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Funeral Service Insider
3349 Highway 138, Building D, Suite D
Wall Township, NJ 07719

Headline news daily!
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Forethought Warns Customers: Expect Cuts in Growth Payments

Company Introducing Bonus Plan for Loyal Customers

Many funeral directors took the news hard: Forethought Financial Group plans to lower discretionary growth payments come Jan. 1, and the move will probably be significant.

As the news spreads throughout the profession, the rumors are running amok. Some funeral directors think they will be paid 0 percent growth on existing policies. Others are under the impression that those who exclusively write Forethought policies will receive better discretionary growth payments. And of course, many people are wondering that if this is true, could it even be legal?

Those fears are false, John Graf, president and chief executive officer of Forethought Financial Group, told the *Insider* in an exclusive telephone interview. "We will not be taking rates down to zero," he says. "We will continue to credit growth the same for everyone, but unlike prior practice, we will have a more dramatic move downward, which is a once-in-a-lifetime reaction to what's happened in the investment markets."

When pressed on how significant the decrease would be, Graf says, "We've never dropped rates more in a quarter than 25 basis points. And my guess is that it will be more than 25 basis points – almost for sure – and likely to be less than 125 basis points." He adds, "The caveat I would tell you is that in this environment, you just don't know."

As far as confusion among funeral directors, much of it has to do with Forethought's new PartnerShare program, which the company has outlined in bits and pieces. The new program will reward businesses that do business exclusively with Forethought by paying them an annual bonus of 0.25 percent to 1 percent based on the size of their books. So, a firm that has $5 million in Forethought life insurance policies could receive as much as $50,000 per year as a bonus.

payments and an insured product for installment payments because no insurance company can outperform a trust over the normal life expectancy because both invest in the exact same entities, and a trust does not need a profit margin for shareholders of an insurance company."

Graf to Funeral Directors: Stop Guaranteeing!

Forethought isn't just changing its discretionary growth payments and promoting its new PartnerShare program. The company is also urging funeral professionals to get away from the guaranteed funeral.

A flier the company recently distributed reads, "In the current environment, the traditional model of guaranteeing funerals at today's prices and funding those future guarantees through a traditional preneed insurance policy no longer works effectively. Funeral firm costs are highly sensitive to commodity prices like wood, steel, copper, fuel, and healthcare costs – all of which have been growing at double-digit rates. Unfortunately, preneed insurance policies are funded almost entirely by investment grade corporate bonds and U.S. treasury securities whose yields have declined dramatically over the last 20 years. This has resulted in steadily declining discretionary growth rates over this period. As a result, the cost of a funeral at time of need often exceeds the death benefit available. This mismatch is the source of concern frequently expressed as the 'shortfall risk.'"

Forethought isn't the only one answering questions about whether to guarantee funerals in this environment and in the future. In the open letter sent out by Homesteaders, it also addressed the issue but took a softer stance. Homesteaders' statement reads, "We believe that the decision to offer price-guaranteed advance funeral plans in your choice. Our job is to offer you the best products possible to support your business decisions. "

Graf, who arrived at Forethought in January 2006, says he began to question the concept of guaranteeing funerals almost as soon as he arrived at the company. "I started to question early on why anyone would do universally guaranteed funerals when they are effectively unhedged," he says. "Basically, many of the firms we talked to say, 'Because you trained us to do this.'"

While Forethought will continue striving to offer the best options to funeral directors who continue to guarantee, Graf is personally convinced that it just doesn't make sense. Consider how risky it would be for an airline to be selling airline tickets today that could be redeemed 10 years from now. If gasoline costs kept going up, it would be almost impossible to charge enough. Funeral directors who are facing escalating costs on the supply side are taking the same sort of gamble when they guarantee a preneed funeral, Graf says. "When you sell a preneed policy, you are selling only that, and you are at risk that the discretionary growth rate won't keep up with costs at some unknown date," he explains.

Regardless of what type of growth Forethought pays, the bigger issue in the profession is that costs are not correlated to discretionary growth rates on any level. "Whenever you guarantee one thing that is based on variable costs associated with elements A, B and C, and you are funding it with something whose benefit structure is sensitive to D, E and F; the risk that D, E and F won't outperform A, B and C is a risk that you as a businessman shouldn't be taking," Graf warns.

The bottom line is that a better model needs to be built, according to Graf. "It's impossible to see a place where fixed-income yields can keep up with costs being incurred from everything from caskets to health care to gasoline and everything else," he says.

But some, including Lang, question how Forethought is going about dissuading funeral homes from guaranteeing. "They are taking the position, and it's fair, that we don't want to encourage or promote or endorse guaranteed prices ... that's great; there's nothing wrong with that," Lang says. "But my concern is for the contracts in force and that were already sold under the premise that guaranteed contracts are OK. If Forethought or any company told a funeral home that they were offering a product to help support guaranteed funeral prices and helped market it that way, then you have to continue to support that decision and make a good faith attempt to help them keep their promises to families. I would guess that 90 percent or more of contracts have guarantees attached to them, and the rates we are hearing about from our customers are unlikely to even get the funeral home close."

Lang admits that Homesteaders isn't immune to shortfalls. And Forethought says that its PartnerShare program and various products *will* help funeral homes offset the risk associated with guaranteeing funerals. As is usually the case with statements from competitors, you must research and look at your own situation to determine your best partner, be it Forethought, Homesteaders, NGL, Lincoln-Heritage or any other firm.

William "BT" Hathaway, with Hathaway Family Funeral Homes in Massachusetts, shares Graf's concerns about guaranteed funerals and preneed in general. "When you couple growth of less than 1 percent with casket increases in excess of 10 percent, we get closer and closer to an industry train wreck," he says. Still, he's frustrated with declining rates.

Count Isard among those who are happy that Forethought is at least renewing the conversation about whether to guarantee preneed funerals. He thinks the company, on this count, is spot on. "I've been advocating getting rid of the guaranteed funeral since 1986," he says. "Just picture a 30 year old going out and buying a whole life insurance policy, and the company has a bad year and its investments lose 20 percent of their value in one year. The company has how many years to make up the difference? Forty, 50, 60 – God willing? They have lots of years to make up the shortfall."

But when it comes to a preneed contract, the game changes. "If a 70 year old buys a preneed contract and one year into the contract, an insurance company has the exact same decline, how many years are there to make up the shortfall?" Isard asks. "Maybe three to five years on average. So the mainstream life insurance companies – because of the amount of time they have until death claims are going to be processed, they can make up these shortfalls. But the preneed insurance companies cannot."

With all the changes at Forethought, it's clear many funeral service professionals are considering their next move. They know that their growth payment will be cut, but the offer is on the table: They can offset that by remaining loyal to Forethought. If they don't, they won't get their PartnerShare payment and their shortfall will be that much more as rates are being cut more than usual. More than one funeral director has said he feels like he is "being held hostage," or that he "has a gun to his head." With firms that have a large amount of preneed already on the books, it can be particularly complicated in figuring out the right thing to do.

It remains to be seen by just how much Forethought will lower its rates come Jan. 1, and whether competing firms will be forced to dramatically slash rates. With market conditions the way they are, however, it's time to factor lower discretionary growth rates into your thinking.

Carriage Services Reports Earnings

HOUSTON – Carriage Services Inc. announced on Nov. 4 the results for the third quarter, ended Sept. 30, 2008.

Melvin C. Payne, chairman and CEO, stated, "Net income from continuing operations was $158,000, or 1 cent diluted earnings per share, compared to $703,000, or 4 cents diluted earnings per share, in the third quarter of 2007. While revenues for our third quarter increased as a result of increases in both volumes and average revenue per contract, we experienced a decline in Consolidated EBITDA, Consolidated EBITDA Margin and Net Income due to higher costs and expenses."

Same store funeral operations revenue increased $0.8 million or 3 percent, resulting from a 0.9 percent increase in contracts and a 2.1 percent increase in the average revenue per contract. Funeral operations revenue from acquired businesses contributed an additional increase of $1.2 million. The cremation rate for the third quarter of 2008 was 39.8 percent compared to 37 percent in the third quarter of 2007 and the growth in the volumes came in the form of cremation contracts.