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Funeral finance fiasco

Millions are lost when greed replaces common sense

BY BRUCE RUSHTON



There is no shortage of blame and stain in the saga of a failed trust fund once administered by the Illinois Funeral Directors Association.

Alleged villains range from Merrill Lynch, which has agreed to pay \$55.4 million to funeral directors who lost millions in the scheme, to Springfield corporation counsel Mark Cullen, the IFDA's former attorney, who has agreed to pay funeral directors \$1.75 million to settle a class-action lawsuit finalized last month.

Cullen, a defendant whose name was mentioned 145 times in the first of four lawsuits filed by funeral directors, declined comment on his portion of the settlement package, which also covers claims against Sorling, Northrup, Hanna, Cullen & Cochran, the Springfield law firm where Cullen worked before joining Mayor Michael Houston's staff. A message left at the firm was not returned. The IFDA will pay \$2 million to funeral directors under terms of an agreement to settle lawsuits in which directors alleged fraud and conspiracy.

Merrill Lynch, which agreed to pay \$18 million to funeral directors in 2009 to end an investigation by the state Department of Insurance, agreed last month to pay an additional \$25.9 million to end a probe by the Secretary of State. Funeral directors will also receive \$15.25 million to settle lawsuits, with \$11.5 million of that

amount coming from Merrill Lynch and the balance from the IFDA, Cullen and his former law firm. All told, funeral directors throughout the state will receive \$59.15 million.

Beyond big money, the tale of the IFDA includes greed, dysfunctional government watchdogs and a regulatory system that remains sketchy despite scandal, judging by a recent report by the federal General Accountability Office, which includes an appendix devoted to chronicling problems in Illinois' system of regulating cemeteries and the funeral industry.

The IFDA scheme dating back to the 1980s was relatively simple. Funeral directors sold prepaid funeral plans to customers and the IFDA set up a trust. Edward Schainker, a Merrill Lynch broker based in Springfield, suggested life insurance, but not on the lives of folks who bought funeral plans. Rather, Schainker convinced the IFDA to insure the lives of association officers and funeral directors to underwrite the trust, with big payouts coming when folks died. In the meantime, the IFDA would act as trustee, collecting millions of dollars in administrative fees on a fund that swelled to as much as \$300 million.

There were more than a few problems.

Funeral directors and association officers who had life insurance plans taken out on them didn't die on time, but consumers with prepaid funeral plans did. An even more basic issue was insurability. It isn't kosher under insurance laws to insure the life of just anyone, as if investing in death were the same as buying stocks. Years after the insurance policies were purchased, regulators determined that the IFDA had no "insurable interest" on funeral directors who agreed to let the association buy policies on their lives in exchange for free \$25,000 life insurance policies.

Also problematic was a state law that made it illegal to spend money from pre-need purchasers on life insurance without telling purchasers, who remained blissfully unaware that money to pay for their funerals was being spent to insure the lives of strangers. There was also the matter of administrative fees collected by the IFDA. A 1989 state law capped fees at 25 percent of earnings from funeral trusts, but the association, which had been operating under a cap of 5 percent of principle, ignored that limit on a fund worth hundreds of millions of dollars.

The IFDA didn't have a license to act as a trust from the state Department of Financial and Professional Regulation, which licenses trusts and fiduciaries. The IFDA did, however, have a license from the state comptroller's office, which renewed the license for years until looming fiscal catastrophe became too big to ignore or hide.

Implosion

Given its purpose, the pre-need funeral fund was supposed to be rock solid. The IFDA, however, saw the fund as a treasure chest, tapping the trust to make loans to funeral directors, including an association board member who used the money to build a funeral home. Collecting as much as \$2 million in administrative fees in a single year, the association also opened a funeral museum in Springfield.

Shortly before he retired in 1999, Robert Ninker, the IFDA's former executive director, told the association board that the trust "is the greatest storehouse of wealth you will ever have," funeral directors say in a lawsuit against the association. Instead, the fund proved the association's biggest albatross.

The first cracks appeared in 2001, when an internal IFDA audit showed a \$10 million deficit in the trust – there would not be enough to pay for contracted funerals if everyone died at once. Making matters worse, the policies could not be liquidated without steep tax penalties, and the association was locked in to paying commissions, premiums and management fees to insurance companies and brokers regardless of the performance of securities within policies that dictated the value of the policies.

Despite the deficit, the association continued issuing rosy financial reports to members on the hook for losses. And the comptroller's office, which licensed the IFDA, remained ignorant.

"Having this regulatory oversight should have provided comfort and actual protection, but clearly the latter was lacking," funeral directors say in one of their lawsuits against the association, Merrill Lynch, Cullen and his law firm.

By the time the comptroller's office began an audit in 2005, the deficit had swelled to more than \$38.5 million. The shortfall mushroomed as new money was spent covering losses – new customers were paying to bury previous customers, according to funeral directors who sued, likening the trust to a Ponzi scheme.

Any violation of the state Burial Funds Act, the law governing prepaid funeral plans, is a felony, but the comptroller's office didn't call police after discovering the mess nearly six years ago, when Dan Hynes was nearing the end of his second term as comptroller and running for re-election. After sending a 2006 letter to the IFDA saying that the situation was "intolerable" and that the association had collected \$9.6 million in excessive fees between 2000 and 2005, contrary to the Burial Funds Act, the comptroller called the Department of Financial and Professional Regulation, which licenses banks and other fiduciaries.

Between the comptroller and the department, regulators spent more than a year trying to get the trust into the hands of a properly licensed fiduciary. Despite the escalating deficit, the IFDA wouldn't give up on life insurance as an investment tool until the Department of Financial and Professional Regulation finally forced the issue with a series of cease-and-desist orders issued in 2008.

Cullen, who became the association's lawyer in 2000, proved an obstacle to getting the association to rid itself of toxic insurance policies and get the money from funeral directors into the hands of a legal fiduciary, according to lawsuits filed by funeral directors who had sold pre-need funeral plans to consumers and were responsible for any losses.

Although regulators found that the policies violated state law because the IFDA had no insurable interest in funeral directors whose lives were insured, funeral directors-turned-plaintiffs and their association, which became a defendant, say that Cullen at some point issued an opinion that approved the enterprise.

As IFDA general counsel, Cullen was a regular at association board meetings and was well acquainted with the trust. Attorneys from Sorling, Northrup, Hanna, Cullen & Cochran, Cullen's law firm, had been providing legal advice to the association since the 1980s, and the firm had long known that the IFDA's authority to act as trustee was on shaky legal ground.

In a 1996 letter to the IFDA, Michael Connelly, an attorney with Cullen's firm, noted that the comptroller issued licenses for sellers of pre-need plans, not trustees charged with safeguarding money from consumers. He suggested that the IFDA resign as trustee to avoid any questions about its legal authority to administer the funeral trust.

"Recall our concern that if the market value of the pre-need trust funds were to fall dramatically, that one or more pre-need customers could bring a class action alleging that the IFDA was acting as a trustee without proper authority and therefore would be liable for the loss in value of the trust funds," Connelly wrote.

His words proved prophetic.

Meltdown

A decade after Connelly put the IFDA on notice that its license from the comptroller could be meaningless, the association was under scrutiny from regulators. And Cullen got in deeper as the pressure grew.

In February of 2008, Cullen became the association's managing staff director. He assumed his new role one day before the expiration of a deadline set by the Department of Financial and Professional Regulation for the IFDA to transfer the trust to a licensed fiduciary, funeral directors say in court papers. At the time, Regions Bank, which had a license, was considering taking over the trust, and the state extended the deadline by 90 days, based on assurances from the bank that it would become trustee and a promise from the IFDA that it would agree to transfer authority. But the transfer never happened.

After determining that the fund was losing \$18,000 a day, Regions insisted on liquidating the life insurance policies. No insured funeral director had died in 2005, and just one had died in 2006, when the IFDA paid \$2.8 million in premiums and received less than \$650,000 in life insurance payouts. Meanwhile, management fees and commissions were depleting the



fund by more than 3 percent annually, the bank determined, and the policies contractually bound the association to make the payments.

“You can’t get enough people to die fast enough to make up this ongoing expense,” a consultant for the bank wrote in a 2008 letter to the IFDA’s accountant.

The consultant also put Cullen on notice, telling the attorney-turned-staff-director in letters that time was critical and that life insurance should never have been used to underwrite a pre-need funeral trust. But Cullen and the IFDA balked, asking Regions to further justify the need to liquidate policies. The bank refused, and when Regions discovered that the IFDA and Cullen had started looking for a different trustee, the bank terminated talk of taking over the trust two months after Cullen joined the association’s staff, saying that further dealings with the IFDA would threaten the bank’s reputation.

“As managing staff director, Cullen was the one responsible for overseeing the transfer of the tax-exempt trust to a bona fide trustee,” attorneys for funeral directors wrote in a lawsuit against the association. “Instead, he actively participated in the selection of a new trustee that would allow the pre-need trust assets to continue to be held in illegal insurance policies.”

Cullen gave poor legal advice, according to funeral directors-turned-plaintiffs who said that the attorney and his law firm had a duty to prevent the association from investing in life insurance policies and, after the fact, a duty to advise the association to end illegal conduct that would increase liability and damages.

“Instead, Cullen was part and parcel of the Life Insurance Enterprise, a conflicted attorney who repeatedly failed to protect his clients’ interests,” lawyers for funeral directors wrote in a lawsuit against Cullen, Merrill Lynch and the IFDA.

Three weeks after Regions walked away in the spring of 2008, the Department of Financial and Professional Regulation issued the first of three cease-and-desist orders to the IFDA that ultimately forced the association to get out of the trustee business. The first order came on May 30, 2008, but Cullen didn’t mention it when he met with funeral directors five days later.

By then, funeral directors who later became plaintiffs were worried. Their first inkling that something was amiss had come in the fall of 2007, when the comptroller’s office revoked the IFDA’s license, saying that it should never have been issued in the first place and that the trust needed to be in the hands of a properly licensed fiduciary. Under state law, funeral directors would have to pay for funerals themselves if the fund went kablooey, and money from more than 40,000 consumers was in the trust.

Concerned funeral directors met with Cullen three times in June, 2008. When directors demanded that their money be transferred to Regions, Cullen told them that the association would release funds only if they signed forms releasing the association’s officers from liability, funeral directors say in court papers.

Funeral directors backed off on their demands that the IFDA transfer their money when the association's president asked them to "stand down" and said that an actuarial firm would analyze the fund and deliver findings so that funeral directors could know the true state of the trust and its prospects. But funeral directors say they never got the promised findings.

End game

In late 2008, the IFDA finally transferred trusteeship to a licensed fiduciary: Merrill Lynch's trust division.

The investment giant that had sold the association on life insurance as an investment tool began liquidating the insurance policies, and the value of the fund was written down by \$59 million.

The scandal turned public in early 2009, when newspapers reported on the first lawsuit filed by funeral directors against the association, Merrill Lynch and Cullen. Alerted by the media, the Secretary of State stepped in and suspended Schainker's license to sell securities and give investment advice.

With funeral directors fretting about bankruptcy, the Department of Insurance, which had been a division of the Department of Financial and Professional Regulation, fined Schainker \$100,000 in 2009, the maximum allowable penalty, and reached a settlement with Merrill Lynch, which admitted no wrongdoing but agreed to pay \$18 million to funeral directors. But there was a catch.

To get the money, funeral directors had to agree to release Merrill Lynch from future liability. Directors refused and sued the comptroller, the Division of Insurance and Merrill Lynch, ultimately winning their case and forcing the state and the investment company to drop the requirement that would have prevented them from seeking more money via lawsuits.

Thanks to private attorneys and the Secretary of State, a lot more money came, but it took three years to calculate losses.

"It was complicated," says David Finnegan, senior enforcement attorney with the securities division of the Secretary of State. "We wanted to make sure the analysis was done correctly."

From the start, the Secretary of State's office vowed that it would force Merrill Lynch to make the fund whole. While there have been at least three analyses of the fund to determine the size of the deficit, the Secretary of State required Merrill Lynch to pay for another study that included an actuarial analysis.

"We're professionals here," Finnegan said. "We weren't going to rely on other studies, so I didn't look at them."

Over the years, the life insurance arm of Merrill Lynch received more than \$32 million in premiums from the IFDA, according to the Secretary of State's consent order, and the arm that sold the policies collected nearly \$7.2 million in commissions. Between lawsuits and agreements with the government, Merrill Lynch will pay more than \$55 million to funeral directors who had money in the association's pre-need trust.

Finnegan said the investment firm was "very cooperative," although there were some "frank discussions" when the analysis was complete and his office demanded a payment that assumed the most conservative return on investment.

"We could revoke their registration in Illinois – that could have a huge impact in Illinois, that could also reverberate across the country," Finnegan said. "It was always out there. Because of their cooperation, it wasn't something we discussed with them."

Bill Halldin, Merrill Lynch spokesman, wouldn't say whether the scandal has prompted the company to change its business practices.

"Our focus in our discussions with the state and other parties has been on ensuring that consumers receive the services that they paid for," Halldin said.

The state has revoked licenses to provide investment advice and sell insurance and securities that were held by Schainker, the former Merrill Lynch broker credited as the architect of the failed trust.

Dale Kurrus, who runs a Belleville funeral home that was a plaintiff, said he didn't want to discuss the saga in detail.

"It's a touchy subject for everybody," Kurrus said. "I'm just glad all this is behind us."



Aftermath

Funeral directors whose money was at risk say that the failed trust constituted a crime. State Rep. Dan Brady, R-Bloomington, who is a funeral director, notes that any violation of the state Burial Funds Act is a felony.

The act puts strict limits on management fees, and the comptroller's office has said that the IFDA exceeded those limits by \$9.6 million. The act also says that consumers must be notified and give consent before their money can be spent on life insurance, but no one told purchasers of pre-need funeral plans that their money was going toward insurance premiums.

"The question still begs: Was there a criminal offense here?" Brady asks.

In 2009, the U.S. attorney's office in Springfield served a subpoena on the comptroller's office, demanding records on the IFDA, but there has been no further sign of prosecution. In a federal report on the funeral industry issued in December, the General Accountability Office wrote that Illinois regulators were

still trying to determine what, if any, charges should be filed.

State officials point fingers when asked why criminal charges haven't been filed. Natalie Bauer, spokeswoman for attorney general Lisa Madigan, said that the question is best addressed to the comptroller, given that the comptroller's office is the agency charged with administering the Burial Funds Act that proscribes criminal penalties. In an email, Bradley Hahn, spokesman for comptroller Judy Baar Topinka, said the question should be put to the attorney general. Asked directly via email whether the comptroller has asked for a criminal investigation, Hahn did not answer.

"As the attorney for the state, the AG's office would be the most appropriate place to address any potential criminal prosecution," Hahn wrote.

The state first alleged that the IFDA had taken excessive fees from the fund in 2006, but regulators have not recovered the money. When the association sued the comptroller in 2009 in

Cook County, asking a judge to declare that it shouldn't be required to pay anything, the comptroller countersued. The case is pending. Hahn in his email said the state is working out a settlement.

"The comptroller's office is confident that it will have a favorable settlement to announce in the near future, but terms remain confidential pending a final agreement," Hahn wrote.

The GAO report included an appendix devoted to the way Illinois regulates funeral sales and cemeteries, and the IFDA scandal is prominent. The GAO reported that there was \$300 million invested in pre-need funeral trusts in Illinois as of last June, but the comptroller's office is still having trouble regulating the pre-need industry.

"Officials representing the Illinois Office of the Comptroller stated that they are very limited on the types of disciplinary actions that they can take against licensees," the GAO reported. "For example, to revoke or suspend a license is slow and the proceedings are very costly."

Hahn said that Topinka retained two hearings officers last June who are working to create a license revocation system and expects to start revocation hearings this month for funeral homes that break the rules. While Brady says the comptroller's office should stop regulating the funeral industry and cede all authority to the Department of Financial and Professional Regulation, Hahn says that Topinka, after consulting with funeral home operators, thinks the power should stay with her.

"Based on her interaction with the industry and the fiscal nature of her position, the comptroller believes that the pre-need industry is appropriately within her regulatory purview," Hahn said in his email.

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