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INDEPENDENT REGULATORY REVIEW COMMISSION

October 8, 2007

Arthur Coccodrilli, Chairman
Independent Regulatory Review Commission
333 Market Street, 14th Floor
Harrisburg, PA 17101

Via e-mail to: irrc@irrc.state.pa.us
Hard copy to follow by regular mail

IN RE: Proposed rulemaking concerning preneed activities of unlicensed employee(s)
Pennsylvania State Board (the Board) of Funeral Directors Reference No. 16A-4816
Link: <http://www.pabulletin.com/secure/data/vol37/37-39/1793.html>

Dear Chairman Coccodrilli

Homesteaders Life Company is an Iowa based mutual insurer specializing in the administration of life insurance and annuity products marketed through the funeral industry to fund formal preneed contracts. We are a national leader and innovator in this niche of both industries and we have considerable concerns about Pennsylvania consumer's and their opportunities regarding funeral planning.

Mr. Ernie Heffner, President of Heffner Crematory and Funeral Chapel and licensed funeral director from York, PA, has provided me with a copy of his comments to you dated October 1 and 2, 2007 regarding this same proposal by the Board. His comments and your possible review of the Board's action relative to this rule have prompted me to provide you with these comments.

We see funeral home operations in many, many states similar to what we here propose. In fact, it is our observation that in most of the other states funeral regulations regarding the activities of unlicensed persons are now more liberal than those currently in force in Pennsylvania.

The Board should find some comfort regarding the liberalization of controls on unlicensed person from the stellar track record of the funeral industry in providing the utmost in terms of consumer satisfaction. Since it relies on the complete satisfaction of not only its immediate customers but also on successive future generations of those customers, the funeral industry makes sure that it conducts itself with the highest of standards. From this position of self-conduct the funeral industry stands in good stead to merit more self-control over its activities.

We have also observed a great deal of unwarranted over-regulation in the funeral and insurance industries. We hope that the Board takes this opportunity to acknowledge that a move toward liberalization is due in the Pennsylvania preneed market.

We look forward to working with the Board and the members of the funeral industry in preserving the value of funeral service. We provided testimony previously on this subject to the Board and have remaining concerns we hope you will give due consideration.

1. Since some funeral providers wish to engage persons to act for them who may not be employees we suggest the term "employee" throughout this proposal be revised to read "employee or agent". This would be consistent with the Federal Court Order in Walker v Flitton. There should be no valid reason to require these persons to be employees so long as they operate under the close supervision of a licensed funeral director and under the terms of a formal engagement or authorization agreement with the funeral entity.
2. In conformance with the suggestion above the "employment" agreement should be renamed an "engagement" agreement or "authorization" agreement. Again, this would be consistent with the Federal Court Order in Walker v Flitton
3. The transaction of the funeral agreement should be considered a distinctly separate act from the transaction of the sale of insurance. Given that distinction, any licensed insurance agent involved in the insurance transaction should be permitted to receive a commission, irrespective of licensure or lack of licensure of any other type.

Both funeral providers and other persons not licensed as funeral directors, so long as they have a valid insurance license, should be permitted to receive insurance commissions. The funeral entity can adequately control the actions of both funeral directors and unlicensed persons through the engagement agreement and their supervisory procedures to the extent that any concerns associated with insurance commissions should be negated.

4. In today's world of electronic commerce the requirement that each customer must consult face-to-face with a licensed funeral director is overly restrictive. Unlicensed persons should be permitted, within the terms of their engagement agreement and under the close supervision of a licensed funeral director, to perform all of the activities involved in preneed contracting.

If the individual funeral entity wishes to further restrict these activities then they can be controlled at the individual funeral home level under the terms of the engagement agreement. The individual funeral entity could then chose how liberally or restrictively to control the activities of unlicensed persons.

Some jurisdictions, including our home state, Iowa, require that if funeral services are provided in the contract a licensed funeral director must sign the contract. These types of variations in controlling these activities need not be controlled by regulation however, since they can be adequately controlled individually by the funeral entity. This permits much wider flexibility by the funeral entity and the regulator.

5. The requirement that any document provided to the consumer by the unlicensed person contain the proposed 20-point type disclosure seems an unwarranted burden on funeral entities. The practice would have many unintended consequences including alarming families about the actions of unlicensed persons in handling documents that are now routinely handled by unlicensed persons but have nothing to do with the funeral contract.

We favor consumer disclosure but feel this part of the proposal has not been well considered. The disclosure seems partially appropriate for situations where the parties may decide not to contract formally, such as when only a worksheet is prepared. The portion that discloses the need for the face-to-face meeting with a licensed funeral provider seems inappropriate, especially for situations where no contract is transacted.

We recommend the proposed disclosure requirement be deleted in its entirety.

6. The permitted activities of unlicensed persons under the proposal should be expanded to include the authority to contract for the funeral entity as permitted under the terms of the engagement agreement.
7. Unlicensed persons should be permitted to act for more than one funeral entity so long as the supervision and engagement agreement requirements are met. This is particularly important for smaller funeral entities and communities where the unlicensed persons may be now acting for more than one funeral entity.

We will again provide these comments to the Board, with little optimism for their favorable consideration, since the Board has previously ignored them summarily.

We appreciate your thoughtful inquiry into the Board's oversight of this important consumer market. Please let me know if you have questions or need more information.

Sincerely

Gerry Kraus

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USA PRENEED INSURANCE

AN OVERVIEW



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This overview is intended to increase awareness of preneed insurance. It is not copyrighted so feel free to use all or part of the information contained herein. We welcome your questions or suggestions on how to make this a more informative piece. Please email to rob.harrington@assurant.com.

Please make sure to consult your own personal advisor, such as an attorney or an accountant, to discuss the specific facts of your particular situation.

TABLE OF CONTENTS

PAGE

INTRODUCTION

I. Who 1

II. What 1

III. Where 1

IV. When 1

V. Why 1

VI. How 1

REASONS WHY CONSUMERS PREFER TO PREARRANGE THEIR FUNERAL? 2

REASONS WHY FUNERAL DIRECTORS AND CEMETERIANS
OFFER PREARRANGED OPPORTUNITIES? 2

DEFINITIONS 3

FUNDING MECHANISMS 5

MARKET PRACTICES

I. Types of Marketing – Active and Passive Preneed Programs 9

II. The Insurance Product 9

 a) Consumer Eligibility 10

 b) Commissions 11

 c) Consumer Cost 12

 d) Company Integrity and Support 12

III. The Prearrangement Agreement or Funeral Contract 13

 a) Guaranteed vs. Non-guaranteed Prearrangement Agreements 13

 b) Revocable vs. Irrevocable Agreements 14

 c) Excess Proceeds 15

FEDERAL TRADE COMMISSION FUNERAL RULE 15

TABLE OF CONTENTS

(CONT.)

	<u>PAGE</u>
PRENEED LICENSING	
I. Preneed Funeral Sale	16
II. Preneed Insurance Sale.....	16
ANNUAL PRENEED REPORTING REQUIREMENTS	16
FILING OF A PREARRANGED FUNERAL AGREEMENT	17
SPECIFICATIONS FOR A PREARRANGED FUNERAL AGREEMENT	17
REGULATORY ISSUES	17
I. Application of State Anti-burial Insurance Laws to Insurance-funded Prearranged Funeral/Cemetery Programs	18
II. Application of State Preneed Funeral/Cemetery Trust Laws to Insurance-funded Prearranged Funeral Programs.....	18
III. Conversion of Trust-funded Prearrangements to Insurance-funded Prearrangements	19
IV. Irrevocable Assignments and Eligibility for Supplemental Security Income and Medicaid	20
V. Tax Issues	21
CONCLUSION.....	22
AUTHORS' NOTE	23
EXHIBIT A – Frequently Asked Questions about Preneed Insurance	24
EXHIBIT B – FTC General Price List, Casket Price List, and Outer Burial Container Price List.....	26
EXHIBIT C – SAMPLE PRENEED CONTRACTS-INSURANCE FUNDED	32

INTRODUCTION

I. Who

The people typically making funeral arrangement in advance of death and purchasing preneed insurance are in their sixties or seventies, with the typical customer being female. A significant amount of these customers may be in the process of qualifying for Medicaid. Funding for a prearranged funeral is usually considered an exempt asset for purposes of Medicaid.

II. What

Preneed insurance is a whole life insurance policy. These policies typically provide coverage of \$10,000 or less. The majority of policies sold are paid immediately with a single premium payment, however, the premiums may also be paid over a limited period of 3, 5, 7, or 10 years. Premiums are fixed and after the premium-paying period, the policy is paid up for life. The fact that they fund a formal preneed contract makes them distinctively "preneed" policies.

III. Where

Preneed insurance is most often sold at the funeral home when the funeral is prearranged. The funeral goods and services are selected first and the method of funding the funeral, such as insurance, is then selected. Preneed insurance or final expense insurance may also be sold in the individual's home.

IV. When

Preneed insurance is purchased before death to pay for a funeral and the cost of the policy is locked-in. If the funeral is contracted on a price-guaranteed basis then the funeral provider agrees to assume the risk of future funeral price increases in exchange for the available benefits from the funding. If the contract does not guarantee prices then the family retains the risks.

V. Why

Preneed insurance is most often purchased to lock in costs and obtain a price guarantee in advance of death. The funeral is often formally contracted so that the wishes of the customer can be documented beforehand so the customer can feel that the funeral has been taken care of.

VI. How

The provision by which the insurance pays for the funeral is usually found in the funeral services contract. The funeral services contract specifies the funeral goods and services selected. Also, the funeral service contract usually contains an insurance assignment provision. This assignment typically provides that the insurance proceeds be paid to the funeral provider at death.

REASONS WHY CONSUMERS PREFER TO PREARRANGE THEIR FUNERALS

Consumers prefer to prearrange their funerals to:

- let surviving family members know exactly what type of funeral and/or cemetery arrangements they want by choosing specific goods and services.
- provide an opportunity to personalize the funeral service and other post-death activities.
- indicate that survivors should not select a funeral service that differs from the one desired.
- prescribe that a surviving spouse prefers to have the same service as the one selected for a deceased spouse, if desired.
- fix the costs of funeral funding based upon the consumer's personal wishes and decisions.
- provide parameters with regard to the amount that should be spent at the time of the funeral.
- provide protection from future inflation in the prices of funeral goods and services.
- avoid problems caused by family separation, alienation and mistrust.
- relieve the surviving family members of the financial responsibility.
- give "peace of mind" to the person planning his or her final arrangements in advance of need.

REASONS WHY FUNERAL DIRECTORS AND CEMETERIANS OFFER PREARRANGEMENT OPPORTUNITIES

Funeral directors and ceterians offer prearrangement opportunities to:

- provide a means to discuss funeral and cemetery options and the benefits of securing those arrangements with the person present.
- provide an opportunity to discuss cost and value relationships on goods and services selected.
- provide a source of funds for payment of the financial obligation.
- secure future business.
- provide a competitive advantage in the quest for market share.
- provide a means for the consumer to prepare financially for the costs associated with their final disposition.
- allow the consumer to pay for the desired funeral arrangements during his or her working years from discretionary income.

DEFINITIONS

Adverse Selection	The tendency of individuals who believe they have a greater-than-average likelihood of loss to seek insurance protection to a greater extent than do those who believe they have an average or a less-than-average likelihood of loss.
Assignment	Process by which certain rights are assigned to a third party as consideration under a contract. Life insurance benefits are often assigned to fund the cost of funeral and cemetery goods and services through the assignment provision in the funeral services contract.
At-need	A preneed industry term referring to the act of selecting and/or funding one's funeral at the time of death (need).
Cemetery	An establishment where burial rites are provided either through burial, entombment, or inurnment. Although closely related to the provision of funeral merchandise and services, cemeteries are commonly distinct business operations and not related to a funeral home.
Earmarked	Funds set aside for a specific purpose, such as paying for funeral goods and services and other final expenses.
Federal Trade Commission ("FTC")	Federal agency which, among other things, promulgates rules and regulations impacting the funeral industry; for example, the FTC Funeral Rule. (The FTC does not regulate activities of the cemetery industry.)
Final Expense Insurance	A term used to identify life insurance that is purchased primarily for use in paying expenses incurred immediately before and at the time of death of the insured, such as final nursing home expenses, hospital or hospice costs, and cemetery and funeral expenses, yet is not linked to a formal funeral contract.
Fixed or Guaranteed Price	These terms are used synonymously and indicate that the funeral and/or cemetery arrangements that have been contracted and prefunded will be provided regardless of whether the funding, plus accrual if any, is or is not sufficient to pay for the selected goods or services, regardless of the price at the time death occurs. Under the contract the provider assumes these risks.
Freedom of Choice	A term indicating that a person's right to select a different funeral home to provide goods and services should not be limited unless prescribed by law.
Goods and Services	Generic industry term for the funeral or cemetery contract that can also be referred to as a statement of funeral goods and services or funeral services contract.

Graded, Limited or Restricted Death Benefit Product	A type of life insurance product that would typically pay less than 100% of face amount if death occurs within a given period of time after policy issue. For instance, such a policy may pay 30% of the face value for death in the first policy year, 70% in the second year, and 100% immediately thereafter.
Medicaid	A joint federal/state program that provides hospital and medical expense benefits to qualified people.
Multi-Pay Products	Policies may be preceded by a number that indicates the number of premium paying years. For example, 3-pay refers to a 3-year premium-paying period.
National Association of Insurance Commissioners ("NAIC")	A nongovernmental organization in the United States that consists of the commissioners or superintendents of the various state insurance departments. Among the NAIC's duties are drafting model laws and regulations on a variety of topics, which may or may not be implemented at the state level.
Portability of a Contract	Contracts which are portable provide that when death occurs and the funeral and/or cemetery service is conducted by a firm other than the one with whom there is a contract, funding can be transferred to the other establishment.
Prearranged and Prefunded	This refers to both the prearrangements for a funeral and/or cemetery goods and services and, respectively, making provision for payment.
Prearranged or Preplanned	This term refers to a funeral and/or cemetery arrangement made prior to need (death). It would involve writing specifics of what is desired, as well as possible selection of goods and services. It does not involve payment of money (funding) or formal contracting.
Prefunded	This term refers to the providing of funds for the cost of a funeral or cemetery goods and/or services in advance of need that are deposited, placed or allocated but not necessarily directly tied to a prearranged funeral contract. Final expense insurance is a type of prefunding.
Preneed	A term used in reference to any aspect of prearranging, prefunding, or preplanning a funeral. It encompasses the entire subject. In the definition of preneed, "need" means death.
Prepaid	Refers to the customer <i>paying</i> and the funeral home <i>receiving</i> money for goods and services when prearranged while the customer is living. Money is received now by the funeral director and usually placed in a trust vehicle to accumulate for the future. Funeral trusts contain prepaid funds.
Prepledged or After-paid	Paying for funeral goods and services only after they have been performed or delivered. Preneed insurance is an after-paid product since proceeds are paid only <i>after</i> death of the insured and the delivery of funeral goods and services.
Provider	A provider is an individual or firm who/that will provide the services,

facilities, and goods for the funeral or cemetery.

- Supplemental Security Income (SSI)** A federal program designed to help individuals who are aged, blind or disabled. It provides basic cash needs for food, clothing and shelter. The program is administered by the Social Security Administration.
- Trust** Another means of funding, referring to a traditional deposit in a bank. Roughly half of all preneed contracts are funded by deposits into a bank trust.
- Trust Retainage** The amount of money that can be taken and kept by the trustee of a funeral trust for the trustee's services. Retainage can typically be taken when the trust is established or when it pays money out of the trust at time of need. The percentages of the monies that can be retained vary from state to state.

FUNDING MECHANISMS

One of the oldest ways to prefund a funeral or cemetery prearrangement is by way of a bank trust. With bank-trust funding, monies are deposited into a bank trust by the funeral home or cemetery as received and are invested in accordance with the provisions of the applicable state trust or state funeral trust laws. From the customer's point of view, this is simple and understandable and usually permits deposits at the consumer's discretion. However, there is rarely a price guarantee for the merchandise and services selected since the trust fund is usually not fully funded at the time it is made. This may result in the customer having no greater advantage financially than if he or she had invested the monies personally in an alternate earmarked account.

Life insurance products specifically designed for the purpose of funding prearranged funerals or cemetery contracts provide a number of benefits not available when a trust option is used. First, funeral and cemetery trusts are often not portable. Second, in many states, the funeral home or cemetery is entitled to retain a portion of the trust funds received, and only the remaining funds are actually deposited into trust. The withdrawal of administrative fees and/or taxes permitted by many states also diminishes the amount of available funding. Thus, the full amount of funds needed to pay for the selected merchandise and services would not be available to a subsequent funeral home or cemetery if a transfer is desired. Additionally, cancellation rights are also often restricted, since the ability to move funds from one funeral home or cemetery to another often results in financial loss to the consumer, or is rendered impossible under the provision of the trust.

Also, current IRS regulations require that interest income of a trust is subject to federal tax. This mandates issuance of IRS Form 1099 for the trust's taxable income to be provided to the owner of the monies held in the trust, unless the funeral home or cemetery elects to pay this tax. This tax liability exists throughout the lifetime of the individual for whom the trust was established.

Finally, in some states, the use of trust funds creates a future hidden liability for the funeral home/cemetery that may impair its financial condition and its obligations, especially where it has guaranteed the future price of funeral goods and services. In some states, the funeral home or cemetery may withhold a portion of the monies received and the interest earned to pay for the costs associated with running a preneed trust program.

An example may clarify the nature of the risk that this creates. Suppose a client prearranges a \$3,000 funeral with a single payment and the funeral home guarantees that it will provide the funeral at no further cost whenever death occurs. This example assumes a 5% annual inflation in

costs, an 8% pre-tax return, and that the funeral home may retain 10% of the initial deposit, as well as 10% of the interest income for its expenses.

Compare the projected cost of a funeral with the projected amount available in the trust fund.

FUNERAL TRUST ACCOUNT

3% Earnings Rate (Compound)

10% Retainage

10% Administrative Fee Rate (as a percent of earnings)

Year	Consumer Annual Payments	Consumer Cumulative Payments	Beginning of Year Balance	Interest Earnings	Administrative Fees	End of Year Balance
1	\$3,000.00	\$3,000.00	\$2,700.00	\$81.00	\$8.10	\$2,772.90
2	0.00	3,000.00	2,772.90	83.19	8.32	2,847.77
3	0.00	3,000.00	2,847.77	85.43	8.54	2,924.66
4	0.00	3,000.00	2,924.66	87.74	8.77	3,003.62
5	0.00	3,000.00	3,003.62	90.11	9.01	3,084.72
6	0.00	3,000.00	3,084.72	92.54	9.25	3,168.01
7	0.00	3,000.00	3,168.01	95.04	9.50	3,253.55
8	0.00	3,000.00	3,253.55	97.61	9.76	3,341.39
9	0.00	3,000.00	3,341.39	100.24	10.02	3,431.61
10	0.00	3,000.00	3,431.61	102.95	10.29	3,524.26

PROJECTED FUNERAL COSTS

4% Increasing Rate (Simple)

Year	Funeral Costs	Price Increases	Increased Funeral Costs
1	\$3,000.00	\$120.00	\$3,120.00
2	3,120.00	120.00	3,240.00
3	3,240.00	120.00	3,360.00
4	3,360.00	120.00	3,480.00
5	3,480.00	120.00	3,600.00
6	3,600.00	120.00	3,720.00
7	3,720.00	120.00	3,840.00
8	3,840.00	120.00	3,960.00
9	3,960.00	120.00	4,080.00
10	4,080.00	120.00	4,200.00

Thus, the trust may not provide adequate protection to the consumer and/or provider against increases in funeral and cemetery costs.

In addition, the owner may be subject to tax liability every year on the investment income.

While the amount at-risk for the provider may vary depending on the laws of the particular state, as well as the investment returns and inflation, there is a risk that a funeral provider may find itself

in a position where trust accounts are under-funded. This is particularly true if there has been a change of ownership of the establishment. The subsequent funeral home ownership often finds itself responsible for providing goods and services with insufficient funds in the trust account.

It is not unusual for consumers to use life insurance proceeds on an at-need basis upon the death of the insured to pay for the cost of the funeral. Occasionally, policies (commonly referred to as "final expense insurance") are purchased and earmarked specifically for this end. However, these policies are not true preneed policies because they were not purchased to provide funding for a formal prearranged funeral and/or cemetery goods and services contract. With these final expense policies, the funeral home has not agreed to a fixed price for the funeral in return for an assignment of insurance proceeds. Many final expense insurance policies have level death benefits and are used in situations where the individual has not selected funeral or cemetery goods and services in advance. Further, some companies that sell final expense policies choose not to facilitate assignment of the death benefit to a funeral home or cemetery.

It is very important to remember the distinction between prearranging (preplanning) and prefunding. Prearranging involves identifying the type of funeral or cemetery services the individual desires for his or her final disposition. It may include entering into a preneed funeral/cemetery contract with the funeral home and/or cemetery that will provide the goods and services at the time of death. This contracting is often done by an individual who has a strong preference for a particular service and who needs to have completed a formal arrangement before entering a nursing home or a continuing care retirement community. Typically, such people are in the process of spending down assets in order to qualify for Medicaid or Supplemental Security Income ("SSI") benefits and may have no close relatives or a spouse to handle final arrangements. Others simply want to spare loved ones the task of making arrangements at a very difficult emotional time.

Prefunding occurs when the individual places monies in a trust or purchases a life insurance contract to provide funds to pay for the funeral and/or cemetery goods and services to be provided at the time of death. In the insurance realm, these policies are typically assigned to the funeral home. Very often an irrevocable assignment of policy benefits is executed in exchange for funeral goods and services at-need since this is typically a prerequisite for favorable treatment under Medicaid and SSI. Both programs allow applicants to retain the benefit of prearranging and prefunding their funeral and cemetery needs without any adverse impact upon the asset spend-down requirements associated with the programs if the rights to benefits are irrevocably assigned.

Preneed life insurance policies are different from other life insurance policies in a number of ways:

1. Death benefits are typically designed to increase each year so that the amount of benefit available at time of death equals or exceeds the then-current cost of the merchandise and services that will be provided by the funeral home or cemetery. Because of the increases, the funeral home or cemetery can guarantee the price of the funeral goods and services whenever death occurs with little or no risk to the funeral home's future financial soundness.
2. The policy owner purchases a policy with an initial death benefit sufficient to fund the current cost of the funeral and/or cemetery goods and services selected. Preneed insurance policies are therefore written for relatively small face amounts, averaging around \$6,000-\$10,000, and at much higher issue ages than traditional life insurance. The typical applicant is in his/her sixties or seventies.

3. Many older people have some impairment(s) that make it difficult for them to qualify for traditional life insurance using normal underwriting standards, or they simply may not wish to answer health questions. To make it easier for these insureds to qualify, less stringent underwriting methods are used and/or guaranteed issue products are offered. These factors, coupled with the small policy size and the policy's increasing death benefits, results in relatively high premiums when judged against the price of other insurance policies lacking such features. Nonetheless, preneed insurance provides an efficient and cost-effective way to prefund a funeral arrangement with advantages over other funding options.

The use of preneed insurance to fund prearrangement provides a number of benefits to the insured:

1. It is usually easy to qualify for the insurance because underwriting requirements are not difficult to satisfy or are not required.
2. The proceeds will be there when death occurs as long as required premium payments are made. This is a significant advantage in situations where the consumer must make payments over a period of time. If the contract is insurance funded the benefits can far exceed those available from identical periodic payments into a trust account, even if the death occurs during a limited death benefit period.
3. Commission payments, or fees from the insurance company, help to pay current preneed expenses without creating a hidden liability, which might jeopardize the viability of the provider and its ability to meet its future obligations.
4. Unlike the investment income in a trust, there is no federal income tax on the accumulation of internal build up of values in a life insurance policy.
5. If the life insurance policy is owned by the consumer, it is portable. Relocation to another part of the country, or merely a desire to change the funeral home or cemetery that was initially selected to provide the goods and services, may be accomplished by reassignment without any loss of funds normally associated with the cancellation of a trust.
6. Any death benefit remaining above the cost of the funeral or cemetery costs may also pass to the beneficiary, depending upon the terms of the funeral contract.

Another aspect of insurance is that it is particularly appealing to people who worry about making large purchases, because if a policyowner wishes to change his or her mind about the policy purchased, he or she can cancel the policy completely without penalty during the "free look" period. This period varies from state to state, but typically lasts for 30 days. During that time, an insurance policyowner can change his or her mind and receive a full refund of premium(s) paid.

MARKET PRACTICES

I. Types of Marketing – Active and Passive Preneed Programs

A funeral home, like any other business, is concerned with profitability, competition, and market share. The changing dynamics of the funeral and cemetery industries are forcing

providers into the marketing arena, in what was traditionally a very conservative "please see me at time of need (death)" business. For many providers, marketing previously consisted of maintaining a good reputation for service and spreading that message by word of mouth, public service, and use of institutional advertising. The growth of preneed marketing has continued to evolve and is now a major element in any progressive provider's marketing plans.

The presence and type of preneed marketing in the funeral industry is shaped by the needs of each particular establishment and its business plan. Even though each situation is unique, preneed marketing programs are typically classified as either "active" or "passive."

An "active" preneed marketing program is generally more assertive, characterized by a separate staff of preneed counselors who use direct mail, customer referrals, telemarketing, and personal contact to obtain sales prospects. In addition to obtaining prospects from the general public, the preneed staff may also contact families previously served by the funeral home and follow-up on any inquiries the funeral home receives on its prearrangements. Most of the sales appointments take place outside of the establishment. Such programs may be managed by the funeral director or a third-party marketing organization under contract with the funeral home.

A "passive" program should not be confused with apathy toward marketing. There are many situations where a passive program is suitable, especially in smaller communities. The sales appointments are usually in the funeral home and may be the result of working with a previously served family, or the result of other sales or service activity, including prospecting methods more readily associated with active programs. A passive preneed marketing program is generally less assertive and characterized by preneed functions conducted by members of the general funeral staff, as opposed to separate preneed staff.

II. The Insurance Product

Once the decision is reached on which type of marketing program best suits the funeral home's objectives, the funeral home must then consider which funding mechanism to use. For purposes here, we will assume that insurance is selected over trust funding for all of the reasons cited earlier. Before deciding on an insurance product, the funeral director should carefully weigh the following major elements of product design that are generally present in all insurance-funded programs:

- Consumer Insurability
- Insurance or Annuity Benefit Structure
- Insurance Company Integrity and Support
- Consumer Cost
- Medicaid Spend Down Eligibility
- Suitability of the Product for the Consumer
- Commission Structure
- Financial Security of the Insurance Company

The funeral home, as the provider of the goods and services and guarantor of the funeral contract, must have confidence in and an understanding of the insurance or annuity contract used as funding. The consumer, on the other hand, generally places emphasis on the specific

funeral goods and services listed in the prearrangement agreement, with secondary emphasis on the funding vehicle. The ultimate satisfaction of the consumer's loved ones will occur only at such time that the funeral home fulfills the prearrangement contract.

a) Consumer Eligibility

Funeral prearrangements are often sought by older individuals, many of whom have impaired health. Many companies in this market will issue policies to customers who have an average issue age in the mid-70s. There seems to be a direct correlation between the type of marketing employed and the average age. Companies engaged in a passive marketing approach will have a higher age, because passive marketing is more reliant on purchasers who come to the funeral home seeking to prefund. This consumer will generally be older than the prospect sought through a more active program.

The insurance companies that have been successful in this sector of the preneed market are those with simplified systems for risk classification and paperwork. Not only is this important from the standpoint of sales simplicity, but it is also a factor in expense control due to the small policy size. Smaller face amount policies typically have less profit built into them than traditional life insurance. This is because of the higher mortality of the customer, particularly in the early years of a policy's duration, and higher per-unit costs of administering a small face amount policy. From this perspective, providing increased value products is a difficult challenge to insurance companies.

Companies have addressed this problem by way of various methods. Some companies have gone to issuing guaranteed-issue-basis products with two- or three-year graded benefit periods. The graded benefit may be stated as a percent of face amount or a return of paid premium with interest. Others have opted for simplified underwriting using a few health questions, with a full first-year death benefit. The following is an illustration showing characteristic issue ages and underwriting practices in the market today.

Issue Ages

<u>Company</u>	<u>Single Premium</u>	<u>3-Pay</u>	<u>5-Pay</u>	<u>10-Pay</u>
A	0 - 99	0 - 95	0 - 90	0 - 80
B	0 - 95	45 - 80	40 - 80	40 - 70
C	0 - 90	0 - 75	0 - 75	0 - 70
D	40 - 95	40 - 80	20 - 75	20 - 70
E	35 - 80	35 - 80	35 - 80	35 - 80

Underwriting

GI = Guaranteed Issue - Usually with graded benefits, except on single-premium policies.

U/W = Underwritten - Usually with full benefits.

<u>Company</u>	<u>Single Premium</u>	<u>3-Pay</u>	<u>5-Pay</u>	<u>10-Pay</u>
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A	GI	GI	GI	GI
B	GI	GI	GI	GI
C	GI	GI & U/W	GI & U/W	GI & U/W
D	GI	GI	U/W	U/W
E	U/W	GI & U/W	GI & U/W	GI & U/W

As shown by these illustrations, issue ages extend to age 99 in many of the single-pay guaranteed-issue-basis products which pay the full death benefit. Conversely, 3-pay, 5-pay and 10-pay plans, on a guaranteed-issue-basis, usually contain graded benefits. Some companies do not extend their age ranges to younger ages to protect against adverse selection. A funeral director evaluating a particular plan must weigh the issue ages and underwriting requirements in light of his business objectives and overall marketing plan. Note that some companies offer both guaranteed issue and underwritten versions of their period-payment plan policies.

b) Commissions

Commissions or retained funds from trust deposits are essential to supporting the preneed marketing program of the funeral home. In an active preneed program these funds compensate preneed counselors and managers, and generally pay for advertising, telephone, and office expenses. A passive program is typically a less expensive endeavor for the funeral home. These factors must be taken into account by a funeral home before it selects its preferred funding options, a funding company and/or type of preneed program.

As mentioned previously, some state trust laws allow for the seller to retain a portion of the trusted funds or interest earnings from the trust. This, however, serves to reduce the available funds for the funeral director at the time of need. Insurance, on the other hand, allows for a commission and still provides a death benefit equal to, or greater than, the original funeral price.

Some funeral directors and cemetery operators elect to secure a corporate insurance agency and/or individual insurance license(s) to sell life insurance products in connection with their preneed funeral/cemetery operations. Commission income is an obvious incentive for a business to offer insurance as a funding option.

Commissions are usually expressed as a percentage of the face amount or funeral price, a compensation formula practice that is also common in trust-funded sales. Some companies pay flat commissions regardless of age, while others vary commissions based on age, plan, and face amount.

c) Consumer Cost

The cost to the consumer in the preneed transaction is driven by the current price of funeral goods and services selected in the prearrangement agreement. When that price is determined, the amount of the policy to be purchased is set and the payment method is selected as either a single premium payment or some other mode, such as monthly,

quarterly, or semi-annually, over some selected premium payment period (3-Pay, 5-Pay, etc.) selected by the consumer based on his/her budget and other personal financial means.

Premium rates are determined with special emphasis given to the extra mortality due to the older average age of the insured and the cost of issuing and administering small policies. Premium rates vary by company depending on the company's emphasis on benefit design, underwriting, commissions, investment earnings and expenses of operations.

A cost that may not be readily recognized by the consumer is the cost of surrendering the life insurance policy for cash after the free-look period. Cash surrender values in the early years of the coverage will be substantially less than the premiums paid. Although cancellation rates are low, consumers who elect to cancel their policies will not receive the same amount of refund as they might have had the preneed funeral contracts been funded through a trust. The detrimental choices are clearly disclosed in the policy and the application.

d) Insurer Integrity and Support

Thus far, we have discussed a number of fundamental elements in product design that must be considered when selecting an insurance carrier to fund prearranged funeral agreements. Obviously the funeral/cemetery director should also investigate the financial strength and professional integrity of the companies under consideration. Companies should be willing to provide for review copies of its annual statutory financial statement, A.M. Best rating, and/or other substantiating documents. The A.M. Best Company is a separate rating organization that relates to the financial soundness and stability of the rated company. If the funeral/cemetery director is not familiar with the underwriting company, he or she should also obtain the names of other funeral homes, cemeteries, or organizations that have worked with the company in the past. The level(s) of administrative services and claims payment performance are also important considerations.

A funeral provider should also consider an insurer's marketing and customer service departments. The level of marketing support will vary depending on whether active or passive marketing is chosen and the amount of control the provider wants to have in the program. Who will locate and train counselors? How will prospects be obtained and who will pay for their acquisition? What sales material is available and at what cost? These questions should be considered before final decisions are made.

Some insurance companies and/or marketing organizations representing an insurance company will provide counselor hiring, training, and lead generation along with training about the specific insurance product. Similarly, others specialize in providing only product and product training with limited marketing support. Some provide a full gamut of business planning. The expenses of those providing more support are usually passed on by way of lower commissions. However, these lower commissions are often more than offset by the additional sales from an active program.

III. The Prearrangement Agreement or Funeral Contract

The prearrangement agreement or funeral services contract (or preneed contract) is the primary contract between the consumer and the funeral home/cemetery. This document typically sets

forth the specific items chosen by the consumer, often including casket, urn, services, etc. The insurance policy is a funding mechanism secondary to the sale of the funeral contract. Many times, the consumer is not able to pay for the entire cost of the funeral goods and services selected, but insurance can be used to provide full coverage at the outset. Because there are two distinct but linked sales, care must be taken to comply with the requirements governing both funeral and insurance sales transactions.

While neither transaction standing alone is a new concept, the recent expansion of the preneed market has resulted in additional regulatory activity. As a result, insurance companies and providers engaged in promoting the sale of insurance-funded prearrangements monitor and maintain compliance with the rapidly changing regulatory environment as a service to themselves, the funeral home/cemetery, and the general public.

The preneed contract is a critical component of the transaction between the consumer and the funeral home/cemetery. The agreement must be drafted to clearly delineate the responsibilities of the parties involved, namely the funeral home/cemetery (the seller), the purchaser, and the insurance company. Insurance companies whose products fund such funeral service agreements must research the unique requirements of each state.

a) Guaranteed vs. Non-guaranteed Prearrangement Agreements

Prearrangement agreements can be guaranteed or non-guaranteed. As discussed in the following paragraphs, the word "guaranteed" refers to the assurance by the provider of goods and services that the funding will be accepted as full payment for the goods and services selected at the time of the prearrangement.

Guaranteed agreements provide that the survivors will not incur independent and/or additional costs when funeral/cemetery services and merchandise are supplied as contracted, regardless of when death occurs, provided that the funding insurance is adequately maintained and remains unencumbered. (Certain items identified as "cash advance items" including, but not limited to, such items as flowers, sales taxes, death certificates, and clergy honorarium are outside the control of the funeral home or cemetery and are often not price guaranteed even in otherwise-guaranteed contracts.)

Non-guaranteed agreements are used in situations where the provider chooses not to offer price guarantees. In these contracts there may or may not be funding or the available funding may be inadequate to provide for the full cost of the goods and services at the time of need. Such agreements prescribe that survivors, or the decedent's estate, are responsible for paying the difference between the at-need cost of the contracted goods and services and the total of benefits available from the funding.

Guaranteed-price contracts funded with insurance policies that feature graded or restricted death benefit products (for deaths that occur during the early years of the policy) are generally not fully-guaranteed until these periods expire so during these periods the guaranteed contracts work like non-guaranteed contracts.

Under any of these circumstances, it is incumbent upon the preneed counselor to adequately disclose to the purchaser the nature of the funeral services guarantee and the potential financial impact to survivors at the time of need. Insurance companies encourage such disclosure in customer communications.

b) Revocable vs. Irrevocable Agreements

The concept of revocability and irrevocability stems from freedom of choice on the part of the consumer. As mentioned earlier, irrevocability is essential in Medicare and other public assistance situations.

Freedom of choice provides that contracts for goods and services may not be written in such a way as to prevent the customer or customer's family from enjoying the advantages of competition or from choosing a different funeral provider up until the time services are actually performed.

Sometimes, freedom of choice is defined as the right of the deceased's survivors to select an alternate funeral provider (or alternate goods and services). However, there are mixed feelings with regard to whether this extension of rights to the survivor negates the pre-death expression of wishes by the funeral purchaser as evidenced by the prearranged agreement.

If the state by statute or regulation requires such an extension of rights to survivors, concerns arise for the provider and the insurance company. Sales presentations, payment procedures, disclosure statements, and preneed sales contracts must all be reviewed to ensure that they correspond to the rights which may have to be afforded to the survivors.

Irrevocability is a concept that is also often authorized by statute. Most states provide that the preneed contract should not be written in such a way as to prevent the consumer from making the assignment of proceeds irrevocable. Regardless of the wording, the rationale for the law is usually to facilitate qualification for public assistance or welfare ("Medicaid spend-down").

If the state authorizes irrevocability as an option, and a freedom of choice law is present, carefully worded contract language is necessary to preserve the purchaser's rights to change funeral providers but yet restrict the purchaser's rights to controlling the proceeds of the funding. Restricting the purchaser's rights to controlling the proceeds of funding is required in Medicaid spend-down cases. The insurer must be aware of how to properly administer such cases since a return of control of insurance proceeds to the funeral purchaser, however temporary, may render such funeral purchaser ineligible for medical assistance.

c) Excess Proceeds

Excess proceeds refers to the amount of funding proceeds that exceed the at-need retail price of the funeral and/or cemetery goods and services provided at the time of fulfillment. The distribution of excess proceeds is usually determined by the prearrangement funeral/cemetery contract, when not controlled by state law.

Some states proscribe that excess proceeds must be paid to the estate of the policy owner, often in trust-funded cases to allow such funds to be claimed by Medicaid. However, some states do allow the provider to retain all of the policy proceeds regardless of the cost of the goods and services provided at time of death in recognition of the provider's risks.

FEDERAL TRADE COMMISSION FUNERAL RULE

The Federal Trade Commission ("FTC") has indicated that the itemized list of funeral goods and services is a part of the prearranged funeral agreement subject to the provisions of the Funeral Rule adopted by the FTC in 1984 (16 CFR 453). Please note that the Funeral Rule does not currently apply to cemetery operations.

The itemization on the Statement of Goods and Services must resemble the funeral establishment's FTC General Price List, Casket Price List, and Outer Burial Container Price List (an example is illustrated in EXHIBIT B). The funeral establishment has some latitude within the general guidelines of this rule, so these documents often vary from funeral home to funeral home.

PRENEED LICENSING

A question that arises is, "Who can or must be licensed to sell prearranged funeral or cemetery agreements?" This requirement varies from state to state.

Some states extend the right to formally execute prearranged funeral agreements only to licensed funeral providers; thus, requiring a funeral or cemetery service license to sell preneed contracts. Similarly, some states extend the authority to execute preneed agreements to employees of funeral providers, third-party marketers, and insurance agents.

Typically, small face amount whole life insurance or annuities are used to fund preneed contracts. These are relatively simple and straight-forward products. The insurance representatives selling such products are usually engaged for the majority of their time performing funeral activities. Recognizing these facts, some states provide for limited insurance licenses. Limited insurance licenses typically empower the licensee to write preneed and/or final expense policies up to a specific dollar amount without having to satisfy the other requirements of a traditional life insurance licensee. This limited license is sometimes offered to traditional insurance agents, and sometimes just to funeral directors or preneed counselors, depending on the state. The limited license exam is often shorter and focuses upon preneed and final expense insurance products and sales. The limited license requirements do not include an examination of unrelated products, such as estate planning and/or financial counseling. However, regardless of the variations in licensing, without exception all states require that the person selling insurance be licensed as an insurance agent.

Addressed below are the licensing requirements for the two distinct preneed transactions: I) a funeral sale that occurs first, and II) an insurance or trust sale to fund the funeral sale.

I. Preneed Funeral Sale

All states permit a prearranged funeral sale to be conducted by a licensed funeral director. Some states permit a prearranged funeral sale to be conducted by a person with a special funeral prearrangement license that is not a funeral director's license. Other states permit

individuals not licensed in funeral service to prearrange a funeral provided they are working under the supervision of a licensed funeral director. These individuals are sometimes referred to as preneed counselors.

II. Preneed Insurance Sale

All states require that an individual take and pass the standard insurance agents' exams to sell preneed insurance.

ANNUAL PRENEED REPORTING REQUIREMENTS

Many states require funeral establishments to report, at least annually, on the details of preneed contracts into which they have entered. These requirements grew out of the already established requirements for traditional trusting activities and now often include insurance-funded agreements.

Some states have altered the reporting requirements in recognition of the presence of independent third-party preneed marketers. The burden of reporting in these states has shifted from funeral providers to preneed contract-funding sellers, which may include insurance companies.

FILING OF A PREARRANGED FUNERAL AGREEMENT

State requirements, with regard to the format of the preneed contracts, range from rigid specification to no requirements whatsoever. One state, for example, publishes an agreement that must be used verbatim except for an allowance to insert the name of the funding company and the funeral provider.

Some states produce a prototype document as a suggested format and require sellers to file their tailored agreements for approval prior to use. In many cases, some type of approval must be obtained through a funeral provider, even though a third-party marketer or an insurance company may be producing the agreement. Typically, states consider it a funeral/cemetery industry document rather than an insurance document, irrespective of who provides it. In addition, some states require the use of prearranged contracts but do not regulate content, and a few waive or do not have any requirements for insurance-funded preneed contracts altogether.

SPECIFICATIONS FOR A PREARRANGED FUNERAL AGREEMENT

Although similar in appearance to a form using trust funding, an insurance-funded funeral services agreement is a distinct and separate agreement. The insurance is designated in this funeral service agreement to pay for the funeral by means of the assignment provision in the funeral services agreement.

REGULATORY ISSUES

The legal requirements relevant to prearranged funeral and cemetery products that are funded through life insurance policies and annuity contracts can be divided into two groups of requirements relating to the operation of:

1. an insurance company; and
2. a prearranged funeral/cemetery program.

Both involve federal and state requirements.

The McCarran-Ferguson Act establishes that the regulation of the business of insurance still takes place principally at the state level. Accordingly, state regulation concerns itself with the solvency, market conduct and trade practices of insurance entities, and consumer protection. To the extent that the states provide regulation in these areas, the McCarran-Ferguson Act prohibits the federal government from becoming involved. The federal government, however, plays the principal role in regulating insurance companies with regard to securities and federal income taxation (not including state premium or state income taxation).

Prearranged funerals are also governed by both federal and state law. At the federal level, every funeral service business is regulated by the FTC Regulation Rule on Funeral Industry Practices ("FTC Funeral Rule"). In addition, of course, other federal laws (for example, antitrust, taxation, Medicaid, Social Security, and securities laws) also apply.

At the state level, the funeral and cemetery businesses and the prearrangement aspect of those businesses are regulated by various laws and regulations. The administration of these laws differs from state to state. For example, the relevant administrative agency may be the Office of the State Attorney General, the Department of Insurance, or the Comptroller's Office. Frequently, the State Board of Funeral Directors and Morticians also take an active regulatory role.

The NAIC develops model laws and regulations regarding the regulation of insurance. The NAIC adopted a model regulation in 1988 that requires the disclosure of specified, relevant information regarding insurance-funded funeral prearrangement. This model regulation has been adopted in many of the states and has been routinely adopted by companies marketing life-insurance-funded preneed programs throughout the United States. As a practical matter, most companies that market life-insurance-funded preneed contracts have adopted the NAIC model disclosures as part of the preneed contract. This assures some uniform consumer protections throughout the country.

I. Application of State Anti-burial Insurance Laws to Insurance-funded Prearranged Funeral/Cemetery Programs

Some states have adopted prohibitions on the sale of burial insurance products. Traditionally these products were level benefit whole-life insurance policies sold in very small face amounts. In some states these products were offered by funeral providers and the policy benefits were actually funeral goods and service rather than money. These products played a historic role in the development of today's preneed life insurance products. Over the years, a number of methods have been developed or proposed to ease the emotional and financial hardships that come from making these decisions and having to incur these expenses at the time of death.

One of the traditional approaches has involved purchasing a small face amount life insurance policy for the specific purpose of using the proceeds to pay for funeral and cemetery expenses. Under this approach, the consumer may or may not choose to separately assign the insurance proceeds to the funeral home or cemetery of his choice. While this approach assures that some funds are available, it does not necessarily enable or require the consumer to indicate precisely

what types of goods and services he or she desires, and it does not guarantee that the policy proceeds will be sufficient to pay for all of the funeral costs.

Present day preneed products and programs seek to enable consumers to plan their final arrangements in advance of death and to fund them with life insurance. These programs are a modern attempt to deal with a historic problem that families face when a loved one dies. It is a very stressful time for any family that can become even more stressful when the family is faced with having to plan and pay for a funeral after death.

So most current preneed insurance has none of the limitations previously associated with burial insurance that had been sold during early times in our history. Today's policies are issued only by highly qualified insurers and these forms are approved in advance by the Department of Insurance in the state where it is sold. The payment of proceeds is in cash and not the provision of funeral goods and services. Nothing in the insurance policy form identifies it as a "preneed policy." The policy becomes a preneed policy simply through the operation of the assignment provision in the funded funeral service agreement.

II. Application of State Preneed Funeral/Cemetery Trust Laws to Insurance-funded Prearranged Funeral Programs

The preneed funeral/cemetery industry in the United States has been regulated since the early 1950s by state statutes known as "Preneed Laws." These preneed laws were promulgated in order to regulate a preneed contract seller's receipt of cash in exchange for a promise to provide funeral/cemetery goods and services at a later date.

Originally sold exclusively by the funeral home or cemetery providing the goods and services, these traditional preneed contracts were a straight-cash transaction. In other words, the consumer paid cash to a funeral home or cemetery which, in turn, promised to apply those funds to provide goods and services at the time of a consumer's death.

In order to protect the consumer's monetary investment in these cash-funded contracts, the state legislatures required that a certain percentage (ranging from 60% to 100%) of the funds received by the preneed contract seller be placed in a regulated trust account. This statutory protection ensured that the funds were available to pay for the consumer's funeral/cemetery service at the time of death.

However, in the mid-1970s, a completely new prearrangement program was developed that eliminated the requirement for trusting any money. Under this new insurance-funded program, the consumer's funeral/cemetery contract was funded by the guaranteed death benefits of a life insurance policy, or annuity contract, issued and sold by an insurance-licensed representative of a duly-licensed life insurance company. The life insurance company was licensed in each state where its life insurance products were sold and was subject to all applicable insurance laws and regulations, including various reserve requirements.

Ultimately, the insurance company (not the trustee, the preneed marketing company, or the funeral home/cemetery) receives the consumer's premium payments in exchange for an independently regulated policy of insurance. Stated differently, most insurance-funded prearranged programs create an option to purchase goods and services in the future. At no time prior to the delivery of funeral/cemetery goods or services is the consumer contractually

bound to the terms of his or her funeral prearrangement. It is a completely unilateral contractual arrangement (that is, the provider is bound but the consumer is not). Since no monies are exchanged for goods and services until after the consumer dies, there can be no current sale of goods and services on a preneed basis subject to the state preneed trust laws.

III. Conversion of Trust-funded Prearrangements to Insurance-funded Prearrangements

According to a 1987 Internal Revenue Service Ruling (Rev. Rul. 87-127), the purchaser of a trust/preneed funeral contract must pay income taxes on the income generated by the payments held in trust even where the contract seller receives all of the interest earned. Before this ruling, the establishment of a single-purpose trust was probably the most common form of funding a prearrangement funeral.

Under such an arrangement, the money collected by the funeral home was deposited in a trust or in an interest-bearing bank or savings and loan account. The funeral home typically kept the interest as a hedge against rising costs of funeral goods and services. This 1987 ruling also provided that income earned from prepaid funeral trusts was taxable to the preneed buyer under all circumstances. If the preneed contract was cancelled, the buyer paid the taxes even if the funeral home kept the interest income. If the contract was not cancelled, the buyer was still liable for taxes on interest earned by the trust.

This ruling has contributed to the increased utilization of insurance-funded prearranged funeral programs throughout the United States. Under current IRS regulations, earnings in life insurance policies are not taxable. If the buyer of an insurance-funded prearranged funeral does not cancel his life insurance policy and the death benefits are paid to the funeral home at death, no tax liability is incurred by the beneficiary on any amounts remaining.

IV. Irrevocable Assignments and Eligibility for Supplemental Security Income and Medicaid

Supplemental Security Income (SSI) is a federally administered cash assistance program available to the general public. It is designed to provide a floor of income for the aged, blind, or disabled who have little or no income and/or resources. The SSI program is administered by the Social Security Administration (SSA) and is funded from general tax revenues.

Medicaid is a program designed to pay for medical care for individuals who are either already receiving income assistance under Aid to Families with Dependent Children (AFDC), SSI (a state supplemental income program), or who are medically needy because of very limited income resources. The federal government helps to finance the Medicaid program, but the primary responsibility for administering the program rests with each of the states.

In order to receive federal funding, the states must provide Medicaid benefits to individuals who are already receiving public assistance under AFDC, SSI, or a state supplemental income program. The states may establish independent eligibility criteria for individuals who are not on public assistance.

Many states choose to apply the same criteria established by the federal government for SSI eligibility in determining eligibility for Medicaid benefits. The result is that eligibility determinations involve the same basic issues in every state but will vary depending on the statutes, regulations, and administrative policy of the applicant's particular state of residence.

In determining and maintaining eligibility for SSI, a countable resource limitation is established that is adjusted every calendar year by Congressional action. Certain resources are totally or partially excluded from countable resources. Typically, life insurance policies on any individual with a total face value of \$1,500 or less are generally excluded. If the aggregate face value amount of all policies owned by the applicant exceeds \$1,500, the cash surrender value must be counted as a resource.

The basic statutory limit established by the Social Security Act for exclusion of funds set aside for burial funds is \$1,500 each for any individual and spouse. However, each individual's maximum limit will be reduced by:

- a) the face value of an insurance policy on that individual's life if the cash surrender value of said policy was excluded from countable resources by another provision of the Social Security Act; and
- b) an amount equal to the amount held in an irrevocable burial contract, an irrevocable trust, or other irrevocable arrangement (for example, an irrevocable assignment of the benefits payable under a life insurance contract).

Burial spaces are also excluded as a resource when eligibility is being determined. Burial spaces are defined to include burial plot, gravesite, crypt, mausoleum, casket, urn, niche or other repository, vault, headstone, markers or plaques, burial containers, arrangements for opening and closing the gravesite, and contracts for the care and maintenance of the gravesite. These items are excluded when determination of eligibility for SSI and Medicaid is determined without regard to value.

The above discussion relates to SSI on the federal level. This summary applies to most states but may not be totally applicable in some states because of the way a state may make a Medicaid determination. Please note that Medicaid rules, regulations, and interpretations may also vary from county to county at the state level.

Certain marketers of insurance-funded prearranged programs have developed various irrevocable assignment forms that have been used by their clients who wish to qualify, or continue to be eligible for, public assistance. Their purpose is to eliminate access of the SSI or Medicaid applicant to the cash-surrender value and loan value of the life insurance policy that was initially purchased to fund the prearrangement. This allows the policy to qualify as an excluded resource and from being counted as a resource when evaluating SSI/Medicaid eligibility.

Irrevocable assignment forms typically assign *ownership* of the life insurance policy to a third-party dry trust. A "dry trust" merely holds ownership of the insurance policy. The trust is dry because it holds no money or cash. Some forms only assign to a funeral home the right to receive proceeds under the policy, while others accomplish simultaneously the assignment of ownership to a dry trust and of proceeds to the funeral home.

Such assignments may demonstrate to Medicaid authorities that the insured cannot go back and change the insurance funding for the funeral once the insured qualifies for Medicaid. In other words, if the funeral is listed as an exempt asset, then Medicaid does not want the

consumer canceling the funeral and surrendering the insurance policy for cash. The proper form or type of assignment varies from county to county and state to state.

Irrespective of the method used, the Medicaid/SSI applicant is permitted to change the funeral/cemetery establishment designated to render the services upon the death of the insured (freedom of choice).

V. Tax Issues

From the consumer's perspective, life insurance is often considered an advantageous funding vehicle for prearranging funerals. Revenue Ruling 87-127 of the Internal Revenue Service requires the reporting and taxation of the income earned in preneed trust accounts. Therefore, the individual beneficiary of the trust is required to include the earned income on both state and federal income tax returns. In addition, the trustee is obliged to calculate the income earned on an individual basis and to provide appropriate tax information (generally in the form of a Form 1099) to both the individual taxpayer and to the state and federal taxing authorities.

If an annuity is selected as a funding vehicle and it properly qualifies under the Internal Revenue Code, the taxable incidence may be deferred until death. However, upon death, the beneficiary most likely will be deemed to have received income on the difference between the investment value of the annuity and the death-benefit proceeds. This may result in the assessment of income tax on the income that was deemed to have been received by the beneficiary but not received in cash.

Life insurance, on the other hand, may appreciate without any present federal income tax consequences. The taxpayer benefits because he is not currently taxed on the appreciation of his investment (which is set aside for funeral funding), and he is not obligated to report such appreciation for tax purposes.

CONCLUSION

Preneed insurance serves as a useful tool in helping consumers fund their preplanned funerals. In many instances, consumers prearrange their funerals and fund them with insurance as part of a Medicaid spend-down plan. Preneed insurance customers and their families or personal representatives most often have freedom of choice to change the funeral home providing services up until the time the funeral services are provided.

Preneed insurance is portable. In the case of an irrevocable assignment, the customer may move the insurance from one funeral home to another with the permission of the funeral home. If the preneed insurance is held until death, the proceeds are not taxable and no annual forms are received from the IRS.

A prearranged funeral allows the consumer to specify the exact type of funeral desired. Also, a guaranteed price prearranged funeral contract provides that the consumer's family or personal representative will never have to pay for the funeral at the time of death if it is fully funded. Preneed insurance is sold by licensed insurance agents as provided in the state in which they operate. Prearranged funerals are sold by licensed funeral directors, or other individuals under their direction who may also be licensed, as provided by state law.

Preneed funerals funded by insurance involve two sales: 1) the sale of a funeral, and 2) the sale of insurance to fund that funeral. The funeral home or cemetery does not receive any payment until the funeral or cemetery service is preformed, other than a sales commission. Preneed insurance can be referred to as an after-paid funding vehicle since payment is only made after the funeral goods and service are delivered

AUTHORS' NOTE

The purpose of this overview is to communicate generally available information about preneed and final expense insurance. We welcome your comments and suggestions, which can be sent to matt.mcguire@assurant.com.

Please note that the use of this overview is not a substitute for legal, accounting, or other professional services or advice. This overview contains information that is dated and may change as time passes. Please consult a competent professional for answers to your specific questions.

Thank you.

EXHIBIT A

FREQUENTLY ASKED QUESTIONS ABOUT PRENEED INSURANCE

Q.1. Who buys preneed insurance?

A.1. Often people in their 60s or 70s buy this type of insurance. Many times, preneed insurance is purchased in connection with a Medicaid spend-down situation.

Q.2. Who regulates preneed insurance; is it subject to state trusting or state funeral trusting laws?

A.2. Preneed insurance is usually regulated by the state Department of Insurance. It may also be regulated by other state agencies, however. Because it is an after-paid funding vehicle it is not subject to state trust or state funeral trust laws. This means that it is paid after death only when the funeral goods and services have been provided.

Q.3. What is preplanning?

A.3. When a person arranges for his/her funeral before death, it is called preplanning. A funeral home representative assists the customer in prepaying funeral services detailing the specific funeral goods and services selected. Funding may also be arranged in advance or the funeral plans may simply be kept on record for reference at time of need (preplanning).

Q.4. What is prefunding?

A.4. When a person arranges payment for his/her funeral before death, it is called prefunding. Prefunding can be accomplished by paying cash, putting money into a funeral trust, or using insurance. If insurance is used, then it is by means of an assignment of insurance proceeds contained in the funeral services contract.

Q.5. What is preneed insurance?

A.5. Preneed insurance is small face amount life insurance or annuity coverage, usually \$10,000 or below, which is pledged to pay for a funeral.

Q.6. What type of policy is preneed insurance?

A.6. Preneed insurance is small face amount, limited pay, whole life insurance or annuity coverage. It is not a new type of insurance product.

Q.7. What type of license do you need to sell preneed insurance?

A.7. This varies from state to state but it always requires some type of insurance license.

Q.8. Where is preneed insurance sold?

A.8. It is usually sold in the funeral home but may also be sold in the person's residence.

Q.9. When is preneed insurance purchased?

A.9. Preneed insurance is purchased before death (or "need").

Q.10. Why do people preplan?

A.10. People like to feel that they have taken care of their funeral, which grants peace of mind of not burdening family with these final decisions. Preneed insurance is bought for protection and not as an investment vehicle or for interest-rate growth.

Q.11. Why prefund a funeral?

A.11. When a person prefunds his/her funeral, he/she locks in the price of the funeral at today's cost (guaranteed funeral expense), which provides full or limited coverage of the funeral amount from Day One (depending on the product chosen). Prefunding also saves family members from bearing financial burden at time of death.

Q.12. How is the funeral paid for?

A.12. The funeral is paid for by an assignment of the insurance proceeds in the contract for funeral services.

EXHIBIT B

FTC GENERAL PRICE LIST, CASKET PRICE LIST, AND OUTER BURIAL CONTAINER PRICE LIST

I. Sample Price Lists

The FTC staff has attached these sample price lists to help you to understand the Funeral Rule's requirements. You do not have to adopt these sample price lists. They are only examples. In addition, the fact that the FTC staff has developed these price lists does not mean this format is the only appropriate format. A variety of formats will satisfy the Rule's requirements.

a. Sample I

ABC FUNERAL HOME
100 Main Street
Yourtown, USA 12345
(123) 456-7890

i. General Price List

These prices are effective as of [date]. The goods and services shown below are those we can provide to our customers. You may choose only the items you desire; however, any funeral arrangements you select will include a charge for our basic services and overhead. If legal or other requirements mean you must buy any items you did not specifically ask for, we will explain the reason in writing on the statement we provide describing the funeral goods and services you selected.

A. Basic Services of Funeral Director
and Staff and Overhead\$ _____

Our services include: conducting the arrangements conference; planning the funeral; consulting with family and clergy; shelter of remains; preparing and filing of necessary notices; obtaining necessary authorizations and permits; and coordinating with the cemetery, crematory, or other third parties. In addition, this fee includes a proportionate share of our basic overhead costs.

This fee for our basic services and overhead will be added to the total cost of the funeral arrangements you select. (This fee is already included in our charges for direct cremations, immediate burials, and forwarding or receiving remains.)

B. Embalming\$ _____

Except in certain special cases, embalming is not required by law. Embalming may be necessary, however, if you select certain funeral arrangements, such as a funeral with viewing. If you do not want embalming, you usually have the right to choose an

arrangement that does not require you to pay for it, such as direct cremation or immediate burial.

- C. Other Preparation of the Body\$ _____
- D. Transfer of Remains to the Funeral Home (within __ mile radius)\$ _____
beyond this radius we charge __ per mile
- E. Use of Facilities and Staff for Viewing at the Funeral Home.....\$ _____
- F. Use of Facilities and Staff for Funeral Ceremony at the
Funeral Home.....\$ _____
- G. Use of Facilities and Staff for Memorial Service at the
Funeral Home.....\$ _____
- H. Use of Equipment and Staff for Graveside Service\$ _____
- I. Hearse\$ _____
- J. Limousine.....\$ _____
- K. Caskets\$ _____ to \$ _____

A complete price list will be provided at the funeral home.

- A. Outer Burial Containers\$ _____ to \$ _____
- B. Forwarding of Remains to Another Funeral Home\$ _____

Our charge includes: basic services of funeral director and staff; a proportionate share of overhead costs; removal of remains; embalming or other preparation of remains, if relevant; and local transportation.

- C. Receiving Remains from Another Funeral Home\$ _____

Our charge includes: basic services of funeral director and staff; a proportionate share of overhead costs; care of remains; and transportation of remains to funeral home and to cemetery or crematory.

- D. Direct Cremation\$ _____ to \$ _____

Our charge for a direct cremation (without ceremony) includes: basic services of funeral director and staff; a proportionate share of overhead costs; removal of remains; transportation to crematory; necessary authorizations; and cremation if relevant.

If you want to arrange a direct cremation, you can use an alternative container. Alternative containers encase the body and can be made of materials like fiberboard or composition materials (with or without an outside covering). The containers we provide are a fiberboard container or an unfinished wood box.

- A. Direct Cremation with Container
 Provided by the Purchaser\$ _____
- B. Direct Cremation with
 a Fiberboard Container\$ _____
- C. Direct Cremation with an Unfinished Wood Box.....\$ _____
- D. Immediate Burial.....\$ _____ to \$ _____

Our charge for an immediate burial (without ceremony) includes: basic services of funeral director and staff; a proportionate share of overhead costs; removal of remains; and local transportation to cemetery.

- A. Immediate Burial with
 Casket Provided by Purchaser\$ _____
- B. Immediate Burial with
 Alternative Container [if offered]\$ _____
- C. Immediate Burial with
 Cloth-covered Wood Casket.....\$ _____

b. Sample 2

ABC FUNERAL HOME CASKET PRICE LIST – These prices are effective as of [date].

- i. Alternative Containers
 - A. Fiberboard Box.....\$ _____
 - B. Plywood Box\$ _____
 - C. Unfinished Pine Box\$ _____
- ii. Caskets
 - A. Beige Cloth-covered Soft-wood with
 Beige Interior\$ _____
 - B. Oak-stained Soft-wood with
 Pleated Blue Crepe Interior\$ _____

- C. Mahogany-finished Soft-wood with
Maroon Crepe Interior\$ _____
- D. Solid White Pine with
Eggshell Crepe Interior\$ _____
- E. Solid Mahogany with
Tufted Rosetan Velvet Interior.....\$ _____
- F. Hand-finished Solid Cherry with
Ivory Velvet Interior\$ _____
- G. 18-gauge Rose-colored Steel with Pleated Maroon
Crepe Interior (available in a variety of interiors).....\$ _____
- H. 20-gauge Bronze-colored Steel with
- I. Blue Crepe Interior.....\$ _____
- J. Solid Bronze (16 gauge) with
Brushed finish White Ivory Velvet Interior.....\$ _____
- K. Solid Copper (32 oz.) with Sealer (Oval Glass) and
Medium Bronze Finish with Rosetan Velvet Interior.....\$ _____

c. Sample 3

ABC FUNERAL HOME OUTER BURIAL CONTAINER PRICE LIST – These prices are effective as of [date].

In most areas of the country, state or local law does not require that you buy a container to surround the casket in the grave. However, many cemeteries require that you have such a container so that the grave will not sink in. Either a grave liner or a burial vault will satisfy these requirements.

- i. Concrete Grave Liner\$ _____
- ii. Acme Reinforced Concrete Vault (lined).....\$ _____
- iii. Acme Reinforced Concrete Vault
(stainless steel lined)\$ _____
- iv. Acme Solid Copper Vault\$ _____
- v. Acme Steel Vault (12 gauge).....\$ _____

d. Sample 4

ABC FUNERAL HOME

i. Statement of Funeral Goods and Services Selected

Charges are only for those items that you selected or that are required. If we are required by law or by a cemetery or crematory to use any items, we will explain the reasons in writing below.

Deceased: _____

Purchaser: _____

Address: _____

Tel.No. _____

Date of Death: _____

Date of Arrangements: _____

A. Basic Services of Funeral Director and Staff and Overhead.....\$ _____

B. Embalming\$ _____

If you selected a funeral that may require embalming, such as a funeral with viewing, you may have to pay for embalming. You do not have to pay for embalming you did not approve if you selected arrangements, such as a direct cremation or immediate burial. If we charged for embalming, we will explain why below.

ii. Other Preparation of the Body

A. Cosmetic Work for Viewing\$ _____

B. Washing and Disinfecting Un-embalmed Remains\$ _____

C. Transfer of Remains to the Funeral Home.....\$ _____

D. Use of Facilities and Staff for Viewing\$ _____

E. Use of Facilities and Staff for Funeral Ceremony\$ _____

F. Use of Facilities and Staff for Memorial Service\$ _____

G. Use of Equipment and Staff for Graveside Service\$ _____

H. Hearse\$ _____

I. Limousine\$ _____

- J. Casket.....\$ _____
- K. Outer Burial Container\$ _____
- L. Forwarding of Remains to Another Funeral Home\$ _____
- M. Receiving Remains from Another Funeral Home\$ _____
- N. Direct Cremation\$ _____
- O. Immediate Burial.....\$ _____

iii. Cash Advance Items

We charge you for our services in obtaining: [specify relevant cash advance items].

- A. Cemetery charges.....\$ _____
- B. Crematory charges.....\$ _____
- C. Flowers.....\$ _____
- D. Obituary notice\$ _____
- E. Death certificate.....\$ _____
- F. Music.....\$ _____
- Total Cash Advance Items.....\$ _____**

Total Cost Of Arrangements (including all services, merchandise, and cash advance items).....\$ _____

If any legal, cemetery, or crematory requirement has required the purchase of any of the items listed above, we will explain the requirement below:

Reason for Embalming:

EXHIBIT C

Specimen Preneed Contracts

The contract forms that follow are specimens typical of those used for life insurance funding. Note that there are many variations on such forms, however, due to state-to-state regulation differences and due to variations in funeral home marketing and contracting.

The first specimen is designed for used in Iowa.

The second specimen is one of two choices required to be used in South Carolina.

The third specimen is designed for use in Arizona.

2639

Cooper, Kathy

From: Gerry Kraus [GKraus@Homesteaderslife.com]
Sent: Monday, October 22, 2007 5:15 PM
To: Jewett, John H.
Cc: ernieheffner@hotmail.com; jkutz@postschell.com; IRRC
Subject: Preneed industry information

RECEIVED

2007 OCT 23 AM 9:25

INDEPENDENT REGULATORY
REVIEW COMMISSION

Mr. Jewett

Though my communications with an associated PA funeral provider, Mr. Ernie Heffner, I understand that you are interested in information about the preneed market both in PA and nationally. I collaborated with some of my fellow preneed insurers in preparing the attached document, *USA Preneed Overview*, recently and I hope you will find it useful in explaining some of the fundamental characteristics of this important consumer market. I have also provided the IRRC with comments (also attached) regarding the IRRC investigation of the Funeral Board's regulation of this market.

If I can help you further, please do not hesitate to contact me.

<<IRRC comments Homesteaders.doc>>

<<USA Preneed Overview.doc>>

Gerry Kraus*Vice President-Compliance*

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Homesteaders Life Company

Preserving the Value of Funeral Service®

www.homesteaderslife.com

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