In 1960, Equity Funding Corporation of America was founded by four individuals who assumed equal partnership interests in the firm. Two of the partners soon resigned, leaving the small company to Stanley Goldblum, who held the title of president, and Michael Riordan, who served as chairman of the board. Equity Funding’s principal line of business was selling life insurance policies and “funding programs” that merged life insurance and mutual funds into one financial package for investors. Developing creative financial investments was a trademark of Equity Funding throughout its existence. After going public in 1964, Equity Funding quickly gained a nationwide reputation as one of the most innovative companies in the ultraconservative life insurance industry.

TRAGEDY THEN TRIUMPH AT EQUITY FUNDING

In January 1969, Michael Riordan died in a mudslide that destroyed his home in the exclusive Brentwood suburb of Los Angeles. Goldblum was immediately appointed chairman of the board. One of Goldblum’s first decisions in his new role was naming Fred Levin, a company employee since 1967, as executive vice-president in charge of life insurance operations. Equity Funding’s revenues and earnings increased dramatically under the aggressive, growth-oriented management policies of Goldblum and Levin. By 1972, Equity Funding ranked as one of the ten largest life insurance companies in the United States and easily qualified as the fastest-growing company in the industry. At the time, Equity Funding’s assets totaled approximately $500 million, compared with assets of only $9 million when the company went public eight years earlier. During that same period, the company’s pretax earnings surged from $620,000 to $26 million. In late 1972, securities analysts for the financial services and insurance industries chose Equity Funding’s common stock, out of several hundred stocks in those industries, as their most popular investment recommendation.

The skyrocketing price of Equity Funding’s common stock in the early 1970s made both Goldblum and Levin fabulously wealthy and allowed them to join the
innermost circle of Los Angeles’s celebrity social circuit. The fortune and notoriety achieved by these men was particularly impressive since both were from modest backgrounds. Levin, who earned a law degree from Chicago’s DePaul University, worked briefly for the Illinois regulatory agency responsible for overseeing the state’s insurance industry before joining Equity Funding. Levin’s quick wit, his charming humor, and, most important, his ruthless nature quickly endeared him to Goldblum. Reportedly, Goldblum’s chief lieutenant had no qualms about humiliating employees publicly or “firing them on the spot” when he saw fit.

Levin recognized the benefits of having a network of powerful friends and business associates. When he became embroiled in legal problems in the early 1970s, Levin retained one such friend, Edmund Brown, an attorney and former governor of California, to represent him. Levin’s wit made him much in demand as a speaker at meetings of insurance executives and financial analysts across the country. At one such meeting in January 1973, he summarized Equity Funding’s management philosophy: “We’re conservative in our financial management. . . . We are innovative in product development . . . and we are very traditional in our conviction that by serving the public’s real needs, we will continue to grow in accordance to the objectives we set for ourselves.”

In many ways, Goldblum was a striking contrast to Levin. Goldblum disliked winning and dining business associates and instead preferred spending long hours working out on weights. In the early 1970s, Goldblum’s personal fortune topped $30 million, an astonishing figure given that a little more than a decade earlier he was a college dropout working in a meat-packing plant. Besides attaining tremendous wealth, Goldblum became widely respected within his profession and held a number of important positions in professional and business organizations. One such position was chairman of the ethics committee of the Los Angeles branch of the National Association of Securities Dealers. Former associates recalled that Goldblum was a vigorous enforcer of that organization’s code of ethics: “He was harsh on transgressors . . . [and gave] substantially stiffer penalties than had been anticipated.”

THE HOUSE OF CARDS COLLAPSES

In the spring of 1973, Equity Funding collapsed in a period of a few weeks when a disgruntled former employee disclosed the existence of a massive financial fraud within the company. The stories told by the former employee were so incredible that many parties familiar with the company refused to believe the revelations when they were first made public. The individual charged, and federal and state investigators later confirmed, that the majority of Equity Funding’s life insurance policies were bogus. A lengthy audit by Touche Ross, which was requested by Equity Funding’s court-appointed bankruptcy trustee, disclosed that the company had generated more than $2 billion of fictitious insurance policies.

1. L. Seidler, F. Andrews, and M. Epstein, The Equity Funding Papers: The Anatomy of a Fraud
Most of these bogus policies had then been sold to reinsurance companies. Goldblum and other company executives were forced to disguise the fictitious nature of these policies from insurance examiners and outside auditors by regularly holding midnight “file-stuffing” parties. The purpose of these parties was to generate supporting documentation for the thousands of nonexistent policyholders who had allegedly purchased life insurance from Equity Funding.

The Equity Funding fraud, like most financial frauds, began modestly. Before taking their company public in 1964, Goldblum and Riordan were concerned that potential investors would not be impressed by the firm’s reported earnings. To correct this “problem,” Goldblum decided that Equity Funding was entitled to rebates or kickbacks from the brokers through whom the company’s sales force purchased mutual fund shares. (These mutual fund shares were one component of the “funding programs” that Equity Funding sold to the general public.) Goldblum referred to these rebates, which were purely illusionary, as reciprocal income, or reciprocals. The reciprocals boosted Equity Funding’s 1964 net income to the level that Goldblum thought the company should have reached during that fiscal year. According to one account of this scheme, “Goldblum supplied [a subordinate] with an inflated earnings per share figure—attributing the overstatement to reciprocals. [The subordinate] was instructed to make whatever increases were necessary to support the inflated earnings per share figure.”

In subsequent years, the reciprocal income had to be supplemented with other fraudulent amounts to achieve Goldblum’s predetermined earnings targets. In truth, Equity Funding was never profitable. Prior to imploding in the spring of 1973, the company was technically insolvent, although Goldblum had just issued a press release reporting record earnings for 1972. In that same press release, the brassy Goldblum reported that Equity Funding had increased the dollar value of the life insurance policies it had in force by nearly 50 percent over the previous twelve months.

One of the most alarming features of the huge Equity Funding fraud was the number of individuals who were aware of its existence. Dozens of individuals, both Equity Funding employees and external third parties, helped perpetuate and conceal the company’s fraudulent schemes. Eventually, federal prosecutors convicted or obtained guilty pleas from twenty-two individuals associated with the company, including three of the company’s independent auditors. As many as fifty additional Equity Funding employees, primarily clerical personnel, participated directly or indirectly in the fraud; however, prosecutors chose not to bring criminal charges against these individuals.

The numerous books and articles documenting the life insurance industry’s most infamous scandal suggest that Goldblum and Levin gradually and deliberately induced their co-conspirators to become involved in the fraud. More often than not, these individuals were persuaded with significant monetary rewards in

3. Life insurance companies often sell a portion of their outstanding policies to reinsurance companies. This practice effectively dilutes the business risk associated with selling life insurance.


5. The Equity Funding scandal provided the story line for a major movie produced by a British film company. The Billion Dollar Bubble starred eventual Academy Award winner James Woods, Christopher Guest, and several other notable actors.
the form of stock rights, large salaries and bonuses, and exorbitant expense accounts. Goldblum and other company executives who masterminded the fraud reaped their largest financial benefits from the sale of Equity Funding stock. Goldblum alone reportedly earned more than $5 million from the sale of Equity Funding common stock. In fact, maintaining the company's stock price at a high level appeared to be the key motive underlying Goldblum's fraudulent activities. During 1972, several of the Equity Funding co-conspirators met with Goldblum and pleaded with him to report modest earnings for the next several years. They argued that by doing so the company would have an opportunity to stop the fraudulent practices and become a totally legitimate operation. Goldblum refused to cooperate, pointing out that if reported earnings did not increase each year, the company's stock price would fall.

One of the seamiest anecdotes from the annals of Equity Funding, and one that graphically characterized the company's amoral culture, came to be known as the Cookie Jar Caper. Several lower-level Equity Funding employees devised an ingenious scheme to pad their bank accounts. These individuals "killed off" a number of fictitious policyholders who had "purchased" Equity Funding life insurance policies, policies subsequently sold by Equity Funding to reinsurance companies. The employees then diverted to themselves the payments made by the reinsurance companies to the beneficiaries of the allegedly deceased policyholders. When Goldblum and Levin discovered this scheme, they ordered the individuals involved to continue it on a much larger scale but to channel the beneficiary payments to Equity Funding's corporate bank accounts.

The numerous insurance examiners and independent auditors who reviewed and reported on Equity Funding's financial records over more than a decade were often victimized by the criminal mischief of the company's executives. At one point, Levin ordered the Equity Funding offices being used by state insurance examiners to be bugged so that he would know the specific questions or issues they were addressing. Three independent auditors who were involved for several years in the annual audits of Equity Funding were eventually convicted of complicity in the fraudulent scheme. However, most of Equity Funding's independent auditors were unaware of the huge fraud. Equity Funding executives went to great lengths to conceal their fraudulent activities from these individuals. As an example, on the pretense of lunch at an elegant and busy local restaurant, company officials rushed several auditors out of their office, hoping that they would leave their files unlocked. The auditors did just that, which allowed other company employees to spend the lunch hour copying the insurance policy numbers that had been randomly selected by the auditors for testing. With those numbers in hand, client executives were able to ensure that the selected files were totally "clean."

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6. Many of these individuals expressed remorse when they testified regarding their involvement in the massive fraud. For example, one reported, "I simply lacked the courage to do what was right." (H. Anderson, "12 More Ex-Equity Officials Get Jail, Fine or Probation," Los Angeles Times, 25 March 1975, section 3, 9 & 11.)

7. The various public accounting firms that were unfortunate enough to have been associated with Equity Funding at some point in its existence collectively paid $44 million to settle the civil lawsuits filed against them following the company's collapse.
THE AFTERMATH OF EQUITY FUNDING

The stockholders of Equity Funding and those of companies that Equity Funding
3. In your view, was it appropriate for Seidman & Seidman to resign as the audit firm of Goldblum's new company after he was elected its president and chief executive officer? Under what conditions is it appropriate for a professional firm, such as a CPA firm, to choose not to provide professional services to a company or individual requesting such services?