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Suit alleges funeral fund conspiracy

Funeral home sues Merrill Lynch, others, saying documents contain forged signatures

By **BRUCE RUSHTON (bruce.rushton@sj-r.com)**
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A downstate funeral home is suing Merrill Lynch, a Springfield law firm and others, saying that signatures were forged on life insurance documents as part of a conspiracy to collect millions of dollars in commissions and fees from a pre-need funeral trust fund that ultimately collapsed.

In the lawsuit, filed last summer in St. Clair County, attorneys for the Kurrus Funeral Home in Belleville say Dale Kurrus, co-owner of the home, agreed to allow the Illinois Funeral Directors Association to insure his life in June 1994.

Insurance forms did not specify a value, but Kurrus says he was told the IFDA would be paid $1 million upon his death. Six months later the amount of insurance was increased by more than $400,000, according to Kurrus' lawyers.

In his lawsuit, Kurrus says he and his father agreed to have their lives insured but had no idea the policies carried a total value of $10 million.

Ed Wallace, attorney for Kurrus, declined to say what his clients believed the policies were worth.

"The fact that there was a complete lack of transparency is really what's at issue," Wallace said.

Edward Schainker, a Merrill Lynch investment adviser to the IFDA, signed witness forms stating that Kurrus signed the insurance documents in Springfield, when in fact the forms were signed in Belleville, according to the lawsuit.

Kurrus also alleges that the signatures on two forms, one that increased the amount of insurance and another that gave an insurance company access to his medical records, are not his.

"In other words, these documents were forged," attorneys for Kurrus say in the lawsuit.

The suit says misdeeds by Merrill Lynch, the Springfield law firm of Sorling, Northrup, Hanna, Cullen and Cochran and others led to the collapse of the pre-need funeral trust fund, with losses totaling as much as $145 million.

Phillip Stern, one of Schainker's attorneys, said Schainker did nothing wrong.

"It's my understanding that there are no signatures that were forged," Stern said. "We do not believe that Mr. Schainker has engaged in any wrongdoing in connection with any activities."

Stern declined to say how he came to understand that no documents were forged.

William Halldin, Merrill Lynch spokesman, also dismissed the forgery accusations.

"We believe there's no merit to those allegations, and we've asked the court to dismiss that case," Halldin said.

Halldin said Schainker, whose license to sell securities and act as an investment adviser was suspended by the secretary of state in 2009, is no longer employed by Merrill Lynch.

But Wallace said Kurrus might not be the only funeral director whose signature was forged.

"We've heard of other claims (of forgery) that we're investigating," Wallace said.

'Staggering' losses

The Kurrus lawsuit is one of a series of legal actions filed since the collapse of the IFDA's pre-need funeral trust fund in 2008.

Beginning in 1987, the funeral directors' group bought life insurance policies on funeral directors using funds from consumers who bought pre-need funeral contracts. Rather than pay fixed benefits, the policies paid out based on the performance of investments made with premium monies. The idea was to create a tax-exempt fund with earnings sufficient to pay for contracted funerals.

However, those insured didn't die fast enough to pay for customers' funerals. Furthermore, state regulators have determined, the IFDA had no legal insurable interest in the funeral directors whose lives were insured, raising questions about whether insurance companies could be forced to pay benefits.

By 2001, the fund was running a $10 million deficit, according to funeral directors who are responsible for the losses. With income insufficient to pay expenses, plaintiffs say the fund became a Ponzi scheme — money from new purchasers of pre-need contracts covered funerals for prior purchasers, as well as premiums for life-insurance polices on funeral directors.

While funeral directors were told the trust was tax-exempt, the fund was, in fact, subject to federal excise taxes, Kurrus' attorneys say. Merrill Lynch and insurance companies that issued policies were taking in as much as $6.5 million a year in fees and commissions, Kurrus' attorneys say, so Merrill Lynch resisted liquidating the policies even after it became clear the trust was insolvent.

If money had been invested in conservative, tax-exempt financial instruments, the fund would have been worth about $280 million as of September 2009, Kurrus' attorneys say. Instead, it was worth $135 million, a difference of $145 million.

The Kurrus Funeral Home alone has lost hundreds of thousands of dollars, according to the lawsuit.

Law firm implicated

Kurrus says the defendants engaged in a civil conspiracy that cost funeral directors millions of dollars, while generating income for Merrill Lynch, the IFDA and Schainker.

From the beginning, the trust fund was illegal, according to the lawsuit.

In 1987, lawyers with the Sorling firm asked the state comptroller's office, which then regulated the pre-need funeral industry, to approve the IFDA's plan to buy life-insurance policies with money from purchasers of pre-need funeral contracts. The comptroller declined, although officials said approval would be given if the Illinois attorney general's office issued an opinion stating the scheme was legal.

No such opinion was issued, the suit says. Nonetheless, the IFDA started buying life insurance, and attorneys for Kurrus accuse the Springfield law firm of green-lighting the purchases.

Citing a 1996 letter from Michael Connelly, a Sorling attorney, to the executive director of the IFDA, attorneys for Kurrus say the law firm knew the IFDA had no legal authority to act as trustee.

In the letter, Connelly recommended that the IFDA resign as trustee to eliminate any issues regarding the association's authority to administer the trust.

"The trust advisor would not have the same potential liability as the trustee of pre-need trust funds," Connelly wrote.

"Documents could be written in a way that would give the trust advisor much of the control currently enjoyed by the trustee, including the right to change the trustee from time to time."

In the fall of 2007, the comptroller's office stripped the IFDA of the license it used to manage the trust, saying the license should never have been issued in the first place.

Because the IFDA didn't take Connelly's advice and resign as trustee in 1996, the Sorling law firm knew for years that the funeral directors association was violating the Burial Funds Act whenever it collected a fee for managing the trust or otherwise took any action as a trustee, Kurrus' attorneys say.

Mark Cullen, an attorney in the Sorling law firm who is named as a defendant, declined comment.

Attorneys for Sorling say state law did not bar the IFDA from purchasing insurance policies. They also say the lawsuit against their client should be dismissed because the law firm never had an attorney-client relationship with Kurrus. Claims under the Illinois Consumer Fraud Act also should be dismissed because of insufficient facts and because courts have held that the consumer-fraud law doesn't apply to lawyers, the Sorling attorneys say.

Sorling's attorneys also argue that the statute of limitations for suing the law firm has passed and that the issues in Kurrus' lawsuit already are pending in other lawsuits filed in connection with the trust fund's collapse.

No insurable interest

Kurrus' attorneys say Merrill Lynch acted in its best interests, not that of funeral directors who now must provide funerals for pre-need contract purchasers regardless of losses.

Schainker knew the IFDA had no insurable interest on funeral directors when he sold the policies to the funeral directors association, Kurrus' attorneys say.

"As a result, Schainker knew or should have known that these insurance policies were mere wagering bets on the lives of funeral directors," attorneys for Kurrus write in the lawsuit. "These 'investments' were therefore against public policy, mere speculation and not investments made with regard to the permanent disposition of funds."

Schainker and his employer Merrill Lynch profited even as the trust fund failed, plaintiff's attorneys allege.

In 2007, the IFDA trust had more than $70 million — more than 36 percent of all IFDA monies in trust sub-accounts — invested in mutual funds managed by Merrill Lynch, plaintiff's attorneys say.

Rather than reveal the trust fund's deficits and dire prospects, Merrill Lynch and the IFDA created documents showing that the trust was earning 4 percent annually so that funeral home directors wouldn't withdraw money, the plaintiff's lawyers say.

By early 2008, state regulators had determined the trust was in trouble and the IFDA should not act as trustee. Regions Bank offered to take over but backed out after the IFDA balked at liquidating the insurance policies.

Merrill Lynch also opposed liquidation, according to the plaintiff.

“They had a clear economic interest in doing so, as the fees, commissions, premiums and other income they earned from the life insurance enterprise would be eliminated if the policies were liquidated,” attorneys for Kurrus write.

After the comptroller’s office revoked the IFDA’s license in the fall of 2007, funeral directors grew worried. At the group’s annual convention in June 2008, the association’s president told directors that an actuarial study was under way to determine the trust’s financial position and prospects.

However, directors were not told that the life-insurance arm of Merrill Lynch paid for the study, which has never been released to directors who invested money in the trust, Kurrus’ attorneys say. By concealing the study, the attorneys say, defendants in the lawsuit have fraudulently hidden the damage the life-insurance polices did to the trust.

Policy liquidation

The question of when Merrill Lynch became the fund’s trustee could prove important.

The trust division of Merrill Lynch took over as interim trustee in May 2008, after state regulators issued a cease-and-desist order telling the IFDA it could no longer administer the trust, according to attorneys for Kurrus. Merrill Lynch became permanent trustee in October 2008, plaintiff's attorneys say.

Attorneys for the funeral home say Merrill Lynch waited months before liquidating insurance policies, and by the time the policies were liquidated in 2009 and 2010, financial markets had hit bottom, which worsened losses.

However, Merrill Lynch attorneys say the trust division of the investment firm didn’t take over the trust until November 2008 and that the insurance policies were then promptly liquidated.

Regardless of when Merrill Lynch took over the trust, funeral directors say they didn’t have a choice: The state comptroller's office told funeral directors that if they did not agree to let Merrill Lynch manage the money, the state would revoke their licenses, putting them out of business. And funeral directors could not withdraw funds because the state had frozen the trust in the spring of 2008.

Kurrus attorneys accuse Merrill Lynch of protecting the firm at the expense of funeral directors.

In a motion to dismiss, attorneys for the trust division of Merrill Lynch say the firm had no obligation to investigate or bring claims against anyone for anything that happened prior to Merrill Lynch assuming trustee duties. The firm also argues that funeral contract purchasers, not funeral home directors who sold contracts, are the trust’s beneficiaries, so Merrill Lynch had no fiduciary duty to funeral homes.

Attorneys for the insurance and investment divisions of Merrill Lynch say Kurrus doesn't have standing to sue and that any claims are barred by statutes of limitation.

Schainker is asking that the case against him be dismissed on the same grounds asserted by the investment and insurance divisions of Merrill Lynch.

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Merrill Lynch may have to bail out trust fund

Officials in the Illinois secretary of state's office say they will punish Merrill Lynch for its conduct in connection with the collapse of a funeral trust fund and might require the investment firm to bail out the trust, which has bled tens of millions of dollars.

Tanya Solov, director of the securities department in the secretary of state’s office, said her department has commissioned an analysis of insurance contracts within the failed trust to determine the amount that the trust is under-funded.

Once the department has determined the amount that is needed to ensure that purchasers of pre-need funeral contracts will receive services, Merrill Lynch and any other entity deemed responsible for any shortfall will be required to make the trust whole, said Solov and Dave Finnigan, senior enforcement attorney for the securities department.

Merrill Lynch is paying for the analysis and is cooperating with the secretary of state's investigation, Solov said. The analysis should be complete within a few months, she and Finnigan said.

Under a settlement with the state Department of Insurance, Merrill Lynch already has paid $18 million to funeral home directors who must provide funerals regardless of losses. Funeral home directors have said losses could be so steep that some funeral homes could go bankrupt.

“If $18 million covers it, that’s fine,” Solov said. “But $18 million might not cover it. That is what we would be requesting from Merrill Lynch.”

Loss estimates have varied.

In 2007, an actuarial report ordered by the Illinois Department of Financial and Professional Regulation showed that the fund needed as much as $40 million to remain solvent. In the spring of 2008, Regions Bank, which had been asked to take over the trust, concluded the fund was bleeding $18,000 a day. Funeral directors say they have lost as much as $145 million.

Solov and Finnigan said the state has the authority to levy penalties into the millions of dollars.

“If that ($145 million) is what the documents show, certainly that would be on the table,” Solov said.

In any case, Merrill Lynch is facing punishment, Solov and Finnigan said.

“Even if it (losses) comes up to zero — and I don’t think it will be a zero — we will still require Merrill Lynch to pay some sort of sanction,” Finnigan said.

The most severe punishment would be revocation of Merrill Lynch’s license to sell securities in Illinois, Finnigan said.

William Halldin, Merrill Lynch spokesman, said the investment firm wants to protect consumers.

“Our consistent goal in this matter has been to ensure that families get the services they paid for,” Halldin said.

Finnegan and Solov said that their office is aware of allegations that signatures have been forged on forms used to insure the lives of funeral directors, but they declined to say whether they have called in law enforcement agencies to conduct a criminal investigation.

“We have looked at the issue of forgery,” Finnigan said. “It’s something we’re still looking at.”

Ed Wallace, attorney for several funeral directors who have sued the IFDA and Merrill Lynch, said he has no faith that the secretary of state’s office can make the trust fund whole.

Wallace noted that the state Department of Insurance in 2009 approved the $18 million settlement that included a clause that required funeral directors to release Merrill Lynch from liability as a condition for receiving settlement funds. Funeral directors won a ruling from a Cook County judge that said regulators could not require directors to release Merrill Lynch from liability.

“The only entity that can make a determination is a court of law,” Wallace said.

Bruce Rushton can be reached at 788-1542.

Timeline of the fund

1987: With itself as trustee, the Illinois Funeral Directors Association begins buying life-insurance policies on funeral directors to fund the IFDA’s pre-need funeral trust, which contains money from thousands of Illinoisans who bought funeral contracts from funeral homes.

1997: The IFDA stops buying life-insurance policies to fund the trust.

2001: An audit shows a deficit of $10 million in the trust, but funeral directors responsible for shortfalls are not told.

2006: The state comptroller’s office, which regulates the pre-need funeral industry, reviews the IFDA’s books and determines the fund is running a deficit of nearly $40 million. The IFDA asks regulators to keep the information confidential, and funeral directors are not notified.

2007: The comptroller’s office revokes the IFDA’s pre-need funeral license, ruling the license should never have been issued. Despite having no license, the IFDA continues acting as the fund’s trustee.

Spring 2008: Regions Bank considers taking over as trustee but backs out after the IFDA resists the bank’s insistence that the life-insurance policies be liquidated. The state subsequently issues the first of a series of cease-and-desist orders freezing the trust and directing that the IFDA stop acting as trustee.

Fall 2008: The trust arm of Merrill Lynch becomes trustee. The fund’s value is written down by $59 million, 25 percent of the trust’s value.

November 2008: Two purchasers of pre-need funeral contracts sue the IFDA, the first in a series of lawsuits involving the troubled trust.

Early 2009: A half-dozen funeral directors sue the IFDA and Merrill Lynch.

February 2009: The Illinois Secretary of States’ offices suspends the license of Edward Schainker, a Springfield-based Merrill Lynch investment adviser who provided advice to the IFDA, to act as an investment adviser. The Illinois Department of Insurance takes similar action against his insurance license. The state says Schainker's advice led to the IFDA buying more than 300 insurance policies and paying more than $88 million in premiums, including more than $32 million that went to Merrill Lynch.

March 2009: The U.S. attorney’s office in Springfield subpoenas state regulators for documents related to the trust fund’s collapse. The status of the federal investigation is not clear.

May 2009: Merrill Lynch agrees to pay an $18 million fine levied by the state Department of Insurance.

September 2009: Schainker settles a case filed by the state Department of Insurance, agreeing to a $100,000 fine, the maximum allowed, and revocation of his license to sell insurance.

July 2010: Kurrus Funeral Home in Belleville sues Merrill Lynch, Schainker and others, alleging that signatures of a home co-owner were forged on life-insurance forms.

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