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Insurance Company Sues IFDA, Says that Coverage Should be Void

Illinois Suspends License of Merrill Lynch Employee; A Slew of Other Developments Rock the State

A New Jersey-based insurance company is suing the Illinois Funeral Directors Association and many of its past and current executives in a Chicago federal court. It says it should not have to pay claims the association filed as the result of two lawsuits.

Federal Insurance Co. of Warren, N.J., a subsidiary of Chubb Corp., filed the suit March 16. The company is represented by Meckler Bulger Tilson Marick & Pearson, a Chicago law firm. The insurance company is arguing that the association did not file its claims on time.

Here are the details on the two lawsuits with coverage in question:

- *Virginia H. Dunkle and Maria Dusembery for the benefit of Dr. Ludimilla Petraskas, individually and on behalf of all others similarly situated vs IFDA Services, Inc. and IFDA*: Filed Nov. 26, 2008, the suit purports to represent a class of individuals who purchased preneed funeral and burial services through IFDA. They are suing the association because it never obtained a certificate of authority to act as a trust business and failed to provide account information to trust beneficiaries. The suit accuses the association of consumer fraud and breaching its fiduciary duties.

- *Calvert Funeral Homes, Ltd., et al., derivatively on behalf of the Illinois Funeral Directors Association and IFDA Services, Inc., v. Robert W. Ninker, et al.*: Filed Jan. 28, 2009, the suit includes a group of six funeral homes who are also accusing the association of breaching its fiduciary duties. The Calvert suit also cites the association's imprudent investments, accuses it of negligence and other wrongdoing.

In trying to convince the court that it should not have to pay claims related to the two suits, the insurance company argues that both lawsuits essentially stem from issues identified in a June 21, 2006, letter from the Illinois Office of the Comptroller, Cemetery Care and Burial Trust Division. According to the insurance company's lawsuit, the letter was sent to then executive director Paul Dixon and included a notice of audit findings. It stated that the trust was underfunded by about $39 million and further asserted that "this is an intolerable situation that IFDA must rectify."

Federal Insurance Co. argues that the Dunkle Action, the Calvert Action and any related claims actually constitute a single claim first made on June 21, 2006, in the letter sent to the association by the IOC. The problem, however, is that the insurance company did not even know about the letter identifying a massive shortfall until it read about it years later when it was referenced in the suit led by Calvert Funeral Homes. In its lawsuit, the insurance company states that it did not receive a copy of the IOC letter until Feb. 10, 2009, and that was only because it asked for it. "As no Claim was first made during the period of the 2006, 2007 or 2008 policies there is no coverage for the IOC Letter, the Dunkle Action or the Calvert Action under the 2006, 2007 or 2008 policies," the suit states.

Aside from being related claims, there are other reasons that Federal Insurance Co. says it should not have to cover the association in these cases. According to the suit, the reasons include:

• "The actions allege dishonest and fraudulent acts and omissions and the willful violation of statutes and laws by the Insured defendants. The actions further allege that by virtue of their wrongful conduct the Insured defendants

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were unjustly enriched and gained profit to which they were not legally entitled. Thus, there is no coverage for damages arising out of these allegations under the 2006, 2007 and 2008 policies.

• "The policies do not provide coverage for any amounts incurred with respect to the breach of contract allegations."

•"The actions are based upon, arise from or are in consequence of alleged acts, errors, omissions or breaches of duty committed in connection with the rendering of or failure to render professional services for others. Thus, the policies do not provide coverage for any amounts incurred with respect to said professional services."

And the list goes on. In short, Federal Insurance Co. concludes by asking that the court determine and declare that no coverage exists under the 2005, 2006, 2007 and 2008 policies issued to the IFDA with respect to the IOC letter, the Dunkle Action and the Calvert Action.

State Takes a Closer Look

Meanwhile, Illinois Funeral Directors Association board members recently met with state lawmakers to talk about its beleaguered preneed trust and the Secretary of State's Securities Department suspended the license of a Merrill Lynch adviser who sold the association life insurance policies.

State legislators are now taking an even closer look at how the mess at IFDA got so bad, with Rep. Dan Brady (R-Bloomington) proposing that a legislative task force be created to scrutinize the

The IFDA and its Preneed Trust

Here is a timeline of important developments related to the IFDA and its preneed trust. Some of this information is included as background in a lawsuit a group of six funeral homes filed in response to problems with the IFDA's preneed trust.

• 1979: IFDA's wholly owned subsidiary, IFDA Services, establishes the IFDA Preneed Trust.

• 1986: The preneed trust program is supplemented with the creation of a tax-exempt fund, which provides clients with the opportunity for their accounts to grow on a tax-free basis. This option was and is still the preferred choice for about 75 percent of preneed funeral planning customers.

• Early 2006: The Comptroller's Office begins investigating IFDA Services and its preneed trust. The Banking Division of the Department of Financial and Professional Regulation joins the probe.

• May 2007: The trust possessed about 300 life insurance policies issued by seven insurance companies, including more than 120 "Merrill Lynch Investor Life" policies.

• September 2007: The Illinois Comptroller's Office strips IFDA services of its trustee status.

• Oct. 4, 2007: The IFDA sends a letter to members informing them that their license has been revoked, but it promises "There is no need for concern."

• May 30, 2008: IFDA Services is ordered to stop performing all activities related to the trust. Merrill Lynch Bank and Trust Co. takes over as temporary trustee shortly thereafter.

• July 7, 2008: The state issues another order to IFDA Services, asking it to cease and desist, prohibiting it from participating in any activities related to the trust.

• November 2008: Merrill Lynch takes over as permanent trustee. (When IFDA Services served as trustee, Merrill Lynch had served as an adviser.)

• Dec. 22, 2008: The *Insider* reports that a class-action suit is filed, accusing IFDA and IFDA Services of improperly acting as the trustee for more than $300 million. The suit seeks compensatory damages for injuries caused by the alleged unlawful conduct.

• January 2009: A group of six funeral homes, led by Calvert Funeral Homes, files a lawsuit in the Circuit Court of Cook County, Ill., suing a number of past and current board members and executives of IFDA and IFDA Services, Merrill Lynch, Schainker, IFDA and IFDA Services.

preneed industry and work to determine how the IFDA's preneed trust plummeted in value. Brady is also partnering with Rep. Lou Lang (D-Skokie) to co-sponsor a proposal that would require sellers of preneed funeral contracts to get state licenses and provide consumers more input into how preneed money is invested.

The entire situation has angered plenty of funeral directors. "I'm sick and tired of the double standard in funeral service with ethics," says Terry Plummer, owner of Plummer Funeral Home in Litchfield. "The IFDA board has just become a closed, secret society over the years. It's almost like the association belongs to them and the rest of you peons can go to hell. That's pretty much the arrogance and attitude you get from them."

Plummer, who notes that the lawsuit filed by six funeral homes names a number of IFDA board members, thinks it's time for those people to step down. "You usually are asked to step down until you are vindicated, but these guys just will not do it," he says. "They are a pretty proud bunch," but they no longer have the faith of members, and they should wait on the sidelines, he says.

Meeting Seeks to Work Out Issues

Members of the Illinois Funeral Directors Association's board of directors met March 11 with officials from the Comptroller's Office, the Illinois Department of Financial and Professional Regulation and about two dozen funeral directors to review concerns surrounding its preneed trust. Representatives from Merrill Lynch Trust Co., which serves as trustee of the preneed trust, were also at the meeting.

Some funeral directors were upset, however, because the association told at least some members that the meeting was closed to the public. The confusion apparently resulted because state officials first met just with the group of six funeral homes suing a number of past and current association board members; Merrill Lynch and its employee, Edward Louis Schainker; IFDA and IFDA Services.

After the meeting, the IFDA sent out an electronic news bulletin that reported the following:

- The association is still analyzing the assets in its trust to determine how to best manage assets for the long and short term.

- An actuarial report has been completed, but it has not yet been released to Merrill Lynch, IFDA or others. Merrill Lynch doesn't expect the report to offer any alternative actions, but it will serve as a database to help manage the trust.

He Said What?

We recently read with interest the latest issue of Preneed Perspective, written by Dan Isard of The Foresight Companies. In it, he pulls out an exchange from the archives of the publication that he had with Bob Ninker, then the executive director of the Illinois Funeral Directors Association. (Ninker is named as a defendant in the lawsuit led by Calvert Funeral Homes.)

Here is the exchange, which took place in 1995:

Question: At $150 million, the Illinois FDA's master trust is the biggest funeral trust in the nation. What's your secret?

Ninker: There's no secret. Our master trust is tax exempt and eliminates the need for 1099 reporting. We've created a sophisticated investment vehicle – very similar to key-man insurance – in which we recognize our major contributors by creating a corridor of insurance that is tax exempt. When one of these major contributors dies, the insurance proceeds go right back into the trust. Pennsylvania, Missouri, and a few other states have looked at it. Once the tax-exempt quality is acquired, the vast majority of funds, 98 percent say, are invested in a balanced portfolio of highest quality stocks and bonds to assure income far exceeds funeral inflation."

Isard reports that while delivering a presentation in Pennsylvania, he asked someone whether the state association would follow the lead of Illinois. He quotes his friend as responding, "Yes, we were asked if we would look at this, and we did meet with the representative of Merrill Lynch. The meeting didn't last long. The salesperson started to get complicated and after just a few moments the presentation was concluded, as it was too complex for us."

Isard concludes, "It doesn't matter how many states or other associations considered this method of financing. It matters that there were significant errors which are costing the IFDA member that invested in it a large amount of money."

• The management of the trust will evolve based upon market conditions and cash flow needs.

• Merrill Lynch expects that life insurance policies will be liquidated on an as-needed basis. Policies will not be liquidated all at once but in steps.

• If the trust fund grows to the point that the value of contracts are exceeded, the excess money would be given to the funeral director who could disburse it as he or she saw fit.

• Merrill Lynch will provide quarterly performance reports to trust participants.

When the two dozen or so funeral directors at the meeting were asked whether they are honoring non-guaranteed contracts, those in attendance said they were, according to the IFDA statement.

The association notes that it plans on meeting further with state officials to determine a proper resolution to problems surrounding the trust.

David Nixon, president of Nixon Consulting in Chatham, Ill., says he was heartened by the March 12 memo sent out by the IFDA. "It was one of the first 'let's talk about some of the details here' that I've seen in a long time from them," he says. "I am hoping that the stonewalling is behind us; I think the only way for the association to survive is to be forthcoming."

Dan Isard, president of The Foresight Companies in Phoenix, however, still has doubts about the association. "I felt great sorrow for the board and the executive team at IFDA when the story broke," he says. "I even called and offered my help on this matter." He adds, "I think the IFDA will be judged by their members based upon two different timelines: prediscovery and post-discovery. In prediscovery, if all that I think was done improperly, the organization can be held accountable and the executive leadership dealt with. However, post-discovery is the way they are dealing with matters today. Frankly, I think that the organization is not acting today in the interests of their members."

License Suspended

According to a public document from the secretary of state's Securities Department, it has temporarily suspended the license of Schainker, the Merrill Lynch employee who served as an adviser to the IFDA as it bought the key-man life insurance policies that led to many of the trust's problems.

According to the document, Schainker became the investment adviser representative and/or salesperson for certain trust accounts opened at Merrill Lynch in the name of the IFDA Preneed Trust by IFDA Services, and he counseled the association on its investments until September 2007.

The document states, "From 1976 to the present, Schainker recommended and sold to IFDA Services, Inc., acting as trustee, over 300 insurance contracts issued by approximately 7 insurance companies including over 120 policies issued by a Merrill Lynch affiliate." It adds, "As the salesperson and/or investment adviser representative for the accounts at Merrill Lynch, Schainker received a commission for each sale of an insurance contract to the IFDA Preneed Trust."

The temporary order of suspension goes on to state that neither IFDA Services, the IFDA Preneed Trust nor Schainker obtained permission from the purchasers of preneed contracts before investing funds in insurance or deferred annuity contracts, as required by Section 4a.(d) of the Illinois Burial Funds Act.

The insurance contracts recommended and sold by Schainker were on the lives of board members, officers and directors of IFDA Services and its affiliates. "No analyses were conducted by Schainker to determine if the purchases of these contracts were suitable in light of the investment requirements and goals of the IFDA Preneed Trust, its investment policies and the applicable regulations of the Illinois Burial Funds Act or State and Federal Securities laws" the order of suspension reads.

The investments in such contracts apparently were not only illegal but also very unprofitable. The order states that an independent order conducted at the end of 2007 determined there was a deficit of $39 million in the trust due to the purchase of the life insurance funds and that the deficit continued to increase thereafter. (It would grow to at least $59 million.) The order concludes that "the recommendations of these insurance contracts to the IFDA trust fund was unsuitable and in violation of Rules 130.850 and 130.853 of the Rules and Regulations Under the Illinois Securities Law of 1953, Admin Code 130.100 et seq." Schainker's license is "suspended until further order of the Secretary of State," according to the order.

Isard says that it seems in this case the salesman is being hung out to dry by Merrill Lynch, and that he wouldn't be surprised if the company is next to suffer. "Merrill Lynch should be wondering if their license to operate in the state could be in jeopardy as they obviously knew what was going on," he says. "If this was a suspension of the agent's life insurance license it is one thing, but I understand it was the securities license. Broker dealers and issuers of variable life insurance policies have a regulation of supervision of their salespeople. This one accounted for hundreds of millions of dollars and was awarded many sales awards. Merrill Lynch had to know what he was doing."

Through his attorney, Carl Draper, Schainker has denied any wrongdoing. Draper says his client was in no position to attain the permission of contract purchasers before buying life insurance policies. "He had absolutely no involvement with those consumers," Draper told the State Journal-Register.

State Refuses to Release Records

In other news, the State Journal-Register reported that the office of State Comptroller Dan Hynes is refusing to release records that show how his office regulated the trust fund. Hynes won't release copies of audits and financial reviews and states that they are exempt from disclosure under the Freedom of Information Act.

The refusal is being appealed by the newspaper, which states that the exemptions in the Freedom of Information Act are discretionary, not mandatory. The newspaper states releasing the records would not violate any laws.

Edward Wallace, an attorney for the group of six funeral homes that is suing the past and current IFDA executives, Merrill Lynch, Schainker and the association, wants the records released as part of the discovery process. Many of the allegations in that group's lawsuits were mirrored in the state's recent suspension of Schainker's license.

Both the newspaper and Wallace have received some vocal support from state Rep. Brady, who holds a funeral director's license. "Provide the documents, answer the questions," he told the State-Journal Register. "It's not only reasonable to ask, it's imperative to ask. It's imperative for some 49,000 Illinois residents who put their trust in the IFDA that they get answers."

Isard thinks it's ridiculous that the state won't release the records and speculates that perhaps the state is worried about whether or not it would have any liability for failing to properly oversee the trust. On the other hand, Harvey I. Lapin, a lawyer specializing in funeral service, says there is ample precedent to refuse releasing such records. "However, if the court orders them to provide the records, I am sure they will respond," he says.

Plummer hopes that instead of continuing to hold little publicized meetings, the state will take a more proactive role in looking at the problems that surround IFDA and its trust. "It would be helpful if they had a couple meetings across the state where more funeral directors could come in, talk and get things off their chest," he says. "It would be more helpful than waiting and sitting around wondering what is going to happen, and it would give these guys an opportunity to speak their peace." He adds, "This is kind of like the Bernie Madoff situation; there are just so many people hurt. They are just kind of stewing, and it's not healthy."