Pre-need funeral investor demands repayment of principal

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Lynda Canger of Lake Zurich didn't think she had to worry about her father-in-law's funeral. Then she called the funeral home near Chicago where she purchased a pre-need funeral contract in 2003.

The funeral home told her there was slightly more than $3,700 in her father-in-law's trust account, $1,000 less than Canger had originally deposited. Making matters worse, Canger said, the state comptroller's office told her that the trust fund was frozen, so she couldn't withdraw what money was left.

It was a hard awakening to hard times in the Illinois funeral industry, which has been rocked by big losses in a pre-need funeral trust fund that's supposed to pay for funerals for 49,000 state residents. Funeral home directors on the hook for losses blame the Illinois Funeral Directors Association, which managed the money. But the IFDA didn't operate in a vacuum.

Tens of millions of dollars melted away despite numerous safeguards in state law designed to keep the money safe, including provisions for annual audits by the state comptroller's office. Even after it became clear that deficits were staggering, it took nearly two years for the state to wrest control of the fund from the IFDA, which regulators now say should never have been allowed to oversee the trust – which it administered for 27 years.

After calling The State Journal-Register, Canger called the funeral home back. She said the home agreed to restore the principal — state law says consumers who buy pre-need policies aren't supposed to lose money — but interest amounting to more than $800 was wiped out. It's not what she expected six years ago, when she paid $4,700 to ensure her father-in-law, now 92 and in a nursing home, would be buried in a fashion appropriate for a decorated World War II veteran.

Like funeral home directors who are suing the IFDA alleging fiscal mismanagement, Canger said she thought the money was safe. The woman who sold her the pre-need contract said it would pay enough interest to keep up with inflation, Canger recalls.

"She said, 'Don't worry — with the 4 percent you're getting, you guys will never have to add any more money,'" Canger said. "I was told (our money) was in a CD type of thing, and the rate was guaranteed."

In fact, the trust fund was heavily invested in life insurance policies taken out on funeral directors and IFDA officials. Rather than pay fixed benefits, the policies pay out based on the performance of investments. By all appearances, those investments haven't done well. The fund had a deficit of at least $59 million last fall, when its value was written down by 25 percent. And the life insurance policies can't be cashed in without hefty tax penalties, nor can they be borrowed against.

The funeral home directors who are suing the IFDA say they never saw it coming.

"The fact that we were led to slaughter like we were just fumes me," says Terry Plummer, a Litchfield funeral home director who isn't a plaintiff but has been one of the IFDA's most vocal critics. "As far as we know, this thing's still hemorrhaging."

Money back?

Canger says she would like her money back so she can make a wise investment. And state law guarantees refunds to consumers who buy pre-need funeral contracts. But state law doesn't apply while regulators untangle the financial train wreck that is the pre-need funeral trust fund.

Cease-and-desist orders issued by the Illinois Department of Financial and Professional Regulation forbids withdrawals from the trust except to pay administrative or burial costs. Carol Knowles, spokeswoman for the state comptroller's office, said the fund is frozen while regulators review the fund's books.

"Everything is kind of on hold," Knowles said. "Consumers will have an ability to access funds once the fund is unfrozen."

A bar on refunds, however temporary, isn't the only instance in which safeguards contained in state law didn't come to fruition.

*Trust funds must be managed by either a banking institution or a trust company licensed by the state, but the IFDA acted as trustee for nearly 30 years without a proper license.

*If insurance policies are used to fund pre-need contracts, the comptroller is supposed to be notified, as are consumers who purchase contracts. But funeral home directors and consumers who are suing the IFDA say they were never told that trust funds were used to buy life insurance. Knowles said the IFDA stopped buying life insurance policies in the late 1990s, before current Comptroller Dan Hynes took office, and she isn't certain if prior comptrollers were notified.

Some people outside the IFDA offices knew about the policies.

“It was known within the funeral industry,” says Wendell Hahn, retired executive director of Federated Funeral Directors of America, which provides financial advice to funeral homes. “When I heard about the policies, I thought it was a weird situation. … They kept it very quiet. I think they should have shared it more openly.”

*The comptroller’s office is supposed to receive annual financial reports from sellers of pre-need contracts, and the office has broad authority to audit pre-need funeral trust funds. But the fund was tens of millions of dollars in the red before an audit revealed catastrophe. Six funeral homes that are suing the IFDA allege the losses started in 2001.

First signs of trouble

Knowles said the first signs of trouble came during an audit in 2005.

“The numbers didn’t match up,” she said.

By early 2006, the comptroller’s office had determined the fund had a $39 million deficit. Yet, the comptroller’s office didn’t revoke the IFDA’s license to manage the money until the fall of 2007, ruling that the association should never have been overseeing the fund. Even then, the IFDA continued managing the money, despite having no license, until the spring of 2008.

U.S. Sen. Roland Burris was state comptroller in 1980, when the comptroller’s office issued a license to the association. But Burris was only the first of four comptrollers who allowed the IFDA to manage the money — until deficits became overwhelming.

In a bulletin issued to funeral home directors a year ago, the IFDA said that the fund had run a deficit of as much as $1.5 million during the 1990s. According to the bulletin, one of the reasons for the current crisis is “we now have state regulators looking at us and asking why it’s not balanced.”

Dawn Clark Netsch, who was Illinois comptroller from 1991 through 1995, says riding herd on undertakers wasn’t a priority.

“It had absolutely never been a major interest of the comptroller, whoever it was,” said Netsch, now a professor at Northwestern University School of Law. “This is something that shouldn’t be in the comptroller’s office at all.”

Netsch said she told comptroller Dan Hynes as much shortly after he took office in 1999.

“I remember he and I had an early, early talk: This didn’t belong in the office, it was always a side issue and he would probably have problems with it from time to time,” Netsch said.

Knowles declined to respond to Netsch’s recollection. Hynes in 2001 pushed a bill through the legislature that strengthened the comptroller’s enforcement powers, particularly when it comes to revoking licenses. But revocation of the IFDA’s license didn’t come quickly.

Saying the situation was “intolerable,” the comptroller’s office notified the IFDA that the fund had a $39 million deficit in June 2006. Four months later, the comptroller told the IFDA it must file an application for a trustee’s license with the Department of Professional and Financial Regulation. Nearly a year later, the comptroller revoked the association’s license.

Plummer says that was the first sign of trouble for funeral home directors. In their lawsuit against the IFDA, six funeral home directors accuse the association of a “pattern and practice of deceit.”

The IFDA for years had inflated the fund’s earnings, plaintiffs allege, paying interest rates that had no bearing on the fund’s actual performance, even as the fund’s value dropped. The interest payments, funeral home directors say, lulled them into believing the fund was healthy.

Cease and desist

When it canceled the IFDA’s license issued in 1980, the comptroller gave the association a year to get a trustee license from the Department of Financial and Professional Regulation. In May, the department came down hard, issuing a cease-and-desist order that barred the IFDA from running the trust or accepting money from consumers. Under the order, Merrill Lynch Bank and Trust Co. became the trustee, at least on a temporary basis.

It was the first of three cease-and-desist orders issued last year to the association by department regulators. The second order issued in July barred any disbursements from the fund except to pay for burials and administrative expenses. Any other disbursements might “imperil obligations owed by the IFDA to approximately 49,000 people in the State of Illinois,” according to the order.

Canger says someone should have told her and others with money in the fund.

“There wasn’t a letter sent out or anything,” Canger said. “I don’t like surprises. … I cannot pull that money out and make a wise investment.”

Nor can funeral home directors, who say they’re required to make good on contracts no matter what — presuming losses aren’t big enough to drive them out of business.

Last fall, Merrill Lynch became permanent trustee. In an October letter to funeral home directors, the comptroller’s office said putting the fund in Merrill Lynch’s hands was “the only viable option.” But at least one other financial institution had offered to manage the money.

Regions Bank backed out in the spring of 2008, telling the IFDA it would not oversee the trust unless the insurance policies were liquidated. That wasn't acceptable to the IFDA, which told its members in an emailed bulletin that liquidation would have resulted in a $15 million tax penalty.

It's not clear what losses, if any, would have been sustained beyond tax penalties. Five months later, the trust's value was written down by $59 million, or 25 percent.

Plummer, who says the fund's value has fallen another 9 percent since the write-down, said the policies should have been liquidated regardless of tax consequences. During a 2007 meeting with funeral home directors shortly after the IFDA lost its license, Plummer recalls Paul Dixon, then executive director of the association, saying that the total loss would be $30 million if the policies were cashed in.

"If they'd have just done that, our write-down would have been like 19 percent versus where we're at today, and we would have had this behind us," Plummer said. "This thing would have been on the rebound.

"We had some viable options, and nobody wanted to act. I think they (regulators) should have just dropped the hammer immediately when they found it back in 2006.

"The longer it went on, the more blood, the more damage, was done."

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