

GAO

Report to the Chairman, Subcommittee
on Oversight and Investigations,
Committee on Energy and Commerce,
House of Representatives

October 1994

INSURANCE INDUSTRY

Chronology of F.T. Riley's Activities and Related Regulatory Actions



Office of Special Investigations

B-255978

October 26, 1994

The Honorable John D. Dingell
Chairman, Subcommittee on
Oversight and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Your March 23, 1993, letter expressed concern about the prevalence of fraud and abuse within the insurance industry. In that letter and subsequent discussions with your office, you asked that we conduct an investigation to describe the business practices of Ferrell Travis Riley. As represented by your office, he is a known associate of James Wining, a subject of the Subcommittee's February 1990 report entitled "Failed Promises," who had pleaded guilty on March 13, 1992, to conspiracy to commit wire fraud, mail fraud, and interstate transportation of property obtained by fraud. As discussed with your office, our report presents a chronology of Mr. Riley's activities, his methods of operation, and regulatory actions taken by state regulators against him and his associated companies.

In developing this chronology, we relied on statements made by insurance regulators familiar with Mr. Riley's activities and court documents related to civil and criminal actions that have been filed against Mr. Riley and his related companies. We did not independently investigate the basis for the various charges against Mr. Riley. While Mr. Riley has been indicted in a number of instances, he has never, to our knowledge, been convicted of a criminal act. Because Mr. Riley's attorney declined a request by your office for an interview with Mr. Riley, we did not obtain Mr. Riley's response to the charges.

Prior to September 13, 1994, no federal statutes directly prohibited insurance fraud.¹ State regulators and others informed us that states having statutes prohibiting fraud are reluctant to investigate and prosecute insurance fraud cases because of budget and jurisdictional problems. By taking advantage of this environment, Mr. Riley and his related companies have continued to operate in a questionable manner by moving from state to state. In a little more than a decade, Mr. Riley and his associates have engaged in insurance activities in at least 18 states.

¹On September 13, 1994, the Violent Crime Control and Law Enforcement Act was signed into law, which makes insurance fraud a crime if it affects interstate commerce. (Title 18 U.S.C. § 1033 and § 1034)

Mr. Riley's career in the insurance business has spanned nearly 2 decades. Over the years, Mr. Riley, his associates, and the companies with which he has been connected have been the subject of charges which alleged selling insurance without state approval, diversion of funds belonging to insured or insurer, misrepresentation of company assets, and theft.

Mr. Riley's practice was to locate an insurance company in one state but sell insurance in another state. He then claimed exemption from home state regulation on the grounds that he was a foreign insurer (an out-of-state insurer) and was not doing the business of insurance in the state of domicile. For example, in response to an attempt by the New Mexico Insurance Department to regulate Meadowlark Insurance Company (a Riley-related company), Mr. Riley's attorney stated that Meadowlark was exempt from New Mexico state regulation. In fact, it was Meadowlark's position that it was not subject to the jurisdiction of any state. Further, when a state of domicile strengthened its laws, Mr. Riley moved the company to another state with weaker regulations.

Appendix I summarizes Mr. Riley's insurance business activities from 1976 to 1993. The chronology shows that some state regulators had limited success in keeping Mr. Riley from continuing operations in their respective states. Attempts to regulate Mr. Riley's insurance activities in the companies with which he was associated date from at least 1986. Mr. Riley currently controls an insurance company in Kansas.

Appendix II describes "nonadmitted" insurers, who sell excess and surplus lines insurance—the insurance Mr. Riley sold in most of the states in which he operated.

Our investigation took place between March and November 1993. We interviewed representatives of various state insurance commissions; state enforcement personnel; and liquidators, conservators, and auditors representing state insurance departments to obtain information about what they knew of Mr. Riley's business practices. We also interviewed an attorney representing a private insurance company affected by Mr. Riley's operations and analyzed its records.

As arranged with your office, unless you publicly release its contents earlier, we will not make this report available to others until 30 days after the date of this letter. If you have any questions concerning this information, please contact me or Assistant Director Donald Fulwider of

my staff at (202) 512-6722. Major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Richard C. Stiener". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Richard C. Stiener
Director

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Abbreviations

GAO	General Accounting Office
GGD	General Government Division
NAIC	National Association of Insurance Commissioners
OSI	Office of Special Investigations
RICO	Racketeer Influenced and Corrupt Organizations

Chronology of Ferrell Travis Riley's Insurance Activities

We prepared this chronology on the basis of statements and documents received from various state regulators, auditors, and investigators who had knowledge of Mr. Riley's operations. In addition, we obtained information from public documents, which included indictments, transcripts, cease and desist orders, and injunctions. We also interviewed a representative of an insurance company affected by Mr. Riley's operations. We did not independently investigate the allegations raised by these sources. Because Mr. Riley's attorney declined a request by your office for an interview with Mr. Riley, we did not obtain Mr. Riley's response to the charges. The following summarizes attempts by some state regulators and others to keep Mr. Riley and his related companies from operating in their respective states.

Texas

In 1976, Mr. Riley owned the Sheldon Agency located in Houston, Texas. In 1983, he organized and financed the Riley Insurance Agency on behalf of his son, Frank Riley. According to court documents, Mr. Riley obtained an agency appointment with Dexter Lloyds Insurance Company of Houston, Texas, in May 1982² and in 1983 began acquiring stock in this company. By February 1986, Mr. Riley had become the sole owner of the company. In August 1986, the Commissioner of the Texas State Board of Insurance ordered Dexter Lloyds to be placed under regulatory supervision. According to a 1988 civil complaint filed in U.S. District Court, Mr. Riley secretly obtained control of Dexter Associates, the parent company for Dexter Lloyds. However, the Texas State Board of Insurance was not informed that he had purchased the company, even though state law required such disclosure.

In October 1986, the Commissioner of the Texas State Board of Insurance placed Dexter Lloyds in temporary receivership; and in December 1986, the Texas Attorney General obtained a temporary injunction against Dexter Lloyds. (In the fall of 1986, Mr. Riley moved his operation to Louisiana when he acquired/created North American Underwriters Insurance Company located in Lake Charles, Louisiana.) In January 1988, Dexter Lloyds and Dexter Associates were placed in permanent receivership when the court found that they were insolvent by an amount in excess of \$3.5 million.

While Dexter Lloyds was in receivership, the Texas receiver attempted to secure corporate assets to pay policyholders of the failed company. In this

²According to Texas state insurance authorities, an insurance sales firm grants an agency appointment when it vouches for the credentials and integrity of the appointee and allows that appointee to sell insurance for the company.

regard, the Texas receiver filed a civil complaint in 1988 in U.S. District Court against Ferrell Riley, the Sheldon Agency, Frank Riley, the Riley Insurance Agency, and individuals associated with Dexter Lloyds. The complaint was filed under the Racketeer Influenced and Corrupt Organizations (RICO) Act of 1970. This complaint made numerous assertions, including (1) concealment of ownership in Dexter Lloyds, (2) misappropriation/diversion of Dexter Lloyds' moneys, and (3) misrepresentation of the financial condition and soundness of Dexter Lloyds.

On April 11, 1990, at the request of the state of Texas, the court dismissed the RICO complaint because the defendants had filed for bankruptcy. According to the Texas Liquidation Division's former Director of Legal Services and Receiverships, the expense to the receiver did not justify the continued prosecution of the case.

In September 1989, the Texas Commissioner of Insurance revoked Mr. Riley's Texas insurance licenses. This revocation was based on the Commission's determination that Mr. Riley had illegally withheld money belonging to insured and insurer, had demonstrated a lack of trustworthiness or competence to act as an insurance agent, was guilty of fraudulent and dishonest practices, and had unreasonably failed and neglected to pay over to an insurance company or its agent any premium or part thereof collected on a policy or application for insurance.

In July 1990, a federal grand jury indicted Mr. Riley and his son Frank Riley on charges of mail fraud, false statements, and aiding and abetting. The indictment stated that these individuals had violated criminal statutes while doing business as insurance agents for the Sheldon and Riley agencies. On April 15, 1991, the indictment was dismissed by motion of the government after Mr. Riley reimbursed the victims.

Louisiana

In 1986, Mr. Riley and his associates moved their insurance business to Louisiana and acquired and/or created North American Underwriters Insurance Company.

In March 1987, North American Underwriters' name was changed to Louisiana Underwriters Insurance Company. According to the Louisiana Insurance Commission examiner, Mr. Riley was listed as a consultant to Louisiana Underwriters. Had he been listed as an officer or stockholder, his previous record of insurance abuse in Texas would have disqualified

the Louisiana Underwriters application. Further, Mr. Riley received no salary or consultant fees, but Louisiana Underwriters paid his expenses. The examiner added that Mr. Riley had made all major policy and operating decisions for Louisiana Underwriters.

According to the Louisiana Insurance Commission examiner who examined the business records of Louisiana Underwriters, fraudulent activities had taken place at Louisiana Underwriters in 1987. For example, Louisiana required that assets of an insurance company be located in that state in order for the company to be licensed to do business. The principal asset listed for Louisiana Underwriters—mortgage loans on condominium property—was located in Park City, Utah.

Further, the examination found that Mr. Riley had misappropriated hundreds of thousands of dollars that should have been deposited for future claims. For example, in 1987, Louisiana Underwriters contracted to manage an insurance risk pool of \$1 million for a group of amusement park owners for a \$100,000 management fee. Mr. Riley did not maintain the \$1 million in a required escrow account to pay policyholder claims. The examination concluded that at least \$200,000 had been spent to pay for a trip Mr. Riley made to Monte Carlo. Another \$50,000 had been used to purchase rugs, paintings, vases, scrolls, and sculpture for personal use.

In August 1988, a short time after the state of Louisiana had begun an on-site insurance examination of Louisiana Underwriters, Mr. Riley was alerted (the Louisiana state examiner believes it was through a wiretap of the examiner's office space at Louisiana Underwriters) that the state examiner had preliminary findings of fraud and misappropriation of Louisiana Underwriters' funds. The remainder of Louisiana Underwriters' liquid assets was transferred to Wyoming 1 day before the funds could be seized under a Louisiana state conservation order filed in August 1988. In April 1989, the court transferred the assets of Louisiana Underwriters to Meadowlark Insurance Company—a Wyoming company controlled by Mr. Riley—and, as a result, the conservation order was canceled.

In 1989, a federal grand jury in Louisiana indicted Mr. Riley and his associates for allegedly transporting cashier's checks, obtained through alleged conspiracy and fraud, to Louisiana. According to this indictment, in order to meet Louisiana insurance licensing requirements, Mr. Riley obtained a \$1.7-million unsecured loan in February 1987 from the First State Savings Bank of San Antonio, Texas. The bank president had the loan disbursed in the form of 17 cashier's checks, payable to North

American Underwriters, which were converted to 17 separate certificates of deposit issued to North American Underwriters. On the basis of the \$1.7 million in 17 certificates of deposit that Mr. Riley presented as unencumbered assets for North American Underwriters, Louisiana granted it a license to sell insurance. Shortly after the license was granted, the \$1.7 million in certificates of deposit was returned to the Texas bank that had made the original unsecured loan. According to the Louisiana Insurance Commission, Mr. Riley had failed to disclose the existence of the \$1.7-million loan. On May 3, 1990, Ferrell Riley and his associates at Louisiana Underwriters were tried and acquitted of all charges. Mr. Riley claimed that the funds used to purchase the certificates of deposit had been borrowed, not obtained by fraud.

Wyoming

In August 1988, Mr. Riley and his associates began the move to Wyoming. They incorporated Meadowlark Insurance Company on August 30, 1988, in Wyoming but were not licensed to sell insurance in Wyoming. Mr. Riley was listed as a consultant to Meadowlark but not as an officer, director, or stockholder. According to its corporate charter, Meadowlark was in the business to sell property, casualty, marine transportation, fidelity and surety, and other insurance. On November 16, 1988, the Wyoming Insurance Commissioner, gave formal approval for Meadowlark to write excess and surplus lines insurance in the state of Wyoming.³

As a result of pending legal matters in Texas and Louisiana, on April 26, 1990, Meadowlark was deemed ineligible as a Wyoming insurance company by the Wyoming Insurance Commissioner. Insurance brokers were forbidden to do business with Meadowlark.

Meadowlark Overseas

Some states require an alien corporation (a non-U.S. corporation) to have several years of insurance experience as part of the criteria for writing surplus lines insurance in that state. In 1989, Mr. Riley acquired a dormant shell corporation in the Turks and Caicos Islands, British West Indies, that had been incorporated as Arabian Additives, Ltd. in 1982. On October 5, 1989, the name Arabian Additives, Ltd. was changed to Meadowlark Insurance Company in the Turks and Caicos. Meadowlark now appeared to have a history going back to 1982, allowing Mr. Riley to meet states' criteria for surplus lines insurance. However, the Turks and Caicos

³Excess and surplus lines insurance is property/casualty coverage that is not available from insurers licensed by the state—called admitted insurers—and must be purchased from a “nonadmitted” carrier. Excess and surplus lines is coverage that often is sold by only a few nonadmitted insurers. A brief discussion of nonadmitted insurers is found in app. II.

insurance administrator stated in a letter to the National Association of Insurance Commissioners⁴ in 1992 that Meadowlark was never licensed as an insurer in that jurisdiction. Yet, in 1989, Meadowlark, which was physically located in Albuquerque, New Mexico, distributed brochures that said

“ . . . Meadowlark Insurance Company is a worldwide casualty, property and bond insurer and reinsurer. . . . The company has a full administrative office in Albuquerque, New Mexico, U.S.A. . . . The company was incorporated in the Turks and Caicos Islands, British West Indies in 1982. In 1989 the name was changed to Meadowlark Insurance Company.”

In May 1990, Mr. Riley formed Meadowlark Insurance, S.A. in the Dominican Republic and moved Meadowlark from the British West Indies, which was tightening its regulation of insurance companies. James Wining⁵ assisted Mr. Riley in this endeavor. Although Meadowlark Insurance, S.A. was a legitimate corporation in the Dominican Republic, it never had a license to sell insurance in the Dominican Republic, according to a memorandum dated August 4, 1992, from the Superintendent of Insurance there.

Expansion of Meadowlark Companies Into Other States

Mr. Riley has expanded his activity throughout the United States since 1989. Six states—New Mexico, Missouri, Nebraska, Delaware, Maryland, and Kansas—deserve special mention, as they highlight Mr. Riley's method of operation.

New Mexico

In November 1989, Mr. Riley met the New Mexico Superintendent of Insurance to request approval to sell property and casualty insurance in New Mexico on a surplus lines basis. In negotiations with the state of New Mexico, Mr. Riley was the lead spokesperson and principal decisionmaker, according to New Mexico insurance authorities; however, the New Mexico Superintendent of Insurance did not grant Meadowlark authority to sell insurance in New Mexico. According to the New Mexico Superintendent of

⁴The National Association of Insurance Commissioners consists of the heads of the insurance departments of the 50 states, District of Columbia, and 4 U.S. territories. While it has no regulatory authority, the association serves as a clearinghouse for information concerning unlicensed non-U.S. insurers, especially those operating in the U.S. surplus lines market. It provides a structure for interstate cooperation in examinations of multistate insurers and distributes model insurance laws and regulations for consideration by state insurance departments.

⁵On July 6, 1991, James Wining was indicted concerning an unrelated transaction on federal charges of conspiracy and interstate transportation of stolen goods. On March 13, 1992, he pleaded guilty to those and other charges.

Appendix I
Chronology of Ferrell Travis Riley's
Insurance Activities

Insurance, Meadowlark could not conduct the business of insurance in New Mexico, given that it was not licensed in New Mexico or any other state. Further, the New Mexico Superintendent was concerned that Mr. Riley had moved Meadowlark from the West Indies to the Dominican Republic to avoid having his (Mr. Riley's) insurance practices scrutinized.

In early 1990, the New Mexico Superintendent of Insurance received information from other regulators indicating that Meadowlark was transacting insurance business from its Albuquerque office with consumers in other states. In February 1990, the New Mexico Superintendent of Insurance issued a cease and desist order against Meadowlark to stop it from transacting business in that state without a license. In March 1990, the Department of Insurance began a formal examination of Meadowlark's operations, financial condition, and business affairs to determine its eligibility for certification. Mr. Riley and his associates continued to expand their business base in New Mexico and elsewhere. In April 1990, the Wyoming-based M & M Management Company (a Riley-related company) received its New Mexico corporate charter.

The New Mexico Insurance Commission, through the Superintendent of Insurance, identified several violations of New Mexico insurance law by Meadowlark in 1990 and concluded that Meadowlark had transacted \$1.6 million of insurance business while located in New Mexico without the required authority from the Superintendent of Insurance. Mr. Riley's lawyer contended that Meadowlark was an alien corporation and pure surplus lines company and therefore no state had the authority to examine its operations, financial condition, and business affairs. He further asserted that Meadowlark was not transacting the business of insurance in New Mexico because it was selling to residents in other states.

In July 1990, Meadowlark applied for placement on New Mexico's approved list of alien surplus lines insurers. But regulators denied Meadowlark's application, citing the company's trust fund deficiencies, inadequate loss reserves, incorrect valuation of assets, and false representations. The New Mexico Superintendent of Insurance issued a second cease and desist order against Meadowlark on August 23, 1990.

Because of ambiguities in the New Mexico Insurance Code on the definition of the transaction of insurance business and the regulation of alien insurance companies like Meadowlark, the state legislature changed the law on March 16, 1991, despite intense lobbying against the bill by

Meadowlark. That legislation became known as the "Meadowlark Bill." It increased state regulatory powers over alien insurance companies operating in that state, increased insurers' requirements for capital surplus and funds held in trust, and extended the oversight authority of the New Mexico Superintendent of Insurance. Shortly after this legislation was passed, Meadowlark left New Mexico. The New Mexico Superintendent of Insurance referred Mr. Riley and Meadowlark to the Office of the New Mexico State's Attorney and the U.S. Attorney's Office for investigation.

Missouri

During 1990, although Meadowlark was not licensed to sell insurance in Missouri, Meadowlark contracted with a Missouri insurance broker to sell commercial general liability policies. Complaints received by the Missouri Department of Insurance indicated that (1) Meadowlark Insurance Company and M & M Management Company (as manager of Meadowlark's affairs in the United States) were selling insurance and adjusting claims and (2) M & M was collecting premiums from agents who were producing the business. In response to these complaints, the Missouri Department of Insurance obtained a temporary restraining order against Meadowlark in December 1990, prohibiting it from writing insurance in Missouri. In June 1991, the state obtained a permanent injunction prohibiting Meadowlark from transacting any insurance business with Missouri residents until Meadowlark obtained a Missouri license. In August and September 1991, Meadowlark Insurance Company and M & M moved their offices from Albuquerque, New Mexico, to Kansas City, Missouri.

From April through September 1991, Meadowlark and M & M transferred \$300,000 to Mr. Riley's lawyer, Mr. Kevin Hare. According to Mr. Hare, the moneys were from Mr. Riley and were meant to bribe Missouri regulators to grant Meadowlark a license to sell insurance in Missouri. However, the attorney said that he kept the money instead. In 1994, Mr. Hare was convicted in the Western District of Missouri of schemes to defraud and criminal money laundering. According to evidence entered in Mr. Hare's trial, part of the \$300,000 in M & M funds was to pay claims to insureds in the western United States.

Nebraska

In 1990, while Mr. Riley was operating without licenses in New Mexico, Missouri, and Kansas, he was also active in Nebraska. According to the Nebraska Department of Insurance, Meadowlark Insurance Company sold liability insurance to Nebraska residents without a Nebraska insurance license and without maintaining the required adequate guaranty deposits

in the United States for the protection of policyholders. The state of Nebraska obtained a temporary cease and desist order in February 1990, a permanent cease and desist order in April 1991, and a permanent injunction and restraining order on June 19, 1991, against the company. However, the district court of appeals reversed the April 1991 order on March 31, 1992, because the term “adequate” in Nebraska statutes was unconstitutionally vague. The Nebraska legislature subsequently rewrote its statutes on surplus lines insurance, following the model provided by the National Association of Insurance Commissioners, to clearly define adequately guaranteed deposits. As a result, Meadowlark stopped selling insurance in Nebraska.

Delaware

In early 1990, the Delaware Department of Insurance learned that Meadowlark was insuring Delaware residents but was not licensed in that state or elsewhere. The Department of Insurance also found Meadowlark's annual report to be of doubtful authenticity. Asked if a cease and desist order had been issued to Meadowlark, the regulator said that he had found that issuing cease and desist orders to companies such as Meadowlark “. . . is like giving Willie Sutton a parking ticket.” He had found that it was more effective to concentrate on the agents issuing the policies. This strategy was effective in the case of Meadowlark, as the agent who was writing Meadowlark policies in Delaware has stopped writing them.

Maryland

In 1991, Mr. Riley and Meadowlark began doing business in Maryland. Although the Baltimore City School Bus Contractors Association was self-insured under the Maryland self-insurance program, transportation companies were required to provide evidence of additional security, such as a surety bond with an approved insurance company, for payment of liability claims. Maryland law required that only companies that have been approved by the Maryland Insurance Commissioner to do the business of insurance in that state may bid on the transportation surety bond business.

According to court documents, the manager of the self-insurance program for Maryland, Austin Evans, contrary to Maryland law, approved applications submitted by transportation companies to become self-insured through surety bonds issued by Meadowlark, although Mr. Evans knew that Meadowlark was not licensed in Maryland. Mr. Evans also used his position to illegally influence self-insured transportation companies to buy surety bonds from Meadowlark. Meadowlark, as part of its contract with the Baltimore City School Bus Contractors Association,

also provided insurance coverage for Baltimore City school children bused to extracurricular activities, such as field trips and athletic events, and for busing the elderly and handicapped after school.

In April 1992, prior to a grand jury's discovery of Mr. Evans' involvement, the Maryland Department of Insurance issued a cease and desist order to Meadowlark because it had discovered that Meadowlark had no license to operate as an insurance company in Maryland. In June 1992, Meadowlark entered into a consent agreement with the state of Maryland and ceased insurance activities in that state.

In September 1993, Mr. Evans was convicted of a scheme to defraud the state of Maryland and for accepting a \$17,000 bribe from Meadowlark Insurance Company in return for steering payments of over \$400,000 to Meadowlark from companies that comprised the Baltimore City School Bus Contractors Association and others. An examination of trial testimony reveals that while Mr. Evans was under investigation, Mr. Riley paid his plane fare to Kansas City, put him on the payroll of Consolidated Claim and Financial Services (a Riley-related business) at between \$2,500 and \$3,500 per month, and paid his attorney's fees.

Kansas

Mr. Riley also conducted business in Kansas in 1991. According to officials of the Kansas Department of Insurance, Kansas regulators held hearings in early 1991 to shut down Town and Country Fire and Casualty Insurance Company, a small company in Hutchinson, Kansas, which was nearly insolvent. In early 1991, Town and Country negotiated with 8 to 10 investors to solve its financial problems. Mr. Riley, representing Meadowlark and M & M, met with Kansas regulators concerning M & M's investment in Town and Country stock. Kansas regulators agreed to allow Mr. Riley, representing Meadowlark and M & M, to provide \$400,000 cash to Town and Country, pending further investigation and regulatory approval of M & M by the Kansas Department of Insurance.

By November 1991, the Kansas Department of Insurance investigation had raised concerns over Mr. Riley's running Town and Country, but M & M by then had provided funds totaling \$855,000, making Town and Country solvent. In April 1992, M & M began the process of transferring all its Town and Country stock into Prairie Star, (a Riley-related company). By January 1993, Mr. Riley had provided \$1.4 million in capital through M & M, Magnolia Acceptance Finance Company (a Riley-related company), and his lawyer to Town and Country to maintain company solvency. Through

Prairie Star, Inc., Mr. Riley currently controls Town and Country, a domiciled insurance company in Kansas. Kansas regulators are aware of Mr. Riley and his relationship to Town and Country. They said that they are closely monitoring the company's business practices and operations.

Commercial Indemnity Assurance Company

In late 1991, Meadowlark Insurance Company was winding down its affairs in the United States.⁶ Meadowlark transferred its premiums to, and became known as, Commercial Indemnity Assurance Company. Commercial Indemnity was purportedly organized under the laws of the Dominican Republic in 1991. M & M Management Company compiled Commercial Indemnity's balance sheet as of December 30, 1991, which showed over \$5 million in assets and zero liabilities.

Latest Activities

As of November 1993, Town and Country Fire and Casualty Insurance Company was operating in Hutchinson, Kansas. Ferrell Travis Riley, M & M Management Company, and Magnolia Acceptance Finance Company were still operating from Kansas City, Missouri. Unlike New Mexico regulators who have regulatory authority under the "Meadowlark Bill," Missouri regulators say that they do not have regulatory authority over an insurance company located in Missouri but doing the business of insurance outside the state. As of the close of our inquiries, Mr. Riley, Meadowlark Insurance Company, and Commercial Indemnity were under investigation by the federal grand jury in the Western District of Missouri.

⁶In August 1991, Meadowlark Insurance Company reported \$10 million in sales and a net worth of \$11.9 million.

Nonadmitted Insurers and Surplus Lines Insurance

Insurers are licensed by the states. States call insurers that they have not licensed—but which may be licensed in other states—“nonadmitted” insurers or carriers. Each state has its own rules for nonadmitted insurers.⁷

Nonadmitted insurers range from long-established and well capitalized entities such as Lloyds of London to small, offshore carriers with little, if any, capitalization. Some states permit nonadmitted insurers to sell coverage that is unavailable from licensed insurers within their borders. This kind of coverage is called “surplus lines insurance,” according to the Insurance Information Institute’s Handbook.

Historically, policyholders bought surplus lines insurance for such purposes as covering corporate kidnap ransom demands or insuring rock concerts. Now, as some standard kinds of insurance have become more expensive, nonadmitted insurers have found customers for basic coverage. For example, nonadmitted carriers sold millions of dollars of worthless insurance to property owners in the Los Angeles area after the 1992 riots.

Although surplus lines laws vary by state, the states use three methods to screen unlicensed insurers for eligibility as surplus lines insurers. First, a state may maintain a “white list” of approved surplus lines insurers. Domestic insurers licensed in other states and unlicensed non-U.S. insurers (alien insurers) both must apply and undergo regulatory scrutiny to determine whether they meet that state’s standards for operating as a surplus lines insurer. Second, a state may maintain a “black list” of unlicensed domestic and non-U.S. insurers prohibited from operating in that state’s surplus lines market. In these states, any unlicensed insurer not on the black list can sell insurance to the public on a surplus lines basis without meeting any other criteria. Third, rather than maintain a list of approved or prohibited surplus lines insurers, a state may require only that unlicensed domestic and non-U.S. insurers meet certain reporting requirements, such as surplus lines premium data and types of coverage provided.

⁷Information in this appendix has been adapted from the following sources: Lynn Brenner, The Insurance Information Institute’s Handbook for Reporters (New York: The Information Institute, 1993) and NAIC Screening of Non-U.S. Insurers (GAO/GGD-94-69R, Jan. 18, 1994).

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