked whether he or others at Old Security did not feel that they were incurring a significant hazard in the event that Farmers National did not live up to its responsibilities under the agreement. His answer was that Old Security had been doing business this way for a long time, had been involved in many such arrangements, and had never had that kind of problem (pp. 572, 581).

Such blind trust was clearly misplaced. The Subcommittee's investigation shows that Farmers National obtained labor union insurance business under this fronting agreement which generated more than $18,000,000 in premiums while it was in effect. According to the testimony of James Hanna of the Florida Department of Insurance, these premiums increased the cash flow into Farmers National tenfold (p. 91).

As previously shown, however, Hauser and his associates continued to divert and convert a large portion of these premiums to their own use. As a result, Farmers National did not live up to its responsibilities under the reinsurance agreement, and when Farmers National failed, these liabilities fell back on Old Security as the primary obligor under the insurance contracts.

Moreover, Old Security had also entered into similar reinsurance agreements with the Hauser group's Arizona-based Family Provider Life Insurance Company and with a non-Hauser affiliated company, Washington American Life of Arizona, both of which also failed. Under the weight of the liabilities incurred under these reinsurance agreements both Old Security and its parent company, the ISC Financial Corporation have also been forced into receivership.

In summary, the evidence concerning these reinsurance fronting agreements shows that:

(1) Through the device of reinsurance fronting agreements with Old Security Life Insurance Company, Hauser's companies were able to write millions of dollars of labor union insurance in States where they were not licensed to do business, thereby subverting the intent of the State insurance laws;

(2) Old Security entered into these agreements with only minimal information and without adequate investigation of its prospective reinsurance partner, relying instead on regulation by the State insurance departments to keep unreliable companies out of the insurance business.

(3) Old Security failed to take steps to insure that adequate reserves were set aside to meet claims obligations in the event that its reinsurance partner failed to do so.

(4) Hauser and his associates converted a substantial portion of the premium moneys to their own use with the result that the Hauser companies failed to meet their obligations under the reinsurance agreements.

(5) Old Security was able to enter simultaneously into a number of reinsurance fronting agreements without obtaining the approval of any State insurance department or demonstrating that the company had the financial resources to meet the millions of dollars of liabilities thus incurred.

(6) When Old Security and its reinsurance partners were all placed in receivership, thousands of labor union health and welfare plan members as well as the companies' individuals policy holders lost their money and their insurance.

2. Obtaining Labor Union Insurance Business Under the Fronting Agreement

The Subcommittee's investigation showed that Hauser was taking steps to obtain labor union business outside of Florida even before the agreement with Old Security had been reached. John Boden testified that the agreement was entered into in anticipation of obtaining labor union group business in Indiana, Massachusetts, Hawaii, Arizona, and Rhode Island where Hauser had labor union connections and expected to be able to obtain their business (p. 339). This is borne out by a March 4, 1975 letter of intent from Kavanagh to Halford outlining the proposed agreement which read in pertinent part:

> * * * This master coinsurance agreement shall * * * not become effective unless and until either (i) Old Security is awarded the contract for group life and accident and health coverage by the labormen's union in Massachusetts as mutually discussed by us based upon a proposal made by us to that group on terms mutually agreed to by us, or (ii) if we otherwise mutually agree that such * * * agreement shall become effective (exhibit 6B, p. 46).

According to the testimony of Boden, the agreement was signed in July 1975 and backdated to March of that year (p. 338). The Subcommittee investigation shows that shortly after this agreement was finalized, the Hauser group obtained the insurance business from the Laborers International Union groups in each of the States where Boden testified that Hauser anticipated obtaining such business.

This business was usually in the form of an insurance package including group-term life, accidental death and dismemberment, disability and health insurance. Although the Hauser group's primary effort was to sell the more profitable whole life or group permanent life insurance wherever possible, as explained later, they were prevented from doing so by circumstances beyond their control.

In most cases, the labor insurance contracts awarded to Hauser were ostensibly obtained through competitive bidding. However, the Subcommittee's investigation shows that the Hauser group always managed to have the lowest bid. This was due in substantial part to their willingness to underbid, even to the extent of incurring an underwriting loss, in order to obtain control over the huge cash flow resulting from the premium payments and the claims reserves. Also, in a number of instances, the Hauser group benefited from "inside" information or assistance and support from persons associated with the unions, including a consultant of some of the funds, and relatives or associates of international union officers. In return, Hauser established and underwrote the expenses of several insurance agencies headed by relatives or associates of union officials and caused hundreds of thousands of dollars to be paid to them in loans, commissions, commission advances, or other fees.

The general pattern followed by Hauser and his associates in obtaining this business has already been described. The application of this pattern in obtaining the insurance business of particular labor union groups is described in the following sections.

3. Indiana Laborers

The Indiana State Council of Laborers and Hod Carriers Welfare Fund ("Indiana Fund") awarded its insurance program to the Hauser group in October 1975. The coverage was written under an Old Security insurance policy and reinsured with Farmers National. The business was promoted and obtained by the Hauser group.

As Executive Vice President of Farmers National, John Boden was directly involved in the Indiana promotion. Boden testified that the person most instrumental in obtaining the Indiana Fund business for the Hauser group was Paul Fosco, grandson of the late Peter Fosco, General President of the Laborers International Union until his death in October 1975, and son of Angelo Fosco who succeeded his father as president of the Laborers International Union (p. 339). According to Boden, Hauser knew and met frequently with Angelo Fosco (p. 153). However, investigation has not disclosed any improper payments or other consideration as having been received by Angelo Fosco from Hauser.

Boden testified that Hauser had established Paul Fosco in the insurance business by forming the P. F. Insurance Agency ("P. F. Agency") in Chicago; that Hauser entered into a written agreement with Paul Fosco to pay to P. F. Agency certain commissions and a 1 percent premium override on all insurance or reinsurance sold by the Hauser affiliated companies anywhere in the country; and that the Hauser companies did pay approximately $300,000 to P. F. Agency (p. 339). These assertions were substantiated by the Subcommittee's investigation, and copies of the agency agreement, a lease guarantee for the offices of P. F. Agency, signed by Kavanagh for Farmers National, and documentation of some $260,000 in payments by Hauser companies to P. F. Agency (exhibits 122, 124, 125, 126). Hauser paid $50,000 to Fosco during the period of July through December 1974 before Fosco became qualified under law to sell insurance (pp. 370, 372). In a prehearing interview, Fosco told the Subcommittee staff that this amount represented advances on commissions to be earned later (p. 370). He also stated that, during the period of his association with Hauser, he participated in writing only one insurance contract—the one sold to the Indiana Laborers Fund.

Boden also testified that Paul Fosco was a very close friend of Charles Morris, secretary-treasurer and trustee of the Indiana State Council of Laborers and Hod Carriers Welfare Fund, and that Morris had referred to Paul Fosco as his "younger brother" (p. 339). Morris confirmed this in his own testimony before the Subcommittee (p. 475).

According to Boden, Hauser, through Paul Fosco, brought about a decision by the trustees of the Indiana Fund to rebid their insurance program, to include a group permanent life insurance plan in the request for bids, and the award of the contract to the Hauser group's reinsurance partner, Old Security. Boden also testified that in obtaining the Indiana contract the Hauser group also received advice and assistance from Len Teeuws, a vice president of the Indiana Fund's actuarial consultant, Tolley International Corporation, in return for which Hauser was to assist Teeuws and Tolley International in obtaining the consulting and administrative business of other Laborers' Union groups with which Hauser had influence (pp. 339–340, 343).

Boden's testimony was largely substantiated by the Subcommittee's investigation of how the Hauser group obtained the Indiana award.

From its inception in 1953 until 1975, the Indiana Fund was insured with Continental Assurance Company, a large firm in Chicago. The fact that the contract was never rebid during this 22 year period suggests that the trustees of the Fund had been satisfied with the insurer. However, that situation came to an abrupt halt early in 1975 when the Hauser group set their sights on obtaining the insurance business of this trust fund.

Paul Fosco told Subcommittee staff in a pre-hearing interview that after he obtained his agent's license, in December 1974, he contacted his close friend Charles Morris about the Indiana Laborers insurance business, and that Morris told him they were unhappy with the insurance carrier they had had for 20 years. Fosco also said that, at Morris' suggestion, he made a presentation about Old Security to the fund's representative from Tolley International Corporation (p. 371). In response to the question why Hauser was willing to give him an override commission on all business written by Farmers National and advance $50,000 prior to becoming legally qualified to sell insurance, Fosco replied that it was apparently because of his "connection" and the fact that he "could open doors" (p. 371). While Fosco acknowledged receiving $242,000 from Hauser (which was close to the $260,000 found by the Subcommittee investigation), he did not know, nor did P. F. Agency's records indicate, how much commission he earned or was paid on the Indiana Fund contract or how much he received in commission advances or overrides (pp. 371–372). When Fosco was subpenaed and appeared before the Subcommittee to testify under oath, he invoked his rights under the Fifth Amendment to the Constitution with respect to all questions (pp. 373–375).

The minutes of a March 12, 1975 meeting of the Indiana Fund's trustees show that Morris told the representatives of the existing insurance carrier, Continental, that unless the company reduced its retention (the excess of premiums over claims, to cover expenses and profit) from 5½ percent to 5¼ percent, he would recommend to the Board that the Fund become self-insured. At Morris' suggestion the Board then adopted a resolution giving Continental until the trustees' next meeting to respond. The next meeting was scheduled to take place in June, 1975 (p. 378; exhibit 127).

However, the fund did not wait until June for Continental's answer. Instead, on April 25, 1975, the fund's administrator, Robert Edwards, sent out letters of invitation to bid on the fund's insurance program, including a request for bids on group permanent insurance. Letters were sent to nine insurance companies, including Old Security (exhibit 131, 132).

Morris testified that he had instructed Edwards to take this action, because he had been informed by the Continental representatives that the company would not lower its retention. Morris acknowledged that he had taken this action without specific authorization from the board, but said he felt that he had an obligation to do so. As to why he sought new bids from insurance companies rather than recommending self-insurance, as he had stated he would do, Morris testified that some of the management trustees were opposed to self insurance (pp. 472–473).

Morris testified that the specifications used in the bidding were delivered to Edwards by Robert Carney, who, he thought, worked for Old Security, and that he had been advised of this by Hauser associate Mike Capurso, who, Morris also thought, worked for Old Security (pp. 473–475). The Subcommittee's investigation shows that the specifications were actually written by John Boden and sent by Roger Carney to Paul Fosco. Both Boden and Carney were associates of Hauser at Farmers National Life.

The Subcommittee obtained by subpena from the files of P. F. Agency a set of specifications which were attached to a draft letter of invitation to bid on the Indiana Laborers Fund business, prepared for the signature of Robert Edwards and dated April 21, 1975, and a letter of transmittal from Roger Carney to Paul Fosco, dated April 22, 1975 (exhibits 128, 129, 130). During his appearance before the Subcommittee, John Boden identified the group permanent life portion of these specifications as those which he had written and given to Roger Carney (pp. 358–359). The transmittal letter from Carney to Fosco stated that the specifications should be signed by Edwards and sent to Old Security and five other listed companies immediately.

The specifications actually sent out by Edwards on April 25 (exhibit 133) were identical to those sent to Fosco by Carney. The group permanent life portion of the specifications was identified by Boden as that which he had drafted and given to Carney (p. 539). The letters of invitation to bid which were signed by Edwards and sent to Old Security, and all of the other companies suggested by Carney (exhibits 131, 132) were also identical to the draft which had been sent to Fosco by Carney, with one exception. The Carney draft stated that the Trustees were asking for competitive bids, whereas the Edwards' letter stated that Charles Morris, the secretary-treasurer was asking for such bids. Apparently this change was made because the trustees had not voted to seek bids on the existing insurance program or to request bids on group permanent life.

Thus it is clear that Hauser's associates actually wrote the specifications and letter of invitation to bid on the Indiana Laborers insurance contract and selected most of the companies invited to bid, including their reinsurance Old Security Life. As Carney had suggested in his letter to Fosco, Old Security's invitation to bid was actually sent to Nationwide Administrators, a subsidiary of Farmers National of which Carney was President, at the address of Farmers National.

When Morris was asked why the Fund's actuarial consultant, Tolley International had not been requested to draft or at least review the specifications and to handle the bidding, as is normally the case, he cited the cost involved and also said that he wanted to "check out" the actuary by seeking the bids directly (pp. 474–475). However, another explanation is contained in the last sentence of the April 22 letter from Carney to Paul Fosco, which reads as follows:

> As self insurance is a realistic alternative and as the current consultant will stand to gain increased earning if self insurance is approved, the spec's should be sent out by an employee of the Fund and not an employee of the consultant (exhibit 128, p. 390).

In fact, when Morris was asked if this suggestion had anything to do with his decision not to have Tolley International prepare or even review the specifications, he replied, "I think so" (p. 477).

Although Morris acknowledged that he was aware that the specifications came from persons who he believed were working for Old Security, he indicated that he did not see anything wrong with that (pp. 473–475). However, Boden testified that:

> Because I tailored these specifications to Old Security's existing group permanent plan, and to my knowledge no other company was offering such a plan, we were virtually assured of receiving the award if the trustees decided to go the group permanent route (p. 340).

Boden's assertion is borne out by the fact that only the Hauser group, acting in the name of Old Security, submitted a bid on group permanent life insurance. Continental bid only on a cost-plus, group term life basis, proposing to continue the existing benefits at the same retention level of 5.5 percent of claims. Continental enclosed a brochure describing their permanent insurance program but stated "it is our opinion that it is illegal for the Fund to purchase this type of coverage with the contributions made by the employers due to the tax implications" (exhibit 135, pp. 395–396).

Boden testified that Len Teeuws of Tolley International, the insurance consultant to the Indiana Fund, had advised the Hauser group that the retention rate bid on the Indiana contract should not exceed 4.5 percent (p. 340).

Old Security bid on both a cost-plus and straight premium group term basis as well as on the group permanent basis. The cost-plus group term bid called for a retention rate of 4.04 percent, well within the 4.5 percent maximum Boden said was advised by Teeuws.

During his appearance before the Subcommittee, Teeuws testified that he could not recall having such a discussion with anyone in the Hauser group (p. 946). The Subcommittee's investigation did not uncover any direct evidence to confirm or disprove Boden's statement on this point. However, Boden made a similar allegation which is supported by the circumstantial evidence that prior to the later award by the Teamsters Fund to the Hauser group, Teeuws told the Hauser group that a 3 percent retention would make its bid competitive (pp. 121–123 of this report).

Also, the Subcommittee did obtain by subpena from Tolley International a copy of an undated memo from Edwards to Morris listing all of the companies which had been invited to bid. Since this document is stamped "RECEIVED April 30, 1975", it shows that Tolley International was aware that Old Security was among the companies invited to bid well before the bidding deadline of May 8, 1975 (exhibit

137). Moreover, the Subcommittee obtained other internal documents from Tolley International which showed that less than an arm's length relationship existed between Teeuws and the Hauser group. (These documents are discussed later in this report.)

No company other than Continental and Old Security bid on the Indiana business.

On May 9, the day after the bidding deadline, Roger Carney and Fred D'Andrea called at the Fund office, presented calling cards identifying themselves respectively as employees of Nationwide Administrators and P. F. Agency and personally submitted Old Security's bid. This information is contained in a letter of May 14, 1975, from Edwards to Tolley International, transmitting the Continental and Old Security bids for analysis (exhibits 134, 136A, 136B). The letter reads in part: "Our understanding is that Mr. D'Andrea is the insurance broker while Mr. Carney serves as liaison between Old Security Life Insurance Company and Farmers National Life Insurance Company, the re-insurer." Thus, the Fund was aware from the beginning that the business would be reinsured with Farmers National and that Fosco's P.F. Agency would serve as broker on the business.

Morris testified that he knew that Fosco's agency would receive commissions on the business (pp. 478–479), but maintained that he did not know anything about the reinsurance until after the award had been made (p. 478). Morris testified that he accepted the Old Security bid even though it was filed after the bidding deadline because no other companies had bid (p. 480).

William Fries, Tolley International's representative to the Indiana Laborers, submitted the company's analysis of the bids to the Board of Trustees in a letter dated June 11, 1975 (exhibit 138, pp. 397–398). The only recommendation contained in the letter was that the Trustees not consider Old Security's pure premium proposal because the $5,096,000 premium would be far in excess of the premium paid under the existing cost-plus plan. Although the letter did not specifically comment on the group permanent proposal, presumably the same recommendation would logically apply, since the premium would have been even higher as Teeuws acknowledged during his testimony (pp. 1187–1188). The Tolley International letter also contained comparative financial information on Continental, Old Security and Farmer's National which showed that Farmers National's total assets were less than the annual premium payable by the Indiana Laborers under either the group permanent of cost-plus plan (exhibit 138, pp. 397–398, exhibit 140, p. 418).

At the hearings, both Morris and the Fund's attorney, Richard J. Shagley, contended that the Tolley International letter of June 11 had never been received by the trustees, although it had been obtained by subpena from the Fund's files (pp. 482–483). Following the hearings, Shagley advised the Subcommittee by letter that the letter had been received by the Fund and given to the trustees, but that it had not been considered by the trustees at their June 11, 1975 meeting or at any date thereafter (appendix A–7). No explanation was offered as to why this was so.

At its meeting on June 11, the Board of Trustees voted to defer the selection of an insurance company until the September meeting to

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1 OF 3

allow Fries to make a study of the possibility of self-insuring, and to permit Fries, Morris and William R. Anderson, a management trustee, to study the program of Old Security and the company itself (exhibit 139).

Ostensibly pursuant to the latter part of this resolution, Teeuws and Morris visited the offices of Farmers National in Miami on July 7 and 8, 1975. However, internal documents from Teeuws' files at Tolley International show that Morris and the Hauser group successfully enlisted Teeuws' assistance and that Morris and Teeuws had already reached a decision to recommend the transfer of the Indiana Laborers Fund insurance to Old Security and the acceptance of Old Security's group permanent life proposal, and that this trip was actually made for a different purpose. The internal documents referred to and a letter explaining the circumstances under which they were obtained by the Subcommittee are as follows (exhibits 265A and 265B, pp. 975–977):

TOLLEY INTERNATIONAL CORP.,
ADMINISTRATORS AND CONSULTING ACTUARIES,
Indianapolis, Ind., October 24, 1977.

Re Subcommittee Investigations of Mr. Joseph Hauser's Operation.

Attention: Owen J. Malone, Esq.

GENTLEMEN: Enclosed please find copies of the documents listed on Annex A hereto. Tolley International Corporation was served last week with two subpoenas to produce documents and requiring my deposition in two civil actions involving Old Security and the Central States Health and Welfare Fund. The enclosed documents were found in a separate file maintained by my secretary. Copies do not exist in the company's regular files. In furnishing the documents in response to your subcommittee's subpoena dated April 11, 1977, copies of the enclosed documents were not produced since I was unaware of their existence. Since I expect that the enclosures may be of importance to you, I will be available to meet with you on Wednesday or Thursday, at your convenience, if you so desire.

Please advise.

Very truly yours,

TOLLEY INTERNATIONAL CORP,
By LEN TEEUWS, *Executive Vice President.*

Attachments.

INTER-OFFICE COMMUNICATION

JULY 2, 1975.

To RUSSELL M. TOLLEY from LEN TEEUWS:

For sometime now Bill Fries and I have been working with Chuck Morris regarding his desire to change carriers from Continental Casualty Company on the Indiana State District Council of Laborers' & Hod Carriers' Welfare Fund.

About a month ago we were introduced to the people that Chuck was interested in working with. They are Paul Fosco, son of Angelo, and grandson of Peter Fosco and John D'Andrea, grandson of Tony D'Andrea who had the original control with the Laborers in Chicago many years ago. Also, a

fellow by the name of Mike Capurso who is extremely knowledgeable about Laborers' International matters but who is not associated with the Laborers Union, to my knowledge. We have indicated to Chuck that naturally we would cooperate with him and he reassured us that our fees in no way would be jeopardized.

The Management Trustees in a Board Meeting made it plain to Chuck that they did not approve of any change in carriers without Bill's recommendation. For this reason, Bill and I had a lengthy meeting with Chuck here in Indianapolis yesterday. In our meeting, we laid out the guidelines that he should follow so that there would be no problems in a transfer and also to make sure that the Trust Fund, the Trustees, as well as the beneficiaries were protected. Chuck was quite pleased and after our meeting he called his contacts to advise them that the groundwork had been laid for the transfer.

Over the last couple of weeks this fellow Capurso has called me several times, around the country stating that Segal was going to be eliminated on certain Laborer's Funds in Boston, New York City, Colorado, Chicago, and both northern and southern California. He also indicated that there was a possibility that we could be brought in on one or more of these cases. Naturally, though this was a "come on" to get our help in Indiana. However, about 10 minutes after Chuck's call to his contact, Capurso called me long distance and stated that the groundwork had been laid for us to become the consultants to the Boston District Council of Laborers Health and Welfare Fund and asked if both Chuck and I could meet with him in Miami this coming Monday to finalize this arrangement.

Naturally, I was quite pleased and while I am meeting with Dan Shannon tomorrow in Chicago, I have been instructed to meet with Angelo Fosco there. The reason I am quite pleased is that Chuck stated that there is no question that on September 5th, Angelo will be appointed International President of the Laborers to replace his father and everybody that I have talked to in this matter says that one of his first steps is to purge Segal wherever he can. Naturally, we will have to see what develops along these lines.

I have reserved the company airplane for Chuck Morris, Bill Fries and me to fly to Miami on Monday morning, July 7th, returning Tuesday, July 8th very early in the morning. I would very much appreciate it if you could make sure that we can rely on our reservations for the company plane in this matter.

There could be one other implication in this matter and that involves Continental. As you know, we were successful in increasing our consulting fees with Continental in the amount of $12,000 in November of 1974. With the change in the Laborers, our volume with Continental will go down from about $26,000,000 annual premiums to $22,000,000. In addition to this, our Midwestern Teamsters Welfare Fund went self-insured recently which eliminated another $3,000,000 I don't know whether we will have a problem with Continental regarding this matter but I will certainly keep you appraised of both these situations.

INTER-OFFICE COMMUNICATION

JULY 31, 1975.

To RUSSELL M. TOLLEY from LEN TEEUWS:

I would like to give you a report as to the status of the Laborers' International Union and the developments since our last conversation, when I brought you up-to-date on the renewal of contracts in Ohio.

I attended the International Union Conference on Monday and Tuesday, July 21 and July 22, as well as Thursday, July 24, 1975, of last week. The reception given to me by everyone involved was unbelievable including Connerton and Powell. I had an opportunity at the banquet on Monday night to spend time with Peter and Angelo Fosco, as well as many other representatives, including many of our friends in the Laborers' Union throughout the country. At the banquet Thursday night, Angelo specifically had a little "get together" with several of the key Laborers and myself. In attendance were: Arthur Coia, Regional Manager of the entire Eastern Seaboard, and also the key man in the Boston area; Anthony Merullo, the head man in New York City; Sam Lee, the head man in the State of Hawaii. In addition to those individuals at the meeting were Fosco's son, Paul, Fred D'Andrea, Mike Capurso, who is Joe Hauser's right-hand man.

My reception by Mr. Coia was excellent and it was obvious that this small cocktail party was established in order for him to get a look at us. On Friday morning before I left, I was advised by Paul Fosco and Mike Capurso that Coia is very receptive to our becoming the Acturial Consultants to as many funds as possible under his jurisdiction. I was also advised that we would be acceptable to Sam Lee in Hawaii and I am sure that these things are starting to develop. Obviously, there is going to be a lot of groundwork to be laid in dislodging Segal in these areas.

On Wednesday, July 23rd, I returned to Indianapolis and Bill Fries and I prepared our complete report for the Indiana State District Council of Laborers & Hod Carriers Welfare Fund. This report was distributed to all Trustees in order that they could review it before the meeting which was on Tuesday, July 29th. We presented our report and the Trustees voted (with one negative vote—Fred Rowley) to accept our recommendation to change carriers and to institute the group permanent life insurance benefits. The Trustees were very complimentary of our report and needless to say, so were Fosco and Capurso. These gentlemen were sitting "in the wings" in our office to see what would occur here.

Naturally, Continental is very upset and I am quite positive

> that Rowley will give a copy of the report (which is attached) to Continental and we will have the problem with them that I had previously discussed with you. I feel confident that inasmuch as we have handled this matter that we will see future developments in these other cases.
>
> I specifically spent some time with Howard Hensen, his wife and son, while in Chicago. I discussed the Jackson-Hardin situation and asked him "for old time sake" if he would give this merger time to develop. Howard reassured me that we would have no problem from his regional offices.

These documents tend to confirm Boden's testimony that Teeuws assisted the Hauser group in obtaining the insurance business of union groups for which Tolley was consultant with the understanding that Hauser would in turn help Tolley obtain the consulting and administrative work for union groups with which he had influence (p. 343). They show that the Hauser group had access to the highest councils of the Laborers' International Union and lend credence to Boden's testimony concerning Hauser's influence in the Laborers' Union.

Teeuws acknowledged that during his meeting with Angelo Fosco in July 1975, Fosco had referred to the involvement of his son Paul in the insurance business, but stated that he could not recall whether or not Fosco had asked him to help Paul in connection with the Indiana contract (pp. 1200–1201).

With respect to the trip to Farmers National on July 7 and 8, Morris testified that Teeuws went in place of Fries, because Fries had another commitment, and that he did not know why Anderson did not make the trip. Morris testified that during the visit they inspected the offices and computer facilities at Farmers National and met with Capurso, Kavanagh and Boden. He said that Hauser joined the group at dinner and was identified to him as "the Boss." He also said that Bernard Rubin of the Southeast Florida Laborers District Council joined them at lunch. Morris said Rubin told him that several of his funds were insured with these people and that they were doing a good job (pp. 480–482).

Tolley International's July 23, 1975 report to the trustees of the Indiana Laborers Welfare Fund on self-insurance and insurance bids (exhibit 140, p. 417) states:

> * * * There is question in our mind that a considerable savings could be realized in regard to self-funding; however, it is our opinion that with the question of possible taxation of future self-insured funds in the State of Indiana, as well as the unanswered questions as they pertain to the jurisdiction of ERISA on self-insured Taft-Hartley health and welfare funds, we would recommend that the Trustees hold in abeyance any decision for self-funding for the present time. * * *

The section of the report dealing with the insurance bids includes a report on the visit of Morris and Teeuws with "representatives of the Old Security Life Insurance Company and Farmers National Life Insurance Company." Kavanagh, Boden and Carney are listed as officials of Farmers National, but Mike Capurso is listed as "representative from Old Security Life Insurance Company" which he was not (exhibit 140, p. 413). No mention was made of meeting Hauser. The report also contains the statement that:

> In addition to meeting with representatives of the companies, Messrs. Morris and Teeuws also met with the Laborers International Regional Manager for the State of Florida. At the present time, Farmers National is underwriting the benefits of six laborers local unions in the greater Miami and vicinity area. A great number of questions were asked of him and he indicated his satisfaction with the manner in which the servicing and underwriting of these funds was performed (exhibit 140, p. 416).

This appears to be a reference to Bernard Rubin, who was the Special International Representative and principal leader of the Laborers' Union in Florida at that time. However, this individual is not identified as Rubin nor is any mention made of the fact that he had been indicted on July 8, 1975 for embezzling union trust fund money.

Tolley International's July 23, 1975 report noted that Old Security would cede "a portion" of the premium and underwriting responsibilities to Farmers National, who would handle all administrative responsibilities between the companies and the Fund (pp. 414–415). The report did not indicate that 98 percent of the premiums would go to Farmers National and that 100 percent of the risk would be reinsured with Farmers National as provided in the reinsurance agreement. Teeuws testified that Tolley International did not know the terms of the reinsurance agreement and had not made any inquiry concerning them. He said it was not their normal practice to do so because they considered the primary carrier to be fully liable for all risks (pp. 1195–1200).

The report stated that, if the trustees selected the Group Permanent Life Insurance Benefit, commissions would be paid to the P. F. Agency in compliance with insurance codes, but did not say how much (exhibit 140, pp. 415, 416). It also stated that Tolley International's commission, which previously had been .48 percent of the claims paid, would, under the Old Security proposal be based on .48 percent of the accident and health claims and .48 percent of the life insurance premiums (exhibit 140, p. 415). However, no specific mention was made of the fact that this would represent a substantial increase to Tolley International, particularly if the group permanent proposal, with its higher premium were adopted.

The report contained an analysis of the cost-plus bids which showed a cost saving of $70,000 annually in retention under the Old Security-Farmers National quotation and a recommendation that "the trustees should give definite consideration to changing carriers * * *." The report then stated: "We would also recommend that the trustees give serious consideration to adopting the proposal of Old Security regarding the group term whole life permanent arrangement for the life insurance benefits" (exhibit 140, pp. 418–419).

Appended to the July 23 report were financial statements of Old Security and its holding company, ISC Industries, Inc.[14] on a consolidated basis as of April 30, 1974 and of Farmers National as of

[14] Old Security's holding company was later renamed ISC Financial Corp.

December 31, 1974 (pp. 420–421). In contrast, Tolley International's June 11, 1975 report showed financial information for Old Security only (p. 398). The difference was quite significant as shown by the following table:

Financial data re Old Security (in millions)

June 11, 1975, report (Old Security):	
Assets	$22.9
Capital	16.6
Surplus	6.3
July 23, 1975, report (ISC Industries, Inc., and Old Security, Consolidated):	
Assets	418.7
Stockholders equity	23.2

The financial statements in the July 23, 1975 report were preceded by Tolley International's statement that "it is our opinion that the companies are financially large enough to handle the underwriting of the fund's benefits and the Group Term Permanent Life Insurance" (exhibit 140, p. 419). The July 23 presentation created the misleading impression that the full financial strength of the holding company stood behind any Old Security insurance commitment.[15]

Teeuws acknowledged that the July 23, 1975, report represented a change in Tolley International's position with respect to Old Security's group permanent proposal as expressed in its June 11 report. His explanation was that he had originally felt that the Fund could not afford group permanent, but that certain of the trustees had indicated that they wanted group permanent and were willing to forego other benefits in order to pay for it (pp. 947–948). However, Teeuws did not identify which trustees had expressed such a desire, or how it had been communicated to him.

Although the trustees had previously voted to defer a decision on the insurance contract until their regular meeting in September, a special meeting was called to decide the matter on July 29.

The minutes of this special meeting (exhibit 142, pp. 425–428) show that Teeuws made a presentation which was essentially the same as Tolley International's written report and that Morris recommended that the Fund adopt a permanent life insurance program. During the discussion, several questions were raised about the financial statements of both Farmers National and Old Security, but Teeuws stated that "he would feel secure with Old Security as the insurance carrier."

The minutes also state that "Secretary Morris moved that the fund change its insurance carrier from Continental Assurance Company to Old Security Life Insurance Company (Farmers National Life Insurance Company) and adopt a program of permanent life insurance for the fund, all in accordance with the recommendations of Tolley International Corporation." The motion carried with one dissenting vote (exhibit 142, pp. 427–428). According to Teeuws, "the trustees were very complimentary of our report and needless to say, so were

[15] Similar misleading financial information was passed to the Teamsters Fund by Tolley International and the Hauser group (see pp. 217–220 of the report). In this connection, the Arizona Laborers, Teamsters and Cement Masons Local No. 395 Health and Welfare Fund specifically asked Old Security if its parent, ISC, would agree to hold the Fund harmless if Old Security failed in its commitment to the Fund and was advised that applicable law precluded making any such agreement. (Appendix A–29.)

Fosco and Capurso. These gentlemen were sitting in the wings in our office to see what would occur here" (exhibit 265B, p. 976).

On the same day telegrams were sent to both Old Security and Continental advising them that the change in carriers would be made on or before December 1, 1975. A telegram was received back from Old Security on August 21 requesting a binder of $100,000 and according to a receipt signed by Paul Fosco a check for this amount was given to him on August 22 (exhibits 143, 144, 146, 147, pp. 429–434).

On September 5, however, the Fund's attorney, Ralph Berry, sent the trustees a letter questioning whether the acceptance of Old Security's group permanent proposal was in compliance with the Employee Retirement and Income Security Act since there were no competing bids from other companies. The letter states:

> We would, therefore, feel that under the terms of ERISA that we should take competitive bids on the group permanent life insurance, or in the alternative, that the Fund's consulting actuaries furnish the Board with some assurance that the bid of Old Security is a competitive bid and it is, therefore, in the best interests of the Fund to accept it at this time.
>
> * * * * *
>
> We are, therefore, respectfully suggesting to the Board that an analysis be made of the competitiveness of the bid of Old Security for the portion of their bid involving group permanent life insurance. Such an analysis would aid the Board in determining whether we are truly in compliance with the terms of ERISA (exhibit 147, pp. 433–434).

In a letter dated September 8, 1975, Edwards requested Tolley International to prepare such an analysis for the Fund (exhibit 148, p. 388). Tolley International's analysis dated September 17, 1975 concludes:

> It is our opinion that the trustees did submit clear and concise Specifications requesting proposals from recognized insurance carriers for not only the present schedule of benefits, but also an alternate schedule of benefits, i.e. group permanent life insurance. A proposal was received which, in our opinion, is competitive with the industry and, inasmuch as we have reviewed all of the actuarial aspects of the insurance which is more expensive than term life insurance but also provides greater benefits to the beneficiaries, it is our opinion that the trustees have a valid basis for accepting the proposals from Old Security and transferring the underwriting of the Plan of Benefits to the Old Security Life Insurance Company pursuant to the actions taken by the trustees at the Board meeting held July 29, 1975 (exhibit 149, p. 437).

However, the Subcommittee's investigation showed that approximately two-thirds of the Tolley International report to the Fund was identical to an analysis written on the letterhead of Actuarial Consultants and signed by John Boden, which Boden identified during his testimony as having been written by him (exhibit 150, pp. 359–360). This document was obtained in response to a subpena from Tolley

International. Moreover, the remainder of the Tolley International report, while not identical in language, uses the same arguments cited by Boden in a letter of September 8, 1975 to Teeuws contending that the bidding process on the group permanent program was competitive (exhibit 151, p. 388).

Taken together, these documents show that Tolley International gave to its clients as its own opinion concerning this bidding, information and opinions which were in fact written by an official of one of the affiliated bidding companies. Teeuws acknowledged that he had incorporated into some of his reports and letters promotional and analytical materials prepared by representatives of Old Security, but maintained that he had independently decided that the material correctly reflected his professional judgment. He also indicated that he saw nothing improper in the practice (pp. 948–949).

The minutes of the September 17, 1975 trustees meeting show that William Fries of Tolley International distributed and read to the Board Tolley International's September 17 report and stated that competitive bids had been received by the Board and that the cost of the Old Security Life Insurance program was competitive. A representative of Continental Assurance Company told the trustees his company was opposed to permanent life insurance for the fund because of income tax liabilities it imposed upon the covered employees and because breaks in service would cause administrative problems. Roger Carney of Farmers National, who was also present, disputed the tax arguments and offered arguments in favor of group permanent. However, Berry, the Fund's attorney, stated that the report did not answer his questions in regard to the competitiveness of the bids, and two of the trustees expressed concern over the cost of group permanent.

The Board then voted to rescind the action approving the group permanent plan, but still awarded the insurance contract to Old Security for group term life, accident, and health coverages, effective October 1, 1975 (p. 385).

As Boden testified, the Hauser group tried several times to persuade the trustees to convert the group term plan to group permanent. Although these efforts proved unsuccessful, the Indiana Laborers Fund did continue their insurance program with Old Security until December 31, 1976. During this period, the Fund paid premiums totalling $5,649,504 and collected claims totalling $5,430,107—96 percent of the premium. The reason the premiums and claims were so nearly even is that the Fund paid no further premiums after September 1976, due to adverse publicity and litigation involving the Hauser operation, while Old Security continued to pay claims incurred through December 31, 1976. An investigation by the Department of Labor shows that the Fund did not sustain any loss on the insurance contract (Appendix E). However, had the trustees' original approval of Hauser's group permanent plan been allowed to stand, the fund would probably have lost a great deal of money because the cash values of the policies would have been wiped out.

4. Massachusetts Laborers

The Subcommittee's investigation showed that during the same period of time that the Hauser group was acquiring the insurance business of the Indiana Laborers' Fund, they used much the same techniques to obtain an insurance contract from the Massachusetts Laborers' District Council Health and Welfare Fund ("Massachusetts Fund") that provided insurance coverage for members of 24 local unions affiliated with the District Council and the Laborers' International Union.

Like the Indiana Laborers' Fund, the Massachusetts Fund during the entire 20 years of its existence prior to 1975 had had its insurance program, consisting of group term life and health and accident coverages, with a single insurance company, Union Labor Life, a firm owned entirely by labor unions and their trust funds. Although the insurance contract had been put out for competitive bids several times during this period, each time the contract had been re-awarded to Union Labor Life (p. 505). This suggests, again, that the Massachusetts Fund, like the Indiana Fund, had been satisfied with its existing insurer until the Hauser group set its sights on obtaining their insurance business.

According to the testimony of John Boden:

> Hauser's plan of operation in pursuing the Massachusetts Laborers' business was much like that which was used in Indiana. First, he contacted several individuals who were highly influential in the Laborers' Union or with fund trustees. One such individual in Massachusetts was a Mr. Joseph Vaccaro. Vaccaro was associated with a construction company in Massachusetts and had dealt with the Laborers' Union for many years. Vaccaro thus was well acquainted with all the people who were involved in the Laborers' Union in that part of the country.
>
> Another such individual was a Mr. James Merloni, president of the Massachusetts Laborers' District Council. Carney and myself had a number of meetings with Vaccaro and Merloni before meetings of Massachusetts trustees when Merloni would indicate how he thought certain trustees would vote and what their concerns were.
>
> Another key person in the Massachusetts award was a Mr. Arthur Coia, Sr., at that time held the position of vice president and regional director for the International Laborers Union. Vaccaro and Merloni told me that Mr. Coia had called the trustees on behalf of the Old Security proposal.
>
> The second step in Hauser's operation was to encourage some key person to establish an insurance agency of his own. Hauser would promise to underwrite expenses and salaries of the agency.
>
> Early in 1975, Joseph Vaccaro established an agency in Boston called National Group Insurance, Inc. Vaccaro told me he was promised, by Hauser, a salary of $75,000 per year, plus expenses, and the use of a leased Cadillac auto.
>
> Joseph Vaccaro helped persuade the trustees to send the insurance business out for bids and to include Group Permanent Life as part of the bidding invitation.
>
> Hauser told me that he had many meetings with Arthur Coia, Sr. These meetings began early in 1975 and took place in Miami, Massachusetts, and Providence. After each of these

> meetings, Hauser said that Mr. Coia had assured him that we would get the group permanent business in Massachusetts. There may have been other persons, including some of the trustees, present at these meetings. I was not present at them, but I learned of them from Hauser and also from Joseph Vaccaro. These meetings continued through 1975 (p. 341).

Again, Boden's testimony was largely substantiated by the Subcommittee's own investigation of the Massachusetts Laborers insurance award.

According to a sworn affidavit which the Subcommittee obtained from Vaccaro (exhibit 177, pp. 502–504) he had been involved as a contractor in negotiating contracts with the Laborers' Unions in the Boston area since the late 1950's and thus had become well acquainted with many of their officials. He first met Hauser socially in early 1974, and again in the Fall of that year in Las Vegas in the company of Terrence O'Sullivan, then executive secretary of the Laborers' International Union. During this meeting Hauser told Vaccaro of his plan to sell Group Permanent Life to union trust funds and encouraged Vaccaro to become part of the effort.

After some further meetings and conversations, Vaccaro agreed to go to work for Hauser. According to Vaccaro's affidavit, he then visited the Hauser group in Florida and received some indoctrination in the insurance business. While there, he talked to Bernard Rubin—a long-time friend—who vouched for Hauser and told him the Florida Laborers had placed their insurance with his company. Thereafter, at Hauser's request, Vaccaro established an insurance agency in Boston—National Group Insurance Agency, Inc. He had a verbal agreement with Hauser that Hauser's companies would pay all of the expenses of the agency plus a salary of $1,000 a week and a leased Cadillac automobile for Mr. Vaccaro.

In early 1975, Vaccaro said he contacted Arthur E. Coia, regional vice president of the Laborers' International Union for New England, and obtained Coia's approval to meet with James Merloni, president of the Massachusetts Laborers District Council, to discuss Hauser's Group Permanent Life concept. Vaccaro knew both men through his service on the negotiating committee. Vaccaro stated that, while Merloni was not a trustee of the Health and Welfare Fund and would have no vote on the insurance award, he was influential in the union. According to Vaccaro, he met with Merloni in early February 1975 and later in the month, Merloni made a trip to Florida to meet the Hauser people and look over the operation. Vaccaro stated that Merloni became a strong advocate for Hauser's group permanent life insurance plan and, he believed, even considered retiring from the union and going to work for Hauser's organization.

Merloni, in a sworn affidavit (pp. 499–501) stated that he first met Hauser in October, 1974, at a testimonial dinner for Arthur E. Coia in Boston. He also acknowledged the meeting with Vaccaro and the trip to Florida, which he said was made at Vaccaro's suggestion. Merloni also stated that he and his wife made the trip at the expense of Farmers National and that while there he spent 15 or 16 hours at Farmers National in indoctrination sessions on whole life insurance. Merloni also acknowledged that Vaccaro suggested that he retire and join the

Hauser group, but said that he declined the offer. Merloni said that at the conclusion of the Florida exposure he was convinced that the concept of whole life insurance was valid and, if properly underwritten would have more value to the individual members of the Massachusetts group than the existing insurance coverage.

Merloni stated that upon his return to Massachusetts he discussed the plan with a number of individuals in the Council and with Arthur E. Coia, his direct superior, who, he firmly believed, shared his enthusiasm for the plan. Accordingly, Merloni said he "made an honest and diligent effort to convince the trustees and the International of what he conceived to be the merit of the whole life plan" (p. 500). According to Boden, Vaccaro told him that he also met with several of the union and management trustees and persuaded them to vote to rebid the insurance (p. 366).

According to the minutes of the February 3, 1975, meeting of the Health and Welfare Fund trustees, the trustees directed the Fund's actuarial consultant, the Martin E. Segal Company, send out specifications seeking bids on the existing insurance package and on ordinary whole life insurance as well (exhibit 175, p. 496). Merloni was present at the meeting, but there is no indication of who made the motion. In a sworn affidavit, Robert J. Dellovo, the Segal Company's representative to the Fund (pp. 504–507), pointed out the high cost and other drawbacks to ordinary life insurance for the Fund, but the trustees were insistent. Accordingly, Dellovo prepared the requested specifications and a list of major companies to be invited to bid which he presented at the April 28, 1975 trustees meeting. At Dellovo's invitation, the trustees suggested two additional companies and Merloni volunteered four others including Old Security. The invitations to bid and specifications were mailed on May 9, 1975, with a bidding deadline of June 6, at which time the sealed bids were to be opened. The bids were to be sent to the Segal Company and released simultaneously to a number of officials connected with the Fund, including Merloni (exhibit 179, p. 496).

According to John Boden, Old Security's bid was prepared by Roger Carney and reviewed by Hauser, Kavanagh and himself, without any participation by anyone from Old Security. However, he said that Vaccaro had explained to them what he figured the other bids would be so that they could prepare their bids with the strong expectation that it would be low. He said Vaccaro told them what premium they should charge and what their retention should be. He said he did not know where Vaccaro got the information but that it could have come from the trustees, the Fund's administrator, the consultant or someone else on the the inside, and that the information was helpful (pp. 342, 366).

The bids from Old Security and five other companies were turned over to the Segal Company for analysis on June 6, 1975 which was not completed until June 26 (exhibit 178, p. 506). However, among the records obtained from the Fund by subpena was an application, dated June 9, 1975, to the Old Security Life Insurance Company for group permanent life insurance, signed by Joseph Pavone, then Chairman of the Board of Trustees of the Massachusetts Laborers Health and Welfare Fund. The application was also signed by Michael H. Bonacorso, 222 Lewis Wharf, Boston, Massachusetts, as Agent Broker. Bonacorso was an employee of Joseph Vaccaro and National Group Insurance Agency, Inc. The application contains no effective date. This application was apparently signed three days after the bidding deadline and before the bids had even been analyzed or any formal action on the matter had been taken by the Board of Trustees (exhibit 180, pp. 491, 496).

On June 26, the Segal Company submitted its analysis of the bids for the existing insurance program based on group term life and excluding the alternate whole life proposal (Appendix A-8). This report was discussed at a trustees meeting on July 10, the minutes of which show that the trustees received the following advice from Dellovo of the Segal Company:

> * * * there were many unanswered questions dealing with Old Security Life Insurance Company, which appeared to be the lowest bidder on premiums but not on retention, which he stated was a better test of the net cost to the Fund than merely premiums paid. He also pointed out that the program involving whole life would project a deficit for the next fiscal year of $433,000 to the Fund or a deficit of $3 per member per month (p. 497). * * *

The minutes also show that:

> The consultant further advised the trustees to move slowly in the area of self-insurance, inasmuch as it needed further study, and raised further questions which he was not prepared to answer at this time.
>
> Co-counsel advised that in light of the consultant's report and recommendations, the trustees would be acting at their peril without further study, investigation, and report from the consultant (p. 497).

Despite these warnings and other questions raised by Dellovo, all four of the union trustees and one of the employer trustees voted to award the entire insurance package, including whole life, to Old Security. However, the three remaining employer trustees voted against the motion and since the trust agreement required six votes for approval, the motion failed. The trustees then voted unanimously to have Segal do a further study of the matter and report back before the next meeting (p. 497).

Apparently in response to this instruction Dellovo wrote to Halford of Old Security on July 16, 1975, and raised a number of questions, one of which was:

> Will the total coverage in any way be reinsured? If so, please identify the benefit coverages that will be reinsured and also identify each of the companies with which the coverage will be reinsured (exhibit 181, pp. 507–508).

In answer to this question Halford in his reply dated July 29 merely stated "See Schedule S in the attached financial statement for our current reinsurers" (exhibit 182, pp. 508–509). He did not advise Dellovo that 100 percent of the coverage would be reinsured with Farmers National under a fronting agreement.

The trustees met again on August 7, 1975. At that meeting Dellovo distributed an addendum to the Segal Company's report of June 26 which was very critical of both the concept of whole life insurance for labor union trust funds and of Old Security's group permanent life proposal, which it characterized as not significantly different from ordinary whole life. According to the Segal Company's report, Old Security's premiums were not materially lower than for ordinary individual whole life policies, while the cash values were less favorable and the retention for expenses was very high. Because of these excessive costs the report recommended that the same objectives could be better achieved by other alternatives, which it listed. Dellovo also pointed out that Old Security still had not answered some of his questions and that there were discrepancies in some answers he had received (pp. 504–507). A telegram dated August 6, 1975 from Peter Fosco, then General President of the Laborers International Union was also read at the meeting which stated in part:

> We do not believe that it is appropriate and consistent with fiduciary duties for a fund to buy high cost, group permanent or other similar types of ordinary life insurance arrangements (pp. 509–510).

The trustees then voted to bring in another company to evaluate the question of whole life versus term insurance as well as other alternatives. The selection of an insurance carrier was deferred until this other consultant completed its report. On behalf of the District Council, Merloni recommended Tolley International to make this study. A motion was then passed to have Tolley International do so and report within two weeks (pp. 497, 506–507).

According to the testimony of John Boden, he and Roger Carney were standing by in the Fund's office prior to the August 7 meeting when Merloni informed them of the Fosco telegram and advised them that the award would not be made that day. Boden stated that they were all surprised by the telegram and that Merloni was visibly upset (p. 342). Documents obtained during the Subcommittee's investigation help explain why the Fosco telegram came as a surprise, and how the decision to bring in Tolley International was reached so readily.

A review of the minutes of previous meetings of the Massachusetts trustees and Dellovo's affidavit, make it clear that the Segal Company had been opposed to the concept of group permanent insurance from the beginning, and that Dellovo had made this opposition known to both Merloni and Arthur E. Coia on a number of occasions (pp. 496–499, 504–508). The internal memorandum of July 2, 1975 by Len Teeuws of Tolley International referred to earlier (pp. 144–145) shows that Mike Capurso, Hauser's representative, in obtaining the Indiana Fund business for Old Security, assured Teeuws that the groundwork had been laid for Tolley International to supplant the Segal Company as consultants to the Massachusetts Laborers. The memo also stated that Teeuws had been told that Angelo Fosco expected to succeed his father, Peter, as President of the Laborers International in September 1975 and that one of his first steps would be to purge the Segal Company wherever he could thereby giving Tolley International a chance to obtain the consulting business of other Laborers funds (pp. 975–976).

A similar Teeuws memo dated July 31, 1975 shows that on July 24 Angelo Fosco had a "get together," attended by Teeuws, Arthur E. Coia, Paul Fosco, and Mike Capurso among others. The memo describes Capurso as "Joe Hauser's right-hand-man" and states:

> My reception by Mr. Coia was excellent and it was obvious that this small cocktail party was established in order for him to get a look at us. On Friday morning before I left, I was advised by Paul Fosco and Mike Capurso that Coia is very receptive to our becoming the Actuarial Consultants to as many funds as possible under his jurisdiction (p. 976). * * *

In his affidavit to the Subcommittee, Merloni stated that he had met Teeuws during a union conference in Chicago in July 1975 (possibly the same one described in the Teeuws memo) and told him of his interest in the whole life plan for the Massachusetts Laborers and the resistance he was encountering. According to Merloni, Teeuws told him his firm had wrestled with the same problem in Indiana and offered his services to Merloni. According to Boden's testimony and the affidavits of both Vaccaro and Merloni, strategy sessions involving Boden, Carney, Vaccaro, and on at least one occasion Hauser, were held in Boston before each trustees meeting in the summer of 1975 in order to plan how to get the trustees to adopt Old Security's group permanent plan (pp. 342–343, 500, 503). According to Boden it was at one such meeting that Vaccaro suggested they bring in another consultant to counter the advice being given by the Segal Company. Boden said they decided on Tolley International because they knew Tolley International could be relied on for a favorable opinion group permanent and felt that Teeuws would be willing to help them in anticipation of their assistance in obtaining consulting business in Massachusetts and elsewhere (pp. 342–343).

Another of Teeuws' internal memoranda, dated August 8, 1975, shows that Teeuws had been called at home the previous day by Merloni and advised of Merloni's intention to recommend that Tolley International be brought in. The memo states:

> The pretext of getting us involved was to make a complete and thorough report on group permanent life insurance, inasmuch as both Connerton [counsel to the International] and Segal drafted a lengthy and complex telegram to the Boston trustees over Peter Fosco's signature, outlining the illegality of this approach to insurance. * * *
>
> I know that this is going to involve a "head-on" fight with Segal and Connerton in the International; however the three key men in the International are on our side. Also, Angelo Fosco, Arthur Coia, and Frank Lorello, from New York City want us to go "head to head" as soon as possible. I have suggested that we hold off for the next couple of months until Angelo has been appointed International President of the International Union but they think the time to do this is NOW! (exhibit 265C, p. 977).

Boden testified that at a meeting in Tolley International's Indianapolis offices attended by Teeuws, Vaccaro, Paul Fosco and himself, he prepared an analysis of the group permanent plan which was typed by Teeuws' secretary. According to Boden, it was agreed that Teeuws would base his presentation to the Massachusetts trustees on this analysis (pp. 343, 361).

In another internal memorandum dated August 14, 1975 (exhibit 265D, pp. 977–978) Teeuws states that he had met with two of the people involved in the Boston situation the day before and put together Tolley International's report. The memo also notes that the Massachusetts trustees meeting, which had been scheduled for August 21, conflicted with Tolley International's own Board meeting from which Teeuws asked to be excused on the grounds that "a great deal of potential profit to our corporation hinges on what occurs in Boston * * *."

The memo continues:

> It seems that these fellows are pretty well organized and as far as the timing for the meeting, the following is what has been requested of me:
>
> At noon on Wednesday, August 20th, I will meet with Jim Merloni, President of the Massachusetts Laborers' District Council and the Union Trustees to review our report and lay out the guidelines for our presentation the next day.
>
> Later in the afternoon, I will fly with one of the fellows to Providence, Rhode Island, to have dinner with Arthur Coia, who is the Eastern Regional Manager, as well as International Vice President. He has previously given us his "blessings". Inasmuch as he is not a Trustee he wants to review everything before the meeting.
>
> Then, of course, we will have the meeting on Thursday in Boston.

The memo also notes:

> Yesterday, I was advised that Peter Fosco, upon the insistence of Connerton will not step down this September, in order that Angelo can step in. As I understand it now, Pete will run for election at the Convention next summer and then turn the reins over to Angelo. Even though this is the case, Angelo and his people—Coia in the East, Lorello in New York City, Wilbur Fretag and the people from the West Coast are still insisting that we continue with the confrontation with Segal in these areas.

At the August 21 trustees meeting another telegram over the signature of Peter Fosco was read which reiterated the International's opposition to high cost group permanent life insurance and warned that the International would take whatever remedial action necessary to protect the trustees, participants, and the good name of the union. Afterwards it was decided to defer action on the insurance plan, and the Tolley International representatives who were present in the Fund office were so advised (exhibits 178, pp. 506–507).

In his affidavit Merloni stated that he discussed the group permanent plan with Arthur E. Coia after the telegrams were received from Peter Fosco and that since Coia continued to express approval, he felt entitled to continue his efforts to have the trustees adopt the plan (p. 500).

A further meeting of the Board of Trustees was held September 21, 1975, at which, according to the minutes, Merloni introduced Len Teeuws of Tolley International and "Mr. John Boden, an actuary for the Tolley Corporation" (p. 498).

Teeuws then distributed several documents including Tolley International's report of August 13, which was very favorable to the concept of group permanent life and to Old Security's proposal. It concluded:

> * * * It is our opinion that a Group Permanent Life Insurance program, along the lines which have been described in this report, can be adopted by a Trust Fund such as yours. Group Permanent Life offers the benefits of insurability to all employees regardless of health while creating systematic savings and real benefits to the long-time employees in a manner that does not create additional Trustee responsibility. It is further our opinion, that based upon the material and data submitted to us as prepared by the Fund's Consultants, that the Old Security Life Insurance Company is the lowest bidder for both the A & H coverages and the Group Permanent Life Insurance (exhibit 123, p. 365).

John Boden was shown a copy of this document during his appearance before the Subcommittee. He identified it as the same analysis which he prepared in Teeuws' office (pp. 361–362).

As indicated above, the analysis Tolley International submitted to the Massachusetts Fund trustees highlighted the cash savings to be obtained through group permanent life insurance. In his testimony, Teeuws acknowledged that a so-called group ordinary life or permanent life insurance plan is a poor plan if the group of people covered have a high turnover rate (i.e., loses or leaves his job, dies or becomes disabled) because the premiums are very high and a great percentage of the premiums go to administrative expenses (p. 950). He also acknowledged that if a significant percentage of covered employees leave in the initial stages of such a plan, there is not any accumulation of cash values and those persons leaving the plan in the initial stages would have little or no cash value to take with them (p. 951). While Teeuws admitted that the turnover rate is a factor in determining whether a fund should adopt group term or permanent life (p. 951), Tolley International's written report submitted to the Massachusetts Fund trustees does not address the impact of the turnover rate on plan costs or cash values available to employees covered by the plan.[16] While Teeuws indicated that the adverse impact of turnover was pointed out "orally," the minutes of the Massachusetts Fund trustees' meeting do not reflect it (pp. 498, 951).[17]

Although Tolley International ostensibly was acting as independent consultant to the Massachusetts Fund, Teeuws testified that the Tolley analysis was "prepared for the Massachusetts Laborers Dis-

[16] See pp. 71, 72 of this report which discusses the adverse impact of high turnover of construction industry employees covered by the Florida Laborers Union trust funds to which the Hauser group sold whole or permanent life insurance.

[17] Teeuws said that Tolley International's written report in the Indiana Fund case discussed the turnover factor (p. 951). However, neither that report nor the minutes of the trustees' meeting at which Tolley made its presentation on the permanent life proposal reflect a reference to the impact of employee turnover (pp. 419, 427).

trict Council and not the board of trustees" of the Fund (p. 1205). He also stated that he did not receive any compensation from the Fund, the District Council, or Hauser (pp. 1204–1205). Teeuws stated, however, that it was Tolley International's "hope and expectation" that the Fund would replace the Segal Company as consultant (p. 1205).

The minutes of the September 21 meeting makes it clear that the Fund's existing insurance consultant and co-counsel were still very concerned over the possible consequences of adopting group permanent life and also about certain discrepancies in the Old Security proposal. However, the minutes also show that:

> Mr. Merloni stated that on behalf of the Massachusetts Laborers District Council he was advising the trustees that the matter had been deferred long enough and that he had talked to the Laborers International President who had advised him that this was entirely a District Council matter; and that the Council wanted whole life insurance and that the Old Security Insurance Company was the low bidder and should be awarded the entire insurance contract as had been done in Indiana (p. 498).

A motion to award the insurance package, including group permanent life, to Old Security failed to carry, although all of the union trustees and one employer trustee again voted for it. A motion was then passed to forward all material, including that from Tolley International Corporation, to the International Union for comment.

In another internal memorandum dated August 25 (exhibit 265E, p. 978) Teeuws stated,

> While meeting with Arthur Coia in Boston the day before the Massachusetts Laborers Welfare meeting, he committed the complete statewide Laborers Welfare and Pension Funds' actuarial consulting to us. * * *

The memo also stated:

> The purpose of Paul Fosco's special visit to me this afternoon was in behalf of his father, Angelo, to make sure I understood that the people on his team are going to press this struggle with Martin Segal to the end: and to make sure that they could depend on us. There is no doubt in my mind that once this pendulum starts swinging, we are going to have a lot of business. * * *

Apparently in response to the motion passed at the September 21 meeting, Merloni, on September 23, transmitted the Tolley International report and other material to the International Union, but he addressed the letter to Arthur E. Coia (attachment A to exhibit 176, p. 501). The letter stated that the District Council felt strongly that the issues raised by the Fosco telegrams had been answered and requested that any additional information or objections from the International be stated. The letter concludes:

> If, however, you feel we have acted prudently and are now in a position to make a decision based upon the best posssible benefits to be acquired for our membership, please so advise us.

The Subcommittee has been unable to locate any response from Coia. However, on October 24, 1975, Peter Fosco sent a letter to the Trustees which Merloni stated was apparently the only reply to his letter. It stated that:

> * * * the International Union does not endorse any insurance company, nor does it have any objection to any insurance company. Specifically, the International Union does not inquire into the status of insurance companies as such. The International Union has no objection to, nor any derogatory information concerning any insurance company which submitted a proposal for "whole life" insurance, or for the plan in general. Our objection was, and is, clearly to the type of insurance—whole life. Beyond that particular point the International Union has no involvement in the bidding process. The decision as to what insurance carrier to select lies solely with the Trustees carrying out their fiduciary responsibilities, based upon all the facts and circumstances in a particular case (attachment B to exhibit 176, p. 501).

This letter, which Merloni introduced at an October 30 trustees meeting, apparently paved the way for a compromise whereby the group permanent life proposal was dropped and the insurance contract was awarded to Old Security for group term life as well as accident and health coverages. The minutes of that meeting show that Dellovo pointed out that the difference in retention between Old Security and the existing carrier was minimal, and the Fund's co-counsel pointed out that Old Security's total health and welfare business the previous year was less than the annual premium of the Massachusetts Fund. Nevertheless, the trustees voted unanimously to award the contract to Old Security effective December 1, 1975 (p. 499).

Following the award an account was opened at the Bay Bank/Middlesex, Burlington, Massachusetts in the name of Old Security c/o Nationwide Administrators into which the premiums were paid. According to Boden, Carmine Mercadente, who was connected with this bank was put on the Board of Directors of Farmers Financial Corporation at the direction of Joseph Vaccaro (p. 145). Vaccaro acknowledged in his affidavit that he made the arrangements to open this account (p. 503). The Subcommittee's investigation showed that $850,000 out of the first full quarter premium of $1,353,981.72 was drawn out of the Middlesex bank account immediately upon its receipt and forwarded to Florida where it was apparently used by Hauser's National Financial Agency and Farmers National in connection with fraudulent transactions with the Sage Corporation discussed previously (pp. 28–29, exhibit 2F, exhibit 48). See pp. 75–77 of this report for discussion of Golden Horn Mortgages.

The Massachusetts Laborers insurance contract was held by Old Security until December 1, 1976, when it was again awarded to Union Labor Life following adverse publicity concerning Hauser and Old Security. At the time of the Subcommittee investigation the Massachusetts Laborers had paid some $5,265,000 in premiums and had collected $4,603,000 in claims under this contract (exhibit 1A, p. 14). Although Old Security was continuing to pay claims, it is not known whether all outstanding claims were paid before Old Security was placed in receivership.

During its examination of the available books and records of Farmers National and the other Hauser-affiliated companies the Subcommittee found cancelled checks showing payments of $50,000 to Joseph Vaccaro and/or National Group Insurance. Because of the important role played by Vaccaro in the Massachusetts award, the Subcommittee examined the books and records of Vaccaro's National Group Insurance Agency. They showed total receipts of $127,500 from Hauser's companies (p. 494; exhibits 186–188, p. 496). Boden testified that there was no correlation between the money the Hauser group paid to Vaccaro's agency and the insurance business generated by Vaccaro (p. 366). This testimony was corroborated by other evidence. Vaccaro said he had no formal commission agreement with Hauser and his only services to Hauser were in connection with the Massachusetts Fund award (pp. 502–504). Also, his agency's records do not identify payments his agency received as commissions on any specific business (p. 518).

5. Hauser Is Threatened

Vaccaro indicated in his affidavit that he constantly had problems in trying to collect the money Hauser had agreed to pay him. Vaccaro said that he mentioned this during a conversation with Bernard Rubin and George Waugneux, the president of the Sage Corporation, in June 1976 and was told that they would see what could be done (p. 504). Shortly thereafter, according to Boden's testimony, he and Hauser and Hauser's bodyguard, George Herrera, were staying at the Sheraton Carleton Hotel in Washington, D.C. on July 14 and 15, 1976, when "someone from Rhode Island" informed Hauser that two "thugs" from Sage Corporation had been in the hotel lobby. After one of the men asked about Hauser, Herrera called the police, who escorted them from the hotel. Boden identified one of the men as Wuagneux's bodyguard, who Boden said had threatened Hauser on a previous occasion. Boden said he was later told by Kavanagh, Rubin and Vaccaro that the two men had gone to the Carleton to persuade Hauser to travel to Providence, Rhode Island to discuss money he owed Vaccaro (pp. 151–152). Wuagneux acknowledged that he had sent one of his employees to see Hauser at the Sheraton Carleton, but he denied that it involved any threats or was on behalf of Vaccaro (pp. 291–293).

In his affidavit, Vaccaro stated that he had also discussed his difficulties in collecting from Hauser with either Arthur A. Coia, son of Arthur E. Coia, or the younger Coia's law partner, Albert Lepore, because he believed that Lepore had an interest in an insurance agency in Providence connected with Hauser's operations and was having similar money problems. Vaccaro said that whichever one he spoke to indicated that a couple of persons had called on Hauser in Washington, D.C. concerning his financial obligations. Shortly thereafter, Lepore called Vaccaro and told him he had received some money from Hauser, who instructed him to send $20,000 to Vaccaro, which Vaccaro picked up (p. 504).

In a sworn affidavit (exhibit 190, pp. 513–14) Arthur A. Coia acknowledged that Vaccaro had discussed with him his difficulties with

Hauser and that he had made several calls to Hauser on behalf of Vaccaro and Lepore. Both Arthur A. Coia and Lepore acknowledged receiving the $20,000 for Vaccaro from Hauser in their separate affidavits filed with the Subcommittee (pp. 515, 516).

Because of the interest which Arthur E. Coia, as Regional Vice President of the Laborers' International Union demonstrated in the Massachusetts Laborers insurance contract, the Subcommittee inquired into the operations of the Northeast Insurance Agency in Providence, Rhode Island which, according to Boden's testimony was established by Arthur A. Coia and his law partner, Albert Lepore. Boden testified that at a meeting in Providence in July 1976, Arthur A. Coia told him that the agency had been established at the suggestion of Hauser who promised to pay all expenses, including the salary of an experienced insurance man, Vincent Vallero, who was employed to manage the agency. According to Boden, Hauser also promised Arthur A. Coia, as he had promised Paul Fosco, that his agency would become the controlling agent for all business that Hauser companies wrote nationwide and that the Northeast would also receive a commission on all business that it wrote (pp. 347–348).

In his affidavit, Arthur A. Coia stated that he had had a casual social acquaintance with Hauser since 1971 and that in the Fall of 1975 Hauser asked if he could recommend someone with expertise in the insurance field whom he could hire. Arthur A. Coia said he recommended Vincent Vallero, a registered insurance agent in Providence, Rhode Island, and set up a meeting early in January, 1976, in his own office between Hauser and Vallero. Vallero was subsequently hired (p. 514).

Arthur A. Coia and Lepore, in their affidavits, both stated that at about the same time, early in 1976, Hauser indicated to them he wanted to set up an insurance agency in Providence to handle the affairs of other agencies throughout the country. Arthur A. Coia said he was not interested, but that Lepore was interested. The Northeast Insurance Agency, Inc., was formed by Lepore in March, 1976. Lepore said he knew nothing about the insurance business and Vincent Vallero was to manage the business. Hauser agreed orally to pay Vallero $1,000 a week salary and to pay all expenses of the Northeast Agency. Lepore said there was an understanding with Hauser that money advanced by Hauser would at some time be offset by commissions. The agency was in operation until August 11, 1976 (pp. 513–516).

Examination of the books and records of Northeast Insurance Agency and the available records from the Hauser-affiliated companies show that $110,000 was paid to Northeast and/or Arthur A. Coia and Lepore, exclusive of the $20,000 subsequently passed on to Vaccaro (p. 513; exhibits 2E and 2G). The records of Northeast contained no formal set of books and no written agreements as to commissions or other payments. No records were found which identify any of the payments to Northeast as commissions or fees on any specific insurance business (pp. 512–513).

According to Arthur A. Coia and Lepore, $30,000 of the $110,000 in payments was for legal representation of Hauser in connection with an effort by Hauser to acquire a New Jersey insurance company. At the time of the Subcommittee's hearings, $31,000 of the money received from Hauser was being held in escrow in connection with limitation involving the receivership of Hauser's National American Life Insurance Company. The balance was used to make Lepore whole for the expenses of the Northeast Insurance Agency (pp. 514–516).

In his affidavit, Arthur A. Coia stated:

> I at no time received any commissions nor any remuneration for insurance business. I do not know if Northeast Insurance Agency received any insurance business and at no time solicited or attempted to obtain any insurance business from any individual, any group, any union, or the Laborers' International Union (pp. 514–515).

The Subcommittee's investigation shows that on July 16, 1976, Hauser sent Arthur A. Coia a check for $50,000 for the agency which Coia endorsed over to Lepore (exhibit 193, p. 516; exhibit 2G). In addition, Len Teeuws of Tolley International testified that Arthur A. Coia was present with his father, Arthur E. Coia, at a strategy meeting on how to sell the Group Permanent Plan to the Massachusetts Laborers' Fund (p. 1206). Moreover, as discussed below, at the time the Northeast Agency was being established and Arthur A. Coia and Lepore were representing Hauser in his attempt to purchase a New Jersey insurance company, a Laborers' Union Fund in Rhode Island with which they were associated decided to rebid its insurance contract and awarded it to Old Security.

6. Rhode Island Laborers and Amalgamated Foodworkers

In his affidavit, Arthur A. Coia stated that for 10 years he had been Business Manager of the Rhode Island General Council, an affiliate of the Laborers' International Union representing local unions in the State. Ronald Coia, a nephew of Arthur E. Coia and cousin of Arthur A. Coia, was Chairman of the Rhode Island Laborers' Health and Welfare Heavy Construction Fund. According to documents obtained by subpena from the Fund's files, the Fund was represented by Arthur A. Coia's law partner, Albert Lepore (Appendix A–9).

The minutes of a February 5, 1976, meeting of the trustees of this fund show that Ronald Coia recommended that the Fund's insurance contract be placed out for bids inasmuch as bids had not been requested for several years, and that a motion to that effect was adopted (Appendix A–10). Accordingly, on April 12, 1976, specifications and invitations to bid on a joint contract for the Heavy Construction Fund and a sister fund, the Rhode Island Laborers' Health and Welfare Fund (also known as the Building Fund) were mailed to eight insurance companies. Included was Great American Life Insurance Company, the New Jersey company which Arthur A. Coia and Lepore were trying to help Hauser acquire. The Great American Life Insurance Company invitation was mailed to Roger Carney of Nationwide Administrators at the address of Farmers National in Miami (Appendix A–11).

According to the testimony of John Boden, the specifications for this bidding were drawn up by Roger Carney who also prepared the Hauser group's bid, thereby giving them an advantage over other bidders (pp. 348–368).

Although Hauser never succeeded in acquiring Great American Life, a bid was submitted in the name of that company, on typed letterhead, using a California address, and over the signature of John Boden (Appendix A–12). Although Old Security was not on the list of companies invited to bid, an identical bid was submitted on the same date, on the letterhead of Old Security Life over the signature of its president, C. Robert Barton (Appendix A–13). Old Security also submitted a separate bid for a group permanent life plan although this was not requested in the specifications (Appendix A–14).

The Great American and Old Security bids stated that the health claims would be paid by the London Insurance Agency of Rumford, Rhode Island, which was described as an independent claims administration company with close ties to the local labor movement and which was serving as administrator for Amalgamated Food Handlers Locals Numbers 10 and 328 and Amalgamated Meatcutters Local Number 2.

An analysis of the bids prepared by the Fund's insurance broker dated May 25 shows that on the existing insurance program the Great American-Old Security bid was lowest on premium but not on retention. The analysis mentioned the group permanent proposal, but stated that it should be discussed separately. No other recommendation was made (Appendix A–15).

Boden for Great American, Barton for Old Security, and a representative of the existing carrier, New York Life, as low bidders, were invited to attend a joint meeting of the Fund trustees on June 2 (Appendix A–16). Carney attended representing Old Security, but no one represented Great American since Hauser's application to purchase the company had been turned down a few days earlier. The minutes of the meeting show that, following discussions with the insurance company representatives, including the group permanent proposals, it was decided to defer action until a later meeting (Appendix A–17). The minutes of a later meeting of the Heavy Construction Fund trustees on June 22 attended by Arthur E. Coia, Roger Carney and a Bob Reed of London Insurance Agency show that after further discussion, including the concept of whole life versus term insurance the trustees voted:

> * * * to change carriers from the New York Life Insurance Company to the Old Security Life Insurance Company effective August 1, 1976 to provide group term life insurance, health, dental and vision benefits as covered in the proposal, subject to similar action by the Board of Trustees of the R. I. Laborers Health and Welfare Fund and also to set up an ad hoc committee of two members from the heavy fund and two members from the building fund to continue to explore the concept to group whole life. (Appendix A–18.)

A binder on the contract was signed by Ronald Coia for the trustees on July 28, 1976, as authorized by the trustees at a meeting on that day (Appendix A–19).

Documents obtained by subpena from the health and welfare trust funds of Amalgamated Food Handlers Locals Numbers 10 and 328 in Rumford, Rhode Island show that during the same period that the Rhode Island Laborers were rebidding their insurance program, Robert Reed of London Insurance Agency, administrator for the Foodhandlers' funds, recommended that they also rebid their insurance programs and solicited bids from Old Security. Both funds awarded their insurance business to Old Security. The Subcommittee's investigation shows that London Insurance Agency collected almost $20,000 in payments from Hauser affiliated companies, from March through September, 1976 (exhibit 2E, pp. 26–27).

7. *Arizona Laborers*

The Hauser group also obtained the insurance business of two Laborers Union trust funds in Arizona. They were the Arizona Laborers, Teamsters and Cement Masons Local 395 Health and Welfare Fund, and the Construction, Production, Maintenance and Laborers Industrial Health and Welfare Fund (CPMLU). The Local 395 fund provided benefits for approximately 8,500 members of Laborers', Cement Masons, and Teamsters local unions. The CPMLU covered some 500 union members employed primarily by building supply firms.

John Boden testified that Hauser told him they had a very good chance of obtaining the business of these funds because he knew two of the union trustees, Fred Brown and Bill Soltero (p. 246). The Subcommittee's own investigation and the testimony of other witnesses show that Brown, who was a trustee of the Local 395 fund, and Soltero, who was a trustee of both funds and president of Local 383, did have a relationship with Hauser and his associate, George Herrera, and did play prominent roles in the awarding of the insurance contracts for these funds to the Hauser companies' reinsurance partner, Old Security.

a. *The Local 359 Trust Fund.*—From its inception in 1973, the local 395 Trust Fund had had its insurance program with Occidental Life Insurance Company. According to the minutes of an October 22, 1975 trustees' meeting, the Fund's actuarial consultant, Herbert J. Bool of the Martin E. Segal Company, had reported to the trustees that claims were running about 30 percent higher than the premiums resulting in a $1,000,000 annual deficit to the company. Bool indicated that unless Occidental were willing to forgive or amortize the deficit, a sizable premium increase could be expected and recommended that the trustees consider rebidding the insurance program. A motion to this effect was adopted by the trustees (Appendix A–20).

Therefore, Bool prepared and on November 6, 1975, sent specifications and invitations to bid to 23 major insurance companies (Appendix A–21). None of the Hauser companies nor Old Security were included. However, on December 3, 1975, the day after the bidding deadline, two trustees, Soltero and Brown, requested Bool to send specifications to five additional companies including Old Security and Farmers National (Appendix A–22).

According to the testimony of Bruce Babbitt, the then Attorney General and now Governor of Arizona, whose office conducted an extensive investigation of the Hauser Group's activities in Arizona, Soltero testified in that inquiry that he had recommended that Old Security be invited to bid on the Local 395 contract at the request of George Herrera, whom he had known for about 4 years. In his Arizona testimony, Soltero also acknowledged that he had known Hauser as long as he had known Herrera. * * * Babbit also stated that "Our inquiry clearly established that Soltero and Herrera had business dealings going rather extensively across a variety of topics," and that "Soltero particularly seems to have provided the [Hauser group] entree into the Arizona Laborer scene * * *" (pp. 536–537, 552).

A December 22, 1975 memo from Bool to the Fund's trustees shows that he complied with the requests of Soltero and Brown and invited the additional companies to bid, advising them at the time that the deadline for bidding had passed. Old Security, Farmers National, and—although it had not been invited to bid—Hauser's Family Provider Life Insurance Company all submitted late bids on December 16, 1975 (Appendix A–22).

At a trustees meeting on December 23, 1975, Bool discussed the Segal Company's analysis of the bids. Among the companies that had bid within the deadline, Union Labor Life was lowest in terms of both premium and retention. Of the late bids, Old Security was lowest on premium, but Family Provider had the lowest retention (Appendix A–23). Boden testified that the Hauser group had prepared the Old Security, Farmers National, and Family Provider bids and hoped that the business would be awarded to Family Provider (their Arizona-based company) so that they could save the Arizona premium taxes and also avoid having to pay Old Security its 2 percent under the reinsurance agreement (p. 346).

At the December 23 meeting, objections to the Hauser affiliated companies were raised by two of the employer trustees on the grounds that the bids were late, that their assets as reported by Bool might not be great enough to sustain the risks, and that they would not cover preexisting hospitalizations. According to the minutes of the meeting, Soltero and Brown said they thought additional information might clarify these areas. However, the trustees, including Soltero and Brown, voted to award the contract to Union Labor Life, effective January 1, 1976 (Appendix A–23). Union Labor Life was notified by letter on December 24, 1975 that they had received the award (Appendix A–24).

Boden testified that the trustees' action took the Hauser group by surprise and that soon afterwards Hauser, in his presence, telephoned Soltero and Brown and complained about not getting the business (p. 347). According to Governor Babbitt, the Arizona inquiry showed that Soltero argued strongly that the later bids had not received the full consideration to which they were entitled (p. 552). In addition, the Arizona investigation showed that on December 29, Brown notified the attorney for the union trustees that he had been advised by Old Security representatives that the company's assets were greater than had been reported by Bool and that Bool had misinterpreted Old Security's bid. This was followed immediately by a personal visit to the attorney by Herrera who, as Old Security's representative, presented an annual report from Old Security's parent holding company showing larger assets than had been reported by Bool. Herrera also got Boden on the phone to clarify the Old Security bid (appendix A–25).

Documents obtained by the Subcommittee show that the attorney for the employer trustees, Lawrence J. Lee, made inquiries of both the Florida Department of Insurance and Old Security on January 2 and 6, 1976, respectively, about the financial condition of Farmers National and that company's involvement with Hauser. The Florida official, James Hanna, indicated that Farmers National was in financial difficulty and needed additional capital to write any further business. He also stated that, since Hauser had taken control of Farmers National, questionable "paper" had been infused into the company to cover "huge losses" incurred. He also advised that the Department had just fined Farmers National for failure to report Hauser's ownership and to disclose a loan to a director. According to Lee's memorandum, Richard K. Halford, the vice president in charge of group insurance operations at Old Security, advised Lee that Old Security was aware of Farmers National's difficulties and of "Mr. Hauser's reputation." However, Halford said they understood that a new group of investors was in control and that Hauser was no longer connected with the company. He also said that, unless Farmers National cleared its problems, Old Security would cease doing business with the firm. In his testimony before the Subcommittee, Halford stated that in response to a question he told Lee that Farmers National was "involved in the reinsurance of this business and the proposal by Old Security" (p. 575). He also stated that he had relied on Brian Kavanagh, the President of Farmers National, for the information he had transmitted to Lee concerning Hauser and Farmers National's problem with the Florida Insurance Department (p. 586).

Lee transmitted the information he had received from Hanna and Halford to all of the trustees in memos of January 2 and January 6, 1976. (Appendix A–26.) However, Lee's memoranda to the trustees made no reference to a reinsurance agreement between Old Security and Farmers. Bool testified in the investigation by the Arizona Director of Insurance that he had some recollection that Old Security was asked about whether it had a reinsurance arrangement because of the trustees' concern about Old Security's financial ability. Bool recalled that the question was answered rather vaguely by Old Security which indicated that they perhaps would reinsure a portion of the risk and that it had reinsurance agreements with about 20 companies on a list, one of which was Farmers National. Bool further stated that he would have been concerned if he had known that Old Security would reinsure the Fund's $6 million policy with Family Provider as turned out to be the case (Appendix A–30). From all the circumstances in the case (including those discussed below), it does not appear that the trustees were apprised of the reinsurance arrangement whereby Old Security was fronting for Farmers National and Family Provider which would reinsure 100 percent of the risk.[18]

At a meeting held on January 7, 1976, the Fund's trustees voted to suspend their previous selection of Union Labor Life and to request new proposals from the companies that had responded to the original invitation plus the three Hauser-related companies (Old Security, Farmers National, and Family Provider) that submitted late bids. However, at a special meeting of trustees the following day a decision

[18] The Fund specifically asked Old Security whether its parent company would agree to hold the Fund harmless if Old Security failed in its commitment to the Fund and was advised that Old Security was precluded by law from doing so (Appendix A–29).

was made to exclude Farmers National and Family Provider, and to invite only Old Security (Appendix A–27). Specifications for the rebidding were sent out by Bool on January 9, 1976, along with a letter stating that because of some misunderstanding regarding the timeliness of the previous bids the Fund's trustees had rejected all bids received. New proposals were requested by January 23, 1976 (Appendix A–28).

The trustees met on February 2, 1976 to consider the resubmitted bids, which had been analyzed by their consultant, the Segal Company. According to the Segal Company's analysis (Appendix A–29) and Bool's testimony in the Arizona inquiry (Appendix A–30), the bids received from all of the companies that had bid originally were the same in terms of premium and retention. Governor Babbitt testified that the consultant recommended that neither Family Provider nor Farmers National be given serious consideration; that Family Provider was simply too small (the annual statement only reflected $225,000 of assets) and according to the consultant, "answered the telephone with a telephone number." According to Governor Babbitt, Farmers National was rejected primarily because of the information developed by Lawrence Lee, the trustees' lawyer about the company's financial difficulties and Hauser's involvement. He testified that the insurance contract was awarded to Old Security "ostensibly" because under the Hauser group's bid, the annual premium would be almost $400,000 less than that proposed by Union Labor Life (pp. 552–553). The minutes of the trustee's February 2 meeting state that Bool recommended that the Fund accept Old Security as the low bidder, and that a motion to that effect was passed (Appendix A–29). Bool, on the other hand, testified in the Arizona inquiry that he had made no such recommendation (Appendix A–30).

Ironically, the award of this business to Old Security exposed the Fund to the very risk its trustees sought to avoid when they accepted their consultant's advice and rejected the Farmers National and Family Provider bids. Old Security's reinsurance agreement with Farmers was not disclosed during the bidding process. After the award was made, 100 percent of the business was reinsured first into Farmers National and then into Family Provider, despite the fact that the trustees had declined to do business with either company. The Hauser group obtained control of the Fund's premium dollars under the cover of its fronting arrangement with Old Security.

b. *The Construction, Production, Maintenance and Laborers' Industrial Health and Welfare Fund (CPMLU)*.—The CPMLU was an employee benefit plan that provided benefits for Laborers' Local 383. Soltero was Business Manager and Secretary-Treasurer of the Local and a trustee of the CPMLU.

The Segal Company was CPMLU's consultant on insurance matters, as it was for the larger Local 395 trust fund. As in the case of the Local 395 fund, CPMLU's insurance program had been placed with the Occidental Life Insurance Company for many years before it was awarded to Old Security in June, 1976.

The record before the Subcommittee shows that in the Spring of 1976, Occidential advised CPMLU—as it had the Local 395 Fund—of its intention to increase the insurance premium some 20 percent. Thereafter, the steps were taken to solicit new bids for the Fund's insurance program. On April 23, 1976, the Segal Company representative handling the CPMLU account sent specifications and letters to 30 insurance companies, including Old Security. Neither Farmers National nor Family Provider was included in the invitation (Appendix A–31). Nonetheless, unsolicited bids were submitted by both Hauser companies. It is not clear how this came about. Bids were also received from Old Security and two other carriers.

The bids were analyzed by the Segal Company. Their analysis shows that the Family Provider bid was the lowest, followed by Farmers National and then Old Security (Appendix A–32). The minutes of a CPMLU trustees meeting held on May 27, 1976 (Appendix A–33), show that Mike McGinn, of the Segal Company, informed the trustees that the difference in premium bid by Old Security, Farmers National and Family Provider was less than 2 percent, and advised them that of the three, Old Security appeared to be the most substantial carrier. McGinn also reported that Old Security appeared to be aggressively marketing the kind of insurance program sought by CPMLU and that it had recently been awarded contracts by Laborers' Union funds in Indiana, Massachusetts, Arizona and Hawaii. Following McGinn's presentation the trustees voted to award the contract to Old Security effective June 1, 1976 (Appendix A–33).

Thereafter, and pursuant to Old Security's arrangement with the Hauser group, the CPMLU business was reinsured with Family Provider (p. 553). Here again, there appears to have been no disclosure of the reinsurance arrangement. On the advice of their consultant, the CPMLU trustees had elected not to accept Family Provider's low bid. Indeed, had they done so, and because none of its insurance policy forms had been approved by the Arizona Department of Insurance, Family Provider would not even have been in a position to issue an enforceable policy (p. 552, note 15). Nonetheless, and as they had in the case of the larger Local 395 trust fund, the Hauser group managed to gain control of the CPMLU insurance premiums using Old Security as a "front."

c. *Hauser's Modus Operandi.*—The Hauser group's procurement of this Arizona union trust fund insurance business was marked by the same kind of questionable contacts with trust fund officials evidenced in their acquisition of Laborers' Union contracts in Indiana and Massachusetts. As noted earlier, Hauser told Boden that they had very good prospects of obtaining the Arizona business because he knew Soltero and another of the union trustees (p. 346). Both transactions were extensively investigated by the Arizona authorities. In his statement before the Subcommittee, Governor Babbitt had this to say about Soltero's role:

> The procurement of insurance by the two Arizona trusts reveals that important contacts with labor leaders were nurtured and maintained by the Hauser group. Soltero, particularly, seemed to offer a need (sic) entree into the Arizona labor scene, and the health and welfare trust fund business that could be derived from it. He admitted having known Herrera (a long-time associate of Hauser) for four or five years. He acknowledged knowing Joe Hauser for a similar

length of time. When asked, "Would that (the first meeting with Hauser) have been about the same time you met George Herrera?" he responded, "Right." It is improbable that at the time of the Old Security bid that Herrera's connection with Hauser escaped Soltero. The warnings about Hauser imparted to the trustees by their lawyer in early January,[19] evidently failed to move Soltero to inform his fellow trustees of Herrera's past relationship with Hauser. In fact, our inquiry clearly established that Soltero and Herrera had frequent dealings on both a social and business basis, during much of 1976.

* * * * *

Suffice it to say, that the Hauser group had a steadfast supporter sitting on the Board of Trustees of the two Arizona labor trusts.

The experience of the two statewide health and welfare trust funds provides an instructive example of how the Hauser group successfully solicited labor union insurance business. Although the amount of business, when compared to the premium dollars generated by the Central States account, was not significantly great. The incentive was clearly present to sign up a number of labor trust funds. I think that it is a fair presumption that the Arizona experience bore a striking similarity to the solicitation methods utilized by the Hauser group throughout the nation (pp. 553–554).

Elsewhere in his testimony, (p. 537) Governor Babbitt discussed a letter (exhibit 195, p. 537) that Soltero had written to Lawrence Lee, an attorney for the CPMLU management trustees, after Lee had made inquiries of the Missouri Department of Insurance concerning Old Security's financial condition. The letter follows:

CONSTRUCTION PRODUCTION & MAINTENANCE LABORERS' UNION,
Phoenix, Ariz., July 2, 1976.

LAWRENCE LEE,
Shimmell, Hill, Bishop & Grunder, Phoenix, Ariz.

DEAR LAWRENCE LEE: The letter sent to Mr. Glenn R. Jourdan concerning Old Security Life Insurance Company was received in my office.

I find your continued attempt at harassment of Old Security Life Insurance completely out of taste. I feel that your authority has been exceeded. I as a trustee will assert that your authority must be expressly granted by the Trustees in proper session.

Please advise my office under what authority you have continued these attempts at harassment against our carrier. Unless you have been requested by the Trustees in proper session I will insist that your efforts be curtailed unless and until the action has been ordered by vote of the Trustees.

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[19] See discussion pp. 112, 113 of this report.

I do not condone any wrong doing by any Organization doing business with our Trust. However, the Trustees are the only body that is responsible for the Trust. I have no intention of having any liability placed upon my office as Trustee, without the express consent of the Trustees by majority vote.

I am much disturbed by your action. Please respond immediately.

Very truly yours,

WILLIAM SOLTERO, *Trustee.*

d. *The Credit Union Transaction.*—The Hauser group's Arizona activity was marked by another questionable transaction. Throughout the period a credit union operated on behalf of the members of Soltero's CPMLU Local 383 was experiencing severe financial difficulty. On February 27, 1976, after the Local 395 trust fund contract had been awarded to Old Security, and before bids were solicited for the CPMLU insurance business, $20,000 was deposited to an account in the troubled credit union (p. 553). The deposit was effected by a wire transfer of funds from an Old Security account at the First National Bank of Arizona (Appendix A–34). The Arizona investigation showed that the transaction was arranged by George Herrera at Soltero's request. Governor Babbitt testified as follows:

> Soltero, when examined under oath during the course of our investigation, acknowledged that he had approached Herrera about making such an investment. Soltero testified that he informed Herrera: "Your group ought to invest some money in our credit union. It's a good thing. It's for the membership." Herrera responded that he would see what he could do. The money appeared shortly thereafter. When questioned whether there was any connection between the credit union investment and the award of the insurance contract on the Arizona Laborers trust funds, Soltero denied that the two were related.
>
> The financial plight of the credit union continued to worsen. Finally, on June 25, 1976, my office, on behalf of the State Superintendent of Banks, appeared in court and petitioned to have the National Credit Union Administration appointed as the receiver for the credit union. An order granting our petition was entered the same day. Interestingly, the amount of the insolvency for this rather small credit union was determined to be approximately $23,000. An individual, whom Soltero admitted having hired as the treasurer for the credit union, left the State abruptly. He then offered to return $6,500, apparently constituting funds belonging to the credit union. Both the general ledger and minutes of the directors meeting were discovered missing (p. 553).

e. *George Ralph Herrera.*—Governor Babbitt testified that George Herrera held himself out as a representative of Old Security during the Hauser group's activities in Arizona (p. 535). He provided the Local 395 trustees an annual report of Old Security's parent corporation. He hand delivered bid material from all three of the Hauser related companies (p. 535). He was a close acquaintance of Soltero, a trustee for both of the Arizona union trust funds. Herrera clearly played an active role for the Hauser group in Arizona (pp. 535–537, 550, 552, 554).

John Boden described Herrera as a "very close associate" of Joe Hauser (p. 151). He testified that Herrera was Hauser's chauffeur; that he performed various chores for Hauser such as delivering messages, packages and money to people across the country. According to Boden, although he was not a licensed insurance agent, Herrera operated a Hauser-related insurance agency known as the Pacific Southwest Insurance Agency which received very large "commission advances" that bore no relation to any insurance business produced by Herrera or Pacific Southwest (p. 346), and that, at times, he withdrew large sums of money out of Hauser company bank accounts. Boden was unable to say what was done with this money (p. 350). I. Irving Davidson testified that on April 6, 1976, Herrera accompanied him to the Diplomat Bank in Washington, D.C. to discuss the opening of a bank account for a Hauser related firm, and that Herrera would frequently come to Washington and withdraw and deposit substantial sums of cash on behalf of Hauser.

Davidson recalled an occasion when Herrera showed him a stack of bills totaling $100,000 that he had obtained from the bank. He testified that he (Davidson) had no idea what Herrera did with the cash, and that when he mentioned it to Hauser he received no response (pp. 999–1000).

Clearly, George Herrera was deeply involved not only in the Hauser group's Arizona activity but many other transactions. In an effort to probe his involvement Herrera was placed under subpena and appeared before the Subcommittee on November 2, 1977. He exercised his rights under the Fifth Amendment of the Constitution and declined to respond to questioning.[20]

E. PHASE THREE—THE TEAMSTERS FUND

By the end of 1975, the Hauser group's Farmers National Life Insurance Company was in desperate financial condition due to the continued draining of the company's assets and diversions of labor union premium moneys by Hauser and his associates. The company also anticipated a stringent examination by the Florida Department of Insurance. Although the group had succeeded in obtaining the insurance contracts of the Indiana and Massachusetts Laborers Funds, the cost of obtaining the business had been high and much of the initial premium money had already been diverted or used to pay claims on preexisting business. While efforts continued to obtain other Laborers Union insurance contracts, most of them were relatively small. Farmers' overall financial condition and particularly its cash flow problem remained acute.

The Subcommittee's investigation shows that in early 1976, the Hauser group moved to remedy this situation by setting its sights on

[20] Herrera was indicted along with Hauser, Bernard Rubin, and Brian Kavanagh by the Grand Jury for the U.S. District Court for the District of Arizona (Appendix C). Herrera and Kavanagh have not yet been tried.

the huge life insurance contract of the Teamsters Central States, Southeast and Southwest Areas Health and Welfare Fund. This account was described by the Fund's Executive Director as one of the largest ever put on the market, with $2.6 billion in force insurance, covering 180,000 working Teamsters Union members and an annual premium of $23,000,000 (exhibit 230B, p. 738; p. 829).

The Subcommittee's investigation indicates that initially the Hauser group relied on its relationship with Len Teeuws of the Tolley International Corporation for assistance in obtaining the Teamsters Fund business. Tolley International was the actuarial consultant to the Central States Fund. However, resistance was encountered within the Fund's staff and from the Fund's claims processing agency. Hauser also engaged in a costly effort to bring influence to bear using persons with access to Frank E. Fitzsimmons, President of the International Brotherhood of Teamsters, was then a trustee of the Fund.[21]

The Hauser group succeeded in obtaining the Teamsters contract, but its success proved relatively short lived. Soon after the award, the entire Hauser operation was brought to a halt, but not before Hauser and his associates had converted to their own use millions of dollars in premiums paid out by the Teamsters Fund. The details concerning how the Hauser group managed to obtain this huge Teamsters contract, their diversion of Teamsters premiums to their own use and of the collapse of the Hauser operation are discussed below.

1. Background

The Teamsters Central States Health and Welfare Fund (sometimes referred to as "Central States Fund," "Teamsters Fund," or "the Fund") is a separate but sister fund to the Teamsters Central States Pension Fund. All of its trustees are also trustees of the Pension Fund.

From 1960 until 1976, the Health and Welfare Fund had contracted out its entire insurance program with Republic National Life Insurance Company of Dallas, Texas. The insurance package included life, accidental death and dismemberment, accident and sickness, hospitalization, surgical, major medical, dental and vision coverages for about 180,000 union members and 500,000 dependents. In 1975 the annual premium exceeded $160,000,000. An analysis of the annual reports filed by the Fund with the Department of Labor shows that during the 6 year period from 1970 to 1975, the premiums paid to Republic National totaled $761,467,782 (exhibit 211, p. 681).

From the inception of the Fund, Amalgamated Insurance Agency and other firms associated with Allen M. Dorfman of Chicago have served as agents and consultants on all of the Fund's insurance business.

Dorfman's association with Teamsters insurance programs has been well-known to the Subcommittee over the years. Evidence developed in the course of the investigations of the Select Committee on Improper Practices in the Labor or Management Field in the 1950s shows that Dorfman has been involved in the insurance business of the Teamsters Central States Conference for many years. Testimony and documents produced as part of those investigations (exhibit 212, p.

[21] Fitzsimmons resigned as a trustee in April 1977.

681) show that Dorfman was an insurance agent for the Northeastern Life Insurance Company. From about 1950–1960 all of the Central States insurance business was underwritten by that company with Dorfman as broker.

When the Central States insurance business was shifted from Northeastern Life to Republic National in 1960, Amalgamated and three other Dorfman-associated insurance businesses, which share a common office in the Teamsters International Tower Building in Chicago, became associated with Republic and continued to perform insurance services for the Teamsters Fund. An analysis of reports filed by the Fund with the Department of Labor for the period 1970–1976 shows that Amalgamated and the other three companies collected a total of $22,091,820 in fees and commissions during this period (exhibit 211, p. 681).

In March 1972, Dorfman was convicted and served time in prison on a conspiracy charge involving a kickback of approximately $55,000 to Dorfman in connection with a loan from the Central States Pension Fund (exhibit 214A and 214B, pp. 685–687).

In December 1972, Tollev International completed a study of the Fund's insurance program which had been requested by the board of trustees. In its report, Tollev International recommended that the Fund work toward self-insuring, or self-funding, of its insurance program (exhibit 213, p. 681). However, that recommendation was not acted on. The Fund's insurance business was left with Republic National and Dorfman's Amalgamated Agency.

During 1974 Republic National was placed under supervision by the Texas Insurance Department while an examination of its financial condition was under way. This development led the Central States Fund's auditors, Seidman and Seidman, to question Republic's ability to honor its unpaid claims and the effects this might have on the Fund, since Republic was then holding some $45,000,000 of the Fund's money as reserves (exhibit 215, p. 681).

As a result of the Seidman and Seidman report (exhibit 215), the Fund began limiting its monthly premium payment to Republic to the amount of claims paid in the second preceding month plus Republic's 5 percent retention (expenses plus profit) rather than paying a flat estimated monthly premium, which would have continued to add to the reserves held by the company (exhibit 216B, p. 681).

In June 1975, after the Texas Department concluded its examination and certified that Republic National was in compliance with the Department's orders, the company, through its actuary, A. M. Kunis, requested that the Central States Fund pay the premiums which had been withheld during the examination and return to paying flat monthly premiums (exhibit 216A, p. 681). The Fund resisted for several months, but at their meeting on October 13, 1975, the Fund trustees voted to pay Republic the back premiums it had requested. However, at the same time, the Trustees also voted to terminate the Fund's arrangement with Republic National effective January 31, 1976, to become self-insured on health coverage and to rebid the Fund's life, and accident and disability coverages.

The minutes of that meeting also contain the following statement.

> It was reported the Amalgamated Insurance Agency, Inc. presently performs services in connection with the premiums paid to Republic National Life Insurance Company, and if Republic National were thus replaced, Amalgamated would continue with its present arrangement (exhibit 218, p. 695).

Thus, the Trustees made it clear that although they had decided to self-insure the Fund's health coverage and to rebid the life and other coverages they expected that Dorfman's firm would continue to perform services for the Fund.

Records obtained from the Fund show that Dorfman and his associate, Mike Breen, appeared at a December 19, 1975 Trustees meeting and requested that the method of compensating Amalgamated for its services be changed to pay them a flat monthly fee of $435,000 per month, increasing by stages to $480,000 per month, rather than a percentage of the claims processed as had previously been the case. The request was approved by the Trustees (exhibit 219, pp. 695–696).

2. Preparation for Obtaining the Central States Business

The Subcommittee's investigation showed that the Hauser group became aware of the trustees' decision to rebid the Health and Welfare Fund's life and accidental death and liability insurance contract well before it was announced and had already made elaborate preparations to obtain the contract.

a. *Inside Information Obtained in Advance.*—John Boden testified that, at a meeting in the Jockey Club in Miami in December, 1975 attended by himself, Len Teeuws, Hauser, Brian Kavanagh, and Terrance O'Sullivan (another Hauser associate who was formerly an officer in the Laborers' International Union), Teeuws advised them that he was Tolley International's representative to the Central States Fund on insurance matters; that the Fund was preparing to rebid its life insurance program; that he would be drawing up the specifications; that if Old Security were to submit a bid with a retention rate of about 3 percent, it would have a good chance of getting the award; that if they bid, they should consider offering to pay the Fund interest on the reserves; that Republic National was holding some $19,000,000 in reserves on the Fund's life insurance; and that if Old Security were successful, he (Teeuws) would try to be helpful in obtaining the release of these reserves to the Hauser group's company. Boden said that in return for assisting them in obtaining the Central States business, Teeuws requested that Hauser assist Tolley International in obtaining the consulting business of a Laborers Union fund in Canada over which Arthur E. Coia had some say, and that Hauser promised to do so (pp. 608–609, 646, 649–650, 661).

In his testimony, Teeuws acknowledged attending such a meeting and discussing the forthcoming rebidding of the Central States contract, but said he could not recall whether the Hauser group was already aware of this fact. He also stated that he could not recall discussing the reserves being held by Republic or advising Hauser and his representatives that, if they bid at the 3 percent retention level, they would have a good chance of success. However, Teeuws said that, if he had so advised them, he saw nothing improper about it (pp. 957–960).

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Boden testified that this would not have been improper had the same information been given to other potential bidders. However, he stated that, because they knew this information was not going to be provided to other companies, it was very helpful to them in that it enabled them to know just how competitive they would have to be in their bid (pp. 646–647, 649). In fact, Boden stated:

> We realized that before we could write the Teamsters business, we would need a new reinsurance agreement between one of our companies and Old Security. This was because, No. 1, the existing reinsurance contract gave Old Security 2 percent of the premium off the top, and we would also have to pay a State premium tax, averaging 2 percent or more; this added up to 4 percent.
>
> We knew, secondly, our Teamsters bid had to include a retention figure of only 3 percent. Thus, it was clear a 3-percent retention would not produce a profit on the Teamsters business under the existing reinsurance agreement with Old Security (p. 609).

In his testimony, Teeuws did not specifically address Boden's testimony that Teeuws requested Hauser to assist Tolley International obtain consulting business of a Laborers Union in Canada. However, in response to Senator Percy's question "Were you ever promised new consulting business by Mr. Hauser?", Teeuws testified:

> As I mentioned in my statement, we also received and Mr. Hauser had commented at times about the potential new business. But this in no way influenced our contracts or activities with any of our clients (p. 990).

Fund Executive Director Daniel Shannon testified that had he been aware of this relationship he could have disqualified Tolley International from acting as the Fund's consultant (p. 836). Frank Fitzsimmons testified that he felt that Tolley's prior dealings with the Hauser group and Old Security "raise serious questions concerning Tolley's independence and create the appearance, if not the presumption, of a conflict of interest * * *" (p. 1106).

b. *Second Reinsurance Agreement with Old Security.*—As explained earlier in this report, in late 1975 Hauser and his associates had activated a dormant subsidiary of Farmers National known as Family Provider Life Insurance Company, a "shell" corporation licensed to do business only in Arizona, with total assets of $250,000. John Boden was its president and only employee. One of their purposes in doing so was to have a company in place to which they could transfer their existing labor union business in the event that the 1975 year-end review by the Florida Department of Insurance resulted in Farmers National being put out of business.

According to Boden, it was decided to make Family Provider the vehicle for the new reinsurance agreement on the Central States business in order to avoid the adverse publicity resulting from Farmers continuing problems with the Florida Department of Insurance (p. 650). Boden further testified that in January 1976 he and Kavanagh met with Halford of Old Security in Kansas City. At that time they advised Halford that under an agreement, dated January 1, 1976, Family Provider had assumed Farmers National's position in the fronting agreement with Old Security. They requested Halford to draw up two additional reinsurance agreements between Old Security and Family Provider—one to cover the Central States Teamsters business and a second to cover the Florida labor union business in the event that Farmers was put out of business (p. 345).[22]

In an affidavit filed with the Subcommittee, Halford stated that late in December 1975 Boden had called him and requested that Old Security enter into a new quota-share reinsurance agreement with Family Provider since the 2 percent fee which Old Security was charging under the Farmers National agreement would make a bid on the Central States contract uncompetitive. Halford further stated that after obtaining the approval of Old Security's President, C. Robert Barton, he drafted such an agreement (p. 558).

Under the terms of this new agreement (exhibit 202, pp. 593–596) Old Security was to reinsure only 80 percent of the risk into Family Provider and would not receive any fee "off the top" of the premiums, but was to receive 20 percent of the profits. The reserves were to be held by Old Security and invested at the direction of Family Provider.

Halford testified that the agreement was signed during the first week of January 1976 (pp. 558–600). Boden testified that the agreement was negotiated in January 1976, but was not signed until February or March and backdated to January 1, 1976 (pp. 650, 661).

Although the record shows that Halford wrote in an April 21, 1976 memorandum to Barton (exhibit 201, p. 592) that this agreement was only to take care of the Teamsters Fund, in his testimony before the Subcommittee he said that he did not believe any specific group was mentioned at the time it was signed. However, he also testified that very shortly afterwards, he was called by Kavanagh, Boden or Carney and told that Old Security would be receiving shortly a set of specifications for a bid on the Teamsters business (pp. 559, 661).

3. The Rebidding Process

The record shows that the handling of the rebidding of the Central States insurance program was entrusted largely to the Fund's insurance consultant, Tolley International and its representative, Len Teeuws. According to the testimony of Daniel J. Shannon, the then Executive Director of the Fund, Tolley International's responsibilities included drafting the specifications, developing a list of companies to be invited to bid, drafting letters of invitation to bid, and the analysis of the bids received. Shannon said he also asked for and received the assurance of Tolley International that they would not receive a commission or have any other financial interest in the insurance coverages being offered for bid (p. 832).

Documents obtained by the Subcommittee through subpena show that on January 7, 1976, Teeuws sent a set of suggested bidding specifications to Shannon and Shannon's assistant, Richard Heeren (exhibit 220B, pp. 697–698). On the following day, Teeuws sent Shannon a letter which stated:

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[22] According to Boden, the second agreement was never concluded.

> If you so desire, I would be pleased to suggest several insurance companies who would be licensed to write business in all of the states covered by the Central States Southeast and Southwest Areas Health and Welfare Fund and also those that I am sure would be interested in submitting proposals (exhibit 220A, p. 697).

The Fund's records also show that on January 13, 1976, Teeuws sent Heeren a list of 11 insurance companies to be invited to bid, including Old Security Life (exhibit 221, pp. 706–707). On January 14, Shannon sent the specifications and bid invitations to the 11 companies suggested by Teeuws, plus Republic National and two others (exhibit 220C, p. 698).

According to Shannon, the decision to invite Old Security to bid was made by Tolley International without consultation with the trustees or the Fund's professional staff (p. 832). In fact, both Shannon and Heeren testified that they were prohibited from suggesting or clearing the names of companies to be invited (p. 876).

In his testimony before the Subcommittee, Frank E. Fitzsimmons, the Teamsters International President and Fund Trustee, also stated that:

> Tolley had a completely free hand to manage the rebidding procedure including the terms of the invitation for bids, the specifications of the insurance coverage and the companies which would be included in the invitation list. I did not review any of the Tolley bidding arrangements or the names of the invitees on the bid list prior to the invitations being sent out to the prospective bidders (p. 1103).

John Boden testified that the Hauser group requested Teeuws to put Old Security on the invitation to bid list (p. 609). Teeuws testified that he could not recall whether such a request was made of him (p. 961).

a. *The Bid Specifications.*—The specifications invited the companies to bid on both a fixed premium and a cost plus basis and provided data on past experience to assist them in computing their bids. While there was nothing in the specifications to favor Old Security or any other company, they did not elicit certain information which later became of vital importance. Specifically, they did not ask whether the bidding company intended to reinsure any portion of the business with another company. Although Teeuws testified that he was not at this time aware of the reinsurance agreement between Old Security and Family Provider (p. 961), because of his earlier dealings with Hauser he was aware of the Hauser group's reinsurance arrangement with Old Security in the Indiana Fund and certainly should have been aware of such an arrangement with respect to the Massachusetts Fund award.

The specifications and letter of invitation stated that no proposals would be accepted which were post-marked after the bidding deadline of midnight, February 13, 1976. The bidders were instructed to submit their bids to Shannon's office. Teeuws' letter of January 8, 1978, to Shannon transmitting the specifications suggested that bids be kept sealed until they are all received and then be transmitted to Teeuws for analysis (exhibit 220A, p. 697). Instead, the record shows that they were opened, copied and transmitted to Teeuws as they were received by the Fund and without preserving or recording the post markings (p. 877).

The "General Information" section of specifications in the invitations to bid issued by the Fund stated:

> It should be explicitly understood that there shall be no commission and/or allowances paid to any individual or organization in regard to the underwriting of this Fund. If it is required that your company must pay a so-called finder's fee, please state the amount, the individual or individuals to whom the fee would be paid and/or any other pertinent information relative to this matter (p. 700, exhibit 220D).

In addition, a Questionnaire included in the invitations asked the following:

> Are you required to pay commissions on this business? Yes ——No ——. If yes, please explain. If commissions are not paid, what would be the percent reduction on your retention? —— percent. Total retention —— percent (first year) (p. 706, exhibit 220D).

According to Boden, the Old Security bid was prepared by himself and Roger Carney [23] and proposed a 3 percent retention just as Teeuws had suggested. However, they did not accept Teeuws' suggestion that Old Security offer to pay interest on the reserves because, according to Boden, the Hauser group expected to make their money on the contract by investing the reserves. In fact, Boden stated:

> Personally, I would have been glad to lower the bid to a 2½ percent retention level to get the business because most of the profits in that case were coming from the interest earnings on reserves, not from the retention (p. 609).

Bids were submitted by eight companies. Although the copy of the original bid by Old Security which the Subcommittee obtained from the fund by subpena bore no postmark or date received stamp, it was transmitted by Heeren to Teeuws by a letter dated February 13, 1976, a Friday (exhibit 223A, 223B, p. 707).

The bid from the Prudential Life Insurance Company, dated February 13, 1976, also proposed a retention rate of 3 percent. There was no postmark or receipt date noted on the bid. The Prudential bid was transmitted by Heeren to Teeuws by letter dated Monday, February 17, along with a bid from the Washington National Life Insurance Company proposing a retention rate of 2.28 percent (exhibits 225A, 225B, pp. 713–720).

b. *Additional Old Security Bid.*—Among the documents obtained from the files of the Central States Fund was a second bid from Old Security which was stamped "Received, Adm. Office, Feb. 18 '76, 9:20 a.m." (exhibit 224A, p. 710). A copy of this same bid was also obtained by subpena from Tolley International and bears the additional stamp

[23] Halford acknowledged that the bid was prepared by the Hauser group, but stated that he checked the rate calculations and cleared it with Barton before it was submitted (pp. 559, 586, 590).

"Received, Health Services, Feb. 20 '76, 10:12 a.m." (exhibit 224B, p. 713). There was no postmark notation, although this second bid is largely the same as the original one, it appears to have been typed on a different typewriter and contained one significant addition, a new section headed "Alternate Suggestion" which read as follows:

> If the Trustees elect to adopt a Cost Plus Program, we would like to suggest a different approach to claims payment. Since the necessary records are maintained by the administrator, it would be more timesaving and economic if, in addition, the administrator also paid the claims. We would welcome an opportunity to discuss this in detail if such an approach seems feasible to the Trustees. There would be, of course, an appropriate reduction in the insurance company's retention if this approach is adopted.

This "Alternate Suggestion" represented a departure from the specifications which stated that the insurance company awarded the contract would be required to process its own claims and which suggested that bidders plan to maintain a claims office in Chicago for this purpose. Teeuws testified that the specifications were drawn in this manner because Shannon wanted to remove the claims processing function from the Amalgamated Insurance Agency (pp. 962–963).

In an affidavit which he submitted to the Subcommittee, Teeuws stated that during the bidding process he had discussions with representatives of a number of bidding companies, including Boden, Carney and Hauser; that he may have advised them that Shannon and his staff were interested in developing their own in-house claims staff to replace Amalgamated Insurance Agency; and that it may have been as a result of these discussions that Old Security supplemented its bid, but that he did not believe he had solicited such a supplement from Old Security or any other company. Teeuws said that he could not recall having given consideration to the fact that "it [Old Security's supplemental bid] may have been received a few days late since bid materials were sent to the Fund's office and then forwarded to me" (p. 1174).

Heeren testified that he did not know how two bids came to be submitted by Old Security and stated that he probably would not have noted the difference in them. Shannon testified that he was unaware of the second bid, or that it was late (p. 879).

4. Analysis of the Bids

Under its arrangement with the Fund, Tolley International was responsible for analyzing all the bids. Teeuws submitted Tolley International's report on its analysis to the Fund on March 1, 1976 (exhibit 228, pp. 720–738). The report summarized the bids of the various companies and their answers to a questionnaire included in the specifications. The Tolley International analysis showed that Washington National Life Insurance Company had submitted the lowest bid in terms of gross retention, whether expressed as a percentage (2.28 percent) of the estimated claims of $23,000,000, as provided in the specifications, or as an actual dollar amount ($524,256). Next lower, according to the Tolley International report, were Old Security and Prudential with identical retention rates of 3 percent or $690,000.

However, because the bidding companies had used varying estimates of the State premium taxes due on the business, Tolley International recalculated the retention eliminating the premium taxes. Under this calculation, Old Security had the low bid with a retention of $97,750 or .425 percent of $23 million; Washington National was second with $110,940 or .48 percent and Prudential was next lowest with $115,000 or .50 percent. On this basis, the dollar difference between the Old Security and Prudential bid was only $17,250. Also, the analysis showed that Prudential had offered to pay the Fund 7⅛ percent interest on the total and permanent disability reserves, which would have amounted to $17,830 the first year and up to $1,302,463 by the seventh year. In addition, Prudential had also offered to pay 5¾ percent interest per annum on total reserves held. Old Security did not offer to pay any interest on reserves.

The Tolley International report contained the following recommendations:

> The Prudential Insurance Company of America indicated that they would credit interest on their overall reserves *which would become applicable in the third plan year.*
>
> If the Trustees are interested in remaining insured for any period of time less than a three-year period, certainly consideration should be given to the low retention charges. However, if it is the consideration of the Trustees to remain insured for a *longer period of time than two years*, certainly consideration should be given to the Prudential Insurance Company of America's proposal which results in credits to the fund from interest on reserves (p. 737) (*Emphasis* added).

However, the recommendation continues by noting:

> It should be kept in mind, that Republic National will guarantee the retention for three years and even though their net retention is higher than all other companies, if the Fund is only going to remain insured for a short period of time the administrative problems inherent in a change of carrier could outweigh the retention savings (p. 737).

Tolley International's report also included the following statement:

> It should be kept in mind that the company with the lowest net retention, Old Security Life Insurance Company, also would be agreeable to allowing the administrative offices of the Fund to pay all Life and AD & D claims, as well as the T & PD payments. They have stated they would negotiate a reduction in the retention if this approach were used. It would be our recommendation that the carrier be requested to train and set up the claims paying system within the administrative offices of Central States, Southeast and Southwest Areas Health & Welfare Fund if the Trustees decide to elect this method (p. 738).

The highlighting of this offer, contained in the amended bid submitted by Old Security after the bidding deadline, is significant. It represented a departure from the specifications. There is no evidence that any other bidder was afforded an opportunity to match this change.

Finally the Tolley International report states:

> If the trustees decide on an alternative decision, consideration should be given to the Prudential Insurance Company of America's proposal whereby interest on reserves would be retroactively credited to the experience of the Fund (p. 738).

Thus, Tolley International's report did not make a clear recommendation as to which company should be awarded the business. However, in calling specific attention to the "Alternate Suggestion" contained in Old Security's late supplemental bid, and in recommending that Old Security be requested to train and set up an in-house claims paying system, the report did portray Old Security in a highly favorable light. This is consistent with John Boden's testimony that Teeuws had a special relationship with the Hauser group. For example, John Boden testified that Teeuws kept him advised of developments concerning the Old Security bid during the time the bids were pending; that Teeuws told him what was taking place and what he anticipated would take place. Boden described a conversation in which he said Teeuws told him that Fund Executive Director Daniel Shannon had expressed a preference for the Prudential Life Insurance Company's bid and that this was going to create a problem for Teeuws in recommending the Old Security bid. According to Boden, Teeuws was concerned at the time that, if he recommended Old Security and the trustees went against his recommendation, Tolley International might lost the Teamsters Fund as a client (pp. 609–610).

Regarding the payment of commissions and fees, Tolley International's analysis of the bids on the cost-plus insurance program stated that:

> All companies [including Old Security] indicated that there would be no requirements to pay commissions, fees, or any other allowances, nor would they require an appointment of a broker of record or agent (p. 727, exhibit 228; pp. 712–13, exhibit 224 A).[24]

Tolley's analysis also included letters from a number of prominent insurance companies, including John Hancock, declining to bid because of the size of the amounts of insurance and exposure to risk involved (pp. 735–737).

a. *Independent Bid Analysis.*—In order to obtain expert advice on the bids and the Tolley International analysis, the Subcommittee requested the General Accounting Office to assign to its staff Franklin B. Dana, Assistant Director and Actuary for the U.S. General Accounting Office. Dana has had 50 years of actuarial experience. After reviewing all of the bids and the Tolley International analysis, Dana concluded, contrary to Tolley International analysis, that the Prudential bid was lower than Old Security's even on a short-term basis (pp.

[24] Tolley's analysis of the bids on the fixed premium insurance program stated:
"The Aetna Life Insurance Company requires a commission of $1,250 which they would either pay in the first year, or over a ten year period. The Travelers Insurance Companies stated they will not pay commissions if the Trustees so instructed" (p. 734, exhibit 228).

816–827). In his testimony, Dana explained that his conclusion differed from Tolley International's because in his analysis, he had allowed for the dividends and interest which Prudential had agreed to pay on the reserves, while Tolley International had not done so.

In this connection, documents obtained by the Subcommittee show that on March 22, 1976, Teeuws submitted a supplemental report to the fund analyzing a bid submitted after the bidding deadline by the Travelers Insurance Company (exhibit 229A, p. 681). This report, which shows the Travelers bid to be lower than either the Old Security or Prudential bids, utilizes the type of analysis which Dana testified should have been used by Tolley International in analyzing the Prudential and other bids. This Traveler's bid was later disallowed for being late.

b. *Shannon Recommends Prudential.*—The Health and Welfare Fund's insurance coverage was due to expire on April 30, 1976. In an effort to obtain a decision by the trustees on the bids, on April 5, 1976, Shannon addressed a letter to each of the trustees forwarding to them materials pertinent to the insurance matter (exhibit 230A, 230B, pp. 738–739). Included was an agenda note describing the insurance bids and a polling sheet listing all of the bidding companies on which each trustee could mark the company he preferred to see selected. This material included the following statements:

> The key element in the decision to be made by the Trustees is whether or not to allow the second Travelers' bid to be included with those bids that were received within the deadline. In all cases, all parties involved with this analysis have been concerned with the objectivity applied to the analysis of these bids in that any apparent discrimination in the analysis would give cause for any of the other companies to register a complaint.
>
> It is the recommendation of Tolley International Corporation that the trustees could be subject to criticism if they accept any bids after the deadline. It is therefore recommended by Tolley that the Prudential bid is the most attractive bid of those received prior to the deadline (p. 738).

In his letter of transmittal Shannon stated:

> Of all the companies bidding, Prudential appears to combine a low retention factor with a superior reputation and the financial stability to handle our account, which has been judged to be one of the largest accounts ever put on the market at $2.6 billion in force insurance.
>
> On the attached sheet, you will find a list of the companies that have bid. Should you feel that you would prefer to do business with one of the other listed companies, please check that company and return the signed sheet to me (p. 739).

Shannon testified that his letter was intended as a recommendation that the contract be awarded to Prudential (p. 884).[25] He believed that Prudential's financial stability and good standing in the insurance

[25] Shannon said he sent the Apr. 5 recommendation in order to secure the approval of the trustees (which could be ratified at a later formal meeting) so his staff could start the necessary transition process, since the Republic Life contract was scheduled to expire after Apr. 30 (p. 902).

industry would lend credibility to and improve the Fund's image and made the recommendation because he felt he had an obligation to the rank and file to make this recommendation (pp. 889–890).

In his testimony before the Subcommittee, Frank Fitzsimmons stated that Shannon had no right or authority to make such a recommendation because that responsibility had been entrusted to Tolley International (p. 1125). Fitzsimmon's position is noteworthy not only because it would deny the trustees the benefit of their Executive Director's professional advice in an important matter committed to his administration, but because Shannon's recommendation was also consistent with his understanding that Tolley International already had recommended Prudential's as the most attractive bid received before the bidding deadline (i.e., excluding Travelers' late bid).

Heeren testified that Teeuws had made this recommendation during a meeting with himself and the representatives of another consultant to the Fund, at the same time that he recommended that the late Travelers' bid not be accepted (p. 885). Teeuws testified that he could not recall having made a specific recommendation of Prudential (p. 973).

Shannon also testified that Fitzsimmons did not tell him that he did not have any right or authority to make a recommendation (p. 891).

Only two of the trustees responded to this poll, John R. Spickerman and Jack Sheetz, employer trustees. Both endorsed Shannon's recommendation of Prudential (pp. 760, 776). The poll produced no decision, but Shannon's recommendation appears to have raised concern in the Hauser camp that additional actions would be needed to insure their success in obtaining the contract.

5. Attempts to Bring Outside Influence to Bear

As noted above, John Boden testified that Teeuws was keeping him apprised of the progress of the bidding. According to Boden, Teeuws advised him of Shannon's preference for Prudential and urged him to match Prudential's offer to pay interest on the reserves. When Boden declined, Teeuws suggested that he have Hauser get in touch with Frank Fitzsimmons because he was afraid that, if he went against Shannon and lost, he might also lose his client. Boden testified that when he relayed this message to Hauser, he was told not to worry about it. Boden could not recall the date of the conversation with Teeuws. He believed it was after the bids were submitted (pp. 609–610, 651–652).

a. *O'Sullivan and Fitzsimmons.*—The Subcommittee's investigation showed that the Hauser group had previously made a direct approach to Fitzsimmons through Terrance O'Sullivan, who joined Hauser in September 1975. Fitzsimmons testified that in early 1976 or possibly late 1975, O'Sullivan, whom he knew, had contacted him in Palm Springs, California, and told him that he had an insurance program he wanted the Fund to look at. According to Fitzsimmons, he told O'Sullivan that he should address his request to the Fund's office in Chicago. Fitzsimmons said he did not himself contact the Fund on O'Sullivan's behalf, and that he did not know what company O'Sullivan was representing (pp. 1105–1107).

Shannon testified that some time between January 14 and March 1, 1976, he received a telephone call from Fitzsimmons asking if Old

Security was on the list of companies invited to bid. According to Shannon, he checked with Heeren; determined that Old Security was on the bidding list and so advised Fitzsimmons. Heeren confirmed Shannon's testimony (pp. 879–882).

b. *I. Irving Davidson and Thomas D. Webb, Jr.*—Boden testified that while in Washington, D.C., in early April 1976, Hauser introduced him to I. Irving Davidson, a Washington public relations consultant. According to Boden, Hauser told him that Davidson had been very close to former Teamsters President James Hoffa, and had very good contacts in Washington including a contact with Fitzsimmons. Boden testified that one of Davidson's associates, Thomas D. Webb, Jr., was very close to Fitzsimmons and regularly played cards with him. Webb is executive vice president of the Burbank International Corporation, Washington, D.C. (pp. 610, 995, 1001).

Davidson testified that he first met Hauser sometime late in 1975. He said he had been entertained by Hauser in January 1976 when he (Davidson) had visited Miami to attend the Super Bowl football game, and became friendly with him at that time. Davidson said that Hauser contacted him in late March 1976 and told him of his interest in the Teamsters Fund insurance contract. According to Davidson, Hauser told him his company had been the low bidder on the contract. He testified that "Hauser was beside himself because he figured that he was going to be cheated out of the contract even though he was the low bidder" (pp. 995–996).

Davidson testified that he then suggested to Hauser that they bring in Webb, whom he described as his good friend, and a "social buddy, golf partner, and gin player with Frank Fitzsimmons," president of the Teamsters Union. Hauser agreed and he, Davidson and Webb met in early April to discuss the problem (p. 996). Afterwards, according to both Davidson and Webb, Webb called Fitzsimmons in California on Hauser's behalf.

According to Davidson, who was present when the call was made, Webb told Fitzsimmons he had a potential client who felt he was being hurt by the people at the Central States Fund, and that he (Webb) wanted to make sure he was not cheated. Davidson said Webb told him later that Fitzsimmons had asked the name of the company involved and told Webb that, if his client was the low bidder and the deal was honest, he (Fitzsimmons) would look into it (p. 997). Webb acknowledged having called Fitzsimmons, but could not fix the date of the call. He said he told Fitzsimmons about Hauser and Old Security, and that Fitzsimmons said at the time that he would look into the matter (p. 1002). Fitzsimmons testified that he could not recall having received such a called from Webb (p. 1108).

Accordingly to both Davidson and Webb, they met with Hauser shortly thereafter and suggested to him that it would be a good idea if Richard G. Kleindienst were brought in to assist with the matter. They reasoned that Kleindienst's prestige as a former Attorney General of the United States would be helpful.[26] They also explained to Hauser that Kleindienst, in addition, was a good friend of Fitzsimmons and

[26] Kleindienst served as Attorney General from June 1972 to May 1973. In May 1974, Kleindienst pleaded guilty to a charge that he violated 2 U.S.C. § 192 by having refused to testify fully and accurately to certain questions put to him in a Senate hearing about the ITT affair. Kleindienst received a sentence of 30 days in prison, which was suspended, and a $100 fine.

could be expected to have more influence and "clout" with him than would Webb (pp. 996, 1001–1002).

Davidson and Webb testified that Webb then called Kleindienst and told him what Hauser had told them; namely, that Hauser was associated with Old Security Life, which had been found by an independent appraiser to have submitted the low bid on the Teamsters Fund contract, but that someone was trying to divert the award elsewhere (pp. 996, 1001–1002). Although the name of the "independent appraiser" was not mentioned, apparently Hauser was referring to the Tolley International analysis of the bids.

Webb testified that Kleindienst, after making a check on Old Security, agreed to handle the matter and said that he would contact both Shannon and Fitzsimmons (p. 1002). Kleindienst's testimony concerning this telephone conversation with Webb was essentially in conformity with Webb's, except that he stated that Webb told him there would be a $250,000 fee if they were successful, which he and Webb would split 50–50 (pp. 1032–1033, 1045–1046). Webb and Davidson maintained that the amount of the fee had not been established at this time and that Kleindienst worked out the amount of the fee (pp. 997, 1008–1009, 1014, 1023–1025).

Kleindienst testified that he had known Fitzsimmons for several years, that they played golf and gin rummy together and visited in one another's homes, and that he considered Fitzsimmons "a close personal friend of mine" (p. 1031).

Fitzsimmons acknowledged that he had known Kleindienst for several years, since the time he was in the Attorney General's Office, but would not characterize him as a close, personal friend. In fact, Fitzsimmons testified that he had been to Kleindienst's home only one time and that Kleindienst had been in his home only once, a Christmas party (pp. 1118–1120).

Kleindienst testified that he assumed Webb brought him into the matter because Webb knew that he had a better relationship with Fitzsimmons and because he was a practicing attorney, which Webb was not. Kleindienst stated that Webb did not tell him what he expected him to do; that he assumed his role was to bring the matter to Fitzsimmon's attention and then to perform any legal services that might be required (pp. 1047–1048).

Kleindienst acknowledged that at the time he was representing the Teamsters Central States Pension Fund in other matters, but stated that he and his partners did not consider this a conflict of interest,[27] and that he had not performed any legal services in connection with the insurance award (pp. 1030–1031, 1052). Thus it would appear that Kleindienst's sole function was to seek the support of Fitzsimmons.

Kleindienst described his conception of his intended role as follows:

> Mr. Webb told me that Old Security was one of the companies deemed qualified for this bid, that it was a highly competitive bid.
>
> It has been my experience as an attorney, over many, many years, representing business people and in business transac-

[27] Fitzsimmons testified that it never occurred to him that this might constitute a conflict of interest, and that he relied on the integrity of a former Attorney General of the United States to realize his responsibilities (p. 1122).

> tions that sometimes situations can be competitive. Maybe you have two bidders who are equally qualified in all respects.
>
> Sometimes one of the bidders under those circumstances is awarded because of the confidence that the awarding authority might have in somebody who represents them or as a result of satisfactory prior business relationships.
>
> It didn't strike me in a matter of this significance and size that would justify a fee of that, that it would be unusual to pay a fee of that kind, and in a competitive situation where if somebody in who Mr. Fitzsimmons had confidence, in terms of his professional career and his relationship with him, made representations with respect to a company that it would hurt that company in getting that bid.
>
> I am certain that is why Mr. Webb called me. That is the reason why I accepted the assignment and that is exactly the reason why I called Mr. Fitzsimmons (p. 1048).

c. *Kleindienst calls Fitzsimmons.*—It appears that Webb first called Kleindienst on behalf of Hauser on or about April 5, 1976, the same day that Shannon recommended Prudential to the trustees.

Telephone and visitor logs obtained by the Subcommittee from Kleindienst's former law firm show that on April 5 Webb spoke to Kleindienst's secretary at 10:27 a.m.; that Kleindienst later called and spoke to her; and that Webb spoke with her again at 2:29 p.m. The records show that on April 6, Fitzsimmons called Kleindienst at 11:55 a.m. from a telephone number in Arlington Heights, a suburb of Chicago, Illinois. They also show that Webb placed a call from Kleindienst's office to the Arlington Heights number at 2:15 p.m. the same day (exhibit 231, pp. 739–745).

Fitzsimmons testified that, according to his recollection, the initial call from Kleindienst was much earlier than April 5 and possibly as early as February. He said he was sure he did not talk to Kleindienst on April 6, because he was then involved in negotiating a union contract in Chicago (pp. 1108–1114). However, the telephone logs and bills from Kleindienst's office show that the call from Webb on April 6 was to the room of a Mr. Previant, an attorney representing the union in the negotiations, and the telephone number given (312) 394–2000, was the listing for the Arlington Park Hilton, where the negotiations apparently were taking place. The telephone bill shows that Fitzsimmons placed a call to Kleindienst's office from this same number on April 6. Thus, there were at least two telephone calls between Kleindienst's office and Fitzsimmons on April 6.

There is additional evidence indicating that some contact between Kleindienst and Fitzsimmons took place prior to April 6. The telephone and visitor logs also show that there were frequent telephone calls and visits involving Kleindienst, Davidson and Webb throughout March and one from Shannon on March 19. Also, Shannon testified that when Fitzsimmons called him in February to ask if Old Security were on the bidding list, Fitzsimmons mentioned that the inquiry had originated with Kleindienst, who was representing the company and had called about it (p. 882). This is consistent with Fitzsimmons' testimony that it was after the initial call from Kleindienst that he called Shannon and asked if Old Security were on the bidding list (pp. 1112–1113).

Kleindienst stated that on one occasion Webb telephoned him at Dulles International Airport in Washington, D.C., as he (Kleindienst) was about to depart on a business trip abroad; that the call had to do with the Old Security bid; that after talking to Webb he called his office for Fitzsimmons' telephone number and then spoke with Fitzsimmons from the airport. According to Kleindienst, following this call Fitzsimmons called him back within a day or two (pp. 1033–1037, 1045–1047). However, Kleindienst testified that according to his records, he was not out of the country on April 5, 1976. It is not clear just when these phone calls took place. They could have occurred earlier in the year.

If in fact the April 5–6 contacts between Kleindienst and Fitzsimmons were not their first ones concerning Old Security, the call from Webb to Kleindienst on April 5 must have been the first in a series of calls in which Webb advised Kleindienst that things were "getting off track" on the Teamsters Fund award (pp. 997, 1038, 1066). In any event, it appears that these calls were stimulated by Shannon's recommendation of Prudential on April 5, although Kleindienst testified that he could not recall having been told of it (p. 1087).

Kleindienst testified that his best recollection of what he told Fitzsimmons in the April 5 call was as follows:

> Fitz, I have been asked to represent Old Security Life Insurance Co. I have been informed that they have submitted a bid to secure the insurance for the fund. I have likewise been informed that they are the low bidder. And it is also a company among others that has been deemed qualified by the insurance consultants for the fund to do this business.
>
> Fitz, I wonder if you would check that out for me and ascertain whether this is correct.
>
> If it is and if they are the low bidder and a qualified company, I would appreciate any help that you could give me in connection with this matter (p. 1036).

Kleindienst also acknowledged that he may have asked Fitzsimmons to let him know whether or not he could help him get the contract for Old Security. In any case, he said that this was certainly implied in the conversation (pp. 1036–1047).

As Kleindienst put it:

> I don't think I ever asked Mr. Fitzsimmons to use influence, but I think it was assumed in the context of our dealings that as a result of our friendship and my representations, I would hope that he could use any influence that he had. I would hope so, or I wouldn't have called him (p. 1048).

According to Kleindienst, Fitzsimmons called him back the next day (April 6) and said:

> I have looked into this Old Security matter. It is apparently the low bidder. It is a company that is apparently qualified to write the business. I think it has a good chance of getting the business, and I will keep in touch with you about it (pp. 1037, 1046).

Fitzsimmons testified that the first and only time he could recall that Kleindienst called him on behalf of Old Security prior to the award of the bid (which he placed in February rather than April 1976) Kleindienst advised him that his client, Old Security, was bidding on the Central States business and asked him if he could be of any help to his client (pp. 1103, 1105, 1112).[28] However, Fitzsimmons further testified that:

> In response to Mr. Kleindienst's request for assistance, I neither offered or provided any. I advised him that if his client's bid was competitive and if the company was sound and viable the bid would be given as much consideration by the trustees as any other bid.
>
> After Mr. Kleindienst's call, I called Mr. Shannon and asked him whether Old Security was on the invitation list. He checked and advised me that the company was on the list. My call to Mr. Shannon was made solely for information purposes. I did not ask Mr. Shannon to do anything with respect to the Old Security bid (p. 1103).

When Fitzsimmons was asked why he called Shannon at all, since he had testified previously in connection with the approach by O'Sullivan, that he referred all such inquiries, even from personal friends to the Fund office, he replied:

> I guess when you get out of character and you go from your regular tenor of operation, you shouldn't do it * * * as far as Mr. Kleindienst is concerned, I can't tell you why I did it outside of the fact that I presume I did it for, * * * anybody that is in contact with me here in Washington (p. 1121).

Fitzsimmons was also asked why it was necessary to call Shannon and ask if Old Security were on the invitation to bid list, since Kleindienst had already told him that Old Security was submitting a bid. He indicated that he also wanted to determine if they were a viable company and if they had submitted a bid (pp. 1112–1114). However, Shannon testified that he could not recall Fitzsimmons asking during his February inquiry whether Old Security was a viable company or anything about the bid (pp. 879–880).

Fitzsimmons acknowledged that he called Kleindienst back within a day and told him that his client had submitted a bid and that "being a viable company his bid would be given as much consideration as any other bid," if it was consistent with other bids. Again, Fitzsimmons gave no explanation of why he needed to advise Kleindienst that his client had submitted a bid. He labeled as "untrue" Kleindienst's testimony that he had advised him that Old Security had been deemed qualified by the Fund's insurance consultant, that it had the low bid,

[28] Fitzsimmons said he had no recollection of having had any contacts in April 1976 with Kleindienst prior to the award to Old Security, although he did recall calling Kleindienst after the trustees' Apr. 30 decision to award the contract to Old Security to tell him of the award (pp. 1105, 1109). In this regard, Fitzsimmons testified that in April and in the preceding three to four months, he was preoccupied with intensive labor negotiations and, thus, could not recall precise dates of meetings, phone calls or other details of events leading to the award of the insurance contract to Old Security. (pp. 1104–1105)

and that he thought there was a good chance it was going to get the business (pp. 1109–1114, 1137).

d. *Meeting in Miami.*—According to the testimony of both Fitzsimmons and Shannon. during the week of April 12, 1976, the week following Shannon's recommendation of Prudential, Fitzsimmons called Shannon from Miami and asked if it might not be prudent to let the life insurance coverage remain with Republic National until such time as the Fund could self-insure. Although this was one of the options included in Tolley International's report, Shannon said that he tried to convince Fitzsimmons that, because Republic National was the highest bidder, such a course would undermine the credibility of the Fund's whole bidding process. Shannon said that since he was not sure he had convinced Fitzsimmons, he and Heeren flew to Miami for a personal meeting with Fitzsimmons on April 12 (pp. 886–888, 1104).

Also present at the meeting was then trustee William Presser,[29] who had originally recommended Tolley International to the Fund in 1972 (pp. 887, 897, 953). The Executive Committee of the Teamsters International Union was meeting in Miami at the time. None of the other trustees sat in on the meeting, nor did Heeren. Len Teeuws of Tolley International testified that he was invited by Shannon, but could not attend (p. 944).

According to Shannon, Fitzsimmons agreed that the Fund could not go back to Republic National. Shannon also recalled discussing the Prudential and Old Security bids and pointing out the advantage of the interest Prudential would pay on the reserves. However, no resolution was reached at the meeting as to whether to select Prudential or Old Security (897).

In an investigation by the Securities and Exchange Commission into Hauser's acquisition of a controlling interest in National American Life Insurance Company,[30] Fitzsimmons gave the following sworn testimony concerning his contact with Shannon regarding the Old Security bid:

> I said, "Dan, in reference to the bid as far as the insurance company is concerned, what about Old Security? I understand they have got a bid in." * * *
>
> *   *   *   *   *
>
> * * * He called me back in a day or two and told me then, as far as the bid was concerned, that there was no question that Old Security was the lowest bidder and in that discussion he, Dan, was the man that mentioned to me as far as Prudential is concerned in reference to a long-term contract on the basis of interest on the reserves, that the Fund would partake in some interest on the reserves. I said, "Well, as far as the

[29] In 1971, Presser pleaded guilty to eight counts of an indictment charging him with receipt of payments while President of Teamsters' Joint Council 41 in Ohio from employers whose employees Teamsters' Joint Council represented or sought to represent. (29 U.S.C. § 186(b).) He was fined $12,000. In 1960, Presser was convicted of obstructing an investigation of the Senate Select Committee on Improper Activities in the Labor or Management Field by mutilating and concealing subpoenaed records. He was also convicted in the same year of contempt of Congress for refusing to answer questions posed by that Committee.

[30] The investigation led to a civil action against Hauser, a number of his companies and associates. *SEC* v. *National Pacific Corp., et al.*, Civil Action No. 76–1784, U.S. District Court for the District of Columbia.

> situation is concerned, what is Old Security's bid?" And he said, "For one year," and he says, "It is the lowest bid." I said to Shannon, "Well in that case, why don't we look at Old Security's bid, if it is the lower bid for one year and after one year, if we are going to renew the risk in some way, shape or form at that time, we can negotiate with Old Security on the basis of the bid of Prudential." * * * (p. 1136).

Both Shannon and Fitzsimmons were questioned concerning this testimony. Shannon acknowledged that a conversation along these lines took place, but he said it was during the April 12 meeting, and not during a telephone conversation, and indicated that he did not regard this as a conclusion on Fitzsimmons' part that the award should go to Old Security (pp. 898, 904–905). Fitzsimmons acknowledged that he had such a conversation with Shannon, possibly during the April 12 meeting, and said his SEC testimony, namely, that this took place during his February telephone conversation with Shannon, was in error, and that he intended to correct his SEC testimony (pp. 1136–1139). In January 1978, Fitzsimmons submitted an affidavit, dated December 22, 1977, to the SEC (Appendix L). In his affidavit, Fitzsimmons said that the conversation described above took place "in or about April 1976, a number of weeks after my initial call to Mr. Shannon. * * * "

Questioned about this conversation with Shannon, Fitzsimmons stated that, as a trustee he was looking for the best benefits the Fund could obtain for its participants; that it was his understanding that the Prudential bid offered to return some interest on the reserves in either the second or third year; that it had been pointed out to him that Old Security's bid was lower than Prudential's; and that to the best of his knowledge the Fund's consultant, Tolley International, had stated that Old Security was a viable, well-respected company. Asked by Senator Chiles whether his recommendation was that Old Security be awarded the contract for one year, Mr. Fitzsimmons stated: "* * * you can call it a recommendation, if you care to" (pp. 1136–1139).

Teeuws testified that, following the Miami meeting, Shannon indicated to him that the union trustees were giving serious consideration to Old Security (p. 944). However, Shannon said that he had no belief at that time that the Trustees had decided on Old Security. He said that he was still hopeful that the award would go to Prudential and that he was trying his best to see that it would (pp. 901, 904–905).

As a part of this effort, Shannon again sent agenda material to the Trustees, preparatory to a Trustees' meeting proposed for April 23, 1976. The agenda item relating to the insurance bids was identical in wording to the one that accompanied his April 5 letter and stated that Tolley International had recommended the Prudential bid as the most attractive one received prior to the bidding deadline (exhibit 232; pp. 746, 885). However, because of scheduling problems, the April 23 meeting did not materialize.

e. *"Things are off track"*.—Davidson, Webb and Kleindienst testified that, on at least two occasions during April 1976, Hauser called Davidson and told him that things appeared to be "off track" with respect to the Teamsters award. Davidson then relayed Hauser's concerns to Webb, who relayed them to Kleindienst who in turn called Fitzsimmons (pp. 997, 1002, 1006, 1038–1039, 1066). Kleindienst testified that he called Fitzsimmons on at least one and maybe two such occasions. Kleindienst recalled receiving calls back from Fitzsimmons advising him that he (Fitzsimmons) did not think there was any problem (pp. 1039, 1066). Questioned about Kleindienst's statements, Fitzsimmons stated that they were untrue and emphatically denied having had any such conversation with Kleindienst (pp. 1114–1116).

A series of such contacts appears to have taken place during the period April 22 through 26, 1976. The telephone logs of Kleindienst's former law firm show that on April 22 Kleindienst received a call from Webb; that on April 23 Kleindienst placed calls to Shannon and Fitzsimmons and received two more calls from Webb; and that on April 26 he received a call from Fitzsimmons (exhibit 231, p. 740).

Both Webb and Kleindienst acknowledged that the calls on April 22 and 23 probably related to one of the instances in which Hauser had said things were "getting off track" (pp. 1002, 1038, 1040). Shannon acknowledged that Kleindienst attempted to call him on April 23, but said that he did not get through and that he did not return the call (p. 906). Kleindienst agreed, but said that he did talk to Fitzsimmons and asked him to look into the matter and let him know if there was a problem (pp. 1038–1039).

It was Kleindienst's recollection that Fitzsimmons called him back and told him not to worry, that everything was going to be all right, but that it will take 3 or 4 days (p. 1066). The telephone logs show a call from Fitzsimmons to Kleindienst on April 26. However, Fitzsimmons testified that he could not remember making such a call (p. 1116). He also denied that he gave Kleindienst any such information.

f. *Signs that the decision had been made.*—The record developed by the Subcommittee includes testimony and exhibits which tend to show that the decision to award the contract to Old Security was made well before the Fund trustees formally approved the award on April 30, 1976.

This evidence includes a memorandum of April 21, 1976, (exhibit 201, pp. 592–593) from Richard K. Halford of Old Security to C. Robert Barton, Old Security's president. The memorandum states that it was Halford's understanding at that point that Old Security's agreement reinsuring the Central States business with Family Provider Life (Hausers' company) was to become effective May 1, 1976. Asked how he knew on April 21 that Old Security would receive the award since the trustees did not approve the award until April 30, Halford testified that on about April 15 he had received a phone call from Brian Kavanagh, Roger Carney or John Boden telling him that it looked very positive that Old Security would receive the business. Halford stated that it was his impression that Old Security was going to receive the award (pp. 591–592).

Also, in a sworn affidavit (exhibit 197, p. 559), Halford stated that on April 28, 1976, 2 days before the trustees met to act on the contract, he received a phone call from Rick Heeren, Assistant to Executive Director Shannon of the Teamsters Fund, telling him that Old Security had won the award and would receive an official notification of it shortly. Questioned about this, Halford testified that he was reasonably sure of the date and recalled that following the phone call there was a 1 or 2 day lapse before a telegram confirming the award was received on April 30 (p. 596). Heeren testified that he made no such phone call to Halford, but he acknowledged having sent the telegram notifying Old Security of the award (pp. 917–918).

The Subcommittee also received considerable testimony concerning a meeting that took place in the Fund's offices on April 23, 1976. Those present were Shannon, Heeren and Teeuws. The Fund's insurance coverage was due to expire on April 30. Shannon's efforts to obtain a decision from the trustees had not proved successful. Only two management trustees had responded favorably to his April 5 recommendation of the Prudential bid (p. 902). Neither the third management trustee nor any of the three union trustees had expressed their preferences. The only guidance available at that point appears to have been Shannon's conversation with Fitzsimmons on April 12 in which Fitzsimmons had observed that Old Security might be awarded the contract on a one-year basis with a view to negotiating with them later to obtain payment of the kind of interest on the reserves proposed by Prudential. However, according to Shannon, he viewed that conversation as conjecture and not as positive guidance (p. 904). The concern on April 23, 1976, was that little time remained to work out a transfer of the insurance program to a new carrier. Heeren testified that the meeting included discussion of rumors that Old Security was going to be selected. Shannon testified that he said at the time that it did not look like his recommendation of Prudential was making much headway and that it looked like Old Security was out in front based upon his Miami conversation with Fitzsimmons and since they had heard nothing further about the Prudential bid. There was discussion at the meeting about contacting both Old Security and Prudential to arrange for the change in insurance carriers depending on which company received the award. Heeren said that, following this discussion, Teeuws telephoned an Old Security representative to arrange to get together with them in order to have a plan of action if they did receive the award. However, according to Heeren, the meeting was cancelled the same day at Shannon's direction. Asked why the meeting was cancelled, Shannon said he reconsidered the matter and directed that neither company be contacted because he did not want to create any appearance that he was evidencing any preference for Old Security in advance of the trustees' meeting; that he did not want to interfere in any way with the trustees' prerogatives (pp. 903–904).

In this connection, materials obtained from the Fund's files by subpena included an unsigned, undated document entitled "Needs Regarding New Life Insurance Contract" (exhibit 233, p. 746). The document lists a number of steps that would have to be taken in connection with the transfer of the insurance program from Republic National to Old Security. For example, one of the steps listed was a meeting between the new company officials and Amalgamated to see how Amalgamated handled the Fund's claims. Another step listed was the need for a meeting with new company officials to review and analyze its proposal, "particularly (the) reduction in retention in relation to payments of claims by Amalgamated." As noted earlier, only Old Security (as part of its late amended bid) had offered to reduce its retention if claims were handled by the fund rather than the carrier. The document also includes a footnote stating that "Mr. Carney will be here Monday, April 26, at 10 a.m., with two additional persons to discuss the contract." Both Shannon and Heeren denied any knowledge concerning who wrote the document.

Heeren speculated that it might have been written or dictated by Teeuws at the Fund's offices incident to the telephone call on April 23 to arrange a meeting with Old Security's people; arrangements which, according to Heeren, were cancelled the same day (pp. 912–913). Teeuws testified that he could not recall having prepared this document or anything about it or any pre-April 30 meeting between the Hauser group and Amalgamated (pp. 972–973). Testimony from John Boden, a recorded staff interview with Carney, and travel records obtained by the Subcommittee, show that Carney did travel to Chicago on April 25–26 to meet with the staff of the Fund, but that the meeting did not materialize (p. 612; exhibit 234B, p. 681).

In a sworn affidavit provided the Subcommittee, George W. Lett, a vice president of the Prudential Insurance Company (exhibit 263, pp. 915–916), stated that at no time did anyone representing the fund ask Prudential to deviate from its policy of administering claims internally or ask that the function be transferred to the fund or any entity outside of Prudential. Nor is there any evidence that Prudential was contacted at any time prior to the award to discuss how the insurance program would be transferred in the event they were the successful bidder.

g. *Misleading Financial Information.*—The record before the Subcommittee evidences a deliberate effort by the Hauser group to mislead the Fund concerning the financial resources of Old Security Life Insurance Company well before Old Security was awarded the contract on April 30, 1976. Shannon had asked Len Teeuws of Tolley International for financial information on Old Security some time prior to April 12, 1976 (p. 899). On October 24, 1977, in late compliance with a subpoena dated April 11, 1977, Tolley International turned over to the Subcommittee copies of three internal memoranda dated April 12, 1976 (exhibit 265G, pp. 980–981). The memoranda record telephone calls received and made that day by Teeuws' secretaries. One of the memos is addressed to "Len" (Teeuws) and reads as follows:

April 12, 1976.

Len: Joe Hauser called and demanded that I call Central States and give them the information that I had gotten earlier from Eldridge. Boden was on the line all the time of the call. Boden asked what figures I had—I told him what Eldridge had given me. Hauser said to call Central States and give them only the top figures (Consolidated Total Assets for April 30, 1975 and April 30, 1974) which I did. Also said not to mention the holding company name, just say Old Security Holding Company. Then Hauser wanted me to call him back and let him know if they asked any other questions. Hauser said that you wanted this information relayed—asked

> if Mr. Tolley was in to authorize the release of information—I told him he was in today but out at the moment. He assured me that he would not ask me to do anything that you were not fully aware of. Then Hauser wanted me to telephone him back after I had talked to Shannon's office and let him know if they wanted any additional information, etc., also wanted to know if the meeting was going to be in Miami or Chicago. I told him Miami but I had no idea where—Kathy said she had no idea (p. 981).

The others show that a Fund employee, Don Maxfield, telephoned Teeuws' office the same day in an effort to reconcile certain financial data he had on Old Security with other figures he had received from Teeuws' secretary that he found quite different.

Maxfield was told that the figures he was questioning related to the "Old Security Holding Company." The memoranda show that after having been given this answer Maxfield called Teeuws' office again later that day saying that he could not find any references to a firm known as "Old Security Holding Company" and asking where the figures conveyed to the Fund had come from. The memo, written by "Christy" (Christy Cookerly, one of Mr. Teeuws' secretaries) states: I again did not tell him anything other than that is what I was told—Old Security Holding Company" (p. 980). In other words, these records show that in response to a request for financial data on Old Security Life, Teeuws' office—on Hauser's demand—passed along consolidated total asset figures for ISC Financial Corporation, Old Security's parent company, without clearly identifying them as such. There is no such company as "Old Security Holding Company," nor was there on April 12, 1976.

John Boden acknowledged that he was on the line when Hauser demanded that Teeuws' office pass this data along to the fund. He testified that the name "Old Security Holding Company" was used because Hauser felt it more likely that the people at the fund would relate the numbers to Old Security Life rather than its parent holding company if that terminology was used. Boden said he knew at the time that this was an attempt by Hauser to mislead the Fund concerning Old Security's true financial resources (pp. 653–657).[31]

Questioned about these records, Teeuws acknowledged that they were written by his secretary. He said that he was attending a conference in Bermuda at the time and did not recall ever having reviewed the material or having seen it until shortly before it was transmitted to the Subcommittee. He said that sometime after he returned from his trip to Bermuda he was advised that there had been calls from the Fund and from Hauser or Boden pertaining to "statistical information" about Old Security that had been questioned by Maxfield. Teeuws said he "assumed" the information had been passed on to the Fund by his office, but denied any complicity with the Hauser group in providing misleading information to the fund (pp. 1179–1184).[32]

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[31] As previously noted (p. 88 of this report), in the Arizona Fund case, Old Security advised the Fund that applicable law precluded its holding company from holding the Fund harmless if Old Security failed. Tolley International was not involved in the Arizona case; however, this information was presumably available to it.

[32] As previously noted (pp. 93, 94 of this report), Tolley International furnished a written report to the Indiana Laborers Funds which contained similar misleading financial information showing consolidated holding company assets of $418 million.

While Maxfield was dealing with this matter in Chicago, Shannon was in Miami for his April 12 meeting with Fitzsimmons. Shannon testified that, while he was in Miami, an Old Security representative delivered some financial information to his hotel in response to his request of Len Teeuws of Tolley International. The data consisted of 1974 and 1975 financial statements of the "Old Security Group Companies" and turned out to be the financial statement of the ISC Financial Corporation rather than Old Security. Shannon recalled that the financial statements show assets of about $458 million. In fact, Old Security's assets were only a fraction of the $458 million referred to in the data referred to by Shannon. According to data furnished to the Indiana Laborers Fund, Old Security's assets as of April 30, 1974, showed assets of $23 million which was about equal to the annual premium payable by the Teamsters Fund under the contract awarded to Old Security.[33] As noted above (pp. 14, 30, 198) insurance companies with assets exceeding those of Old Security by hundreds of millions of dollars declined to bid on the Teamsters Fund because they believed its size involved excessive risk exposure, Shannon felt that this material represented a deliberate attempt to misrepresent the financial status of Old Security, and that he had been mislead by it (pp. 899–901).

Shannon conveyed his comfort with Old Security's financial standing to Fitzsimmons (pp. 901, 1112, 1129). This misleading information, as well as representations by Tolley International vouching for Tolley's financial ability, contributed to the trustees apparent perception of Old Security as a substantial and responsible insurance company (pp. 766, 777, 783–785, 794, 1139).

While Tolley International provided this misleading information and vouched for Old Security, its formal written analysis of the bids did not address the relative financial strength, reputation, and ability to perform of the bidding companies. Len Teeuws of Tolley was aware that Old Security was primarily in the business of writing credit life insurance (p. 989),[34] a fact which he did not bring to the attention of the trustees. In an affidavit, trustee Jack Sheetz stated that he had known this, it

> * * * would have opened my eyes a bit. I know credit life. I mean, to me they're not too much, these people go around and you buy a car and they insure it. I don't think much of that (p. 784).

h. *The Dorfman Problem.*—From the record developed by the Subcommittee, it appears that the interest of Allen Dorfman's Amalgamated Insurance Agency in continuing as the claims processing agent for the Teamsters Fund insurance program was a crucial factor not only for in the final award of the business to Old Security, but in Hauser's fear that matters had gotten "off the track" in mid-April 1976.

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[33] Jack Sheetz, one of the trustees who voted for the award to Old Security, stated in an affidavit that he saw data showing that Old Security had "quite a large amount of assets" (p. 784). This may well have been the same data furnished to Shannon.

[34] Old Security's only experience in selling group life, accident and disability insurance contracts to labor union employee trusts was in Indiana and Massachusetts and under the fronting arrangements, Old Security merely collected a percentage off the top of the premiums and performed no substantial service functions.

As noted earlier in this report, when the trustees decided at their October 13, 1977 meeting to terminate Republic National as the insurance carrier, they provided that Dorfman's Amalgamated Insurance Agency, which had been Republic's claims processing agent, would continue to provide such services (exhibit 218, pp. 694–695).[35] At their next meeting in December 1977, which was attended by Dorfman and Amalgamated's president, Mike Breen, the trustees agreed to an Amalgamated request for a flat monthly fee of $455,000 per month for this service, increasing to $480,000 per month over a 3 year period (exhibit 219, pp. 695–697).

Shortly thereafter, Heeren and the Fund's attorney attempted to negotiate a contract with Amalgamated embodying this agreement, at which time they were advised by Breen that Amalgamated, in effect, already had a no-cut claims servicing contract with the Fund. Breen showed them a letter, signed by trustees William Presser and Jack Sheetz, which designated Amalgamated as the Fund's agent for payment of all claims for the 6 year period from March 1, 1973, through February 28, 1979 (pp. 848–850; exhibit 253, p. 856). Because there was a question as to the legality and binding effect on this letter contract, the trustees, on January 31, 1976, entered into a compromise agreement with Amalgamated for 3 of the remaining 4 years on the letter contract (exhibit 217C, pp. 691–694). This new agreement specified that Amalgamated would provide claims services "requested by" the Fund during the term of the agreement at the rates previously agreed to.

However, the record before the Subcommittee shows that Shannon did not want Amalgamated to process the claims under the new life insurance program about to be put out for bids. Both Shannon and Teeuws testified to this effect (pp. 851, 962). According to Shannon and Heeren, they had experienced difficulty in obtaining information from Amalgamated pertaining to claims (p. 865). Heeren stated that there was little cooperation between Fund personnel and Amalgamated on claims matters and that they were typically "at loggerheads on most things" (p. 865). Shannon evidenced concern over rumors that Dorfman may have had an ownership interest in Republic National Life and over the refusal of that company to turn over a listing of its shareholders (pp. 864–865). Both Shannon and Heeren were concerned that Amalgamated had been involved periodically in the solicitation of "add-on" insurance from Fund participants (pp. 868–869). Shannon's testimony made clear his feeling that over a period of years Amalgamated had had too much control over the claims program to the exclusion of the Fund's professional staff. He described the relationship as an unhealthy one; said that the Fund had been "subservient" to Amalgamated for far too long (p. 867); and felt that the Fund should disengage itself from Amalgamated and make other provisions for claims servicing (pp. 867, 924). Shannon also acknowledged that Dorfman's conviction of an offense related to a Central States Pension

[35] In a complaint dated Sept. 29, 1977, seeking to enjoin the Department of Labor from enforcing investigative subpoenas for documents from Amalgamated and other firms with which he is affiliated, Dorfman acknowledged that he is an "employee" and "principal shareholder" of Amalgamated. *Dorfman, et al.* v. *Lippe, et al.*, Civil Action No. 77–C–3635, U.S. District Court for Northern District of Illinois (Appendix) I).

Fund transaction was also a factor in his thinking (pp. 847–848, 850–851, 863–869, 923–924, 962–963).

Given this background, the specifications for the rebidding of the Fund's life insurance program required each prospective bidder to process the claims and to include in its proposal the direct cost of processing claims under the insurance program. This feature of the specifications laid the groundwork for removal of the claims processing function from Amalgamated and Allen Dorfman to the new insurance carrier. Both Shannon and Heeren testified that they viewed the Fund's new agreement with Amalgamated as permitting the award of a life insurance contract under which the claims would not have to be handled by Amalgamated (p. 852). This is supported by a reading of the contract which provides that Amalgamated shall provide services "requested by" the Fund (p. 691).

John Boden testified that on April 25, 1976, he traveled from Los Angeles to Washington, D.C., to meet with Hauser. On Tuesday morning, April 27, 1976, Hauser instructed Boden to meet with Kleindienst at Kleindienst's office at 9 a.m. According to Boden, Hauser described Kleindienst as the former Attorney General of the United States and as a lawyer with close ties to Fitzsimmons. Hauser told Boden that Kleindienst wanted to discuss the details of the Old Security proposal; that he would be very influential with Fitzsimmons on the insurance award; and that it was very important that he (Boden) perform well. Boden met with Kleindienst as instructed (p. 610).

Kleindienst acknowledged that he had requested that Hauser send an officer of Old Security to discuss the company's bid and his representation of the company (pp. 1033, 1050, 1053, 1067). At the beginning of the meeting, according to both Boden and Kleindienst, they discussed Old Security's bid at some length. Afterwards, according to Boden, Kleindienst asked if he would have any objection to using Dorfman's Amalgamated Insurance Agency to process the claims. Boden said that he did not then know who Allen Dorfman was, but that he told Kleindienst he did not think Old Security would have any objection if the service cost no more than $100,000.

According to Boden, Kleindienst then placed a telephone call to Dorfman in his presence. Boden testified that the call was not completed at first, but was completed a short time later during their meeting. Following this call, which Boden testified was made in his presence, Kleindienst told Boden that Dorfman would process the claims for $96,000. Boden also testified that following the call, "Kleindienst then turned to me and said he thought he could now tell me that Old Securiy would get this business." Also, according to Boden, Kleindienst told him that Dorfman would want an agency agreement with Old Security under which he could sell add-on individual whole life insurance policies to eligible Teamsters members on an individual basis. Boden said he told Kleindienst that any such agreement would have to be left up to Old Security and the Fund trustees. At the end of their conversation Kleindienst told Boden that a couple of mutual friends were waiting in another office. Kleindienst placed a phone call, and shortly thereafter Hauser and Davidson joined them in Kleindienst's office. According to Boden, Hauser, Davidson and he remained in Kleindienst's office for about another half an hour engaging in a general social conversation. He testified that no further business was discussed; that Hauser, Davidson and he left the office together; and that he told Hauser privately what had transpired (pp. 610–611, 635–640).

i. *Kleindienst's Testimony.*—Kleindienst was questioned closely concerning this April 27, 1976, meeting and Boden's testimony. He testified that he had no independent recollection of the matter. However, after reviewing his former law firm's records, he acknowledged that the meeting did take place. According to Kleindienst, it resulted from a request he made to Webb, shortly after the Old Security matter was brought to his attention, that an officer of Old Security meet with his to discuss the company's bid. He said that this was the first time he had met Boden; that Boden introduced himself as the actuary who had prepared the Old Security bid; and that the meeting was devoted principally to an examination of the bid (p. 1067).

Kleindienst's testimony differed sharply from Boden's in a number of material respects:

(1) While Boden testified that he found Kleindienst very familiar with the details of the bid, Kleindienst denied this saying that he had talked to no one else about the bid and that the only information he ever received about it came from Boden (p. 610, 1068).

(2) Contrary to Boden's testimony, Kleindienst denied that he placed a telephone call to Allen Dorfman after first ascertaining that Old Security would be willing to use Dorfman's Amalgamated Insurance Agency to process the claims if it received the Teamsters contract. As noted below, the telephone logs show that on April 27, 1976, Kleindienst's secretary placed a call to Dorfman at an unspecified time, and that Dorfman called Kleindienst at 9:51 a.m. (8:51 a.m. Chicago time). Kleindienst's recollection was that Dorfman called him first (p. 1041).

(3) Contrary to Boden's testimony, Kleindienst testified that there was no discussion of Dorfman or Amalgamated prior to Dorfman's incoming call at 9:51 a.m. (pp. 1069–1070). He had no independent recollection of Boden's having been present during his phone conversation with Dorfman, but since the records show that Boden arrived in his office at 9:05 a.m. he could not exclude the possibility (p. 1068). Elsewhere in his testimony, Kleindienst acknowledged that he could have talked to Boden about using Amalgamated to process the claims after his 9:51 a.m. conversation with Dorfman, but not before, as Boden testified (p. 1069). Kleindienst's recollection of the Dorfman call was as follows: that Dorfman said he understood Kleindienst was representing Old Security; that his insurance agency (Amalgamated) had been processing claims for previous carriers under the Teamsters Fund's insurance policy; and that his company was already set up to do the work more efficiently and cheaper than anybody else including Old Security, which would have to establish a claims processing operation. Kleindienst said he told Dorfman that the matter was one to be settled between Dorfman and Old Security, and that he would recom-

mend that somebody from Old Security contact him (p. 1042). Kleindienst recalled that, when Hauser arrived after the discussion with Boden was finished, he asked him to call Dorfman (p. 1068) and that his secretary then placed a call to Dorfman (pp. 1043, 1069). This is at odds with Boden's testimony that after the meeting Hauser, Davidson and he left Kleindienst's office together; that he (Boden) then informed Hauser of Dorfman's interest; and that Hauser told him at the time that there was no way he would do business with Dorfman (p. 611).

(4) Kleindienst flatly contradicted Boden's testimony that following his phone conversation with Dorfman, Kleindienst turned to him, "and said he thought he could now tell me that Old Security would get the business." He specifically disavowed having made any such statement, and said he had no reason to know at that time that Old Security was going to be awarded the business (pp. 611, 1071).

(5) Contrary to Boden's testimony that, during the meeting, Kleindienst and he had discussed the cost of claims processing and an agreement concerning the sale of add-on insurance by Amalgamated, Kleindienst testified that he had no recollection of ever talking to anyone involved about any specific sums of money (pp. 601, 1058, 1070–1071) or about add-on insurance sales (p. 1077).

j. *Davidson-Webb Testimony.*—The record before the Subcommittee shows that a few days before the Teamsters contract was awarded, Hauser told both Davidson and Webb that Allen Dorfman had been trying to reach him by phone for 2 days and that he was not accepting the calls because he felt Dorfman was trying to inject himself into the Teamsters award and because he wanted nothing to do with Dorfman (pp. 997, 1002). Davidson testified that he told Hauser he was right in not accepting the calls and advised him to bring the situation to Kleindienst's attention. Webb confirmed Davidson's testimony (pp. 998, 1002). Although they were not certain of the date, both Davidson and Webb described a meeting between themselves, Hauser and Kleindienst in Kleindienst's office at which Kleindienst was informed of Dorfman's calls, and that Davidson felt Hauser was right in not accepting them. According to Davidson and Webb, Kleindienst reacted strongly to Davidson's advice. Davidson said Kleindienst was angry. Webb said Kleindienst told Davidson to keep out of his law business. According to Davidson and Webb, Kleindienst than had a call placed to Dorfman and put Hauser on the line (pp. 998, 1002). Davidson testified that Kleindienst spoke first to Dorfman and said: "Allen, this is Dick Kleindienst. I have got Joe Hauser sitting here right in front of me and I understand you had been trying to reach him for the last 2 days * * * I am putting him on the phone right now and he will be in to see you tomorrow" (p. 998). Both testified that when Hauser got on the phone he apologized for not accepting Dorfman's calls and promised to take a plane to Chicago to meet with him the next day (pp. 998, 1002). Both Davidson and Webb also testified that they were sure that Hauser did go to Chicago the next day to keep his appointment with Dorfman (p. 1010).

Questioned about this meeting, Kleindienst could not recall ever being in a meeting with both Webb and Hauser prior to the award of the Teamsters contract. However, he did acknowledge that Davidson and Hauser were together in his office on April 27, 1976 (p. 1079). He testified that sometime after his conversation with Dorfman that morning (the 9:51 a.m. incoming call) he did telephone Dorfman; that he told Dorfman that Hauser was in his office; and that he (Kleindienst) wanted Dorfman to talk with Hauser because he had recommended that Hauser meet with him (p. 1071). Kleindienst denied that he had any argument over whether Hauser should see Dorfman, and denied that he had "told" him to do so. He said he "recommended" to Hauser that he talk to Dorfman; that he put in a call to Dorfman; that he put Hauser on the line; that the call was a brief one; and that from what he overheard of the conversation, Hauser was to meet with Dorfman in Chicago the next day (pp. 1079, 1081).

Asked why he recommended that Hauser see Dorfman, Kleindienst gave two reasons: (1) because Dorfman had told him his firm was already set up to process the Fund's insurance claims and could do it more efficiently than Old Security, and (2) because it was his understanding that Dorfman and Fitzsimmons were very friendly and he felt it could not hurt Old Security's efforts to get the business if Hauser paid Dorfman the courtesy of meeting with him in Chicago. He felt the friendship between Dorfman and Fitzsimmons would not hurt Old Security's chances (p. 1080). Asked whether Fitzsimmons had ever mentioned anything to him about Allen Dorfman or Amalgamated having to do the claims processing prior to April 30, 1976, Kliendienst testified that Fitzsimmons never told him the Dorfman firm would have to process the claims. He also said, "I have no specific recollection of talking to Mr. Fitzsimmons about Mr. Dorfman's company. He could have. I don't recall it." He deferred to Fitzsimmon's recollection on the matter (pp. 1040, 1041).

Fitzsimmons appeared before the Subcommittee on November 2, 1977. Apprised of Kleindienst's testimony, he denied that he ever suggested to Kleindienst that he contact Dorfman or Amalgamated concerning the Old Security award. He testified that he was absolutely certain that he had not (p. 1117).

k. *Pre-award Meetings with Amalgamated.*—Travel records obtained by the Subcommittee show that Hauser traveled to Chicago to see Dorfman on April 28, 1976 (exhibit 234, p. 681). According to Boden, Hauser called him from Chicago that day and told him they were going to get the business, but that someone had to come to Chicago to talk to Sol Schwartz of Amalgamated about claims processing and arrangements for add-on business (p. 612). Travel records, an affidavit obtained from Schwartz, and a letter of May 17, 1976 from Roger Carney to Richard Heeren show that Carney and Brian Kavanagh then met with Schwartz and others at Amalgamated the next day, April 29, 1976 (p. 612; exhibits 234A, 234B, 235; pp. 746–748).

The entries in the Kleindienst law firm's logs for April 27, 1976, are in accord with Boden's testimony regarding his visit to Kleindienst's office on that date. They show that Boden arrived at 9:05 a.m.; that a call was placed to Dorfman by Kleindienst's secretary at an unspecified time; that Dorfman called at 9:51 a.m.; that Webb called at 10:30 a.m.; and that a Jack Mills called from the Amalgamated Insurance Agency telephone number at 10:44 a.m. (exhibit 231, p. 741).

l. *Old Security Bid Lowered.*—Richard Halford of Old Security testified that:

> In late April, I received a phone call, probably from Roger Carney. He said that the Central States Fund had requested that Amalgamated Insurance Agency Services, Inc., be the sub-administrator on the Central States Fund group business and he asked if we would agree to a reduction of the retention from 3 percent to 2.6 percent, with the Central States Fund paying Amalgamated directly for its services. I told him that we would agree to this, as we felt that this was a fair price in view of the fact that Amalgamated would then be performing the bulk of the administrative work (p. 559).

Thereafter, on April 29, 1976—the day prior to the award—a wire was sent to the Fund trustees, over the signature of Halford, stating that "if Old Security does not process nor bear the expense of processing the claims, our previously quoted retention of 3 percent will be reduced to 2.6 percent" (exhibit 237, p. 748). Halford stated that he did not authorize nor send this wire, but he did not object to it since it accurately reflected his previous agreement with Carney (pp. 598–599).

Shannon indicated that his staff played no part in the reduction in retention (p. 919). Shannon and Heeren also testified that they did not know of the pre-April 30 contacts between Amalgamated and Old Security representatives until after April 30 and that they then objected to them as violations of Fund policy (pp. 907–912).

The April 29 wire appears to have set the stage for the action taken by the trustees the following day. The record as a whole indicates very strongly that the arrangement worked out during Hauser's visit to Dorfman on April 28 was a condition precedent to Old Security receiving the award. In addition to the facts and circumstances discussed above (see in particular pp. 138–140 and 142–147), C. Robert Barton, former president of Old Security, stated in a sworn affidavit to the Subcommittee that he had been told by Hauser associate Brian Kavanagh that one of the reasons Old Security was awarded the Central States business was the company's willingness to have Amalgamated service the claim function (exhibit 238, p. 751). Also, as discussed below (see pp. 149–152), the trustee's acceptance of Old Security's proposal to permit Amalgamated to process claims was consistent with the contemporaneous action of the trustees to grant Amalgamated a long-term extension on its claims processing contract with the Fund.

m. *Testimony of Allen Dorfman.*—Allen Dorfman appeared before the Subcommittee on November 1, 1977, in response to a subpena. He was asked questions concerning his occupation, his April 27, 1976 conversation with Kleindienst, and whether it was a condition of the contract award to Old Security that Amalgamated by permitted to process the claims and write add-on business. On the advice of counsel, Dorfman asserted his rights under the Fifth Amendment of the Constitution and refused to answer any of the Subcommittee's questions concerning his role in the Old Security award, including whether an agreement was reached on the occasion of his conversation with Kleindienst whereby Amalgamated would process claims for $96,000; and whether it was a condition of the Teamsters Fund award that Old Security allow Amalgamated to process claims and sell add-on insurance to Teamsters Fund participants. Dorfman also declined to respond to Senator Percy's inquiry as to how Dorfman justified the $22 million Amalgamated had received since 1970 for processing Teamsters Fund insurance claims (pp. 1026–1028).

6. The Award

Old Security was awarded the $23,000,000 Health and Welfare Fund insurance contract by the Fund's trustees on April 30, 1976. The portion of the minutes of the trustees meeting at which the award was made (exhibit 239, pp. 753–754) contains a brief description of an oral presentation by Len Teeuws of Tolley International which includes the following statement:

> Based upon an analysis of all insurance bids, it was the recommendation of Tolley International Corporation that Old Security Life Insurance Company be selected by the Fund on a short term basis. After one year, the Fund can reevaluate its experience with Old Security Life Insurance Company and make a decision on how to proceed in the future (p. 754).

This Tolley International recommendation was, in effect, the same alternative that Fitzsimmons had discussed with Shannon during their April 12 meeting in Miami (p. 109 above, p. 1138). However, Fitzsimmons testified that he had never discussed the matter with Teeuws (pp. 1125, 1136–1139).

The minutes of the April 30 meeting conclude:

> After a full discussion, a motion was made, seconded and unanimously carried to accept the proposal of Old Security Life Insurance Company to provide Life Insurance, Accidental Death and Dismemberment and Total and Permanent Disability insurance coverage for the Fund for one year commencing May 1, 1976. The Trustees also approved the payment of claims by the Fund (as opposed to payment by the insurance company itself) provided that Old Security Life Insurancé Company would reduce its retention charges accordingly (p. 754).

The Subcommittee staff interviewed all of the persons who were then trustees and voted for this motion, except William Presser who declined to be interviewed. All stated that they had not been contacted by anyone on behalf of Old Security, and that they relied entirely on the Tolley International's recommendations in voting for Old Security. The three management trustees, John F. Spickerman, Jack A. Sheetz, and Thomas J. Duffey, signed sworn affidavits regarding the matter (exhibit 240A, B, C, pp. 754–794).

Teeuws testified that he recommended Old Security because the Trustees had indicated that they wished to remain insured only on an interim basis, until they could become self-insured (pp. 944–945, 973–974, 1184–1185). Fitzsimmons indicated that this was also his reason for favoring Old Security and that he too relied on the advice of Tolley International. He also testified that he did not promote Old Security to any of the other trustees (pp. 1101, 1103–1105).

There is no indication in the minutes of the April 30 trustees meeting or otherwise in the record that there was any discussion concerning the discrepancy between Tolley International's recommendation at the meeting and the April 5 and 23 agenda reporting a recommendation of the Prudential bid by Tolley (p. 754), nor was there any indication that the trustees inquired as to whether all bidders were given an opportunity to reduce their retention if relieved of the claims processing function. There is no indication that any inquiry was made as to the nature of any negotiations upon which the reduction in Old Security's retention was based. Also, the Fund Executive Director Shannon remained silent at the meeting and did not advance his own recommendation (previously communicated in two meeting agendas) or challenge Tolley's apparent change in position (p. 871). In response to a question by Senator Percy as to why he remained silent, Shannon gave this explanation:

> Possibly I should have said something, although I would have been out of order to say something. Here they had hired a consultant, they had paid him money, they asked for this analysis, they asked him to stand up at the meeting, make the analysis. One or two of the trustees said give us one name of the two names, Prudential or Old Security, and Old Security was given at that time.
>
> I think you have to take it in the context of at that time, not in hindsight, but on foresight, that here we went out with a good company to consult within an insurance market, to get off of Republic National; to make sure we complete our self-funding program, to go forward in a very short period of time with Old Security and possibly complete that funding program.
>
> *　　*　　*　　*　　*
>
> I talked to John Spickerman on the phone and told him my specific recommendation for Prudential. I talked to Jack Sheetz on the phone and told him my specific recommendation.[36] How long do you beat a dead horse, Senator?
>
> You know, that horse will lie there until hell freezes over because it is dead. I am sure you are both management experienced and with your legislative experience, you recognize when you beat and you continue going on, I felt at that point, it was most important that we did not continue with Republic National after April 30, and that we had all the representations, that we were going with a good company, Old Security, and we could take that representation on a 1-year basis.
>
> I could come back and fight another time. So you fall back a little bit. You come back, at a future date, to fight, if you are right and I have been proven right on the basis of hindsight (pp. 891–892).

Shannon also acknowledged that, on the basis of hindsight, he should have spoken up at the April 30 meeting (p. 892).

[36] Shannon was referring to pre-April 30 discussions with trustees Spickerman and Sheetz that were in apparent reference to the April 5 agenda Shannon sent the trustees soliciting their approval of his Prudential recommendation.

Fitzsimmons called Kleindienst on April 30, 1976, and advised him that the contract had been awarded to Old Security. However, he maintained that his knowledge of Kleindienst's interest in the matter played absolutely no part in the ultimate award of the insurance contract to Old Security (pp. 1105–1109).

On the other hand, Kleindienst testified that he had been very optimistic on the basis of his telephone conversations with Fitzsimmons. He said that he thought his relationship with Fitzsimmons, his impression of Fitzsimmons' regard for him and his opinions and the credence that Fitzsimmons would give to his representations probably helped Old Security (pp. 1039–1055).

a. *Amalgamated Letter Contract.*—The record shows that on April 30, 1976, the same day the insurance contract was awarded to Old Security, a letter contract was drawn up designating Amalgamated as the Fund's agency for paying all of its insurance claims for a period of 10 years running from June 1, 1976 until May 31, 1986 (exhibit 252; pp. 852–856). The letter contract was signed only by then trustees William Presser and Jack Sheetz [37] and stated that it was made pursuant to a resolution adopted by the trustees; however, there is no evidence of any prior resolution. In an affidavit, Sheetz stated that the first time he saw the letter contract was when Presser handed it to him on June 7, 1976 and at which time he signed it (pp. 788–789). The minutes of a meeting of the trustees on June 8, 1976, stated that "the trustees attention was brought to the fact that consideration should be given to the extension of the Amalgamated Insurance Agency contract. As a result of such consideration, the trustees instructed counsel to draft an amendment to the current Amalgamated Agreement (dated January 31, 1976) stipulating an extension of 7 years (or 10 in total) with the price to be negotiated yearly during each of the 7 last years (exhibit 254, p. 857). This action was taken without consideration of alternatives such as the solicitation of competitive bids or the possibility of the Fund performing its own claims processing internally. In this regard, Shannon and Heeren testified that the Fund would be able to process claims by $2 to $3 million per year less than the $6 million charged by Amalgamated (p. 924). Shannon also said that the Fund would have undertaken the performance of that function by the termination of the Amalgamated contract in February 1979 (pp. 924–925).

After adverse publicity concerning the Fund trustees June 8 action and after receiving an opinion from counsel that the April 30 contract was unenforceable because the price was not specified, the trustees voted on August 2, 1976 to rescind their June 8 ratification (exhibit 254, pp. 857, 894–895).

The record also shows that on September 7, 1976, Shannon obtained a further legal opinion that the August 2 rescision was proper; the opinion stated that any implementation of the letter agreement would be a "prohibited transaction" under Section 406(a)(1)(C) of ERISA and that the actions of Sheetz and Presser and the June 8 ratification of their actions by the full board of trustees constituted breaches of fiduciary duty under ERISA (exhibit 255; pp. 857–869). The opinion further noted that the rule of prudence under ERISA dictated

[37] Presser and Sheetz resigned as trustees in October 1976.

an extensive search be instituted of service organizations—and possibly competitive bids be obtained before such a contract is let by the Fund.

The position taken by Shannon as Executive Director of the Fund was that the April 30 letter did not constitute a valid and enforceable contract. Amalgamated contends that it did (exhibits 256, 257, 258, 259, 260, pp. 860–862).

In the meantime Amalgamated has continued to operate as the Fund's claims processing agent under the January 31, 1976 contract, and according to Shannon's testimony was continuing to solicit individual Teamsters for add-on insurance business as late as July 19, 1977 (pp. 868–870, 926).

On July 19, 1977, the Fund's new board of trustees appointed after a Federal joint task force investigation of the Teamsters Pension Fund forced the resignations of the former trustees,[38] voted an additional 10 year extension of the Fund's agreement with Amalgamated, despite Shannon's recommendation to the contrary. The Fund's attorney has taken the position that this was only an agreement in principle to extend Amalgamated pending resolution of certain areas of controversy between Amalgamated and the Fund (pp. 838–843, 847–848, 866–870). As of the time of the Subcommittee's hearings in November 1977, the Fund's position was that the only existing contract between the Fund and Amalgamated was the January 31, 1976 contract (p. 841).

Subsequent to the Subcommittee's public hearings, the controversy concerning the Fund's relationship with Amalgamated has continued. In August 1978, the Fund solicited bids from Amalgamated and six insurance companies [39] on a contract for the period March 1979 through February 1982 to process insurance claims. Amalgamated, Blue Cross-Blue Shield and Travelers submitted bids. The bid analysis performed by the Fund's executive director, John Dwyer,[40] showed Amalgamated to be the low bidder. Before the contract was executed with Amalgamated, the Department of Labor instituted a civil action on October 16, 1978 against the current and former trustees and Dwyer [41] seeking, among other things, a court order enjoining the execution of the new contract with Amalgamated, appointing a temporary receiver for the Fund for the purpose of acquiring processing claim services which are most advantageous to the Fund; and requiring the defendants to reimburse the plan for losses incurred by the plan as a result of breaches of fiduciary duty arising from its retention of Amalgamated's services, *Marshall* v. *Robbins, et al.*, Civil Action No. 78–C–4075, U.S. District Court, Northern District of Illinois (Appendix I). The Department of Labor's claim is predicated upon alleged violations of the fiduciary provisions of ERISA by reason of the trustees failure to adopt and adhere to adequate competitive bid procedures.

On November 1, 1977, the District Court denied the Department's motions for a preliminary injunction and temporary restraining order to prevent the execution of the contract pending outcome of the case. After the Court of Appeals denied the Department a stay pending

[38] See the Subcommittee's Hearings on the Teamsters Central States Pension Fund, July 18, 1977, pp. 10–14, 19–20. Frank Fitzsimmons, John Spickerman, and William Presser resigned as trustees of the Teamster Health and Welfare Fund at the same time they resigned as trustees of the Pension Fund.

[39] Prudential, Metropolitan Life, Equitable, Blue Cross-Blue Shield, Travelers and Aetna.

[40] Daniel Shannon resigned in April 1978.

[41] The Fund and Amalgamated have intervened as party defendants.

appeal, the Department moved for voluntary dismissal of its appeal of the District Court's denial of preliminary relief. The Court of Appeals granted the motion on December 14, 1978. The agreement between the Fund and Amalgamated was executed on January 31, 1979.

On June 25, 1979, the District Court granted the defendants' motion for summary judgment as to the Department's claims for equitable relief. The Department is presently appealing that decision.

b. *Aftermath of the Insurance Award.*—The contract between Old Security and the Central States Fund remained in effect for only three months, from May through July 1976, at which time the fund cancelled the contract and transferred the business to Travelers Insurance Company. The Subcommittee's investigation shows that during the period the contract was in effect the Fund paid out a total of $7,028,000 in premiums against which only $344,009 in claims was paid to union members (exhibit 1A and B, p. 13). The investigation also showed that most of the remaining money was diverted by Hauser and his associates to other purposes (exhibit 243, p. 681).

(1) Diversion of Teamsters Premiums

The misuse of Teamsters premiums began immediately after the Fund, on May 10, 1976, paid the deposit required by the Old Security Contract and the May 1976 premium. The amounts were $1.7 million and $1.76 million respectively (exhibit 208, pp. 652–653). According to John Boden and an affidavit of C. Robert Barton, the former president of Old Security, two checks for these amounts were given to Barton that day at a meeting in the Fund's offices attended by Barton, Shannon, Heeren, Boden and Kavanagh. Arrangements had been made for a representative of the Continental Illinois Bank of Chicago to come to the meeting to pick up the checks and documents and signature cards needed to open an account at that bank. The $1.7 million check was to be deposited immediately. The larger check was to be held a few days to permit the Fund to liquify assets sufficient to cover the check. The account was to be opened in the joint names of Old Security and its reinsurance partner, Hauser's Family Provider Life Insurance Company. Boden was the only person in the Hauser group authorized to be a signatory on the account.

The bank's representative was delayed in getting to the meeting, and because of other commitments, Barton, Boden, Shannon and Heeren departed before he arrived. Barton gave Kavanagh the $1.7 million check to deposit which he did, and the account was opened that day (pp. 615–616, 750–751).

The next day, according to Boden, Kavanagh telephoned the Continental Illinois Bank and wire transferred $1.5 million from the newly opened account, on which he was not a signatory, to an Old Security-Family Provider account at the First National Bank of Arizona in Phoenix. Boden then called the Arizona Bank and transferred the money to various other accounts controlled exclusively by the Hauser group (pp. 616–617, 896). Among the accounts was one owned by the Great Pacific Corporation, a holding company created by Hauser. Family Provider was a subsidiary of Great Pacific.

(2) The Kleindienst Fee

Of this $1.5 million $200,000 was used to cover a portion of a Great Pacific Corporation check for $250,000 which Boden, at Hauser's direction, wrote to Kleindienst's law firm on May 3, 1976. Kleindienst shared half of this $250,000 fee with Webb and Davidson (exhibit 241; pp. 676–677). According to Boden, when he asked Hauser what the $250,000 fee was for, Hauser told him that he was going to hire Kleindienst as General Counsel for Great Pacific and that, while Kleindienst had been helpful in obtaining the Central States award, that was "small potatoes" compared to other business Kleindienst could get for them (p. 613). On May 3, 1976, Kleindienst wrote a letter (exhibit 267, p. 999) to Webb forwarding him a check for $125,000 "constituting your one-half of the fee paid by the Great Pacific Corporation in connection with professional services which were jointly rendered prior to Friday, April 30, 1976." Thus, it is clear that the fee was for services rendered prior to the award of the Teamsters contract.

Kleindienst acknowledged that Hauser retained him as General Council of Great Pacific on April 30, 1976, to represent Great Pacific in the acquisition of Great American Life Insurance Company of New Jersey and a related property known as Continental Homes and Country Club, in Arizona (p. 1080; exhibit 269, pp. 1094–1095). Boden testified, and the Subcommittee's investigation shows, that $1.1 million of the $1.5 million diverted from the Teamsters initial premium payment was used to cover a check written as part of a $2 million down payment on this purchase (pp. 616–617; exhibit 242). However, Kleindienst denied that he was aware of the source of these funds until some time close to the date of the hearing before the Arizona Department of Insurance, held on May 24, 1976. (See discussion below of the Arizona inqury.)

As noted earlier, Boden testified that Hauser wanted to purchase control of a broadly licensed insurance company so as to be able to continue his operation in case Farmers National was forced out of business by the Florida authorities, and also to avoid having to continue to share the profits with Old Security under the reinsurance agreements. Great American, which was licensed in 48 States, would have met that need. According to Boden, in order to obtain the approval of the purchase by the New Jersey Department of Insurance, they told the Department that Great Pacific had acquired $1.8 million of the down payment through a dividend from its Arizona based subsidiary, The Family Provider Life Insurance Company (p. 618).

c. *The Arizona Inquiry.*—According to the testimony of Governor Bruce Babbitt of Arizona, after receiving this information from the Hauser group, the New Jersey Department of Insurance made an inquiry of the Arizona Insurance Department concerning the purported dividend.

Based on this information, the Arizona authorities reviewed Family Provider's latest annual statement and found that the company's assets totalled only $255,000. They immediately notified Family Provider's local counsel and ordered a meeting for May 18, 1976 to explore the situation. Prior to the meeting, the Arizona Department contacted Old Security to inquire about its relationship with Family Provider and advised that $1.5 million of the Teamsters premium deposit payment had been transferred without authority from Chicago to Phoenix (p. 546).

John Boden, who was then President of Family Provider, represented the company at the May 18 meeting. He told the Arizona authorities that the $1.5 million was part of a $1.8 million dividend distributed to Great Pacific by Family Provider and maintained that sufficient securities had been given to the Chicago bank to cover the $1.5 million. He described the situation as "a misunderstanding" on Old Security's part and contended that Family Provider's surplus was adequate to support the $1.8 million dividend. The meeting ended with the Arizona authorities giving Boden 48 hours to rescind the dividend and return the money to Family Provider (p. 546–547).

Boden testified that when Hauser learned of the Arizona demand he did not want to return the dividend, and asked Kleindienst, who was by then General Counsel of Great Pacific, to contact the Arizona authorities. According to Boden, lengthy discussions were held in Kleindienst's office between Kliendienst, Hauser, himself and others of the Hauser group to devise a course of action. Boden testified that:

> We agreed to put the money back into Family Provider bank accounts but not in Arizona banks. We figured that if the money ever returned to Arizona, the State insurance department would seize it (pp. 618–619).

Boden said that the plan was to have two banks in which the Hauser group held sufficient funds—the Provident Bank in Cincinnati, Ohio ($1.1 million) and the Diplomat National Bank in Washington, D.C. ($700,000)—to send written confirmation to the Arizona Department stating that they held deposits in those amounts, totaling $1.8 million in Family Provider accounts. Boden testified as follows:

> "* * * This required the cooperation of the American Financial Corp. and the Provident Bank in Cincinnati. Specifically, American Financial had to agree to transfer the earnest money on the Great American-Continental Homes purchase into a Family Provider account in the Provident Bank. Kleindienst requested the Provident Bank to wire the Arizona insurance director that Family Provider had a $1.1 million unencumbered deposit there. He also requested the Diplomat National Bank to send a similar telegram stating that Family Provider had $700,000 there (p. 619).

A letter to the Arizona Insurance Department from the Diplomat Bank stated that $700,000 was on deposit for Family Provider and unencumbered (pp. 1085–1086). A telegram from the Provident Bank confirmed that $1.1 million was on deposit in Family Provider's account, but made no reference to whether or not the funds were encumbered (p. 1085). In fact, the $1.1 million at the Provident Bank was encumbered, since, as Boden indicated in his testimony, it constituted part of a down payment on the purchase of Great Pacific of certain properties from Continental Homes, Inc. and the Great American Life Insurance Company (pp. 617–619, 1086).[42] Continental Homes, Great American, and Provident Bank were subsidiaries of American Financial Corporation.

In his testimony, Kleindienst acknowledged making requests of both banks that they send communications to the Arizona Insurance Department confirming Family Provider deposits. However, he denied

[42] As indicated later, the purchase was not consummated.

that he had any knowledge that the Provident Bank deposit was encumbered until he read Boden's October 28, 1977, testimony about the encumbrance (p. 1085). In this connection, Kleindienst was asked about a letter, dated May 20, 1976, to Continental Homes, Inc., an affiliate of American Financial Corporation, from Great Pacific Corporation. The letter was signed by Brian Kavanagh. The letter referred to previous agreements, dated February 3, 1976 and May 20, 1973, providing for the purchase by Great Pacific of certain Continental Homes properties.[43]

Kleindienst acknowledged that the letter reflected that the $1.1 million was still encumbered, but testified that "To the best of my recollection, that is the first time I have ever seen or heard of that letter" (p. 1086).

The communications sent by the banks did not satisfy the Arizona authorities (p. 619). A hearing was ordered in Phoenix on May 24, 1976 (p. 547). According to Boden, it was decided that Kleindienst would represent the Great Pacific at the hearing in the hope that his past associations in Arizona would prove helpful (p. 619).

At the hearing in Phoenix, Boden, as president of Family Provider, admitted that the $1,800,000 dividend was attributable to union trust fund insurance business. He also entered into a commitment that the $1.8 million would not again be paid to Great Pacific without obtaining the approval of the Arizona Insurance Director (pp. 547, 619). In addition, Kleindienst assured the Director that no dividend would be paid out by Family Provider without the consent of the Arizona authorities (pp. 547, 619). In papers filed in litigation by the Arizona Director of Insurance as receiver for Family Provider the Director of Insurance stated that at the May 24 1976 hearing, Boden represented in Kleindienst's presence that the Family Provider funds in the Provident Bank account were unencumbered. (Plaintiff's opposition to Defendant Kleindienst's motion for Protective Order, Appendix F.) Based on these representations, the Arizona Department vacated its proceeding, and any imposition of penalties that might have resulted (p. 548 and Appendix F).

The Arizona inquiry shows that while these activities were underway in Phoenix, and despite Boden's commitment that the $1.8 million in Family Provider accounts would be preserved, Hauser wrote substantial checks against Family Provider funds on deposit at the Diplomat Bank. On May 18, the same day Boden met with the Arizona authorities, Hauser withdrew more than $20,000 for what appears to have been personal purposes. On May 26, 2 days following the Phoenix hearing, he transferred $160,000 of Family Provider's money to Great Pacific. And on June 3 he wrote two checks to Great Pacific for $100,000 and $250,000 respectively. Additional checks totalling $56,000 were written against the Family Provider account during the period June 2–10.

On June 9, the $1.1 million held for Family Provider in the Provident Bank in Cincinnati was transferred to the Family Provider ac-

[43] The letter states in part:

Pursuant to the agreements, Great Pacific has deposited with you $1.1 million to implement the purchase of the aforesaid properties. Great Pacific hereby directs and authorizes you to release and transfer said $1.1 million deposit to the Family Provider Life Insurance Co. of Phoenix, Ariz., into its account at the Provident Bank Cincinnati, Ohio (p. 1086). * * *

count at the Diplomat Bank. On June 11, Hauser wrote a check in that amount to Great Pacific. Thus, 18 days after the Arizona authorities had been assured that the Family Provider funds would be preserved, the money was gone. The Arizona authorities were given no notice of these payments of Family Provider funds to Great Pacific (pp. 527–529, 548).

d. *Purchase of National American Life Insurance Company.*—The New Jersey Department turned down the Hauser group's application to purchase Great American Life Insurance Company on May 28, 1976. Moreover, according to the affidavit of Richard Halford of Old Security (exhibit 197, pp. 557–560), Old Security decided as a result of the $1.5 million unauthorized transfer of the Teamsters' money, the adverse publicity the Teamsters Fund was receiving, and a continuing dispute with Family Provider over control of the reserves, that they wanted to terminate its involvement with the Teamster Fund contract and the reinsurance agreement wih Farmers National and Family Provider.[44]

Boden testified that, when it became clear that the New Jersey authorities were not likely to approve Hauser's purchase of the Great American Life Insurance Company, they began to look elsewhere for an available carrier, and asked Kleindienst's firm to research the insurance licensing and holding company laws, to identify States with the least restrictions. According to Boden, Hauser and he wanted to avoid having to seek approval from another State agency (p. 629). Kleindienst denies that he or his firm performed such research. He ackowledges, however, that a member of his firm did locate an insurance company that was available for purchase in Louisiana—the National American Life Insurance Company (NALICO), and that he was advised by Louisiana counsel for NALICO that the property could be purchased without the approval of State authorities. He conveyed this information to Hauser and, at Hauser's direction, entered into negotiations for the purchase (pp. 1088–1089).

As in the case of the attempted acquisition of Great American, Boden says that a "clean" company was needed to carry out the NALICO purchase (p. 630). Accordingly, a new firm, the National Pacific Corporation was incorporated in the State of Delaware on June 8, 1976. The Kleindienst firm did the necessary legal work, drew the contracts needed for National Pacific's purchase of NALICO, and represented the Hauser group in the negotiations. The required down payment was $2 million in cash (p. 1089).

Settlement of the NALICO purchase took place at a meeting in Baton Rouge, La., on June 14, 1976. Boden testified and investigation shows, that in order to obtain the down payment, Hauser transferred $1.8 million from the Family Provider accounts in Cincinnati and Washington to a Great Pacific Corporation account at the Diplomat Bank (p. 633). On June 11, he wrote a check for $1.8 million on that account payable to National Pacific. This check was part of the down payment. The $200,000 balance was obtained by Hauser, in cash. Ac-

[44] The affidavit of Barton, the former President of Old Security, and the testimony of Boden show that Old Security had been aware of the $1.5 million diversion since the day it occurred. They had agreed to accept as a replacement the Golden Horn Mortgages, which had a face value of $2,200,000 but which were in fact, worthless (pp. 662; exhibit 238, pp. 748–752). See pp. 75–77 of this report for discussion of Golden Horn mortgages.

cording to Boden, Hauser appeared at settlement with this $200,000 in cash in a briefcase and showed it to those present, including Kleindienst.

As noted above, the Subcommittee's investigation showed that $1.8 million of the down payment came out of the deposits at the Provident and Diplomat National Banks, which were not supposed to be moved without notifying the Arizona Insurance Department. Governor Babbitt testified that no such notification was ever received (exhibit 242; pp. 528–529). In this connection, Boden testified that:

> On Friday, June 11, 1976, or Saturday, June 12, 1976, before the settlement was to take place in Baton Rouge, La., I called Kleindienst and told him that we could not transfer the $1.8 million out of the Family Provider bank account without causing a lot of problems in Arizona and elsewhere.
>
> Kleindienst told me in effect not to worry about it that we should transfer the money and fix it up later (p. 630).

Kleindienst denied repeatedly that this conversation occurred and testified that he did not know where the money had come from. He also stated that he had asked Hauser and his associate, Melvin Wyman, whether or not the $1.8 million had anything to do with the moneys covered by the Arizona Insurance Department directive, and that they assured him that it had not (pp. 1062–1064, 1090–1091, 1094). However, Boden's diary, a copy of which was obtained by the Subcommittee, contains an entry for June 11, 1976 which reads:

> Kleindienst—money not out of PFL [Family Provider Life] but to National American. Told K (1) FPL can not transfer to GP [Great Pacific] (2) must be done through reinsurance. He said we should fix up later (exhibit 204; pp. 630, 1090).

Kleindienst testified that he had never received such a call from Boden, and that he would have terminated his representation of the Hauser group if he had received any indication that the funds used for the NALICO settlement had been removed from Family Provider accounts contrary to his representation to the Arizona insurance authorities (p. 1063). It was Kleindienst's position that he had no reason at that time to feel that Hauser and his people were not what they represented themselves to be, namely substantial businessmen who were able to support their transactions (pp. 1093–1094).

The Subcommittee's investigation shows that following the consummation of the NALICO purchase on June 14, 1978, NALICO, in separate agreements with Farmers National, Family Provider and Old Security assumed all of their positions in the existing reinsurance agreements, thereby consolidating all of the labor union insurance business of the Hauser group in the new company (exhibit 10B, C, D, E, F, p. 62). As a result, Old Security also turned over to NALICO almost $2,500,000 representing the remainder of the reserves on the Teamsters business less expenses, the $1,500,000 which had been diverted previously, and Old Security's 20 percent share of the profit, which came to $1,405,000. Old Security also passed on to NALICO the worthless Sage mortgages which they had been holding in lieu of the $1,500,000 of diverted premium money (exhibit 243, p. 681). These transactions took place despite the fact that the Hauser group had sought and was denied permission from the Central States Fund to transfer the Teamsters insurance to NALICO.[45] The insurance contract and the Teamsters premiums were transferred anyway (pp. 560, 568, 662, 832–833, 927, 1092, 1105, 1115).

On June 24, 1976, the Arizona Director of Insurance filed a complaint in the Maricopa County Superior Court against Kleindienst, Family Provider, Boden and Great Pacific. The preceding was instituted after the Director of Insurance learned of the withdrawal of funds in violation of the commitment Kleindienst and Boden made at the May 24 hearing. Kleindienst objected to being named as a defendant and furnished an affidavit, that, prior to the filing of the Director's complaint, he had no knowledge that the rescinded dividend moneys that were placed in the Family Provider bank accounts had been removed (p. 549).

Governor Babbitt testified before the Subcommittee that, on the basis of the affidavit, Kleindienst was dismissed as a defendant. However Governor Babbitt stated that "later investigation casts considerable doubt upon the plausibility of that avowal" (p. 549). In this regard, Governor Babbitt stated:

> It appears that Kleindienst had several meetings with the Hauser group at the time of the formation of National Pacific and negotiated on their behalf in the NALICO transaction [discussed below]. It is difficult to believe that the approximately $2 million used as a down payment could have been blithely viewed by a sophisticated attorney as coming from a source other than the Family Provider distribution (p. 549).

On December 20, 1976, Family Provider was placed into receivership (p. 551). On December 19, 1977, J. N. Trimble, in his capacity as Director of Insurance of Arizona and receiver for Family Provider instituted a civil action against Hauser, Kleindienst, Thomas Webb, Irving Davidson, Kleindienst's former law partners Welch, Morgan, and McNelis. *Trimble* v. *Kleindienst, et al.*, Civil Action No. 77–2152, U.S. District Court for the District of Columbia. Trimble sought recovery of the $250,000 fee paid by Hauser to Kleindienst and his firm, and split with Webb and Davidson. The complaint alleged that services rendered by Kleindienst and his law firm and Webb and Davidson conferred no benefit upon Family Provider or Old Security, and that receipt of such fee constitutes, among other things, unjust enrichment. The complaint also included allegations that Kleindienst, Webb, and Davidson conspired with Hauser and others to defraud Family Provider of $1.5 million of the $1.7 million insurance premiums paid by the Teamster Fund by misrepresenting or ratifying misrepresentations to the Director of Insurance that the Family Provider funds in deposit were unencumbered and those funds would not be removed without notice to the Director. (Complaint in *Trimble* v. *Kleindienst et al.*, Appendix F.)

Pursuant to a settlement in January 1979, Welch, Morgan and McNelis returned $66,000 to Trimble. As part of another settlement, Kleindienst, Webb, and Davidson each agreed to return $50,000.

[45] Shannon testified that in late June, Kleindienst called and asked if Old Security's business could be transferred to NALICO. Shannon objected as did Fitzsimmons a few days later in a conversation with Kleindienst (pp. 927, 1105).

Upon receipt of the payments the receivers agreed to dismiss the actions against settling defendants with prejudice. Also, in June 1979, the court rendered a judgment against Hauser in the amount of $1.4 million. (Settlement Agreements, Appendix F.)

In the course of discovery in this case, an issue arose as to whether Kleindienst obtained knowledge of the encumbrance on Family Provider funds from James Evans (an attorney and agent of American Financial Corp., parent of Provident Bank) prior to the aforementioned hearing before the Arizona Director of Insurance. In his deposition, Evans could not recall having told Kleindienst that those funds were encumbered. The notes of former Subcommittee investigator Donald Gray indicate that Evans told him in an interview that he (Evans) had informed Kleindienst of the encumbrance prior to the hearing by the Director of Insurance. (These notes were brought to the attention of the District Court after Trimble obtained access to them pursuant to a Rule XXX resolution—S. Res. 138.) Before Evans could be deposed further and the issue resolved, the case was settled.

The Arizona Director of Insurance also filed a civil action on April 20, 1979, against Evans, American Financial Corporation and Donald P. Klekamp, an attorney and agent for American Financial. *Trimble* v. *Evans*, et al. C.A. No. 79–1190, U.S. District Court for the District of Columbia. The complaint sought compensatory damages to Family Provider resulting from the defendants' failure to disclose in its confirmation to the Arizona Director of Insurance that the $1.1 million in the Family Provider account with Provident Bank were encumbered (Appendix F). Pursuant to a settlement in May 1979, the defendants paid $90,000 to the receiver of Family Provider in return for dismissal of the action with prejudice (Appendix F).

The complaint in the *Evans* action alleged, among other things, that on or about May 20, 1976, a meeting was held at Kleindienst's law office by Kleindienst, Hauser, Boden, Kavanagh, Melvin Wyman, James Evans and Donald Klekamp at which they discussed (a) the proposed acquisition by Hauser's Great Pacific of American Financial's Great American Life Insurance Company, and certain American Financial's real estate; (b) the Director of Insurance's demand that the $1.8 million dividend be returned unencumbered to Family Provider; and (c) plans to have Great Pacific assign its interest in the proposed acquisition and the $1.1 million held in escrow at Provider Bank to Family Provider.

The complaint also alleges that, on May 20, 1976, two letters effectuating the aforesaid plan were prepared, discussed, and executed at the above-described meeting; and that Evans drafted the letters which were typed by a secretary at Kleindienst's firm and were signed by Brian Kavanagh. One of these letters was the letter, dated May 20, 1976, of which Kleindienst had told the Subcommittee he had not previously seen or heard (p. 1086).[46] Since the case was settled, the allegations in the complaint were not adjudicated.

[46] See discussion of this letter on pp. 155, 156 of this report.

F. THE UNRAVELING OF THE HAUSER OPERATION

On July 4, 1976, an article appeared in the Daily Oklahoman newspaper by an investigative reporter named Jack Taylor which dealt extensively with the Hauser operation, the diversion of the Teamsters premium money and the proceedings before the Arizona Department of Insurance (exhibit 264, pp. 929–933). According to the testimony of both Shannon and Fitzsimmons, the first knowledge they had of the reinsurance arrangement, Hauser's involvement and reputation, and the diversion of the Fund's premium money resulted from a call placed by Taylor to Fitzsimmons during the preparation of the article and from the article itself (pp. 927, 929, 1105).

The Subcommittee's investigation showed that the Fund's consultant, Len Teeuws of Tolley International, who had long been aware of the relationship between the Hauser group and Old Security, received a memo from one of his field representatives on May 17, 1976 advising him of Hauser's reputation, his previous financial and legal difficulties in California, and some of his current activities in Arizona (exhibit 265H, p. 981). However, Teeuws testified before the Subcommittee that he could not recall having seen or read the document at the time it was written. He also stated that, if he had, he might or might not have alerted the Central States Fund because Old Security was the responsible underwriting company (pp. 1185–1186).

Following publication of the Taylor article and the Hauser group's successful conversion of almost all of the remaining Teamsters Fund premiums to its own use (exhibit 243, p. 681), the Hauser operation began to disintegrate. On August 2, 1976, the Teamsters Fund declared void the insurance contract with Old Security. In time, most of the union employee benefit plans that had done business with the Hauser group either cancelled or did not renew their coverage, or insisted that Old Security reassume the coverage and liabilities. By the end of 1976, all of the Hauser companies had been placed in some form of receivership.

On August 4, 1976, the Fund filed a civil action seeking the recovery of $7 million in losses resulting from the Hauser group's misconduct. *Central States, Southeast and Southwest Areas Health and Welfare Fund* v. *Old Security*, *et al.*, C.A. No. 76–C–2904, U.S. District Court for the Northern District of Illinois. The complaint names as defendants, among others, Old Security, and its holding company, ISC Financial Corp., certain Old Security officials, Hauser, several of his associates and his insurance and other companies, Tolley International, Kleindienst, Webb and Davidson. The complaint alleges, among other things, that these defendants conspired to defraud the Fund and to breach their fiduciary duties to the Fund under ERISA. (Second Amended Complaint, Appendix D.)

Essentially the same defendants in the trustees' action are also named as defendants in an action filed by two beneficiaries of the Teamsters Fund. The complaint by the beneficiaries also names as defendants the present and former trustees (including Fitzsimmons) of the Fund, plus Daniel Shannon, the former Executive Director of the Fund, whom the plaintiffs charge with breaches of fiduciary duty under ERISA and malfeasance, negligence and possible complicity in fraudulent acts.[46]

On June 12, 1979, the U.S. Court of Appeals for the Seventh Circuit permitted Carpenter and Adcock to intervene in the Fund trustee's suit. These actions are still in pre-trial stages. However, in August, 1979, the Fund trustees submitted for court approval a partial monetary settlement of the case. The settlement provides for the payment to the Fund of $2.3 million from Old Security's parent, $400,000 from the present and former trustees, and $200,000 from Hauser's National American Life Insurance Company. The plaintiff Fund beneficiaries are opposed to the settlement because it does not provide for enforceable protections on the future operation of the Fund (Appendix D). Subsequently, the plaintiff Fund beneficiaries and the trustees reached an agreement which was preliminarily approved by the court in October 1979. The agreement included the $2.9 million payment and protective procedures to be negotiated with any difference to be resolved by the court.

On September 24, 1976, the Securities and Exchange Commission filed a civil action against Hauser, Herrera, Wyman, and a number of Hauser companies, including National Pacific Corporation, National American Life Insurance Company (NALICO) and Family Provider seeking injunctive and other relief. The complaint contains allegations that violations of the anti-fraud and reporting provisions were committed in connection with the misappropriation of the Teamsters Fund premiums from Family Provider and the subsequent takeover of NALICO and misappropriation of NALICO's assets. *SEC* v. *National Pacific Corp., et al.*, C.A. No. 76–1784, U.S. District Court for the District of Columbia (Appendix H).

On December 2, 1976, the Court entered orders effecting settlement of the SEC case by consent, which included injunctions against future violations against the defendants [47] and appointment of a receiver for NALICO. The court also ordered Hauser and National Pacific to return to NALICO the $1.1 million remitted in NALICO's name to Zeevco, A.F., a Swiss company, in August 1976. The receiver succeeded in recovering $832,000 of the $1.1 million. In July 1977, on a motion of the SEC and the receiver, the Court ordered that Hauser be held in contempt of the restitution order and ordered Hauser to pay the receiver $146,000. Hauser made payment of the $146,000 only after being jailed by the Court (p. 74). Also pursuant to the terms of the settlement, the receiver made an investigation of other misappropriations of NALICO's assets and damages suffered as a result thereof. After consideration of the receiver's findings and a report of a Special Master, the Court on August 7, 1979, entered judgment in the amount of $3.9 million against Hauser, his associates Herrera, Boden, and Melvin

[46] On June 8, 1979, two other Teamsters Fund beneficiaries filed a civil action against James Evans, Donald Kiekamp, American Financial Corporation, Richard Kleindienst and Kleindienst's former law firm seeking recovery of $7 million in losses caused by the defendants' failure to disclose to the Arizona Director of Insurance in May 1976 that Family Provider funds on deposit with the Provident Bank were encumbered. *Thornton and Corothers* v. *Evans, et al.*, C.A. No. 79–C–2331 U.S. District Court for the Northern District of Illinois. (Appendix D) The Complaint contains allegations similar to those in the actions filed by the Arizona Director of Insurance against the same defendants.

[47] Also, Hauser was barred from holding any position with NALICO and from being associated with any other public company for a period of 10 years without the consent of the SEC.

Wyman, and one of Hauser's companies, Pacific Southwest Insurance Agency (Appendix H).

As mentioned above, the Secretary of Labor has instituted one action concerning ERISA violations involving Hauser's sale of insurance to one of the Florida Laborers funds and has investigated other cases that will or may result in civil actions. However, the Department has advised that it is not currently investigating Hauser's sale of insurance to the Teamsters' Fund because criminal actions have resulted in that matter. The Fund trustees and participants have filed lawsuits to recover losses, and the trustees involved in the Old Security award have resigned. The Department states that it is monitoring the criminal case and civil suits.

As a result of the failures of the Hauser companies, responsibility for all of the unpaid claims and refunds of unearned premiums with labor union trust funds under the reinsurance agreements fell back on Old Security. As a result of this and a similar failure under a reinsurance agreement with another small Arizona insurance company, Old Security was forced into receivership, and its parent holding company into reorganization proceedings. Old Security and Family Provider are now involved in liquidation proceedings. NALICO has been reorganized, but still has some unresolved claims against it. Therefore, the Teamsters Fund and several other labor union trust funds, as well as many individual policy holders, who lost money as a result of their dealings with the Hauser affiliated companies will have to await the outcome of a myriad of civil litigation in order to determine whether any of the money will be recovered, and if so, how much.

G. PROBLEMS IN THE REGULATION OF INSURANCE

The Subcommittee received testimony at its hearings from State officials concerning the problems they face in regulating the operations of insurance companies and employee benefit plans which extend beyond the confines of a single State. The following excerpts from the statement of then Arizona Attorney General, now Governor, Bruce E. Babbitt, gives a good overview of these problems:

> We share your concern about the continuing abuses of pension and benefit plans through fraudulent insurance schemes. Given the persistence of these abuses, the vast numbers of employees and union members affected, and the interstate nature of the schemes, additional Federal legislation is certainly called for. I hope that our experiences in this area of regulation will be of some assistance in helping you formulate the best results.
>
> Our principal regulatory problems relate to the vast expansion of the group insurance market, particularly through use of the multiple employed trust (MET) form. The sprawling interstate character of the business, usually encompassing groups in several different States, has spawned a whole new set of jurisdictional problems. Administrators are appointed and accounts are established in each of the locales where a group is domiciled. Funds are collected and transferred from

State to State with the rapidity of the wire transfer. Where a State insurance department used to maintain strict control over a domestic insurer's financial dealings, accounts and records, all readily locatable within the State's borders, the activities of the interstate trusts almost defy manageability.

In a sense, attempting to regulate interstate insurance operations is only one part of the State enforcement dilemma. The attraction of the huge labor trusts and METs for the skillful swindler of the 1970's is in the total premium dollar generated by the Group insurance business. The business that is written may not in fact be profitable after future claims are paid and the books are balanced. Unfortunately, that is no deterrent to the unscrupulous operator. The plain fact of the matter is that the initial premium dollars paid in are substantial and can be easily diverted.

* * * * *

Because of the huge sums that are involved in this kind of insurance, the potential for corruption in the placement of the business is great. The Arizona investigation into the Family Provider affair led us into an examination of the placement of insurance coverage for members of labor locals grouped into two Arizona trusts. Interestingly, the handling of that insurance decision by the Arizona labor and management trustees raises the same kind of questions that surround and cloud the procurement of coverage by the Teamsters' Central States Welfare Fund.

* * * * *

* * * I think it important to note that the effectiveness of the States in policing the interstate insurance operations, and the millions of dollars in premium income they generate, requires both the vigilance and resourcefulness of State officials and a firm commitment of cooperation from Federal authorities. Undoubtedly, Family Provider will be remembered as the prototype of what appears to be developing art of reinsurance fraud. However, it also highlights the fine degree of cooperation between State and Federal authorities (specifically, the Arizona Attorney General's Offices, the Arizona Department of Insurance and the Securities & Exchange Commission) that is attainable under such circumstances.

I also believe that new legislative approaches are in order. However, I don't view extensive Federal intrusion into the field of insurance regulation as the solution. Historically, the States have occupied a vital and important role in this area and have established a proven record with respect to protecting the interests of policyholders. The difficulties that have surfaced as of late relate to the jurisdictional barriers that preclude a State from obtaining remedial action when an insurer subject to its regulations has substantial business connections in other States. State insurance laws have traditionally provided remedies that are summary in nature. Although infrequently availed of, the right of an insurance commissioner to procure speedy relief designed to locate and preserve assets, books and records is a crucial element in achieving regulation in the public interest. Unfortunately, the result of present efforts to seek compliance with local enforcement orders in other jurisdictions is too often marked by delay and procedural entanglement. Notwithstanding the Full Faith and Credit Clause of the Constitution, there is no guarantee of swift-footed justice when a sister state's insurance directives are at issue.

I would urge the Subcommittee to consider legislation that would assist the States in carrying out their insurance enforcement responsibilities. Certainly, there are areas affected with labor-management relations which are fit subjects for federal preemptive legislation. For example, requiring the disclosure by an insurer of any reinsurance agreements that would relate, in any way, to policies issued to a Taft-Hartley labor trust. Also, the disclosure of any so-called "finders fee" arrangements attributable to the procurement of labor trust business would serve as an important curb on potential trustee corruption.

However, in order to bolster and enhance the efficacy of State insurance regulation, I would also suggest that some kind of enabling legislation be considered which would permit the various States to enter into compacts, for the purpose of obtaining prompt enforcement of their orders relating to domestic insurers in sister jurisdictions. Such an interstate compact would effectively remove the jurisdictional barriers that subvert meaningful regulation of the insurance trusts. It would provide the States with the capability to translate their commitment to tough controls over the insurance industry into reality. It would, importantly, forestall the impetus for Federal regulation over one more aspect of State police power activity. And, it would truly benefit the millions of Americans who purchase insurance, whether through the giant trusts or individually, to protect themselves and their families from the financial deprivation caused by the unexpected disability or death.

Elsewhere in his testimony, Governor Babbitt noted that the National Association of Insurance Commissioners has a computerized system to pool data about insurance companies, but that there are "a number of problems with it, one of which is a lot of States are still not participating" (p. 523). Governor Babbitt also noted that there is a "big vacuum" between Federal regulation and the "State model which breaks down because of the interstate nature of virtually all commerce today" (p. 524). He said that the Hauser case is a perfect illustration because:

* * * There is no question they [the Hauser group] moved out of Florida when it got kind of hot, they came to Arizona because of a deliberate decision based on historic fact, that Arizona next to Florida was the easiest place to run a big swindle.

When things got hot in Arizona, they moved to Louisiana, kind of a rank ordering of which States had the worse regulatory schemes. To the extent that the legislation could get us together in the harness, it would be very valuable (p. 524).

In his testimony, James Hanna, Director of the Florida Division of Insurance Company Regulation, pointed out that the ability of one State regulator to obtain information and assistance is dependent upon informal personal relationships. He stated that there is "nothing binding" or formal, even though the NAIC, to assure cooperation (pp. 118–119).

Hanna commented favorably—as did Governor Babbitt—on the cooperation his office received from the SEC during its investigation of Hauser's operations. However, Hanna was very critical of the Department of Labor, the FBI and the U.S. Attorney's office, and Department of Justice Strike Forces for their refusals to share information with his office (pp. 96–97, 117).

The Subcommittee's investigation dealt primarily with the impact of Hauser's scheme on union employee benefit plans which purchased insurance. The damage has been referred to in terms of aggregate dollar losses incurred by the affected trust funds. However, these losses have a more personal meaning to the hundreds of thousands of fund beneficiaries. Each of them must share the burden of the losses either by way of reduced insurance benefits or increases in contributions to the funds. Another aspect of the personal adverse impact of Hauser's activities is the extremely poor service Teamsters Fund participants received in the 3 months Old Security was its insurance carrier. According to affidavits received by the Subcommittee from a Teamsters official and widows of Teamsters members, claims payments were frequently delayed up to 4 months. Prior to May 1, 1976, similar claims were usually paid within 2 weeks. The delays in many cases caused extreme hardship. For example, a Teamsters official had to arrange for several widows to obtain food stamps or other public assistance. Also, a 4 month delay resulted in another widow being threatened with legal action over debts incurred during her husband's illness. The widow developed a nervous disorder for which she had to take tranquilizers (pp. 803-810).

In addition, several thousand individual policy holders in insurance companies which failed as a result of Hauser's scheme sustained substantial losses. The policy holders of Farmers National were perhaps the hardest hit. Hanna testified that about 20,000 Farmers National Policy holders had their insurance cancelled and lost the cash surrender values of their policies and, in the case of accident and health policies, unpaid claims. Holders of life or accident and health insurance who had become uninsurable lost their ability to purchase new coverage (p. 76). Hanna estimated that about two-thirds of Farmers National policy holders were of such age or employment level that they would have great difficulty obtaining insurance coverage except at very high prices (p. 120).

In his statement to the Subcommittee, Bill Gunther, Insurance Commissioner of Florida, emphasized the need to reduce the likelihood of insurance company failures because of the "severe psychological and economic impact" they have upon "those who build their lives around the security they purchased through insurance" (p. 98). The personal human dimension of these consequences is best illustrated by the case of Mrs. Rose Mary Angrisini of Orlando, Florida, who furnished the Subcommittee an affidavit describing the impact of Farmers National on her life. After $5,600 in premium payments over 3 years were made on a life insurance policy with an $18,000 benefit covering her husband, the policy was cancelled on January 1, 1977, leaving the Angrisinis with only a claim of uncertain value for the $5,600 in premium payments. On February 10, 1977, Mrs. Angrisini's husband died. A 53-year-old widow, Mrs. Angrisini took a taxing $134 a week job as a cafeteria supervisor to help support herself (pp. 127-129).

The Members of the Committee on Governmental Affairs, except those who were members of the Senate Permanent Subcommittee on Investigations at the time of the hearings, did not sit in on the hearings on which the above report was prepared. Under these circumstances, they have taken no part in the preparation and submission of the report except to authorize its filing as a report made by the subcommittee.

ADDITIONAL VIEWS OF SENATOR SASSER

While I approve the report of the Subcommittee and commend the Subcommittee for its diligent work, I would like to note that the recommendations contained in Section II of the report may have far-reaching implications for the entire insurance industry. Congress should not further regulate this area in an attempt to curb the abuses outlined in the report before carefully considering the industry-wide impact of any new legislation.

JIM SASSER.

SEPARATE VIEWS OF SENATOR JACOB K. JAVITS

I commend the Permanent Subcommittee on Investigations (PSI) staff on the fine work that has been done in preparing this Report on the insurance activities of Joseph Hauser and his associates. Generally, the Report is thorough and well-researched, and will stimulate discussion of further ways to protect participants and beneficiaries in employee benefit plans.

As a co-author of the Employee Retirement Income Security Act of 1974 (ERISA), I have a particularly strong interest in seeing that the laws affecting pension and welfare plans are improved and strengthened. Early this year, Senator Williams and I introduced S. 209, the ERISA Improvements Act of 1979, which, among other things, would establish an ERISA antifraud rule to protect plan participants and beneficiaries against knowing misrepresentations regarding their plans. S. 209 was approved by the Senate Labor and Human Resources Committee on May 16. Also, Senator Williams, Senator Long and I, at the Administration's request, have introduced S. 1076 which would redesign the plan termination insurance for multiemployer pension plans. Hearings on this bill were held by the Senate Labor Committee on June 26 and 27, and the measure is now being analyzed by the Committee.

As the Congress continues its deliberations on pension and welfare plan legislation, it should study the recommendations made in the Hauser Report by the PSI. I have signed the Report because I generally agree with its thrust and because the Report is an effective vehicle for focusing public attention on continuing questionable and illegal activities with respect to employee benefit plans. I am, however, reserving judgment at this time on certain parts of the Subcommittee's Report, including by way of example the following recommendations:

1. That the Secretary of Labor establish minimum standards that insurance companies would be required to meet before an employee benefit plan could deal with such companies;
2. That the Department of Labor issue interpretive regulations which would specify that consultants selected by plans to evaluate insurance matters are fiduciaries under ERISA whenever they render advice or related services that will be relied upon by the plan or otherwise be a significant factor in any decision or action by the plan;
3. That certain changes be made in the way jointly administered-Taft Hartley plans are run; and
4. That certain additional sanctions and remedies be provided with respect to union and plan officials who abuse their positions of trust.

JACOB K. JAVITS.

V. APPENDICES

Appendix B–1

U.S. Senate,
Senate Permanent Subcommittee on Investigations
of the Committee on Governmental Affairs,
Washington, D.C., October 21, 1977.

Hon. F. Ray Marshall,
Secretary of Labor,
Washington, D.C.

Dear Mr. Secretary: As you may be aware, the Permanent Subcommittee on Investigations has been holding hearings in October 1977 looking into possible abuse of union trust funds through health and life insurance contracts. Specific attention is being given to the operations of one Joseph Hauser, the Farmers National Life Insurance Company of Miami, Florida and related companies.

Mr. Hauser's companies have had extensive contracts with trust funds of various locals of the International Laborers Union and with the Central States Fund of the Teamsters.

On October 12, 1977, Bernard Rubin, President of the Southeast Florida Laborers District Council, was called before the Subcommittee to explain the diversion in 1976 of approximately $750,000 from a union pension fund to Joseph Hauser's operations. Mr. Rubin declined to testify, invoking his constitutional rights under the Fifth Amendment.

Mr. Rubin had been indicted July 8, 1975 and convicted October 22, 1975 in the U.S. District Court, Miami, for embezzling $400,000 of union trust funds. Nevertheless, he retained control over some 10 union funds and trust funds until his conviction was affirmed by the Fifth District Court of Appeals on September 22, 1977.

On October 17, 1977, Mr. Marty Steinberg, Special Attorney with the Organized Crime and Racketeering Section of the Department of Justice, Miami, Florida, appeared before the Subcommittee. A copy of his testimony is enclosed.

Mr. Steinberg was in charge of the investigation that led to Mr. Rubin's indictment and conviction. Mr. Steinberg testified that immediately following the indictment of Bernard Rubin, the Justice Department moved to protect the funds remaining under control of Mr. Rubin by placing the unions involved under the trusteeship of the Department of Labor. According to his testimony, this procedure was approved by the local and the district office of the Department of Labor. However, when the matter reached Washington, D.C., Mr. Steinberg was informed by the Solicitor's office that the Labor Department would not accept this trusteeship and would oppose any motion to put the unions in trusteeship. According to Mr. Steinberg, the only explanation given was that this had never been done by the

Labor Department even though Mr. Steinberg pointed out that a precedent existed in a case involving the United Mine Workers. Mr. Steinberg also noted that at the time the Justice Department would have been agreeable to something less than a full trusteeship; that the objective was to obtain Labor Department cooperation in somehow monitoring disbursements to insure that Mr. Rubin did not continue to abuse his control over union funds. Evidently, this effort was unsuccessful as well.

Mr. Steinberg also testified that following Rubin's conviction in October 1975, the Department of Justice continued its efforts to establish some measure of protection for the funds to which Rubin had access during the nearly two-year period his case was on appeal. According to Mr. Steinberg, the Justice Department was not able to obtain any assistance or cooperation from the Labor Department in these endeavors.

I find the facts of the Rubin case and Mr. Steinberg's testimony very disturbing. The record before the Subcommittee indicates that the Government has evidence that from the time of his conviction until his conviction was affirmed in September, 1977 Rubin was involved in some $1.5 million of further unauthorized transfers of union funds. As you know, the Congress has enacted legislation to protect union trust funds from the depredations of corrupt individuals. If the facts outlined by Mr. Steinberg are typical, then it seems clear that the existing laws are not working.

The hearings before the Subcommittee are continuing, and I would like to invite you to prepare a statement concerning the Department's involvement in the Rubin case following the indictment and conviction and the present policy and practices of the Labor Department designed to protect union funds and union trust funds when union officials who control them have been indicted and convicted. I would greatly appreciate the receipt of such a statement by November 1, 1977 so that it may be set out in the record of our hearings.

Consideration can also be given to an appearance by you or by your representative before the Subcommittee at an appropriate time to afford you an opportunity to outline the Departmental policy and practices on this important matter.

Sincerely,

SAM NUNN,
Vice Chairman.

Enclosure.

APPENDIX B-2

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington.

HON. SAM NUNN,
Vice Chairman, Committee on Governmental Affairs, Senate Permanent Subcommittee on Investigations, Washington, D.C.

DEAR SENATOR NUNN: This will respond to your letter of October 21, 1977, concerning the testimony before the Permanent Subcommittee on Investigations of Mr. Marty Steinberg, Special Attorney with the Organized Crime and Racketeering Section of the Department of Justice.

Mr. Steinberg's testimony concerned the activities of Mr. Bernard Rubin, former President of the Southeast Florida Laborers' District Council. Mr. Rubin was indicted and eventually convicted of embezzling union funds and employee benefit plan funds. Upon his conviction, the District Court ordered his ouster from office under the Anti-Racketeering Act. That order was stayed by the Court of Appeals pending Mr. Rubin's appeal from his conviction. The conviction was affirmed last month and, shortly thereafter, another order was entered removing Mr. Rubin from his positions of trust.

Mr. Steinberg complained generally of the Labor Department's alleged lack of cooperation with his efforts to protect the assets of the unions and the trust funds further misuses and specifically of our refusal to assume a trusteeship or monitorship over the District Council and Local 666 of the Laborers' International Union of North America during the pendency of the criminal prosecution. He also expressed concern over our inaction during the pendency of the Court of Appeals stay of the order ousting Mr. Rubin from his offices.

I do not believe there is any real basis for the charge of lack of cooperation by the Department of Labor in this matter. Mr. Rubin's indictment and conviction stemmed from the efforts of an Organized Crime Strike Force, which included Compliance Offices of the Department of Labor, Office of Labor-Management Standards Enforcement (LMSE). The evidence leading to Mr. Rubin's indictment and conviction was obtained in substantial part through the efforts of LMSE Compliance Officers, including an account employed in the National Office of LMSE, who was sent to Miami at Mr. Steinberg's request to assist in the investigation and to testify at the trial.

Mr. Steinberg's concern over the Labor Department's refusal to assume a trusteeship or monitorship over the District Council and Local 666 of the Laborers' International Union during the pendency of the criminal prosecution of Mr. Rubin reflects a misunderstanding of the Department's role under the Labor-Management Reporting and Disclosure Act of 1959 (LMRDA).

The Department's enforcement authority under the LMRDA is confined to Titles II (Reporting and Disclosure), III (Trusteeships), and IV (Elections). Title V, under which Mr. Rubin was convicted, establishes fiduciary responsibilities for officers dealing with union assets, but is enforceable only by private litigation and by criminal prosecution. It confers no civil enforcement authority on the Government. The Labor Department can investigate violations of Title V, but prosecutions for violations of that Title can be instituted and maintained only by the Department of Justice. As noted above, Mr. Rubin's ouster from office was obtained under the Anti-Racketeering Act, and not under the LMRDA. Section 504 of the LMRDA does establish Mr. Rubin's inability to hold union office after his conviction, but only after that conviction becomes final, *i.e.*, after exhaustion of all appeals. Moreover, the ban on office-holding is enforceable only by criminal prosecution or upon the filing of a

Title IV post-election complaint by a union member who has first exhausted his internal union remedies. Accordingly, the LMRDA confers no authority upon the Department of Labor to remove a union official or to assume a trusteeship or monitorship over the assets of a labor organization. The Mine Workers case referred to by Mr. Steinberg involved a limited monitorship imposed in civil litigation instituted by the Secretary of Labor under Title IV of the LMRDA. This case cannot furnish a precedent for the assumption of a monitorship by the Department in connection with a criminal prosecution totally outside the area of its enforcement authority. These legal obstacles were explained to Mr. Steinberg, as was the Department's lack of any appropriation, manpower or expertise to assume such a trusteeship role.

Mr. Steinberg's statement that his proposal of a trusteeship or monitorship had the approval of local officials of the Department of Labor is incorrect. Mr. Steinberg never submitted a request to any responsible official of the Department to assume the function he proposed. Such a request at the local or regional level would have been referred immediately to the national office of LMSE, or to the Solicitor. As soon as the national office was alerted through receipt of a copy of the motion filed by Mr. Steinberg, he was immediately notified of the Department's lack of either statutory authority or the resources to accept such an assignment.

Mr. Steinberg indicated that the Department of Labor should have taken some action to preserve the assets of the unions and the associated trust funds during the Court of Appeals' stay of the order ousting Mr. Rubin from his offices. As explained above, no authority existed for any action by this Department under the LMRDA. Nor did Mr. Steinberg, or any other Justice Department official request any assistance from the Department of Labor from the time of Mr. Rubin's conviction until September 9, 1977, when Assistant Secretary Burkhardt was asked to provide an auditor to look into certain funds. On the next working day, Monday, September 12, 1977, an auditor was sent from the LMSE national office to Miami, where he performed the requested audit and then testified at a bond revocation hearing on October 4, 1977 in Mr. Rubin's case.

While the LMRDA provides no Government authority for the protection of union funds, the Employee Retirement Income Security Act of 1974 (ERISA) provides equitable remedies for the correction of abuses in the management of employee benefit plans (not union funds). Such remedies are available for fiduciary misconduct occurring after January 1, 1975, the effective date of the Act's fiduciary provisions. While Mr. Steinberg testified that such violations have occurred in Mr. Rubin's case, his testimony makes it clear that Mr. Rubin's conviction was based on events which occurred before January 1, 1975, and thus afforded no basis for any enforcement action under ERISA. Neither Mr. Steinberg nor any other Justice Department official advised any official of the Pension and Welfare Benefit Programs of any suspected continuing violations of Mr. Rubin's fiduciary responsibilities after his conviction until October 3, 1977. Under the procedures then in effect, which had been instituted by the Strike Force, the Department did not typically conduct civil investigations of activities which were targeted by the Strike Force. There was a request in

November 1976 for additional manpower to be assigned to the Strike Force-directed criminal investigation. We were unable to comply with the request because of a shortage of personnel.

On October 3, 1977, an attorney from the Criminal Division, Department of Justice telephoned the Associate Solicitor of the Plan Benefits Security Division to advise her that on the following day, at a bond revocation hearing, Mr. Steinberg would seek to have Mr. Rubin removed from all of his union and employee benefit plan positions. He requested the Department's assistance. An attorney was immediately sent from the Solicitor's Office in Washington and was present and available to assist Mr. Steinberg at the hearing on October 4. At that time, Mr. Steinberg was personally advised that the Department of Labor stood ready to take prompt and appropriate action as soon as evidence warranting such action was made available to this Department. He was told that evidence demonstrating the ongoing unlawful diversion of sums of money from an employee benefit plan, subsequent to January 1, 1975, would warrant the pursuit of civil remedies including removal of plan fiduciaries, injunctive relief and money judgments to restore illegally diverted funds.

To date, no evidentiary material of this character has been furnished to this Department. However, in view of the serious allegations made, we are at this time requesting the information in the possession of Mr. Steinberg.

In short, we believe that Mr. Steinberg's concern over the lack of cooperation from the Department of Labor stems from a lack of understanding of the Department's authority and functions, and from a lack of communication with the Department's responsible officials. The Department has responded promptly and effectively to every request received from Mr. Steinberg for assistance, to the extent that it could lawfully and properly do so.

In short, we believe that Mr. Steinberg's concern over the lack of cooperation are extremely important. I am committed to improving our program and I will give special attention to better coordination between the Labor Department and the Department of Justice.

If you have any additional questions I would certainly be willing to discuss them and my staff is available to meet with you at your convenience.

Sincerely,

F. Ray Marshall,
Secretary of Labor.

Appendix B–3

U.S. Senate,
Committee on Governmental Affairs,
Senate Permanent Subcommittee on Investigations,
Washington, D.C., December 14, 1977.

Hon. Benjamin R. Civiletti,
Assistant Attorney General, Criminal Division,
Department of Justice, Washington, D.C.

Dear Mr. Civiletti: As you know, on October 17, 1977, Marty Steinberg, Esq., a Special Attorney with the Department's Organized

Crime and Racketeering Section in Miami, testified before the Subcommittee concerning the Department's efforts to protect the funds of a number of south Florida labor unions following the indictment and conviction of one Bernard Rubin for embezzling some $400,000 of union trust funds. The Subcommittee appreciated the Department's cooperation in making Mr. Steinberg available to testify.

Following his appearance, Mr. Steinberg's testimony was referred to the Department of Labor for review and comment. Secretary Marshall's response is enclosed, and has been made part of the public hearing record.

Since the Secretary takes issue with portions of Mr. Steinberg's testimony, it will be helpful to the Subcommittee if you will review both the testimony and the Labor Department response and provide us the benefit of whatever observations the Department feels may be in order.

Sincerely,

SAM NUNN,
Vice Chairman.

Enclosure.

APPENDIX B-4

FEBRUARY 6, 1978.

Hon. SAM NUNN,
Vice Chairman,
Senate Permanent Subcommittee on Investigations,
Washington, D.C.

DEAR SENATOR NUNN: This letter responds to your letter of December 14, 1977 requesting the Department of Justice's observations concerning Secretary of Labor Marshall's response to the testimony of Mr. Martin Steinberg. Mr. Steinberg testified before your Subcommittee on October 17, 1977 about the efforts of the Department of Justice to protect the funds of a number of Florida labor unions during the prosecution of Mr. Bernard Rubin for embezzling $400,000 from those funds. Our efforts to restrain Mr. Rubin so that he could not embezzle further funds proved unsuccessful, and, as we sought to demonstrate at Mr. Rubin's bond revocation hearing last fall, he apparently embezzled more monies while he was being prosecuted and while his case was on appeal. Secretary Marshall's letter takes issue with some of Mr. Steinberg's testimony. The Department believes that the following information may be helpful to you in considering the issues in this matter:

1. On page 2 of Secretary Marshall's letter the Department of Labor sets forth certain reasons why it did not become involved with a trusteeship or monitorship of the unions and trust funds under Mr. Rubin's control. The letter states that the Department of Labor had no jurisdiction to institute a trusteeship or monitorship over the unions. It points out that the Labor-Management Reporting and Disclosure Act of 1959, (LMDRA) confers no authority on the Department of Labor in such a case. What the letter overlooks is that the Department of Justice had the authority to seek a trusteeship or monitorship as appropriate equitable relief under 18 U.S.C. § 1963(b). The Department of Justice's only concern was that it be able to recommend to the court a

monitor with expertise in labor matters. Someone from the Department of Labor was the only realistic choice. The only "authority" that the Department of Labor would have needed was a court order which was what the Department of Justice was seeking when the Department of Labor withdrew its support. The Mine Workers' case is a perfect example of such a monitorship imposed pursuant to a court order. The Department of Justice was merely seeking the same remedy, although it, rather than the Department of Labor instituted the proceedings and the proceedings were instituted under a different statute.

Moreover, no one at the Department of Labor offered any meaningful explanation to Mr. Steinberg of the legal obstacles, manpower obstacles, or appropriation or expertise obstacles. He was simply informed that the Department of Labor was withdrawing its support for the Government's motion to appoint a monitor.

2. The Secretary's letter states that the Government's motion to appoint a monitor never had the approval of the Department of Labor, a position that rests upon the claim on page 3 that "Mr. Steinberg never submitted a request to any responsible officials".

The facts are as follows:

In June, 1975, about a month before the indictment of Mr. Rubin, Mr. Steinberg orally informed the Department of Labor case agent and the Department of Labor Strike Force coordinator that the Department of Justice intended to move to appoint a monitor. Through the agent and the coordinator, both Mr. Steinberg and Miami Strike Force Chief Atlee Wampler orally requested the Department of Labor to confirm whether or not they would accept such a role. They were informed that the request was proceeding through the channels of the area office, District office, and Washington office of the Department of Labor. They were informed subsequently that the Department of Labor would accept the role of monitor and would approve of the proposed Government motion. Mr. Steinberg was told specifically that a man named Warshaw in the Department of Labor in Washington had approved the motion. The motion was filed approximately two days after Mr. Rubin's indictment in early July, 1975. The original motion called for a "trusteeship", but someone in the office of the Solicitor of Labor called and requested that Mr. Steinberg change the language to "monitorship" since "trusteeship" was a term of art in labor union affairs and had been used incorrectly here. The Government filed a supplemental motion changing the word "trusteeship" to "monitorship".

Shortly before the Judge was to rule on the motion, Mr. Steinberg received a phone call from a Ms. B. Block in the office of the Solicitor of Labor. She informed him that the Department of Labor would not accept a monitorship and would in fact join Mr. Rubin in opposing the motion. Mr. Steinberg attempted to obtain an explanation and pointed out the Mine Workers' precedent, but except for statement regarding lack of manpower, he received no meaningful reply. He told Ms. Block that the Department of Labor had already agreed to accept the monitorship and that the Department of Justice had based its motion on that agreement. Ms. Block responded by saying the Department of Labor would not be responsible for the Department of Justice's problems. Mr. Steinberg told her not only would it be embarrassing to withdraw the Department of Labor as a monitor, but that in his opinion it would affect the court's decision in the matter. Ms. Block replied that there was nothing to talk about. Mr. Steinberg called her back a number of times and also talked to others in the Solicitor's office. He received no further explanation for the Department of Labor's change of heart. Shortly thereafter Mr. Steinberg had to inform the court that the Department of Labor had withdrawn its agreement to be made a monitor. The defendant relied heavily on this withdrawal of support not only at this stage, but as recently as the bond revocation hearings on October 4 and 5 of 1977.

3. On page 3 the Secretary's letter states that (a) the Department of Labor had no authority to move to protect the union and trust fund assets after Mr. Rubin's conviction and (b) the Department of Justice never requested any assistance from the Department of Labor.

Mr. Steinberg's recollection is that even after Mr. Rubin's conviction, the Department of Justice renewed its previous motions to restrain Mr. Rubin and to divest him of his union office. Without the assistance of the Department of Labor however, the Department of Justice was handicapped in its efforts to protect the union funds. Mr. Steinberg, Mr. Wampler, and other personnel of the Organized Crime and Racketeering Section in Washington did attempt, without success, to obtain this assistance.

4. On page 4 the Secretary's letter states that the Department of Justice never advised the Department of Labor of any continuing offense by Mr. Rubin after January 1, 1975. This is inaccurate. The case agent who investigated the Rubin case was and always has been a Department of Labor Compliance Officer. He in turn reports to his superiors at the Department of Labor. On many occasions after January 1, 1975, personnel from the Miami Strike Force discussed with the Department of Labor personnel at the Area and District level continuing violations by Mr. Rubin and the need for manpower. On most of those occasions, they were informed that the local and area officials had informed their superiors in Washington of their conversations and requests.

5. Also on page 4 the Secretary's letter states that the office of the Solicitor of Labor first became aware of the Government's bond revocation hearing on October 3, 1977. The Government filed its motion on September 12, 1977. Again a Department of Labor employee was the case agent who participated in the investigation that led to the filing of the motion. The matter had been discussed with the local Department of Labor officials. In fact, Mr. Steinberg specifically requested an expert to testify at the revocation hearing concerning the Employee Retirement Income Security Act of 1974 (ERISA), and two were provided several weeks before the hearing. On October 3, 1977, one day prior to the bond revocation hearing someone in the office of the Solicitor of Labor called the Department of Justice and stated that the expert witnesses from the Department of Labor could not testify about ERISA. That development necessitated repeated calls by the Chief of the Organized Crime and Racketeering Section to the Solicitor's Office. Mr. Steinberg along with Mr. Wampler, phoned Assistant Secretary of Labor Burkhardt who happened to be in Miami on another matter. They requested someone to replace the

Department of Labor personnel they had depended upon to testify. After a series of phone calls (and, frankly, threats to subpoena a Department of Labor witness if they would not produce one voluntarily) the Department of Labor agreed to send a lawyer to Miami. That lawyer was not sent down in response to any request for testimony by the Department of Justice, but was sent down by the Department of Labor when the Department of Justice insisted that it would subpoena an ERISA expert from the Department of Labor if one were not voluntarily provided. When the attorney arrived in the hallway of the courthouse shortly before the hearings were to start, he informed Mr. Steinberg that the Department of Labor witness would only answer certain questions and that he was there to restrict the witness' testimony. Mr. Steinberg informed him that the Department of Labor witness would be called, that he would have to answer any question put to him by Mr. Steinberg, the defense attorney, or the court, and that the lawyer should not attempt to interfere with the witness in any manner. It was in this manner that the needed expert testimony was obtained at the revocation hearing.

6. Also, on page 4, the Secretary's letter suggests that the Department of Labor has been standing ready to proceed civilly against Mr. Rubin and others for violations of ERISA. The evidence has been available to the Department of Labor for some time and Department of Labor personnel have always been aware of the abuses perpetrated by Mr. Rubin and others.

7. Finally, let me add the observation that the local Department of Labor Compliance Officers working with the Miami Strike Force have done a magnificent job. They have investigated complicated, important cases concerning many organized crime labor racketeers and have performed in an outstanding manner. Over the last five years that limited force of two or three agents has made extraordinary accomplishments in the Southern District of Florida.

If there are any additional questions concerning these matters, we will be happy to respond to them.

Very truly yours,

JOHN C. KEENEY,
Deputy Assistant Attorney General,
Criminal Division.

APPENDIX E-1

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, D.C., June 20, 1979.

Hon. SAM NUNN,
Chairman, Senate Permanent Subcommittee on Investigations,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to the telephonic request by Ms. Kitty Dias of your staff on May 18, 1979 for updated information concerning the Department of Labor's investigations, pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), of employee benefit plans which have purchased insurance from companies associated with Joseph Hauser. To date, one lawsuit has been filed by the Department of Labor; enforcement action has been approved in three other cases; two reports of completed investigations are presently in the Office of the Solicitor for evaluation; one case has been referred to the Pension Benefit Guaranty Corporation; three investigations are still in progress, and eight investigations have been closed.

In January 1978, the Department established a special task force in Miami, Florida to investigate several plans associated not only with Joseph Hauser, but also with Louis Ostrer, Bernard Rubin and Seymour Gopman. The first lawsuit naming Joseph Hauser, among others, as a defendant, *Marshall* v. *Tricario*, C.A. No. 79–914 Civ-JLK (S.D. Fla.), was filed on February 16, 1979, and involves the Laborers' Local 767 Health and Welfare Fund. The work of the special task force had resulted in one previous suit being filed in December 1978, *Marshall* v. *Rubin*, C.A. No. 78–5749 Civ-JAG (S.D. Fla.), in which both Ostrer and Rubin are defendants. The complaint in *Tricario* is based on allegations that plan fiduciaries acted imprudently by expanding excessive amounts of plan assets in funding death benefits through the purchase of individual whole life insurance policies for plan participants from a Hauser-controlled company. Mr. Hauser is alleged to have induced this breach of fiduciary duty, in part, by providing one of the trustees with the use of an expensive boat in exchange for that trustee's continued support for the plan's insurance arrangements. The complaint prays for recovery of all amounts lost by the plan as a result of the alleged fiduciary breaches from the plan's fiduciaries, and from Mr. Hauser who personally benefited by his participation in the asserted breach. A copy of the Secretary's complaint is attached for your information.

Investigation and analysis have also been completed with regard to the Laborers' Local 938 Health and Welfare Fund, the Laborers' Local 666 Health and Welfare Fund, and the Laborers' Health and Welfare Fund of Dade County, all in the Southeast Florida area. The Department has concluded that violations of ERISA have occurred with respect to each of the three plans. We are in the process of notifying the proposed defendants in these cases in order to provide them with the opportunity to enter into consent decrees to be filed with the complaints. The relief in these cases will be designed to make the plans whole as well as to prevent fiduciary breaches in the future.

Two other employee benefit plans affiliated with Joseph Hauser, the Carpenters Local 103 (Broward County) Health and Welfare Fund, and the Plumbers and Pipefitters Local 719 Health and Welfare Fund, have also been investigated by the special task force, and the results of these investigations are now being analyzed by the Office of the Solicitor. A report of investigation of the final Hauser-related plan investigated by the task force, the Southeast Florida Laborer's District Council Pension Fund, has been referred to the Pension Benefit Guaranty Corporation (PBGC), trustee of the plan. PBGC is currently reviewing the matter to determine what action, if any, is warranted.

Three plans outside the Southeast Florida area are still under investigation: the Atlanta Regional Laborers' Health and Welfare

Fund, the Laborers' Local 438 Health and Welfare Fund, and the Massachusetts Laborers' District Council Health and Welfare Fund. Our investigation of the last of these three plans has been temporarily suspended at the request of the Department of Justice.

Eight additional Hauser-related employee benefit plans have been investigated by the Department of Labor. In each of these eight cases, the investigation failed to uncover losses to the plan resulting from breaches of the fiduciary provisions of ERISA. These cases have been closed, subject to reopening if new information becomes available:

(1) Indiana State District Council of Laborers and Hod Carriers Health and Welfare Fund;

(2) Arizona Laborers' Local 383 Health and Welfare Fund;

(3) Arizona Laborers, Teamsters and Cement Masons Local 395 Health and Welfare Fund;

(4) Hawaii Laborers' Health and Welfare Fund;

(5) Rhode Island Laborers' Health and Welfare Fund;

(6) Rhode Island Laborers' Health and Welfare Heavy Construction Fund;

(7) Amalgamated Food Handlers Local 328 Health and Welfare Fund; and

(8) Amalgamated Food Workers Local 10 Health and Welfare Fund.

I hope this information will be helpful to the subcommittee, and if any additional information is required, please do not hesitate to contact me.

Sincerely,

RAY MARSHALL,
Secretary of Labor.

Attachment.

APPENDIX G

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., September 19, 1979.

Hon. SAM NUNN,
Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

DEAR SENATOR NUNN: This is in response to your letter inviting our observations or recommendations regarding possible remedial legislation in order better to protect union trust funds and others against abuses on the part of insurance promoters, in connection with your Permanent Subcommittee's review of its public hearings into the awarding of insurance contracts by certain health or welfare trust funds.

You observed in particular that the hearings illustrated problems associated with the current regulation of insurance companies, notably matters relating to the problems of one state's authority to regulate transactions in another state and also the ease of transfer of their ownership and control. Through our own enforcement activities, we have learned that such problems can indeed exist. We believe that the following description of our recent enforcement actions may be helpful to you. The description is preceded by a discussion of the nature of our somewhat limited jurisdiction in this area. I will then set forth some of my observations and recommendations, which parallel those made in connection with the hearings in September 1977, before the Senate Committee on Banking, Housing and Urban Affairs on S. 1710, a bill which would, among other things, provide for optional federal chartering of insurance companies.[1]

THE COMMISSION'S LIMITED JURISDICTION OVER INSURANCE COMPANIES

The Commission does not possess general regulatory authority over the business operations of insurance companies, nor does it regulate the relationship between policyholder and insurance companies. We do, however, exercise jurisdiction with respect to some aspects of the relationships between insurance companies and their public stockholders, and with respect to transactions in securities issued or owned by insurance companies.

Pursuant to the Securities Act of 1933, an insurance company or insurance holding company which makes a public offering of securities must file a registration statement with the Commission. In addition, while Section 3(a)(8) of the Securities Act exempts most insurance policies and annuity contracts from the registration provisions of that Act, variable annuities and variable life insurance contracts are subject to all the requirements of the Securities Act. Unlike traditional insurance products, the benefits under variable annuity and variable life contracts are dependent upon the investment results of specific portfolios of securities and are not guaranteed by the insurance company.

In conjunction with our consideration in the early 1970's of the status of variable life insurance under the federal securities laws, the Commission had occasion to consider the adequacy of State insurance regulation with respect to the disclosure provided to purchasers of insurance contracts. The Commission determined that, where the contract provides for variable benefits to investors, the disclosures provided by the Securities Act were necessary, since State insurance regulation is directed primarily at maintaining the solvency of insurance companies rather than at providing the purchaser with full disclosure. Having made that decision, the Commission and its staff now review disclosure documents filed with respect to both variable annuity and variable life contracts and have developed a certain amount of experience with those contracts.

Other disclosures required by the Federal securities laws are quite circumscribed in the case of insurance companies. Many insurance companies are exempt from the registration and annual and periodic reporting requirements of the Securities Exchange Act of 1934 by section 12(g)(2)(G). A company qualifies for this exemption if its domiciliary State regulates proxies and insider trading in a manner comparable to the regulation contained in Sections 14 and 16 of the Exchange Act, and if it files annual "convention" (financial) statements on a form prescribed by the National Association of Insurance Commissioners ("NAIC"). The NAIC convention statement requires

[1] See Hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 95th Con., 1st Sess., on S. 1710, Sept. 1977.

neither an audit by independent accountants nor periodic reporting, as is mandatory for other corporate issuers. Holding companies with insurance subsidiaries are not eligible for this exemption, however, and are subject to the registration and reporting requirements of the Securities Exchange Act to the same extent as other publicly-held corporations.

There are other requirements of the Securities Exchange Act which do apply with full force to insurance companies. For example, Section 13(d) provides that a person who acquires more than 5 percent ownership of an equity security of a publicly-held company, including an insurance company, must file a statement with the Commission describing the extent and nature of his ownership interest. In addition, the antifraud provision of the Securities Exchange Act, Section 10(b) and Rule 10b–5 thereunder, as well as other antifraud provisions of the Federal securities laws, are of importance with respect to insurance companies, since the business of insurance involves day-to-day trading in securities. In addition, of course, trading exists in securities issued by publicly-held insurance companies.

Insurance companies, or more commonly their affiliates, are subject to registration as broker-dealers under the Securities Exchange Act, when they act in that capacity. Most insurance company subsidiaries registered as broker-dealers are primarily in the business of selling variable annuity and variable life contracts and mutual funds.

The Investment Company Act of 1940, which regulates pooled investment media, specifically excludes insurance companies from its coverage. Certain "separate accounts" of life insurance companies used to fund variable annuity and variable life contracts are, however, registered under the Investment Company Act and are thus subject to its comprehensive regulation. In addition, since the 1960's insurance companies have increasingly sponsored their own mutual funds by acquisition or formation. By 1974, insurance companies—predominantly through subsidiaries—managed over 50 percent of all mutual fund assets. Insurance companies are not bound by federal statutes, such as the Glass-Steagall Act or the Bank Holding Company Act, which would regulate these and other noninsurance activities.

Finally, an insurance company or, more frequently, its affiliate, is subject to registration under the Investment Advisers Act of 1940 when it acts as an investment adviser, except when its only clients are insurance companies.

ENFORCEMENT ACTIONS

While, as the above discussion indicates, our jurisdiction over insurance companies is rather limited, we have recently brought several enforcement cases relating to insurance companies, which might be of interest to your Subcommittee, and we have several cases pending. These actions have included administrative proceedings, actions for injunctive and ancillary relief, and referrals and assistance rendered in criminal prosecutions conducted by the Justice Department. We set forth below a description of the six cases we have instituted in the past two years. Of the six cases, five were actions in the district courts and the remaining case was an administrative proceeding under the Securities Exchange Act. Final relief was obtained in five of these cases as a result of consents submitted by the defendants and respondents.

Two cases were interrelated and involved allegations of self-dealing. These are the American Commonwealth Financial Corporation case and the National Pacific Corporation case. The latter is, of course, well known to your Subcommittee since it was the subject of the hearings in the Fall of 1977.

In May 1977, the Commission brought an action against American Commonwealth Financial Corp., a Texas-based, publicly-held insurance holding company, and nine other defendants, in the U.S. District Court for the Northern District of Texas.[2] The Commission alleged that the defendants had engaged in a fraudulent course of conduct whereby they used the assets of American Commonwealth and other publicly-held companies for their personal gain. These activities are alleged to have begun in about February 1975 upon the assumption of control of American Commonwealth by a new management group.

The allegations of self-dealing in the complaint related to, among other things, the use of the assets and credit of public companies for loans, and guarantees of loans, made directly and indirectly to certain of the defendants. In connection with personal bank loans, restrictions were imposed on American Commonwealth's ability to conduct certain businesses, issue stock, increase capital, or pay dividends. Also, personal loans were secured from the publicly-held controlled companies through the pledge of assets of doubtful value. Sales and exchanges of such assets and securities and notes of similarly questionable value were made. Finally, there were alleged to be a variety of omitted, false, and deceptive disclosures.

In June 1976, American Commonwealth transferred control of one of its subsidiaries, National American Life Insurance Co., to National Pacific Corp., a private company owned principally by several west coast promoters, the principal one of which was Joseph Hauser.[3] According to the Commission's complaint, filed in September 1976, the National Pacific group immediately set out to engage in a series of self-dealing transactions which resulted in the misappropriation of several million dollars. The Hauser group operated by obtaining lucrative union group insurance contracts from union health and welfare funds, using another unrelated insurance company as a "front" to obtain these contracts. Once the insurance contracts were obtained by the Hauser group through reinsurance agreements with the other company, the proceeds of the contracts were diverted to the personal use of the Hauser promoters. In addition, cash was obtained through the transferring of notes of highly questionable value to National American in exchange for cash. One month before the Commission's complaint was filed, the control person of National American, without any board of directors' authorization, and contrary to applicable State law, transferred $1.1 million in insurance premiums to a Swiss bank account which had just been opened by a newly-formed Swiss company. Following the filing of the Commission's complaint, the Federal

[2] *Securities and Exchange Commission v. American Commonwealth Financial Corporation*, C.A. No. 3-77-0648 (N.D. Tex.).
[3] Hauser and several associates were recently indicted by an Arizona Federal grand jury for their activities in this case.

court, upon the Commission's motion, appointed an equity receiver over National American and the court ordered, pursuant to a consent decree, that the $1.1 million be returned to National American. About $1 million has been returned, after Hauser was held in contempt of court and jailed for failure to return about $142,000.

An interesting aspect of the National Pacific case is that, just prior to National Pacific's acquisition of National American, a Louisiana insurance company, the State of New Jersey had turned down the Hauser group's application to acquire a New Jersey-based insurer, on grounds of unsuitability of the applicant. In Louisiana, however, State approval of such an application is not required, so National Pacific acquired a Louisiana corporation, using, as the source of funds for the acquisition, the proceeds of a dividend from an Arizona insurance company. The State of Arizona had declared the dividend illegal, but National Pacific failed to return it to the paying company.

The following testimony before your Subcommittee by John Boden, one of the Hauser associates, is instructive of the way in which differences among state insurance regulatory standards make it possible for unscrupulous promoters to carry out their activities:

"During the last stages of our difficulties with New Jersey, we asked Kleindienst's law firm for advice as to States where the insurance licensing and holding company laws were the most lenient. In particular, we were looking for States where there was no Insurance Holding Company Act or where such an act was least restrictive. We wanted to avoid having to seek approval of another state insurance department for the purchase of an insurance company.

"One of the States suggested was Louisiana. Kleindienst's firm also advised that a company in Louisiana, the National American Life Insurance Company, was available for purchase." [4]

Two other cases involved failures to prepare adequate financial statements, principally relating to loss reserves. The first culminated in administrative proceedings under Section 15(c)(4) of the Exchange Act against Government Employees Insurance Co., commonly referred to as "GEICO." In these proceedings, the Commission found that GEICO, after April 1975, failed to make necessary disclosures of changes in its manner of computing loss reserves, causing liabilities to be understated. In addition, the Commission found that GEICO capitalized the carrying value of acquisition costs on its balance sheet, which raised questions. The changes discussed above had the effect of substantially decreasing the net loss which GEICO reported in various filings with the Commission and in reports made to its shareholders and the press.

The changes made by GEICO in the manner of computing its loss reserves were inconsistent with that firm's prior practice and were not supported by available data or by the findings of GEICO's outside auditors and certain consultants. Also, GEICO's method of valuing acquisition costs raised questions. GEICO historically deferred certain costs incurred in acquiring insurance businesses, thus avoiding the negative impact such costs would otherwise have had on current earn-

[4] Hearings Before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate, 95th Congress, 1st session, Oct. 28, 1977, at page 629.

CONTINUED

2 OF 3

ings. Recoverability of these costs through future underwriting profits is, however, a necessary prerequisite to deferral, and, of course, the asset must be reduced as portions are deemed non-recoverable. We found that GEICO failed to make downward adjustments in the valuation of its acquisition costs. We also found in this case that an officer of GEICO sold GEICO securities while in possession of material non-public information concerning these matters.[5]

Our fourth enforcement action against an insurance company, *Securities and Exchange Commission* v. *Fisco*, was an action for injunctive and ancillary relief which was filed and consented to in August 1977.[6] While the Commission's complaint alleged other fraudulent conduct, the principal fraud alleged in *Fisco* was the understatement of reserves for losses. As a result of the understatement, over a three-year period, Fisco, a casualty insurance company, was able to report increasing earnings, when in fact, we alleged, it was incurring substantial losses. According to the complaint numerous methods were used by Fisco to understate its loss reserves, including:

1. Direct orders from management to "freeze" reserve increases even where a Fisco claims adjuster had indicated that the previously set reserve was substantially understated.
2. The adoption of a computer program designed to "freeze" reserve increases. The program operated in such a way as to negate all attempts to increase reserves for particular classes of claims.
3. The use of so-called GI parties. These were reviews, by claims personnel, of all claims files. The sole purpose was to find reserves which could be reduced or deleted in their entirety.
4. The so-called Black Friday incident. In February 1972, a physical inventory of the claims files in Fisco's Philadelphia office was taken, involving a comparison of a computer printout of existing files with the files themselves. Claims files reflecting approximately $1,000,000 in reserves were not located and management ordered that the reserves for those claims be deleted as of December 31, 1972. A few weeks later it was found that the missing files were in transit to Fisco's New Jersey office; notwithstanding discovery of the missing files, Fisco failed to reverse the entry deleting the reserves for these claims.

After having reported doubled earnings for the years 1970 through June 1973, Fisco reported, in early 1974, an operating loss of approximately $39,000,000, which completely eliminated all prior reported earnings of the company. This revision principally resulted from its policy of understating loss reserves.

The fifth case involved Vanguard Security Funding Corp., ("Vanguard") a holding company, and also relates to misleading financial statements.[7] It is of particular note that the direct object of the alleged fraud there was a State regulatory agency, rather than the trading market in securities. The Commission alleged that in 1974, Vanguard's operating subsidiary, which is engaged in underwriting individual

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[5] In the Matter of Government Employees Insurance Company Securities Exchange Act Release No. 12930, 10 SEC Docket 790, Oct. 27, 1976. In addition, a private action, brought by certain GEICO shareholders based on the information uncovered by the Commission, resulted in a settlement affording the shareholders substantial economic benefits (*Kuchock* v. *GEICO*, C.A. D.C., No. 77–1583).

[6] D.D.C. No. 77–1426.

[7] *Securities and Exchange Commission* v. *Vanguard Security Funding Corp.*, D. Ala. No. 77–0455, Mar. 16, 1977.

and group life and health insurance and group disability insurance risks, entered into sham transactions in which it acquired real estate in exchange for surplus notes. The alleged purpose of these transactions was to increase Vanguard's statutory surplus, removing an impairment of capital for State regulatory purposes. In a financial statement filed by Vanguard with the Commission, Vanguard valued the newly-acquired real estate at the stated value of the surplus notes. The surplus notes, a form of debt apparently unique to the insurance industry, provided for payment only if and when the statutory surplus of Vanguard exceeded a certain predetermined amount. We alleged that the value of real estate and debt were substantially overstated and that the reported net loss and retained earnings deficit were substantially understated in those financial statements. The Commission also alleged that Vanguard failed to disclose that it filed false and misleading statutory surplus reports with the Alabama State insurance department, including false and misleading appraisals of certain of the real estate.

As a result of our complaint, and based on its consent, Vanguard was permanently enjoined from violating the antifraud and reporting provisions of the federal securities laws. Also, as a result of a suit filed by the Commissioner of Insurance of the State of Alabama, the operating subsidiary of Vanguard was placed in receivership.[8]

The last and most recent case involves Sierra Life Insurance Company and illustrates, not only alleged violations of the federal securities laws, but also the failure of Sierra to comply with state reporting requirements. Those reporting requirements are, of course, the predicate for the Section 12(g)(2)(G) exemption from the reporting requirements of the Securities Exchange Act of 1934 for insurance companies.[9]

In that case, the Idaho Insurance Commissioner had ordered Sierra to divest itself of certain assets which did not conform to Idaho Insurance Code requirements. In connection with the sale of these assets, the chairman of the board and president of Sierra, and other defendants, allegedly engineered a sale of the directors' Sierra stock at a premium price of $15 per share. Concurrently, Sierra agreed to sell 200,000 original shares of its stock to the same buyers at $5.40 per share. The complaint, in addition to seeking an injunction, seeks disgorgement of profits from the officers and directors of Sierra who engaged in this transaction.

The Commission's complaint also alleged that Sierra's annual statements and supplemental documents for 1973 through 1976 filed with the state insurance authorities, as well as proxy materials and annual reports distributed to stockholders, contained false and misleading information concerning, among other things, officers' and directors' participation in material transactions in which Sierra was a party and the valuation of certain Sierra assets. Also alleged in the complaint was that the Idaho insurance authorities were not fully informed as to material facts concerning Sierra.

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[8] *State of Alabama v. Vanguard Security Life Insurance Company*, Circuit Court, Montgomery, Alabama, No. 39431, Nov. 29, 1976.

[9] *Securities and Exchange Commission v. Sierra Life Insurance Company*, D.C. Idaho CA 78–1016. Litigation Release No. 8260 Jan. 18, 1978.

OBSERVATIONS AND RECOMMENDATIONS

The limited number of these cases makes it difficult to generalize about abuses since the cases themselves reveal a variety of misconduct. A few observations may, however, be made regarding these cases, which, with few exceptions, have involved smaller insurance companies. Insurance companies represent large pools of liquid assets, which lend themselves to a variety of intricate techniques designed to enrich controlling persons through looting or use of assets to gain control of other companies or otherwise to mislead regulatory authorities or defraud the public. The American Commonwealth and National Pacific cases indicate the rather amazing speed at which determined persons appear to be able to utilize the assets of insurance companies for their personal gain. In addition, more than one of our enforcement cases has involved fraudulent usage of reinsurance agreements either to conceal underreserved deficiencies or to transfer overvalued assets from company to company.

Other areas of abuse which have surfaced in our investigations are inadequate loan loss reserves and irregularities with respect to valuation of assets. These latter abuses appear to grow out of the desire of insurance companies to inflate earnings and to protect or increase surplus which determines the amount of insurance they can write.

The above description of our enforcement activities with respect to insurance companies also indicates both the growing complexity of possible misconduct in this area, and the difficulties faced by State regulators, with their limited jurisdiction and resources, in attempting to deal with the varieties of problems presented by multistate insurance companies. Because of our limited involvement with the insurance industry, the Commission does not have sufficient experience to suggest any broad conclusions based on experience or to suggest the desirability of broad remedial legislation. Even in the area of the Federal securities laws, the Commission does not have sufficient experience to suggest any broad changes to achieve better regulation of insurance companies. Such definitive recommendations require both greater experience and a specific study of the problems involved. Nevertheless, if your Subcommittee should wish to consider changes in the Federal securities laws to this end, the following alternatives might be appropriate.

POSSIBLE LEGISLATIVE IMPROVEMENTS

A. Audited financial statements

Under Section 12(g) of the Securities Exchange Act, all companies with a class of equity securities held by over 300 persons and with over $1 million in assets are required to register such securities with the Commission, and are required under Section 13 of the Securities Exchange Act to file current, periodic and annual reports with the Commission. Annual reports are required to contain financial statements audited by independent public accountants, and are also required to disclose corporate transactions in which officers, directors, and other control persons have a material interest. Monthly and quarterly reports require disclosure of important corporate transactions, quarterly financial statements, and other important matters.

As previously noted, Section 12(g)(2)(G) of the Securities Exchange Act provides an exemption from the registration requirements of Section 12(g) for any security issued by an insurance company, provided (1) such insurance company files annual "convention" statements as prescribed by NAIC; (2) such insurance company's domiciliary state regulates proxy solicitations in conformance with NAIC provisions; and (3) such insurance company's domiciliary state regulates insider trading in the manner provided by Section 16 of the Exchange Act. The apparent rationale behind the creation of the exemption was that the reports filed with state authorities, and the regulation of proxies and insider trading by the states, would provide an adequate substitute for the provisions of the Exchange Act which would otherwise be applicable.

A revision which would constitute a minimal intrusion by the Federal government in the insurance field might be simply to require that annual financial statements of insurance companies be audited. This change would impose what is essentially a sound and common business practice on those insurance companies which presently are not subject to such requirements.

Your Subcommittee might also wish to consider providing a means for all state insurance regulatory authorities and the public to obtain access to such financial information, if it were required. For example, the establishment of a central repository for this information could promote more efficient application of the state's laws as well as existing Federal law.

B. Requiring state authorities to adopt disclosure and proxy solicitation rules substantially equivalent to those imposed by this Commission

The present coverage of insurance company activities by the Securities Exchange Act is somewhat irregular. As mentioned above, Section 12(g)(2)(G) of the Securities Exchange Act, in essence, exempts insurance companies from filing registration statements, annual statements and proxy solicitation materials in the form typically required by the Commission. Among the further consequences which attend this exemption is the immunity of insurance companies from the provisions of Section 13(e) of the Securities Exchange Act. Section 13(e) gives the Commission authority to adopt rules relating to the purchase of equity securities by or on behalf of the issuer of such securities or a control person of such issuer as defined in the section.

At the same time, and somewhat paradoxically, tender offers relating to the securities of insurance companies are fully subject to Commission regulation under Section 14(d) of the Securities Exchange Act.[10] The reporting requirements of Section 13(d), regarding beneficial ownership, are also applicable to insurance companies.[11] This puts the Commission in the difficult position of having responsibility for policing tender offers, while related disclosure problems may go undetected because of the statutory exemption from other requirements of the securities laws.

One solution would be to amend Sections 12(g)(2)(G)(i) and (ii) to provide for the filing of annual reports by insurance companies

[10] The reason for this anomaly is probably that insurance companies do not object to regulation of tender offers for their securities made by others.

[11] Also, under Section 12(g)(2)(G)(iii), insider trading of the securities of insurance companies is subject to the substantial equivalent of Commission regulation under Section 16 of the Securities Exchange Act.

with their domiciliary state commissioners of insurance in a form which is the substantial equivalent of the annual reports required by the Commission for reporting under Section 13 of the Securities Exchange Act, and to provide for domiciliary state regulation of proxies which would be the substantial equivalent of the Commission's regulation of proxies.[12]

C. Repeal of Section 12(g)(2)(G)

A third possibility would be to repeal Section 12(g)(2)(G). This would impose a uniform system of financial reporting on all publicly-held insurance companies, and would enable the Commission to provide a uniform enforcement policy for disclosure by such companies. Since insurance subsidiaries of publicly-held companies are already subject, in effect, to Section 13 reporting, the repeal of Section 12(g)(2)(G) would result in more comparable disclosure by insurance companies.

We would be pleased to give you any further assistance that you desire.

Sincerely yours,

HAROLD M. WILLIAMS,
Chairman.

APPENDIX J-1

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, D.C., July 24, 1979.

Hon. ABRAHAM A. RIBICOFF,
Chairman, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In compliance with Section 236 of the Legislative Reorganization Act of 1970, I am enclosing herewith the Department of Labor's response to the final General Accounting Office report, entitled "Laws Protecting Union Members and Their Pension and Welfare Benefits Should be Better Enforced" (HRD 78-154, September 28, 1978).

Sincerely,

RAY MARSHALL,
Secretary of Labor.

Enclosure.

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, D.C., May 14, 1979.

Hon. ELMER B. STAATS,
Comptroller General,
441 G Street, NW., Washington, D.C.

DEAR MR. STAATS: I have given careful attention to your report dated September 28, 1978, "Laws Protecting Union Members and Their Pension and Welfare Benefits Should be Better Enforced",

[12] Cf. Section 12(i) of the Securities Exchange Act of 1934, which authorizes the Federal bank regulatory agencies to administer certain provisions of that Act with respect to banks, and requires that those agencies adopt rules and regulations substantially similar to rules and regulations adopted by the Commission.

which came to our attention in the Congressional Record of October 14, 1978. I understand that this report was prepared by the Human Resources Division of the General Accounting Office at the request of the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, United States Senate. I have also reviewed other documents appearing with the report in the Congressional Record of October 14, 1978, including Senator Nunn's letter of November 29, 1977, which initiated the subject study. I am not, however, familiar with the other agreements referred to in your letter to Senator Nunn. You indicate in your letter to Senator Nunn that, at the request of his office, you did not follow your normal practice of obtaining agency comments on the proposed report. Accordingly, I take this occasion to provide certain supplementary information which I believe is pertinent to the matters you examined.

In undertaking to discharge my duties as Secretary of Labor effectively I am committed to aggressive programs to enforce the provisions of both the Labor-Management Reporting and Disclosure Act (LMRDA) and the Employee Retirement Income Security Act (ERISA) for which I have responsibility. I do not take these responsibilities or the GAO recommendations lightly. I am pleased with the numerous positive aspects of our enforcement programs cited in the report and I will give appropriate consideration to each of its recommendations.

It is important to the Department and to the persons whose rights we are charged to protect, that the full range of our responsibilities and our program activities be considered before making judgments on the adequacy of our efforts. In this connection, it is our considered belief that your report suggests at least in part a fundamental misconception with respect to the discussion pertaining to ERISA criminal responsibilities of this Department. Your report appears to assume on balance that ERISA, like LMRDA, places on the Department extensive new criminal responsibilities. However, as I indicated in my appearance before the Permanent Investigations Subcommittee on April 25, 1978 (transcript, pp. 230 ff.), from this Department's perspective ERISA is primarily and essentially a civil statute, although we do have certain criminal responsibilities. It was, I feel, unfortunate for the report to proceed on such a misconception.

The Subcommittee has, of course, indicated special concern with the criminal aspects of these laws, and with investigations of possible violations of other criminal laws related to labor organizations and employee benefit plans. These matters are of great concern to me as well. The Subcommittee's particular concern is reflected in its request of GAO, which largely directed your review to the criminal aspects of our law enforcement activities. As a consequence, we believe that the findings and recommendations of the report do not fully reflect the true scope of our responsibilities and our program activities.

Of course we are aware that the report does not conclude that the Department is devoting too large a proportion of its resources to civil enforcement of the laws; nor does it recommend that civil enforcement resources be transferred to criminal enforcement activities. It recommends that more staff be sought to perform field audits and that both our civil and criminal enforcement activities should be "more vigorous". As I testified on April 25, 1978, I have serious doubts about the efficacy of simply throwing additional staff at these problems. Rather, I believe that the Department of Labor's actions should be focused on root causes and on denying those who would misuse their positions of trust in a union or employee benefit plan the opportunity to do so, by the judicious use of appropriate civil and/or criminal remedies. When the current backlog of union member complaints under the LMRDA is sufficiently reduced, we could then divert some of our resources to the field audits recommended by your report.

In the Subcommittee's letter requesting the study, you were specifically asked "to determine whether the responsibilities of the Labor Department for the detection and investigation of criminal violations of statutes pertaining to labor organizations (LMRDA) are clearly defined, and to determine whether the Department's present organizational structure, procedures, and manning are such that it is able to fully discharge these responsibilities."

The Department agrees with the report's conclusion on the first of these questions that "... both LMRDA and ERISA and the agreements entered into under the Acts clearly delineate the respective areas of investigative responsibility and jurisdiction for Labor and Justice." We are pleased to note in the report that "... officials in the local U.S. Attorney's offices in Philadelphia and San Francisco were generally satisfied with the coordination under the laws and agreements and with the quality of Labor's investigations referred to them."

THE LABOR DEPARTMENT'S CRIMINAL RESPONSIBILITIES

Your report (page 8) clearly states the Department's responsibilities regarding the criminal provisions of the LMRDA, and its agreement with the Department of Justice. It also accurately describes the Department's responsibilities regarding the criminal provisions of ERISA with the following statement extracted from page 9 of the report:

"Under the ERISA agreement, Labor investigates criminal matters involving violations of ERISA's reporting and disclosure provisions."

"Justice investigates criminal matters related to ERISA prohibitions against (1) certain persons holding office and (2) interference with the right of a participant or beneficiary by fraud or coercion. Justice also investigates related offenses under title 18 such as theft or embezzlement from employee benefit plans; false statements and concealment of facts in relation to documents required by ERISA; and offer, acceptance, or solicitation to influence operations of employee benefit plans."

These accurate statements seem inconsistent with the observation found at page 7 that ". . . the Department of Labor is *primarily* responsible for detecting and investigating *criminal* as well as civil violations of *both* laws" (emphasis added).

In addition, the impact of these quite accurate statements may have been partially obscured by the lack of emphasis given to other facts.

As you are aware and the Report points out, certain criminal laws relating to employee benefit plans are not in ERISA and are not within the investigative or enforcement jurisdiction of the Department of Labor. For example, as you noted, 18 U.S.C. 664, which prohibits embezzlement from employee benefit plans, is within the investigative and enforcement jurisdiction of the Department of Justice. The substantive criminal prohibitions of ERISA relate principally to reporting and disclosure, convicted persons' employment with plans and interference with participants' rights. However, there has been some public uncertainty concerning these matters.[1]

In view of the complexities of the allocation of federal law enforcement jurisdiction, it is, perhaps, not surprising that these distinctions are not always clearly recognized. However, in view of the potential for confusion, we have consistently attempted to clarify the role which we play in the enforcement of the criminal provisions of ERISA and in the enforcement of other criminal laws related to employee benefit plans. In this connection, we believe that descriptions of our activities which do not distinguish between these functions may tend to foster confusion. Thus, for example, the statement that the investigators examined files of "cases which may have had potential criminal violations or LMRDA or ERISA—for example, breaches of fiduciary responsibility by labor organizations or benefit plan officials" might lead the casual reader to assume that the fiduciary breach of embezzlement from a plan involved a criminal violation of ERISA. Such misunderstanding in turn may lead to a more general misevaluation of the Department's vigor in execution of its functions.

As you are aware, ERISA is a statute whose principal remedies are civil and whose primary purpose is to protect plans and their participants. The LMSA and the IRS, partners in enforcement under ERISA, utilize these mechanisms to secure plan assets, correct abusive situations, modify policies and practices that are unsound, recover plan assets that may have been lost, and generally ensure that the plan is being operated in the best interest of participants and beneficiaries. In addition we continue to provide information obtained in our ERISA enforcement program to the Justice Department to assist in their efforts to enforce the criminal statutes. We believe these priorities are consistent with our statutory mandates, and we intend to pursue our civil responsibilities as vigorously as possible and to support the Department of Justice in carrying out its mandate under the criminal laws.

It is clear from the statute and the legislative history that Congress gave the enforcement of the election provisions of Title IV of the LMRDA a high priority by setting a time frame into the statute. Moreover, Title IV dictates only a single remedy—civil enforcement—and allows the Department no other options.

The basic thrust of the LMRDA is to guarantee union members free choice of their officers in democratic elections and to ensure disclosure of dealings of the union officers and trustees vis-a-vis their membership. The original Memorandum of Understanding between

[1] See, for example, the letter from Owen J. Malone to the American Law Division, Library of Congress, published at S19545 of the Congressional Record of October 14, 1978; and see also the testimony of various Department of Justice Strike Force attorneys before the Subcommittee in April 1978.

the Departments of Labor and Justice in 1960 provided that jurisdiction for the enforcement of Section 501(c), which relates to embezzlement, would be exercised by the Department of Justice. Investigative jurisdiction is exercised by Labor over Section 501(c) in multiple violations involving Title II on the basis of case-by-case arrangements. The Department of Labor retained jurisdiction to investigate criminal violations of the reporting requirements of Title II, the trusteeship requirements of Title III, and the bonding and certain other requirements of Title V as well as civil matters. In all cases when the Labor Department officials involved discover a criminal violation of the LMRDA, the matter is referred to the appropriate U.S. Attorney. Thus, the U.S. Attorney ultimately makes the final decision as to whether an indictment will be sought and the offender prosecuted. With respect to this Department's enforcement of the criminal provisions of LMRDA, our record clearly demonstrates we have vigorously pursued our responsibilities. During the period from 1959 through 1978, as a result of our enforcement there have been 1,515 LMRDA indictments returned of which 1,099 resulted in convictions.

LMRDA AND ERISA ENFORCEMENT—USE OF REPORTING SYSTEMS FOR DETECTION OF VIOLATIONS

Your office was also asked to evaluate the LMRDA reporting system to ascertain whether the system is adequate for detecting criminal violations of labor union statutes. The report responded that "the Labor-Management Services Administration national office computerized report processing and desk audit systems are principally directed to achieving voluntary compliance with the reporting and disclosure provisions of both laws. The systems identify only potential criminal violations which the labor organizations or benefit plan administrators voluntarily report and are not designed to assure that the data reported are valid or determine the level of compliance with the two laws".

The LMSA has essentially the same view as that of IRS and similar government agencies regarding the effectiveness of computer systems as an investigative tool. Such systems are designed to receive information submitted and test it for certain accuracies and consistencies within broad parameters. In some cases criminal actions may be flagged by computers, but more importantly computer reviews perform a vital function in flagging report errors, failures to report, and anomalous report entries, any of which may lead to enforcement activity. The report monitoring process thus plays an important, but certainly not exclusive, role in uncovering criminal violations, many of which are discovered through complaint or self-initiated field investigations or audits. Random checks can serve to raise the consciousness of organizations covered by LMRDA and ERISA and such investigations may also alert labor organizations, plans and participants that DOL is interested in enforcement of the legislation and will not be responding merely to complaints. But a field audit program is very costly, and must be pursued according to the availability of sufficient resources. Field audits too must be viewed as but one tool among the many employed by the Department to carry out our LMRDA and ERISA responsibilities.

With further regard to ERISA enforcement in this vein the Department has for the time being decided that a targetted enforcement program, directed at specific types of violations, is generally more effective than the random audits suggested by the GAO report. Our strategy assigns the highest priority to the conduct of fiduciary investigations, which often involve limited audits directed at practices where a violation is suspected. Placing primary emphasis on performing randomly targetted comprehensive audits covering overall plan operations, as the GAO proposes, would, we believe, uncover substantially fewer violations for the same resources. To date, IMSA has been successful in identifying violations utilizing existing targetting methods, and as a result, restored $45 million in plan assets during fiscal year 1978. However, we are engaged in a joint effort with the IRS to conduct a series of statistically selected compliance examinations that are intended to furnish measures of compliance among various types of plans, as the report suggests. This is a long term effort, and the development of sophisticated measures of identifying violations is extremely complex.

LMSA TRAINING PROGRAMS

The report concludes also that insufficient training had been provided to LMSA field personnel, and urges "a review (of) training of area field staff to ensure that the auditors and compliance officers receive the training needed to effectively carry out their duties."

I would point out that during the last year, LMSA has implemented a comprehensive training program for staff involved in the enforcement of ERISA. This effort has involved structured classroom training developed and taught by the ERISA enforcement staff. Since the greatest program emphasis has been to obtain compliance with ERISA's fiduciary provisions, the first set of courses concerned basic fiduciary training which was provided to all PWBP professional staff. This was followed-up by advanced fiduciary training which is currently being given to compliance officers in the field. In addition, a course on investigation skills has been developed which covers auditing, investigation planning and other investigative functions. This course is currently being given to ERISA field staff.

As for LMRDA training, the National Office of Labor Management Standards Enforcement will be instituting an on-the-job training program in audit procedures and the analysis of union books and records for compliance officers in the field.

Sincerely,

RAY MARSHALL,
Secretary of Labor.

APPENDIX J–2

U.S. DEPARTMENT OF JUSTICE,
Washington, D.C., June 18, 1979.

Hon. ELMER B. STAATS,
Comptroller General of the United States, General Accounting Office, Washington, D.C.

DEAR MR. STAATS: This is in response to your letter of October 24, 1978, asking for any comments we might have on your report entitled

"Laws Protecting Union Members and Their Pension and Welfare Benefits Should Be Better Enforced" (HRD-78-154).

We agree with the findings in the GAO report that the Department of Labor's (DOL) primary enforcement efforts are directed to priorities other than detecting and investigating criminal cases under the Employee Retirement Income Security Act (ERISA) and the Labor-Management Reporting and Disclosure Act (LMRDA). The Office of Labor Management Standards Enforcement (LMSE), which is responsible for investigations under LMRDA, has as its first priority election matters and as its second priority voluntary, negotiated compliance with the Act's reporting requirements. Our experience is similar to GAO's findings in that, with the exception of cases developed by a few compliance officers who have had criminal investigative training prior to joining DOL, most criminal investigations result when local union officers are cooperative in reporting low-level, small thefts by clerical people or former union officials to a compliance officer, or when a bonding company files a report of loss already claimed by a union. Under ERISA, which is enforced by the Office of Pension and Welfare Benefit Programs (PWBP), the first priority is to work on civil cases and the second to obtain voluntary compliance with the Act. In furtherance of these goals, ERISA compliance officers are not encouraged to undertake criminal investigations.

A further complication under ERISA is the broad grant of civil litigation authority given to the DOL which often results in parallel civil and criminal investigations of the same activities. Once a compliance officer becomes aware of a potential civil violation, the Solicitor of DOL is notified and that office takes full control of the investigation. Because the Solicitor's Office is interested primarily in making civil cases, it has failed to recognize the criminal potential in some investigations. In addition to its ERISA responsibilities, the Solicitor's Office also reviews all criminal investigations done by compliance officers under LMRDA before the results are made available to us. This procedure has caused substantial and potentially harmful delays in the investigative process.

Only selected data elements of reports filed by labor organizations are computerized. Little effort has been made to correlate the different report filings within a single international union to ascertain how many different positions within a union's hierarchy an individual may hold. However, in 1977 a pilot project was undertaken to accomplish this as well as other goals.

Desk audits of labor union reports are made only when computer analysis discovers some mathematical error in the reports and generally result only in correction of the error. This procedure is superficial and not designed to uncover criminal violations. We are advised that lack of personnel is the principal cause of this deficiency. However, a major cause of the ineffectiveness of LMSE's supervision of union disclosure and reporting lies with the design of the report form (LM form) filed by the union because the form does not require full reporting of problem areas such as officer allowances, travel expenses, and organizing expenses. Many unions are lax in requiring full accounting by those incurring such expenditures. With respect to benefit plan reporting, PWBP's review process is now further complicated by the fact that the reports are first filed with and processed by the Internal Revenue Service before DOL gets them.

Field office investigative activities are considerably delayed and weakened because compliance officers are often pulled off criminal investigations to deal with civilian complaints and election matters. Further, compliance officers are unionized and union work rules interfere with after-hours and weekend work. As the report also points out, there is a need for more direct, continuous, and day-to-day coordination between ERISA and LMRDA investigative tracks at the area offices. A further complication is the fact that both national and regional office program personnel work under the added handicap of the fact that case assignments and personnel placement are the responsibility of an office not subject to their control.

We also agree with GAO's conclusions that the Labor-Management Services Administration (LMSA) has not been provided with sufficient manpower and that more formal classroom training is needed. Investigative reports which show weaknesses due in part to lack of training are regularly referred to the Criminal Division. Past efforts by the Criminal Division to have DOL create a special criminal investigative compliance officer or to institute a formal, intensive criminal investigative program have been consistently ignored or put on the back burner. However, the recent assignment of 90 compliance officers to our organized crime program and efforts to institute joint training programs for these and other compliance officers lead us to believe that this problem is being overcome with respect to cases involving organized crime.

In summary, from the perspective of criminal enforcement, we believe the GAO report accurately depicts LMSA's past activities and the problems which need to be overcome. The Criminal Division plans not only to continue but strengthen its efforts to gain a high priority for criminal investigations in LMSA, encourage training in investigative techniques and procedures, and upgrade the exchange of information and coordination of investigations between the two Departments. LMSA has recently demonstrated a high degree of interest in these goals.

These recent developments are highly encouraging and show considerable promise to lead to good results provided that DOL follows up vigorously on its stated intentions. The Department of Justice not only applauds these efforts, but is prepared to assist wherever it can. The cooperative efforts relating to DOL's criminal investigations touching on organized crime should now be expanded to other areas of union problems. The Department of Justice looks forward to further cooperative efforts.

We appreciate the opportunity to comment on the report. Should you desire any additional information, please feel free to contact us.

Sincerely,

KEVIN D. ROONEY,
Assistant Attorney General
for Administration.

APPENDIX M–1

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, D.C. February 17, 1978.

Hon. SAM NUNN,
Vice Chairman, Senate Permanent Subcommittee on Investigations, U.S. Senate, Washington, D.C.

DEAR VICE CHAIRMAN NUNN: Thank you for your January 20, 1978, letter concerning the applicability of the Employee Retirement Income Security Act of 1974 (ERISA) to actuarial consultants.

You state that you are particularly interested in knowing whether and under what conditions an actuarial consultant may be considered a fiduciary of a welfare benefit plan and therefore subject to those provisions of ERISA applicable to such fiduciaries.

The only formal statement of the Department of Labor regarding the status of actuaries or other professionals as fiduciaries is contained in question and answer D–1 in ERISA Interpretive Bulletin 75–5 (29 CFR 2509.75–5, redesignated from 29 CFR 2555.75–5), a copy of which is enclosed. As noted in that question and answer, actuaries (and other professionals) performing their usual professional functions would not ordinarily be considered fiduciaries. However, if the actuary performs services which, in the factual situation of the case, fit within the definition of a fiduciary contained in section 3(21)(A) of ERISA, the actuary would be considered to be a fiduciary.

The Department of Labor has issued regulations describing when a person becomes a fiduciary under section 3(21)(A)(ii) by virtue of rendering investment advice, for a fee or other compensation, direct or indirect. Those regulations are contained in 29 CFR 2510.3–21, a copy of which is enclosed herewith. As noted in the preamble to the regulation, a person will be considered a fiduciary with respect to the plan by virtue of being an investment adviser to the plan where such person provides advice with respect to investments of plan assets where such person regularly provides such advice and it is expected that such advice will serve as one of the primary bases for investment of plan assets.

Whether the actuarial consultants were fiduciaries by virtue of giving investment advice to the plans which invested in insurance contracts issued by companies associated with Mr. Joseph Hauser is a matter to be determined by the factual circumstances of each case. The Department is currently examining these situations.

I hope this information is helpful to the Subcommittee.

Sincerely,

RAY MARSHALL,
Secretary of Labor.

Enclosure.

EMPLOYEE RETIREMENT INCOME SECURITY ACT, DEPARTMENT OF LABOR, OFFICE OF EMPLOYEE BENEFITS SECURITY, INTERPRETIVE BULLETIN

Questions and answers relating to certain aspects of the recently enacted Employee Retirement Income Security Act of 1974 (the "Act") were issued today by the Department of Labor.

Pending the issuance of regulations or other guidelines, persons may rely on the answers to these questions in order to resolve the issues that are specifically considered. No inferences should be drawn regarding issues not raised which may be suggested by a particular question and answer or as to why certain questions, and not others, are included. Furthermore, in applying the questions and answers, the effect of subsequent legislation, regulations, court decisions, and interpretive bulletins must be considered. To the extent that plans utilize or rely on these answers and the requirements of regulations subsequently adopted vary from the answer relied on, such plans may have to be amended.

An index of the questions and answers, relating them to the appropriate sections of the Act, is also provided.

The index and the questions and answers are attached.

Attachments.

INDEX

KEY TO QUESTION PREFIXES

D—Refers to Definitions.

FR—Refers to Fiduciary Responsibility.

Section Number	*Question Number*
3(21)	D-1
3(38)	FR-6, FR-7
402(a)	FR-1, FR-2, FR-3
402(b)(1)	FR-4, FR-5
402(c)(3)	FR-6, FR-7
404(a)	FR-10
405(a)(3)	FR-10
405(b)(1)(A)	FR-10
406(a)	FR-9
409(a)	FR-10
412(a)	FR-8, FR-9

D-1 Q: Is an attorney, accountant, actuary or consultant who renders legal, accounting, actuarial or consulting services to an employee benefit plan (other than an investment adviser to the plan) a fiduciary to the plan solely by virtue of the rendering of such services, absent a showing that such consultant (a) exercises discretionary authority or discretionary control respecting the management of the plan, (b) exercises authority or control respecting management or disposition of the plan's assets, (c) renders investment advice for a fee, direct or indirect, with respect to the assets of the plan, or has any authority or responsibility to do so, or (d) has any discretionary authority or discretionary responsibility in the administration of the plan?

A: No. However, while attorneys, accountants, actuaries and consultants performing their usual professional functions will ordinarily not be considered fiduciaries, if the factual situation in a particular case falls within one of the categories described in clauses (a) through (d) of this question, such persons would be considered to be fiduciaries within the meaning of section 3(21) of the Act. The Internal Revenue Service notes that such persons would also be considered to be fiduciaries within the meaning of section 4975(e)(3) of the Internal Revenue Code of 1954.

FR-1 Q: If an instrument establishing an employee benefit plan provides that the plan committee shall control and manage the operation and administration of the plan and specifies who shall constitute the plan committee (either by position or by naming individuals to the committee), does such provision adequately satisfy the requirement in section 402(a) that a "named fiduciary" be provided for in a plan instrument?

A: Yes. While the better practice would be to state explicitly that the plan committee is the "named fiduciary" for purposes of the Act, clear identification of one or more persons, by name or title, combined with a statement that such person or persons have authority to control and manage the operation and administration of the plan, satisfies the "named fiduciary" requirement of section 402(a). The purpose of this requirement is to enable employees and other interested persons to ascertain who is responsible for operating the plan. The instrument in the above example, which provides that "the plan committee shall control and manage the operation and administration of the plan" and specifies, by name or position, who shall constitute the committee, fulfills this requirement.

FR-2 Q: In a union negotiated employee benefit plan, the instrument establishing the plan provides that a joint board on which employees and employers are equally represented shall control and manage the operation and administration of the plan. Does this provision adequately satisfy the requirement in section 402(a) that a "named fiduciary" be provided for in a plan instrument?

A: Yes, for the reasons stated in response to question FR-1. The joint board is clearly identified as the entity which has authority to control and manage the operation and administration of the plan, and the persons designated to be members of such joint board would be named fiduciaries under section 402(a).

FR-3 Q: May an employee benefit plan covering employees of a corporation designate the corporation as the "named fiduciary" for purposes of section 402(a)(1) of the Act?

A: Yes, it may. Section 402(a)(2) of the Act states that a "named fiduciary" is a fiduciary either named in the plan instrument or designated according to a procedure set forth in the plan instrument. A fiduciary is a "person" falling within the definition of the fiduciary set forth in section 3(21)(A) of the Act. A "person" may be a corporation under the definition of person contained in section 3(9) of the Act. While such designation satisfies the requirement of enabling employees and other interested persons to ascertain the person or persons responsible for operating the plan, a plan instrument which designates a corporation as "named fiduciary" should provide for designation by the corporation of specified individuals or other persons to carry out specified fiduciary responsibilities under the plan, in accordance with section 405(c) (1) (B) of the Act.

FR-4 Q: A defined benefit pension plan's procedure for establishing and carrying out a funding policy provides that the plan's trustees shall, at a meeting duly called for the purpose, establish a funding policy and method which satisfies the requirements of Part 3 of Title I of the Act, and shall meet annually at a stated time of the year to review such funding policy and method. It further provides that all actions taken with respect to such funding policy and method and the reasons therefor shall be recorded in the minutes of the trustees' meetings. Does this procedure comply with section 402(b) (1) of the Act?

A: Yes. The above procedure specifies who is to establish the funding policy and method for the plan, and provides for a written record of the actions taken with respect to such funding policy and method, including the reasons for such actions. The purpose of the funding policy requirement set forth in section 402(b) (1) is to enable plan participants and beneficiaries to ascertain that the plan has a funding policy that meets the requirements of Part 3 of Title I of the Act. The procedure set forth above meets that requirement.

FR-5 Q: Must a welfare plan in which the benefits are paid out of the general assets of the employer have a procedure for establishing and carrying out a funding policy set forth in the plan instrument?

A: No. Section 402(b) (1) requires that the plan provide for such a procedure "consistent with the objectives of the plan" and requirements of Title I of the Act. In situations in which a plan is unfunded and Title I of the Act does not require the plan to be funded, there is no need to provide for such a procedure. If the welfare plan were funded, a procedure consistent with the objectives of the plan would have to be established.

FR-6 Q: May an investment adviser which is neither a bank nor an insurance company, and which is not registered under the Investment Advisers Act of 1940 in reliance upon an exemption from registration provided in that Act, be appointed an investment manager under section 402(c) (3) of the Act?

A: No. The only persons who may be appointed an investment manager under section 402(c) (3) of the Act are persons who meet the requirements of section 3(38) of the Act—namely, banks (as defined in the Investment Advisers Act of 1940), insurance companies qualified under the laws of more than one state to manage, acquire and dispose of plan assets, or persons registered as investment advisers under the Investment Advisers Act of 1940.

FR-7 Q: May an investment adviser that has a registration application pending under the Investment Advisers Act of 1940 function as an investment manager under the Act prior to the effective date of registration under the Investment Advisers Act?

A: No, for the reasons stated in the answer to FR-6 above.

FR-8 Q: Under the temporary bonding regulation set forth in 29 CFR § 2550.421-1, must a person who renders investment advice to a plan for a fee or other compensation, direct or indirect, but who does not exercise or have the right to exercise discretionary authority with respect to the assets of the plan, be bonded solely by reason of the provision of such investment advice?

A: No. A person who renders investment advice, but who does not exercise or have the right to exercise discretionary authority with respect to plan assets, is not required to be bonded solely by reason of the provision of such investment advice. Such a person is not considered to be "handling" funds within the meaning of the temporary bonding regulation set forth in 29 CFR § 2550.412–1, which incorporates by reference 29 CFR § 464.7. For purposes of the temporary bonding regulation, only those fiduciaries who handle funds must be bonded. If, in addition to the rendering of investment advice, such person performs any additional function which constitutes the handling of plan funds under 29 CFR § 464.7, the person would have to be bonded.

FR–9 Q: May an employee benefit plan purchase a bond covering plan officials?

A: Yes. The bonding requirement, which applies, with certain exceptions, to every plan official under section 412(a) of the Act, is for the protection of the plan and does not benefit any plan official or relieve any plan official of any obligation to the plan. The purchase of such bond by a plan will not, therefore, be considered to be in contravention of sections 406 (a) or (b) of the Act.

FR–10 Q: An employee benefit plan is considering the construction of a building to house the administration of the plan. One trustee has proposed that the building be constructed on a cost plus basis by a particular contractor without competitive bidding. When the trustee was questioned by another trustee as to the basis of choice of the contractor, the impact of the building on the plan's administrative costs, whether a cost plus contract would yield a better price to the plan than a fixed price basis, and why a negotiated contract would be better than letting the contract for competitive bidding, no satisfactory answers were provided. Several of the trustees have argued that letting such a contract would be a violation of their general fiduciary responsibilities. Despite their arguments, a majority of the trustees appear to be ready to vote to construct the building as proposed. What should the minority trustees do to protect themselves from liability under section 409 (a) of the Act and section 405 (b) (1) (A) of the Act?

A: Here, where a majority of trustees appear ready to take action which would clearly be contrary to the prudence requirement of section 404(a) (1) (B) of the Act, it is incumbent on the minority trustees to take all reasonable and legal steps to prevent the action. Such steps might include preparations to obtain an injunction from a Federal District court under section 502(a) (3) of the Act, to notify the Labor Department, or to publicize the vote if the decision is to proceed as proposed. If, having taken all reasonable and legal steps to prevent the imprudent action, the minority trustees have not succeeded, they will not incur liability for the action of the majority. Mere resignation, however, without taking steps to prevent the imprudent action, will not suffice to avoid liability for the minority trustees once they have knowledge that the imprudent action is under consideration.

More generally, trustees should take great care to document adequately all meetings where actions are taken with respect to management and control of plan assets. Written minutes of all actions taken should be kept describing the action taken, and stating how each trustee voted on each matter. If, as in the case above, trustees object to a proposed action on the grounds of possible violation of the fiduciary responsibility provisions of the Act, the trustees so objecting should insist that their objections and the responses to such objections be included in the record of the meeting. It should be noted that, where a trustee believes that a co-trustee has already committed a breach, resignation by the trustee as a protest against such breach will not generally be considered sufficient to discharge the trustee's positive duty under section 405(a)(3) to make reasonable efforts under the circumstances to remedy the breach.

APPENDIX M-2

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C., January 20, 1978.

Hon. F. RAY MARSHALL,
Secretary of Labor,
Department of Labor,
Washington, D.C.

DEAR SECRETARY MARSHALL: Thank you for your letter of January 6 in response to my letter of December 8, 1977, regarding the Subcommittee's recent hearings on labor union insurance contracts with companies associated with Mr. Joseph Hauser. You may be assured that the Subcommittee staff will cooperate fully with any inquiry made by the Department of Labor in connection with this matter.

I think it is evident from the transcripts of the hearings that actuarial consultants to jointly-managed welfare benefit trust funds played a crucial role in the awarding of a number of these contracts. For this reason, I would appreciate your having appropriate personnel of the Department advise the Subcommittee concerning the applicability of ERISA to actuarial consultants. I am particularly interested in knowing whether and under what conditions an actuarial consultant may be considered a fiduciary of a welfare benefit plan and therefore subject to those provisions of ERISA applicable to such fiduciaries.

I would also appreciate receiving any regulations, proposed regulations, advisory opinions, guidelines or other documents issued by the Department with respect to the applicability of ERISA to actuarial consultants.

I would like to have the Department's response by February 3, if possible. Questions concerning this request should be directed to Don Gray of the Subcommittee staff at 224-3721.

Your continued interest and cooperation in this matter is greatly appreciated.

Sincerely,

SAM NUNN,
Vice Chairman.

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END