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TOPIC: Insurer Alleges “Free Insurance Scheme and Fraud” Against Agents

CITATION: [Transamerica Life Insurance Company v. Madick Insurance Services, LLC, et al.](#), Case 2:15-cv-01076-SJO-AS (U.S.D.C. C.Dist. CA, S. Div. Filed 02/13/15)

SUMMARY: Transamerica Life Insurance Company alleged an unlawful insurance scheme by certain individuals and entities to manufacture the sale of Transamerica indexed universal life (“IUL”) insurance policies for the sole purpose of reaping huge financial gains at Transamerica’s expense. Allegedly, the ploy was perpetrated to induce Transamerica to issue IUL policies that it would not have otherwise issued had it been aware of the true facts. To date, as a direct and proximate result of these alleged schemes, Transamerica estimates it paid about \$11,137,844 in commissions to producers and their affiliated general agents and is seeking restitution of almost \$6,000,000. Charges also include violations of the Racketeer Influenced and Corrupt Organizations Act (“RICO”).

RELEVANCE: *If* the facts are proven to be as alleged, these distributors are going to be in their lawyers’ offices (and probably in a court room) for quite some time, and could potentially face exposure to jail time for criminal actions. Free insurance never is! (Among other things, don’t forget the insureds could be liable for income tax—not on the value of the term protection they received for their year of free coverage—but for the tax on the entire premium!).

Both proposed insureds and agents are required to deal in good faith with the insurers who accept risks, and when they do not, everyone loses.

For life insurance companies, the details of the Complaint are a good reminder that:

- When total first year compensation is in excess of first year premium, the company could be vulnerable if it turns out the company is doing business with unscrupulous agents.

- Rigorous underwriting practices—especially financial underwriting—can help prevent situations like those described in the Complaint.

FACTS: Transamerica alleged in a Complaint that the defendants, Madick Insurance Services, LLC, Madick Insurance Group, LLC, Professional Planning Corporation, Kenneth Madick, and Jeffrey Ferretta, ran an unlawful insurance scheme designed to “manufacture” the sale of Transamerica’s indexed universal life insurance policies for the sole purpose of reaping huge financial gains at Transamerica’s expense.

Specifically, the insurer claimed that, along with numerous independent producers appointed by Transamerica to solicit life insurance and other non-insurance licensed co-conspirator persons and entities, the defendants formed and ran an enterprise by which they marketed, solicited, and caused to be issued at least 154 policies to individuals who:

- (1) did not need or want the insurance; and/or
- (2) could not afford the insurance; and
- (3) had no intent of ever paying premiums for the policies, including both initially and to keep the insurance in effect after one year.

According to the Complaint, the defendants and their co-conspirators:

- (i) misled prospective policy owners as to the nature, terms and cost of the insurance;
- (ii) offered prospective policy owners “free” or nominal cost Transamerica IUL policies;
- (iii) covertly paid or arranged for the payment of insurance premiums (making it appear to Transamerica that the premium was paid by the applicant, applicant’s business, insured, policy owner, or family member); and
- (iv) engaged in various forms of fraud, including but not limited to, making material misrepresentations to Transamerica concerning applicants’ annual income and net worth, the forgery, falsification and alteration of required policy documents, and the falsification, alteration and forgery of signatures and financial instruments, including checks used to pay premium.

Transamerica claimed the defendants and their co-conspirators profited from this unlawful insurance scheme by improperly taking advantage of a commission structure for Transamerica IUL policies that, in the aggregate, paid producers and their affiliated general agents an up-front, first year commission that exceeded the first year premium for the policies.

Transamerica claimed that, “Due to the wrongful conduct of the Defendants and their co-conspirators, Transamerica has not received any second year premium payments for the IUL policies at issue and all of the policies have lapsed for failure to pay second year premiums.”

Transamerica estimated that, as a result of the insurance scheme described above, its aggregate financial loss to be in excess of \$5.8 million, representing commissions paid by Transamerica in excess of the premium received for the IUL policies at issue, as well as underwriting, administrative and legal expenses incurred in connection with the issued policies.

According to the Complaint, Transamerica IUL policies are generally sold by appointed independent, contracted producers affiliated with Transamerica's general agents. Transamerica typically pays distributors of its IUL policies commissions for each sale as follows: the selling producers are paid commissions up to 90% of the first year target premium and the general agent is paid a "commission override" of 55% of the first year target premium in addition to any portion of the 90% commission not paid to the selling producer. Smaller commissions (2% to the producer and 2% for the general agent) are paid for premium paid in excess of the first year target premium.

Transamerica (as is the case with all insurers) issues permanent life insurance with certain expectations or assumptions. Among these are that:

1. the policy owner has a legitimate need for (and wants) the applied for amount of coverage,
2. the policy owner will keep the coverage in force for many years, and
3. the expense of up-front commissions, underwriting, and administrative costs means the policy owner will have to make a number of years of premium payments for Transamerica to recover just its acquisition outlay.

Transamerica states in the Complaint that it discovered in 2013 that certain of its distributors were engaging in and participating in a scheme with various individuals and entities to unjustly enrich themselves at the expense of Transamerica. Specifically, it alleges that the defendants engaged or participated in in a scheme by which they and other co-conspirators manufactured the sale of IUL policies through the payment of first year premium on behalf of policy applicants who could not afford the coverage, did not want to pay for the coverage, did not understand the true nature or cost of the coverage, did not legitimately need the coverage, and had no intent of keeping the coverage in force through the payment of future premium from their own pockets.

Of course, despite the payment of the first year premium for Transamerica IUL policies on behalf of applicants, defendants and other co-conspirators allegedly involved in the scheme nevertheless reaped a financial benefit for themselves because, in addition to the commissions the appointed independent producers expected to receive from the "sale" of these policies, the producers and their co-conspirators (some of whom were not appointed with Transamerica) negotiated arrangements with certain affiliated general agents to be paid all, or substantially all, of the commission override paid by Transamerica to such general agents. The effect of the foregoing—according to the Complaint—was that, through the "pooling" of commissions from each IUL policy "sale," the defendants and their co-conspirators made a profit over and above the first year premiums that they paid on behalf of the policy owners.

Among other charges, Transamerica claims that *other* producers' names were used on applications one of the defendants took, even though the identified producer never met with, spoke to, or took the application of IUL policy applicants. In other words,

Transamerica alleges that, in exchange for money, one of the defendants agreed that other producers or non-producers with whom they conspired, would use *their* names on applications and other policy-related documents so that IUL applications and policy documents would be associated with a different “writing agent” and, therefore, appear on their face to be legitimate to Transamerica because the IUL policies were spread over numerous producers.

Transamerica further alleged that, in many cases, applications for the IUL policies at issue contained “cut and paste” information and otherwise improperly duplicated signatures of the policyholders, as well as “cut and paste” signatures of other producers—some of whom were given permission to use one of the defendants’ electronic signatures on any and all documents necessary to secure issuance of the IUL policies, including but not limited to application materials, policy illustrations, and policy delivery certificates. Transamerica alleged that when one defendant agent received commissions from Transamerica relating to IUL policies for which he was identified as the producer, he routinely forwarded those commissions to a co-conspirator not contracted with Transamerica, issued a Form 1099 to that co-conspirator reflecting the payment, and later received payment from that co-conspirator representing a percentage of the total commissions the defendants originally received from Transamerica. The allegation states that the co-conspirator to whom the defendant agent provided his commissions then utilized that money to cover the first year premium on IUL policies he had already paid on behalf of prospective policy owners.

According to Transamerica, that defendant agent was aided in this scheme by another defendant who acted as a “case manager” for one or more of the general agents with whom many of the Transamerica IUL producers were affiliated. This case manager acted as a conduit through which IUL application and policy documentation was consolidated and provided to Transamerica. According to Transamerica, the purpose was to make the IUL business appear legitimate. Purportedly, the case manager communicated directly with co-conspirators involved in the scheme and concealed material facts about the IUL business from Transamerica, including the facts that (1) IUL policy applicants were not paying first year premiums from their own funds, (2) that persons and entities not contracted with Transamerica had generated, funded, facilitated and perpetuated the IUL business, and (3) that certain producers were not actually involved in the production of the IUL business but were assigned to that business by the agent defendants or co-conspirators to make the business *appear* as if it had been legitimately generated by multiple, different producers.

Allegedly, the case manager defendants also received from general agents all or substantially all of their commission overrides relating to IUL policies for which they acted as a case manager. Allegedly, they then routinely forwarded these funds, in whole or substantial part, to a non-producer co-conspirator and issued a Form 1099 to that non-producer reflecting the payment.

Transamerica claims that the co-conspirator to whom these override commissions were paid then utilized that money to pay first year premiums on additional IUL policies on behalf of prospective policy owners. In respect to two IUL policyholders, it is alleged that the case manager defendants paid money directly to the policyholders so that they could pay the premiums for their policies, and that they later collected both the producer’s commissions on those policies from the producer who sold those policies and general agent’s override commissions on those policies—which allowed them to reimburse themselves for the funds they had previously given to the policyholders for the

premiums. The general agents allegedly gave the majority of their commissions to the case manager defendants.

According to the Complaint, the case manager defendants also served as the contacts with Transamerica concerning the bulk of the IUL business at issue in this matter so that, if Transamerica had questions when Transamerica asked for information about the IUL business (including responding to any complaints or problems), they communicated directly with the co-conspirators involved in the scheme to develop responses that they concluded would satisfy Transamerica's inquiries and preclude further inquiry—including false or fabricated information addressing policy holder complaints and other IUL policy-related issues.

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