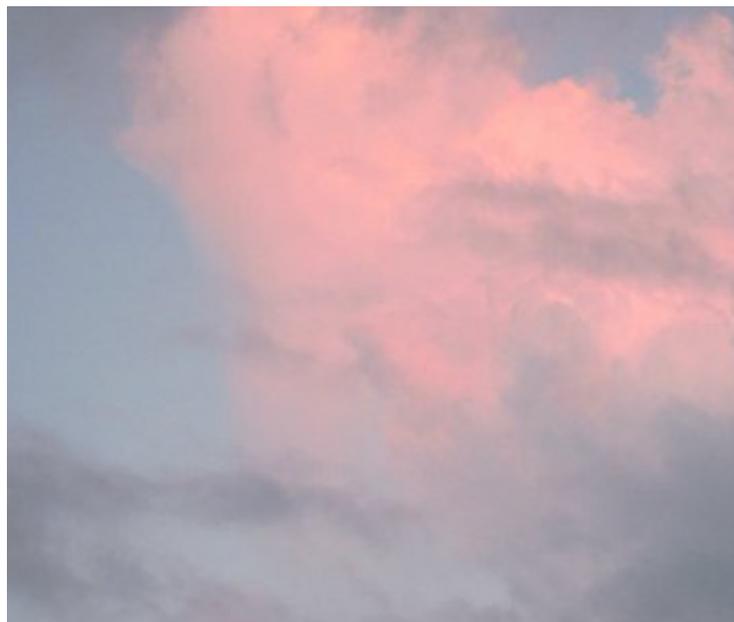


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This Issue:

Settlement Reached in IFDA Preneed Trust Suits.....	P. 1
Setting the Stage for a Settlement	P. 3
Illinois Secretary of State's Consent Order	
Outlines Chronology of Preneed Trust Fund	P. 3
NFDA Asia Funeral Expo & Conference Marks 5th Anniversary	P. 6
The Notebook	P. 6
From the Editor's Desk	P. 7



Settlement Reached in IFDA Preneed Trust Suits

SPRINGFIELD, ILLINOIS – A United States District Court judge has given preliminary approval to a \$59.15 million settlement in the class action suit stemming from actions surrounding the creation and administration of the much maligned Illinois Funeral Directors Association's Preneed Trust Fund. The settlement is designed to resolve all litigation that has been or could have been brought regarding the management and investment of the IFDA Preneed Trust. If the court grants final approval, the settlement will resolve all pending actions involving the trust.

The settlement, ordered by U.S. District Court Judge G. Patrick Murphy, comes on the heels of last week's consent agreement filed with the Illinois Secretary of State's Securities Department, whereby Merrill Lynch, the one-time trustee of the fund, has agreed to pay nearly \$26 million to provide restitution to families and funeral homes that invested in the failed trust fund.

"The Court preliminarily finds that the Settlement Agreement has been reached as a result of intensive, serious and non-collusive arms-length negotiations. The Court preliminarily finds that counsel for the parties are able to reasonably evaluate their respective positions," Murphy wrote. "The Court also preliminarily finds that settlement at this time will avoid addi-

tional substantial costs to all parties, as well as the uncertainty and risks that would be presented to the parties by further litigation of the claims resolved by the Settlement Agreement."

"It still doesn't seem real because it has been a problem for so long, but it is good news," said John Humes III, president of the Illinois Funeral Directors Association. "We're elated after everything IFDA has been through to be able to see the fruits of our hard work turn into some real relief for the victims of this – the funeral homes and the consumers who were harmed by this trust write-down. We're very proud that we have been able to provide something back to our members. We hope this is a springboard to be able to look forward, reunite and come to a common good for funeral service in Illinois.

"As the association president, it is a great feeling to be able to provide some relief to some people who were hit very, very hard," Humes added.

According to the settlement agreement, the total benefits that have or will be paid to, or on behalf of, the members of the class action suits will total \$59,150,000 and will consist of:

- \$18 million previously paid by Merrill Lynch into a Department of Insurance fund;
- The \$25,900,000 to be paid by Merrill Lynch, mentioned

in last week's consent agreement, will be contributed into the Illinois Securities Department fund and will be paid in accordance with that agreement. [The amount of the fund includes a full reimbursement of approximately \$7,192,081 in gross commissions received by Merrill Lynch Life Agency, including the commissions credited to Edward Schainker, a former Merrill Lynch, Pierce, Fenner & Smith financial advisor, who was also an insurance producer for Merrill Lynch Life Agency and Merrill Lynch Life Insurance. Schainker's license also revoked by Secretary of State Jesse White's office.]

- Some \$15,250,000 shall comprise the Qualified Settlement Fund and will be paid in accordance with the settlement agreement. Merrill Lynch will pony up an additional \$11.5 million; \$2 million will come from IFDA and \$1.75 million from IFDA's former lawyers, Sorling, Northrup, Hanna, Cullen & Cochran, Ltd. and Mark Cullen.

Humes said IFDA's goal all along was relief to its members. "Our profession is a noble one and I can say with great certainty that our funeral directors were not letting consumers be harmed," he said. "They were the ones taking the brunt of this. We worked very hard to restructure that litigation and try what we thought was right to do for our members."

Humes said that his understanding of the settlement is that it offers real protection for the association members. "After this trust write-down [funeral directors] had a significant level of liability for all of their preneed files," he said. "We firmly believe this settlement will ensure their futures and protect their interests to the highest extent possible."

Duane Marsh, IFDA executive director, described the investigation into the trust over the last three years. "No stone was left unturned," he said. "Thousands of documents were retrieved, copied and distributed. Hundreds of hours of depositions were taken. More than \$1 million was spent on attorney fees and other related costs. All associated were scrutinized, analyzed and questioned in an effort to determine the causes and to find the best outcome. In the end, settlement was deemed the most appropriate course."

Added Humes, "There is a level of pride in this for me just to be at the helm at the culmination of this. I am most proud to take this off the plate of people who are following me because it was such an ominous thing to have hanging over you. We can get our focus back to where it needs to be and that is service to our members and advancing funeral service in Illinois."

Also included in the agreement, the court appointed the law firm of Wexler Wallace, Chicago, as the lead settlement class counsel. Epiq Systems Inc. was appointed as the settlement administrator, and Fiduciary Partners Inc. as special trustee.

A "fairness hearing" on final approval of the agreement has been scheduled for June 12. The hearing will consider whether the classes should be certified for settlement purposes only, and the fairness, reasonableness and adequacy of the settlement.

MBJ

Setting the Stage for a Settlement

CHICAGO – Last spring's legal wrangling by the Illinois Funeral Directors Association, which realigned the association from nominal defendants to plaintiffs seeking damages from its former legal advisors, was one of the tangible turning points in the legal proceedings involving the Preneed Trust.

On May 25, 2011, IFDA and IFDA Services, acting at the direction of an independent litigation committee, filed a motion to realign the parties, in which it sought to take the case over on its own behalf. The Circuit Court of Cook County granted IFDA's motion.

The case continued as a lawsuit by IFDA and IFDA Services against certain of its former officers and directors and its former legal advisors, Mark Cullen and the firm of Sorling, Northrup, Hanna, Cullen & Cochran Ltd.

Judge Mary L. Mikva ruled that the plaintiff funeral directors make no claim against nor seek relief from IFDA or IFDA Services but rather seek relief from Cullen and the Sorling firm, and various former directors and officers of IFDA.

"IFDA and IFDA Services are the real parties in interest and were only named as defendants in the complaint to ensure their presence before the court," the order said. "IFDA and IFDA Services are the real parties in interest as both entities

allegedly suffered damages as a result of the deficit in the Preneed Trust Tax-Exempt Fund. There is no antagonism between IFDA, IFDA Services and the plaintiffs and thus no reason not to realign IFDA and IFDA Services as plaintiffs. A current majority of the IFDA Board of Directors has not been named as defendants and is in favor of this suit as evidenced by the board resolution adopted in favor of it.”

In the July 21, 2011, edition of the *Memorial Business Journal*, David Nixon, Nixon Consulting, Chatham, Ill., said the action is a “really smart move” on the part of IFDA. “It is definitely a step forward, and a welcome step forward,” he said. “Basically, they have not been an effective organization because they have been mired in this issue for so long, and if they can take this leap and distance themselves from it as a plaintiff, then the true rebuilding will begin.”

That issue also quoted William Stalter, Overland, Kansas-based attorney and founder of Stalter Legal Services and Preneed Resource Company. “With its motion for realignment of parties, IFDA took a crucial step toward restoring the confidence the association lost with members and consumers,” observed Stalter, who publishes the “Death Care Compliance Law” blog on his website (www.deathcarelaw.com). He said credit is due to the funeral director plaintiffs and their attorneys with how the litigation was originally brought.

“Those lawsuits focused on the breaches of fiduciary duty committed by board members and their advisors,” Stalter said. “With the board members refusing to acknowledge any breaches, individual funeral homes had to pursue litigation in their capacities as members of the association and contingent beneficiaries of the master trust.

MBJ

Illinois Secretary of State’s Consent Order Outlines Chronology of Preneed Trust Fund

SPRINGFIELD, ILLINOIS – [Editor’s note: Last week’s consent order signed by Illinois Secretary of State Jesse White detailed the chronology and major players in the Illinois Funeral Directors Association Preneed Trust as the events unfolded. As background, we highlight these developments from the February 10 consent order.]

- Edward Louis Schinker was formerly registered in the State of Illinois as a salesperson, beginning in 1983, and as an investment advisor representative, beginning in 1998. Schinker was employed by Merrill Lynch from 1983 until 2009 and is subject to a Temporary Order of Suspension of these registrations by the Secretary of State dated February 24, 2009.

- Formed in 1976, IFDA Services Inc. is an Illinois corporation created for the purpose of “providing services for the Illinois Funeral Directors Association and its members.” IFDA Services is a wholly owned subsidiary of IFDA.

- Since 1979, IFDA Services has provided preneed trust services to its members.

- Illinois regulates the sale burial purchases under regulations, but primarily of “pre-need” funeral and various statutes and the Illinois Funeral or Burial Funds Act. According to the law, a preneed patron may deposit his/her funeral payments into a trust, which must be maintained (1) in a trust account established in a bank, savings and loan association, savings bank or credit union or “(2) in an account with a trust company authorized to do business in Illinois.” The funeral director receiving the deposit must furnish to the trustee depository the name of each customer and the amount of payment on each account for which a deposit is being made. These funds must be held in trust by a trustee.

- IFDA Services created and served as the trustee for three preneed trusts for the investment of money paid as a deposit for preneed contracts sold by its participating members: A taxable trust created in 1979, the IFDA Preneed Taxable Trust (a tax-exempt or tax-advantaged trust); the IFDA Preneed Tax Exempt Trust (created in 1986) and the IFDA Municipal Bond Trust created in about 1992.

- Funeral homes and/or funeral directors entered into IFDA Preneed Trust Program Member Participation Agreements with IFDA Services naming IFDA Services as the trustee for their preneed contracts. Additionally, IFDA Services provided preneed contract forms for use by IFDA members or their funeral home director/member participants. The forms designated IFDA Services as the trustee. IFDA Services’ role as trustee of the IFDA preneed trusts essentially had two components: the administration of preneed contracts and deposits into and payments from the IFDA preneed trusts and the management of the IFDA preneed trusts, including investment of trust assets and approval of management fees

and disbursements.

- Between 1971 and 2008, IFDA employed two executive directors: Robert Ninker and Paul Dixon. Ninker served as executive director from 1971 through 1998, and in that capacity, served as president of IFDA Services. Between 1983 and 1998, Ninker was Merrill Lynch's primary contact at IFDA concerning the IFDA preneed trusts. In 1999, Dixon assumed the position of executive director, which he held until his dismissal in January 2008. After he became executive director, Dixon was Merrill Lynch's primary contact at IFDA concerning the Tax Exempt Trust, including the trust investments.

- In late 1985, Ninker approached Schainker about attempting to set up an investment program that would not require IFDA to issue Internal Revenue Service (IRS) Forms 1099 to preneed patrons. After researching the matter, Schainker recommended the use of key-man life insurance, which allowed a company to record favorable after-tax yields through cash value accumulation in a life insurance policy written on the life of a corporate executive. In 1985, Merrill Lynch offered through Merrill Lynch Life Agency (MLLA) a single-premium variable life (VL) insurance product underwritten by Monarch Life Insurance called "Prime Plan." In making the recommendation, Schainker explained that death benefits paid to the beneficiary of a life insurance policy are free from income taxation. In addition, increases in the cash surrender value of life insurance policies ("inside buildup") are not currently taxable to the policy holder. Thus, under federal tax law and rules, the recognition of income earned inside a life insurance contract is deferred until the surrender of the contract, and is limited to the gain on the contract. If the contract is held until the death of the insured, no income tax is payable at all.

- In the late winter of 1985, Schainker and a Merrill Lynch insurance specialist made a presentation to the IFDA executive board concerning the use of variable life policies for the purpose of tax-advantaged investment. The presentation focused on: the ability of investments to appreciate tax-free within the insurance policies; liquidity, including the ability of the Trust to borrow against the insurance policies, tax-free, to meet cash flow needs; the costs and expenses of the insurance investments, including all relevant management and sales fees; and the ability of the trust to obtain a tax-free transfer of the insurance proceeds upon the death of the insured. The issue of investment liquidity was raised and discussed at length in the presentation. Schainker related that the insurance policies could not be surrendered without penalty or tax implications but that the Trust could borrow against the insurance, and gave examples of how this could be done at relatively nominal effective rates.

- Commencing in 1986, IFDA Services purchased a series of Monarch Prime Plan variable life policies in the Preneed Tax Exempt Trust, which were written against the lives of various IFDA "key-men," including officers and directors, as well as the lives of certain funeral directors.

- As of February 24, 2009, Schainker had 263 client households totaling more than 1,700 brokerage accounts. His clients included funeral director associations in three states, funeral homes, owners of funeral homes and their families and other individual and corporate clients and not-for-profit organizations.

- As of December 31, 2009, the IFDA Preneed Trust Program held the funds of more than 32,000 preneed patrons, including those deposited in both the taxable and tax-exempt trust. The tax-exempt trust, as of December 31, 2009, had a total asset value of \$128,866,956.

- From 1986 to 1998, Schainker recommended and the Preneed Tax Exempt Trust purchased 275 variable life policies issued by six insurance companies.

- As of January 31, 2009, the tax-exempt trust owned 307 different policies from seven different issuers and had paid \$88,272,900 in premiums over the lifetime of these policies. Merrill Lynch Life Insurance Company, which, prior to December 2007, had been affiliated with Merrill Lynch, received \$32,016,116 in premiums over the lifetime of 129 policies issued by it or Monarch. MLLA received approximately \$7,192,081 in gross commissions, a portion of which was credited to Schainker. Pursuant to service agreements between MLLA and Merrill Lynch, MLLA paid to Merrill Lynch various service fees and reimbursed certain expenses in connection with the sale of the variable life policies.

- Schainker's sales of variable life policies to IFDA Services were done with the knowledge and support of Merrill Lynch and Merrill Lynch Life Agency management.

- IFDA Services, as trustee of the IFDA Preneed Tax Exempt Trust, purchased variable life insurance contracts on the lives of the officers, directors and board members of IFDA, IFDA Services and certain funeral home directors/member participants in the IFDA Preneed Trust program.

- Beginning around 1990 and continuing into 2008, Schainker made presentations to at least six other state funeral directors associations in order to solicit these associations to employ an investment program involving the use of variable life policies in connection with their preneed trusts. Schainker prepared PowerPoint presentations that described the IFDA Preneed Tax Exempt Trust and used it as a model. These presentations were made with the knowledge and approval of Schainker's supervisors. As a result of these presentations and other solicitations, Schainker opened accounts for two other state funeral directors associations' preneed trusts with the knowledge and approval of his Merrill Lynch supervisors. (According to the *State Journal-Register*, those states were Alabama and Mississippi.) Both have ceased being clients of Merrill Lynch.

- Schainker recommended to both these clients the creation of a tax-exempt trust similar to the tax-exempt trust used by IFDA. Schainker sold a total of 131 variable life policies to the other preneed trusts for total premiums paid of \$18,765,503. Additionally, Schainker also recommended to other institutional investors and individual clients the purchase of variable life contracts as an investment strategy in order to accrue earnings on a tax-advantaged basis.

- From 1986 through 2010, 36 policies purchased by the IFDA Preneed Trust Fund through MLLA paid out upon the death of the insured. A total of \$41,457,045 in death benefits was paid to the IFDA Tax Exempt Trust on these policy claims. Additionally, \$269,376.02 in interest on death benefit claims was earned and paid as well.

- No actuarial or other financial analyses were conducted at any time by Schainker or anyone else at Merrill Lynch, Merrill Lynch Life Agency or Merrill Lynch Life Insurance Company prior to 2008 to determine if the purchases of the variable life policies, the continued holding of the policies and the payment of premiums to maintain the policies in force would meet the cash flow objectives of the Preneed Tax Exempt Trust.

- As early as 2002, the independent auditors engaged by IFDA to audit the IFDA Preneed Trust reported to IFDA and IFDA Services a shortfall of \$10,331,252 in the Tax Exempt Trust between the amounts credited on preneed contracts and the investment assets of the Tax Exempt Trust. In 2005 and 2006, the Illinois Office of the Comptroller (IOC) conducted an audit of the IFDA Preneed Trust as of December 31, 2004. The IOC determined that the total Preneed trust program was underfunded by \$38,504,845. In that analysis, the IOC determined that the underfunding was caused primarily by the IFDA's setting the Taxable and Tax Exempt Crediting Rates and payment of earnings on preneed contracts in the IFDA Preneed Trust in excess of the actual performance of the Taxable and Tax Exempt Trusts' investments.

- On or about October 29, 2008, IFDA applied a one-time adjustment to the current principal and/or to the current interest recorded in the records of IFDA for certain preneed contracts with funds on deposit in the IFDA Tax-Exempt Preneed Trust.

- Schainker was subject to at least three internal reviews by Merrill Lynch personnel, none of which were related to IFDA or the other funeral directors association. The investment accounts and variable life policies purchased by the preneed trusts for the state funeral directors associations collectively constituted a major source of Schainker's production at Merrill Lynch. Merrill Lynch's Activity Review Monitoring and Online Reporting system and its precursors triggered account reviews of the Merrill Lynch IFDA Preneed Trust accounts, but these accounts were not otherwise examined, reviewed or audited during any other internal examination process by Merrill Lynch. Additionally, Schainker's immediate supervisor and compliance supervisor stated that although they were aware that the accounts of these three clients contained more than 400 variable life policies and that Schainker made recommendations for allocations in the sub-accounts as part of a corporate-owned life insurance investment strategy, they did not implement any supplementary review or supervisory procedures to ensure that Schainker's recommendations were consistent with the clients' investment objectives.

- Schainker's recommendations of the initial purchase of insurance contracts, and subsequent recommendations with respect to the allocation of the sub accounts of the variable life policies, continued holding of the VL Policies and payments of premiums on the variable life policies did not meet all of the objectives of the IFDA Preneed Trusts or the Trust beneficiaries because: No 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 2007 and only after a regulatory inquiry; and variable life policies, especially Modified Endowment Contracts, limited the liquidity of the investments, hampering the Tax Exempt Trust's ability to meet potential administrative expenses and demands for burial expenses.

The Final Chapter

One day this week while driving I decided to let my iPod, in shuffle mode, select the tunes to be the soundtrack of this particular trip. One of the selections was a Bob Dylan song I hadn't heard in a while. There is a line in the song, "Brownsville Girl," that goes, "Strange how people who suffer together have stronger connections than people who are most content." I always liked that line.

Barring any unforeseen circumstances, the saga of the Illinois Funeral Directors Association Preneed Trust Fund is coming to a close. The final chapter is being written and the book is expected to close officially and finally in about four months when the preliminary settlement reached last week is approved.

It has been a long-time coming and observers seem to agree that the Illinois Funeral Directors Association had come a long way, literally from the brink of financial collapse to position itself well in the aftermath of the breakdown of its preneed trust fund. In addition to the association's legal problems being put in the figurative rear-view mirror, with membership numbers on the rise IFDA had made a return to viability.

IFDA President John Humes III said that his understanding of the settlement is that it offers real protection for the association members. "After this trust write-down [funeral directors] had a significant level of liability for all of their preneed files," he said. "We firmly believe this settlement will insure their futures and protect their interests to the highest extent possible."

With the preneed litigation casting such a long shadow over the association for so long, Humes said it still doesn't seem real. "We're elated after everything IFDA has been through to be able to see the fruits of our hard work turn into some real relief for the victims of this – the funeral and the consumers who were harmed by this trust write-down. We're very proud that we have been able to provide something back to our members."

In covering this story for so many years, this resolution is very welcomed. Over the years, it was interesting to see so many funeral directors in Illinois step forward and get involved at a time when many were content to walk away.

Humes said, "There is a level of pride in this for me just to be at the helm at the culmination of this. I am most of proud to take this off the plate of people who are following me because it was such an ominous thing to have hanging over you."

And thanks to the efforts of those who came before him, and those who will follow, IFDA can get its focus back to where it needs to be and that is service to its members and advancing funeral service in Illinois. David Nixon put it succinctly in last week's edition: "I believe that funeral directors in Illinois who participated in the IFDA Preneed Program owe a debt of gratitude to everyone who searched for the truth and aimed to recuperate their losses. Congratulations to their determination and character."

As Bob Dylan said, "Strange how people who suffer together have stronger connections than people who are most content."



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