

STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT

IN THE MATTER OF: EDWARD LOUIS SCHAIKER

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) File No. 0900049
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)

Notice of Hearing

TO THE RESPONDENT: Edward Louis Schainker CRD No. 1096255
611 E. Monroe St.
Springfield, IL 62701

C/o Mr. Carlos Manuel Morales
Director and Chief Legal Officer
Merrill Lynch, Pierce, Fenner & Smith, Inc.
4 World Financial Center
250 Vesey St.
New York, NY 10080

C/o Mr. Carl Draper
Feldman, Wasser, Draper & Cox
1307 S. 7th St.
Springfield, IL62705

You are hereby notified that pursuant to Section 11.F of the Illinois Securities Law of 1953, [815 ILCS 5/1 et seq.] (the "Act") and 14 Ill. Adm. Code 130, Subpart K, a public hearing will be held at 300 W. Jefferson St., Suite 300A, Springfield, Illinois 62702, on the 20th day of May, 2009 at the hour of 10:00 a.m., or as soon thereafter as counsel may be heard, before Jon K. Ellis, or such other duly designated Hearing Officer of the Secretary of State.

Said hearing will be held to determine whether an Order should be entered against Edward Louis Schainker ("Schainker") which suspends or revokes his investment adviser representative and/or salesperson registration, prohibits him from offering or selling securities in the State of Illinois and granting such other relief as may be authorized under the Act including but not limited to imposition of a monetary fine in the maximum amount

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pursuant to Section 11 of the Act, payable within ten (10) days of the entry of the Order.

Summary

This case involves the violation of Illinois securities laws and regulations, including fraudulent conduct by Respondent, Edward L. Schainker, a financial advisor and fund manager, for the Illinois Funeral Directors Association's trusts. The IFDA PreNeed Trusts were created to invest money received from Illinois consumers for the pre-payment of expected funeral and burial costs by the Illinois Funeral Directors Association, Inc., with IFDA Services, Inc. serving as the Trustee until 2007. From 1983 to 2008, Schainker advised and managed the Pre Need Trusts with assets of about \$300 million dollars at its highest asset value. During the time period that he advised and managed the Trusts, he committed or participated in violations of the Illinois Insurance Code, the Illinois Burial Funds Act and the Illinois Securities Act through fraudulent statements and deceptive practices. Additionally, his advice and management of the Trusts was not in the best interests of the Trusts and resulted in placing over \$200 million of Trust assets in illiquid insurance contracts and the Trusts' incurring significant losses that continue to grow. During this time period, both Schainker and his employing firm, Merrill Lynch and its affiliates received millions of dollars of commissions and other compensation payments for transactions he recommended and effected for the Trusts and his management of the Trusts.

The grounds for such proposed action are as follows:

1. Respondent, Edward Louis Schainker ("Schainker"), is currently registered in the State of Illinois as an investment adviser representative and salesperson for Merrill Lynch, Pierce, Fenner & Smith, Inc ("Merrill Lynch") but subject to a Temporary Order of Suspension of these registrations by the Secretary of State dated February 24, 2009.
2. Before February 24, 2009, Schainker had 263 clients totaling over 1700 brokerage accounts. His clients included other Funeral Director Associations, Funeral homes and Funeral Home directors, individual clients and not for profit organizations.

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3. Beginning in 1983 Schainker became an investment adviser representative and salesperson for certain trust accounts opened at Merrill Lynch in the name of the IFDA Pre Need Trust Program by IFDA Services, Inc.
4. IFDA Services, Inc. is an Illinois Corporation incorporated in September 1976 by and affiliated with the Illinois Funeral Directors Association (IFDA) to serve as a trustee for the IFDA Preneed Trusts. IFDA Services, Inc. served as trustee for the IFDA Pre Need Trust program from 1976 to September 2007.
5. The Illinois Funeral Directors Association is an Illinois Not for Profit Corporation incorporated in 1934. Currently IFDA has over 600 funeral home director members. IFDA provides its members various services, programs and benefits including the IFDA Pre Need Trust program.
6. IFDA and IFDA Services, Inc. formed the IFDA Pre Need Trust program to receive and invest money obtained from Pre-need contracts entered into between Purchasers of the contracts and funeral homes. Pre-Need contracts provide for the pre-payment of anticipated costs for burials and other funeral expenses of a named beneficiary by Illinois consumers, usually the purchaser.
7. Pre-need contracts may be guaranteed or non-guaranteed. The Purchaser selects the type of Pre-need contract at the time it is purchased. Under a guaranteed contract the Purchaser pre-selects the services and goods desired which are offered at a guaranteed price. Under a non-guaranteed contract, services or goods are also pre-selected but the price of the services or goods is not guaranteed. The majority of the Pre-need contracts at issue in this matter are guaranteed.
8. Pre-need Contracts and their trustees are regulated by and must comply with the Illinois Funeral or Burial Funds Act, 225 ILCS 45/1 et seq. ("Illinois Burial Funds Act")
9. The Illinois Burial Funds Act requires that money paid for Pre-Need contracts must be held in Trust by a Trustee.
10. Funeral Homes and/or Funeral Directors entered into IFDA Preneed Trust Program Member Participation

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Agreements with IFDA Services, Inc. naming IFDA Services, Inc. as the trustee for their Pre-need contracts. Additionally, IFDA Services, Inc. provided Pre-Need Contract forms for use by IFDA Members or their Funeral Home Director/member participants. The forms designated IFDA Services, Inc. as the trustee.

11. IFDA Services, Inc. created and served as the trustee for two Pre-Need Trusts for the investment of money paid as a deposit for Pre-Need contracts sold by its Funeral Home Director member participants: A taxable trust created in 1979, the IFDA Preneed Taxable Trust ("Taxable Trust") and a tax exempt or tax-advantaged trust, the IFDA Preneed Tax Exempt Trust, ("Tax Exempt Trust") created in November, 1986.
12. Although Pre-need contract money was co-mingled together in the two IFDA Pre-Need Trusts, administratively each individual Pre-need account was treated as a separate account, received individual account statements and earned rates of return based upon the account value.
13. The Taxable Trust was called such because it was purported to be subject to State and Federal taxation on income and subject to U.S. Internal Revenue Service (IRS) Form 1099 income reporting requirements. Additionally, the Taxable Trust was invested in a mix of equity and fixed income securities which could be subject to State and Federal income tax and tax reporting requirements.
14. The Tax Exempt Trust was called such because it was purported not to be subject to State and Federal taxation of income nor subject to Form 1099 reporting requirements. Additionally, it was invested in insurance contracts that were purported not to be subject to State and Federal Income tax or Form 1099 reporting requirements.
15. Both IFDA Pre-need Trusts had interest crediting rates assigned to each Trust that were applied to the value of each individual Pre-need Account. The interest crediting rate was determined and set by IFDA Services, Inc.
16. The crediting rate on guaranteed contract accounts held little significance to Purchasers of guaranteed Pre-need contracts because their future burial expenses

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were contractually set and guaranteed under the Pre-need contract. Rather their primary concern was to ensure the safety of their initial deposit they had invested in order to purchase the guaranteed Pre-need contract.

17. Purchasers of non-guaranteed Pre-need contracts would have an investment objective in higher interest crediting rates because higher crediting rates would impact the total value of the Pre-need contract account upon maturity. However, they also had an investment objective of safety of their initial deposit to ensure that funds would cover burial costs in the future.
18. Schainker as the investment adviser and fund manager of the IFDA Preneed Trust had a fiduciary duty to IFDA Services, Inc., the Funeral Home Directors/member participants and to the purchasers of Pre-need contracts.
19. Currently the IFDA Preneed Trust Program holds the funds of over 44,000 Pre-need contract purchasers with a total value as of March, 2009 as follows:

Taxable Trust	\$52,712,349
Tax Exempt Trust	\$147,286,317
Total	\$199,998,666

Over 31,000 of the Pre-need contracts are guaranteed.

20. Schainker served as the investment adviser and as the broker for the IFDA trusts and was the Trusts' "financial adviser." Schainker was responsible for servicing the trusts accounts at Merrill Lynch and providing investment advice to the Trusts. Schainker created and developed a proposal for the Trusts that he discussed with Paul W. Felsch, an agent or employee of Merrill Lynch Life Agency. Schainker proposed to IFDA Services, Inc. the creation of a new Trust that would be funded through the purchase of Variable Universal Life Insurance policies and purportedly would be tax exempt.
21. From 1986 to the present, Schainker recommended and sold to IFDA Services, Inc., over 300 insurance contracts in the form of Variable Universal Life Insurance issued by 8 insurance companies. As of January 31, 2009, the Tax Exempt Trust had 307

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different policies, from 7 different issuers and had paid \$88,272,900 in premiums over the lifetime of these policies. MLLIC received \$32,016,116 in premiums over the lifetime of 129 policies issued by it.

22. Variable Universal Life Insurance contracts are variable in their rate of return based upon the investment performance of sub-accounts which may be invested in mutual funds or mutual fund like accounts. The nature, type and diversification of these sub-accounts were selected and managed by Schainker and Merrill Lynch.
23. IFDA Services, Inc. purchased Variable Universal Life Insurance contracts on the lives of the Officers, Directors and Board Members of IFDA Services, Inc. and certain Funeral Home Directors/Member participants in the IFDA Pre-need Trust program.
24. The insurance contracts purchased for the IFDA Tax Exempt Pre-need Trust were purchased as Key Man Insurance, otherwise known as Corporate Owned Life Insurance policies. The majority of these policies purchased and owned by IFDA Services, Inc. were on individual funeral home directors and not on the officers, directors, employees or board members of IFDA Services, Inc.
25. Schainker and IFDA Services, Inc. selected funeral home directors as prospective insured persons and Schainker solicited these Funeral Home directors to agree to be insured as a key man for IFDA Services, Inc. and in return they would receive a \$25,000 life insurance policy funded by IFDA Services, Inc. For example in a letter on Merrill Lynch Life Agency, Inc. letterhead and dated February 28, 1992, Schainker stated: "On behalf of the Illinois Funeral Directors Association and Mr. Robert Ninker, I would like to ask your assistance in furthering the development of the IFDA Tax Exempt PreNeed Trust program...Your help comes by allowing the Trust to obtain an insurance policy, using you as the insured and the Trust as the owner of the policy...As a benefit for helping, the Trust will provide a \$25,000 term insurance policy on your life, with you naming the beneficiary with absolutely no cost to you."
26. IFDA Services, Inc and Schainker's solicitation to insured and prospective insured persons was in

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violation of 215 ILCS 5/151.2 of the Illinois Insurance Code.

27. As the salesperson and investment adviser representative for the IFDA Services, Inc. accounts at Merrill Lynch, Schainker received commissions or other compensation for each sale of an insurance contract to the Tax Exempt Trust. He also received compensation for additional premium payments and longevity payments for the policies remaining in effect.
28. Beginning around 1990 and continuing into 2008, Schainker made presentations to other state Funeral Directors Associations in order to solicit the associations to start a Pre-Need Tax Exempt Trust similar to the IFDA Pre-need Tax Exempt Trust. Schainker prepared Power Point Presentations that described the IFDA Pre-need tax exempt fund and used it as a model.
29. Insurance products and variable universal life insurance generally have higher rates of compensation than other financial products. Additionally, the continuous payment of premiums to maintain the contracts in force ensured a continued and reliable stream of income to Schainker and Merrill Lynch, Merrill Lynch Life Insurance Company and Merrill Lynch Life Agency. Lastly, the investments in insurance contracts made it more difficult for the Trusts to transfer their brokerage and advisory business away from Merrill Lynch and Schainker without incurring substantial surrender or tax liabilities.
30. These presentations were made with the knowledge and approval of Schainker's supervisors at Merrill Lynch and Merrill Lynch Life Agency and as a result of these presentations, Schainker also obtained as clients the Alabama Funeral Directors Association (AFDA) and the Mississippi Funeral Directors Association (MFDA).
31. Additionally, Schainker also recommended to other institutional investors and individual clients to purchase multiple Variable Universal Life Insurance contracts as an investment strategy in order to earn tax-exempt income.
32. The payment of premiums for policies held by the IFDA, and Schainker's similar programs with Alabama and Mississippi were the preeminent source of production

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of Schainker such that he requested Merrill Lynch on at least two occasions to waive their compensation guidelines to recognize the payments as "new production" for the purposes of bonus and award recognitions. In an email dated November 14, 2006 from Mark A. Summer and co-salesperson on the IFDA, AFDA and MFDA accounts he states:

"As the 2006 FOG [Focus on Growth] campaign is drawing to a close, I wanted to take this opportunity to renew the discussion regarding our request to have the premiums from the variable universal life policies for the Illinois Funeral Directors Association (IFDA) the Alabama Funeral Directors Association (AFDA) and the Mississippi Funeral Directors Association (MFDA) be considered as "net new annuitized" business...From 12/01/2005 through 09/01/2006, the following is a summary of the total YTD \$6,335,697 (with September, October and November premiums yet to be determined):

IFDA \$2,559,537
AFDA \$2,524,264
MFDA \$1,251,896

We were understandably shocked to discover that again in 2006 we were not receiving any of the appropriate credit. Ed and I both work very hard for Merrill Lynch and strongly feel that this is unfair. The funeral directors associations are an integral part of our current business, as well as our plans for future growth (and I might add significant revenue for Merrill)."

33. In his presentations to other Funeral Directors Associations and in his Power Point presentation Schainker states that the Rate of Return for the IFDA Tax Exempt Pre need fund was guaranteed. However, the taxable and the tax exempt funds investments and/or their rates of return were not guaranteed by IFDA Services, the insurance issuers of its Variable Universal Life policies or by any other entity and Schainker had no basis for the representation.
34. Sometime in 1997, the Tax Exempt Trust ceased to purchase new variable life insurance policies and used a portion of new Pre-need contract deposits to pay premiums on existing insurance contracts.

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35. In 1999, Section 4a.(d) of the Illinois Burial Funds Act was enacted that requires notice to Purchasers of Pre-Need contracts and their permission before Pre-need Trust Funds may be invested in life insurance or deferred annuity contracts.
36. Neither the IFDA Services, Inc, the IFDA Pre-need Trust, Schainker nor anyone else provided notice or obtained the permissions of purchasers of Pre-Need contracts before their funds were invested in the insurance contracts described above.
37. Marketing material and contract information from IFDA Services, Inc. stated that the money deposited in the Trusts would be invested in high grade investments and the principal kept safe. In its application for Funeral Home directors to participate in the IFDA Preneed trust program, IFDA Services, Inc. states the following: "We will invest your funds predominantly in quality, fixed income securities, such as U.S. Treasury securities, government agency obligations, certificates of deposit, corporate bonds, etc. A portion of the funds will also be placed in equities or mutual funds."
38. The purpose of the Tax Exempt Trust was to invest money from Pre-need contracts that would be used for funeral and burial expenses. Fundamentally, there was no economic or actuarial correlation between the life expectancies of the insured and the pre-need contract purchasers.
39. No actuarial or other financial analyses were conducted at any time by Schainker to determine if the purchases of these contracts, the continued holding of the insurance contracts, and payment of premiums to maintain in force, were suitable or in the best interest of IFDA Services, Inc. and/or the Pre-need contract purchasers in light of the investment requirements and goals of the Pre-need purchasers, IFDA Preneed Trust, its investment policies and the applicable regulations of the Illinois Burial Funds Act or State and Federal Securities laws.
40. As early as 2001, the independent auditors of the IFDA Preneed Trust reported in their annual audit a deficit of \$10,331,252 in the Tax Exempt Trust.
41. In 2005 a compliance exam by the Illinois Office of the Comptroller found that the total Pre Need trust program

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was under-funded (deficit) of \$38,504,845 as of May 31, 2005

42. Each year the deficit continued to grow, solely due to the investment performance and financial commitments of the tax-exempt fund. In 2006 the deficit for the total Pre need trust program was \$41,534,857 and as of the most recent audit date July 31, 2008, the deficit for the total IFDA Preneed Trust program had ballooned to \$54,443,312.
43. Some of the insurance contracts recommended and purchased by Schainker were Modified Endowment Contracts.
44. Modified Endowment Contracts are insurance contracts which do not qualify for a favorable tax treatment by the IRS. This means that any early withdrawal of the funds from the insurance contract is subject to a tax penalty including loans on the policy. As of July 2008 the Tax Exempt Trust had 88 Modified Endowment Contracts.
45. Schainker failed to disclose to IFDA Services, Inc., the Funeral Home Directors/member participants and to Purchasers of Pre-need contracts that some of the investments in the Tax Exempt Trust were in Modified Endowment Contracts. In July 2008 he also misrepresented to IFDA board members and Funeral Home Directors/member participants that the Tax Exempt Trust did not hold Modified Endowment Contracts when in fact they were many such contracts.
46. The holding of Modified Endowment Contracts severely limited the liquidity of the Tax Exempt Trust and also placed its Tax Exempt status in jeopardy.
47. Schainker also failed to disclose to Funeral Home Director/member participants and Purchasers of Pre-need Contracts that their money was invested in Variable Universal Life Insurance and was quoted in a IFDA newsletter dated August 1, 2008 as follows: "The IFDA Tax Advantaged Preneed Trust has historically been allocated conservatively with the majority of funds invested in the bond market, represented through U.S. Treasuries, government agencies, and corporate debt instruments. The current allocation as reflected in the attached report reflects approximately 65 % of the total assets allocated to bonds and cash, and 35% to

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equities with both domestic and international exposure."

48. 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, 14 Admin Code 130.100 et seq.
49. Schainker recommendations of the initial purchase of insurance contracts, selection and management of the sub accounts of the insurance contracts, continued holding of the contracts and payments of premiums on the policies was not in the best interests of the beneficiaries of the Purchasers of Pre Need contracts because:
 - a. No financial or actuarial analysis was done at the time of the initial planning, recommendation and implementation of the tax exempt trust fund and no such analysis was prepared during the existence of the fund until 2006 and only after an inquiry by the Illinois Comptroller's Office.
 - b. The purchase of Life Insurance contracts was contrary to the investment policy and objectives of IFDA Services, Inc.
 - c. Purchases of Life Insurance contracts, especially Modified Endowment Contracts limited the liquidity of the investments, hampering the Tax Exempt Trust ability to meet current expenses and demands for burial expenses.
 - d. Illegal payments were made to funeral home directors/member participants in order to secure their permission to be insured as Key men by IFDA Services, Inc.
 - e. After 1999, new Pre-need contract purchase money was used to invest in insurance contracts without any notice to or permission from Pre-need purchasers as required under the Illinois Burial Funds Act.
 - f. Purchasers of Guaranteed Pre-need contracts investment objective is the safety of their initial investment. They do not receive any gain in earnings in the account and therefore receive

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no economic advantage by investing the funds in higher risk but possibly higher reward investments.

50. Schainker made the following misrepresentations and omissions.
- a. That the program was Tax exempt when in fact due to its investments in Modified Endowment Contracts it could be subject to taxation.
 - b. Failed to disclose to IFDA Services, Inc, Funeral Home Directors/member participants and Purchasers of Pre-Need Contracts that Pre-need contract money would be invested in Modified Endowment Contracts and that the Tax Exempt Trust was invested in Modified Endowment Contracts.
 - c. Stating to Funeral Home Directors/member participants that no Modified Endowment Contracts had been purchased when in fact 88 such policies had been purchase and were held by the Tax Exempt Trust.
 - d. Failing to disclose to Funeral Home Directors/member participants and Purchasers of Pre-need contracts that their funds were invested in insurance contracts and that their funds were also used to pay for free life insurance for IFDA Services, Inc. officers, directors, funeral home directors including the Funeral Home Director who had sold to them the Pre-need contract.
 - e. That Pre-need contract funds were invested in Variable Universal Life policies and not in accordance with the IFDA Services, Inc.'s written investment policy.
51. That by virtue of the foregoing the Respondent has violated sections 12.A, F, G, H, I and J of the Illinois Securities Law of 1953 815 ILCS 5/1 ("the Act").
52. That by virtue of the foregoing the Respondent's registrations are subject to suspensions or revocations pursuant to Section 8.E.1(b), (g) and (m) of the Act.

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53. That Section 11.E(2) of the Act provides, inter alia, that if the Secretary of State shall find that any person has violated subsections F, G, H, I or J of Section 12 of the Act, the Secretary of State may by written order prohibit the person from offering or selling any securities in this State.
54. That Section 11.E(4) of the Act provides, inter alia, that if the Secretary of State, after finding that any provision of the Act has been violated, may impose a fine as provided by rule, regulation or order not to exceed \$10,000.00 for each violation of the Act.
55. That by virtue of the foregoing, the Edward Louis Schainker is subject to a fine of up to \$10,000.00 per violation, an order of censure an order which permanently prohibits the Respondents from offering or selling securities in the State of Illinois and an order that suspends or revokes his investment adviser representative or salesperson registration in the Stat of Illinois.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130) (the "Rules"), to file an answer to the allegations outlined above or a Special Appearance pursuant to Section 130.1107 of the Rules, or other responsive pleading within thirty days of the receipt of this notice. Your failure to do so within the prescribed time shall be deemed an admission of the allegations contained in the Notice of Hearing and waives your right to a hearing.

Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to so appear shall constitute default.

Delivery of notice to the designated representative of any Respondent constitutes service upon such Respondents.

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Dated this 1st day of April, 2009.

A handwritten signature in black ink that reads "Jesse White" followed by a stylized flourish or initials.

Jesse White
Secretary of State
State of Illinois

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