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When Prepaid Funeral Plans Are Wealth Killers

Long Pitched to People of Lesser Means, the Controversial Deals Are Going Upmarket—and Now May Carry Bigger Risks

By ANNE TERGESEN

It's among the best-intentioned and—in the eyes of some—worst investments that people make: paying in advance for a funeral.

Now, in the wake of recent allegations of fraud and mismanagement in this multibillion-dollar industry, state and federal lawmakers are trying to crack down on abuses in so-called prepaid funeral plans.

"Consumer advocates have been urging states to enact stricter regulations of prepaid plans for years," says Sally Hurme, a senior project manager who specializes in consumer education at AARP, the Washington-based advocacy group. "This is a step in the right direction."

Long thought of as products for lower-income families, prepaid funerals are increasingly being sold to consumers across all income levels, even the wealthy.

Delia Fernandez, a financial planner in Los Alamitos, Calif., says prepaid funerals are a hot topic among her clients, whose net worth ranges from $800,000 to $3 million. "A good many are asking about this. A lot of us financial planners are dealing with baby boomers who are taking care of aging parents and want to know how these work."

Some view prepaid plans as an inflation hedge that allows them to lock in today's prices—about $10,000 on average—for an expense that in recent years has risen faster than the consumer price index. Others take the step simply to spare survivors the burden of arranging and paying for a funeral. Consumer advocates say these plans are most appropriate for people who wish to spend down assets in order to qualify for Medicaid coverage.

About one in four Americans age 50-plus—some 20 million people—have paid in advance for a funeral service, according to AARP. While national figures on the size of those payments are scarce, in Texas alone consumers have contracts worth $3 billion.

Prepaid funeral plans come in two basic varieties. With a so-called guaranteed plan, a funeral home promises that if you pay today's prices, it will provide the goods and services you purchased, no matter how much prices rise. "Non-guaranteed" plans offer no such protections. But if these accounts appreciate in value, heirs get to keep the gains. (You can prepay today's full cost or a portion of it, in one lump sum or over time.)

Even guaranteed plans don't always protect against unexpected bills, however. Many exempt such items as flowers and music. And changes, such as upgrades in caskets or a switch to another funeral home, can void the price guarantee.

People who invest in a prepaid funeral generally have two options: They can put their money into a trust run by a financial institution or statewide funeral directors association, or they can buy an insurance policy—usually a whole-life contract.

In either case, getting out of a prepaid deal isn't easy. In many states, trust funds impose fees on refunds. In Texas, for example, consumers forfeit to the funeral director 10% of their prepayments, plus half of any earnings. In California, consumers can lose up to 10% of the prepayment—a penalty that caused Ms. Fernandez, the Los Alamitos financial planner, to decide against purchasing such a contract for her mother, Eva McGee, 90, of Long Beach, Calif.

The fees for cashing in an insurance contract can be even stiffer. In 2005, Gayle and Donald Zeman of Sioux City, Iowa, purchased two $7,000 prepaid funeral contracts funded by life-insurance policies. The couple agreed to pay premiums of $230 a month over 10 years. In March, after having paid more than $11,000, the Zemans opted to cancel the policies.

But people who cancel policies are entitled to receive only the cash value—that is, the premiums paid, minus commissions and costs, such as administrative expenses. The insurer that issued the Zemans' policies, Homesteaders Life Co. of Des Moines, Iowa, recently informed them that they are entitled to just $6,000, barely half what they put in, says their son Don Zeman, a paramedic from Norfolk, Neb. "That won't even cover one funeral," he says. Citing client confidentiality, Homesteaders declined to confirm the $6,000 figure. But Tom Heuer, the firm's vice president of insurance operations, said: "Full disclosure regarding the plans was provided within the insurance applications and policies."

Not only are prepaid funeral plans often stacked against consumers, but some operators engage in fraud. While petty scams have long plagued the industry, in recent years the sums have been growing, say regulators.

In 2008, National Prearranged Services Inc., a Missouri-based seller of prepaid funeral services, collapsed, leaving about $600 million in unfunded liabilities. In a complaint filed on Aug. 6 in the U.S. District Court for the Eastern District of Missouri, regulators in various states accused company officials of "systematically loot[ing] the cash for their personal enrichment" in part by replacing whole-life polices sold to cover funerals with less-expensive term-life coverage—and pocketing the difference.

Last October the U.S. Attorney's Office in the Eastern District of Missouri indicted former NPS president Randall Sutton and former office manager Sharon Nekol Province on nine felony counts, including mail fraud and money laundering. Burton Shostak of Shostak & Shostak LLC in St. Louis, an attorney for Mr. Sutton, says his client "will be totally vindicated." Joseph Green, an attorney for Ms. Province at Leritz Plunkert & Bruning PC in St. Louis, couldn't be reached for comment.

Such cases are prompting lawmakers to curb some of the most obvious abuses. Texas recently passed legislation that requires those selling prepaid contracts, as of June 1, to hand out a brochure approved by state regulators disclosing some of the potential pitfalls of these arrangements. In November, New Jersey started requiring cemeteries to deposit all of the prepayments they receive for burial services into a trust fund for safekeeping.

In Washington, Rep. Bobby Rush (D., Ill.) is sponsoring a bill that would require contracts to disclose the financial consequences to consumers of canceling or transferring the arrangements. "If I am going to incur a penalty for any reason, then that should be spelled out clearly and conspicuously," says Rep. Rush.

When it comes to fraud, consumer protections are spotty. Don Williams, 75, doesn't expect to recover any of the $7,000 his deceased father-in-law, Leonard Richhouse, paid in 2004 to a local funeral home to cover the cost of his funeral. In March, the funeral-home proprietors, Christopher and Nancy Ziomek, pleaded guilty in the Wayne County Circuit Court to one count of embezzlement and were ordered to pay 24 customers more than $257,000 in restitution. According to Robert Spada, head of the Wayne County prosecutor's Elder Abuse Unit, the couple issued false trust documents and spent the money. Timothy Wrather, an attorney for Ms. Ziomek, declined to comment. Theodore Empson, an attorney for Mr. Ziomek, said, "My client and his wife made their best good-faith effort to come up with the funds to pay the victims back" but were unsuccessful.

When Mr. Richhouse died in 2008, Mr. Williams, a retired sales manager for a Midwestern chemical company, says the family had to pay an additional $6,000 for the funeral. "I'm not going to pay an attorney to go after $7,000," he says.

To avoid a similar result, you can open a joint account with someone you trust or a "payable-on-death account" with a bank or brokerage firm, says Jeffrey Bloom, a partner at Margolis & Bloom LLP, a Boston law firm that specializes in elder law. If you want to be sure the money is used for a funeral you can set up a trust. Typically, says Mr. Bloom, such a trust would be relatively simple and would cost "a few hundred dollars."

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