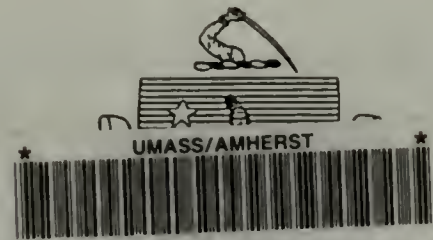


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POLICY BRIEF

Senate Post Audit and Oversight Bureau
Chair, Senator Cheryl A. Jacques

JANUARY 2003

Robbing the Grave

PROTECTING CONSUMERS FROM PRE-NEED FUNERAL CONTRACT FRAUD AND LOSS

- Thousands of consumers in Massachusetts have entered into pre-need contracts with funeral homes in order to protect their loved ones from the burden of costly funerals by paying in advance for their funeral arrangements.
- There have been at least eight separate, documented examples of funeral homes that have left dozens of consumers in Massachusetts empty-handed, stripped of the funds they invested in pre-need funeral contracts due to fraud or other actions by funeral home officials.
- Massachusetts law and regulations govern pre-need contracts, but do not adequately protect pre-need investments that are mishandled or lost through bad investment decisions, fraud or embezzlement schemes.
- At least nine other states have created a financial safety net to protect consumers if their pre-need funeral accounts are mishandled or lost.

Background

The cost of funerals has been increasing at a rapid rate, making payment for funeral goods and services a major expense. According to the Funeral Consumers Alliance, the average funeral costs more than \$5,000. This price excludes cemetery and monument expenses, which bring the total costs of a funeral to approximately \$8,000 to \$10,000. The National Funeral Directors Association found that, even when adjusted for inflation, the average cost of a funeral has risen 26% since 1991.

As a result of high costs, many individual consumers pay and arrange for their funerals by entering into "pre-need" contracts with funeral homes for goods and services upon their death. According to the National Funeral Directors Association, 30% to 40% of the nation's funerals are arranged before the death of the individual. As of 1998, more than

seven million Americans had entered into pre-need contracts. Between 1995 and 1999, the American Association of Retired Persons (AARP) reports that the total amount of money in pre-need contracts rose from \$18 billion to more than \$25 billion.

Mirroring the national trend, pre-need contract sales in Massachusetts have risen over the past several years, and the cost of funerals in the state has continued to rise. Thousands of pre-need contracts exist in Massachusetts.

There are a number of reasons why pre-need contract sales are rising. For many, the most compelling reason to purchase a pre-need contract is to relieve loved ones of the financial burdens associated with death.

Much of the growth over the last several years in pre-need contract sales has occurred as a result of the growing elderly population and the increasingly competitive nature of the funeral industry. Funeral homes have become more aggressive in trying to lock in future business, and as the number of seniors continues to grow, the marketing of pre-need contracts continues to increase. Many seniors set aside money for their funeral arrangements in pre-need accounts when they are entering a nursing home and enrolling in the Medicaid program, an expenditure allowed under Medicaid guidelines.

There have been at least eight separate, documented examples of funeral homes that have left dozens of consumers in Massachusetts empty-handed, stripped of the funds they invested in pre-need funeral contracts due to fraud or other actions by funeral home officials. This can make it necessary for elderly people and their surviving families to raise funds to pay for the funeral a second time. Massachusetts regulates pre-need contracts, but does not provide adequate consumer protection against their misuse. Consumers who invest in pre-need contracts do not expect to lose their money, or to leave their grieving families to scramble for funds to pay for their funeral after they have already made the financial arrangements.

Massachusetts Background

Massachusetts law (M.G.L. c.112 §§ 82-87) regulates funeral directors and funeral homes. All funeral directors and funeral homes are required to fulfill certain qualifications in order to be registered, licensed and certified by the state. The Division of Professional Licensure's Board of Registration of Funeral Services (the Board) has the authority to create rules and regulations regarding standards of service and practice for funeral directors. Additionally, the Board is authorized by law to deny, suspend or revoke the state approved license or certificate of a funeral director who has been convicted of a crime involving moral turpitude or unprofessional conduct. For example, funeral directors could lose their license or certification if convicted of misrepresentation or fraud.

The Board has developed detailed regulations to protect consumers who buy pre-need contracts (CMR 239-4.00 through 239-4.10). However, there is no provision under the Board's regulations that would provide a way for consumers to be reimbursed for any funds lost through fraud and mismanagement.

All pre-need contracts must be arranged between a consumer and a state-registered funeral director on behalf of a licensed funeral home. In Massachusetts, approximately 700 funeral establishments and 2,000 individuals are licensed to sell pre-need contracts.

Under current regulations, money received by a funeral home through a pre-need contract must be invested in a bank account or an insurance policy, such as a funeral trust bank account or a pre-need insurance policy or annuity. The pre-need contract funds are invested in a bank account in the name of the funeral home, as a trust for the individual consumer who is listed as the beneficiary. The funds are to be used exclusively for carrying out the terms of the contract. Upon entering into the contract, the consumer relinquishes the rights and responsibilities for the management of and access to the funds.

It Could Happen to You

Fifty-three consumers lost the pre-need contract money they had invested with the Morrison Funeral Home in Wakefield. These elderly consumers lost amounts ranging from \$445 to \$6,685 for a total loss of more than \$150,000. One Massachusetts woman, the late Eleanor Atwater of Wakefield, entered into a pre-need contract with Morrison Funeral Home worth more than \$5,000. Her son, David Atwater, went to the Morrison Funeral Home every year to receive his mother's account statement and to verify the amount of funds in her account.

After her death, Mrs. Atwater's family was shocked to find that the money she had invested in a pre-need contract had disappeared without a trace. The local police department found that the funeral director, Paul Morrison, had withdrawn the pre-paid money from the bank. Upon further investigation, the state Attorney General's office discovered that Morrison had run into some financial difficulties and closed his funeral home without settling his accounts or notifying his customers. As a result, Mrs. Atwater's family had to take out personal loans to pay for her funeral.

In 1994, Paul Morrison was formally charged with five counts of larceny from customers of Morrison Funeral Home. Morrison pled guilty and was sentenced to one year in jail. In a separate civil lawsuit, the state Attorney General's office initiated negotiations with Morrison in order to collect restitution from him on behalf of his customers. On February 27, 1996, the Suffolk Superior Court ruled in favor of the Commonwealth, specifying that Morrison would be obligated to make quarterly payments, dependent on his income level, to a fund set up at the state Attorney General's office to repay his victims. However, Morrison was disabled and had little income. The most any victim, including Mrs. Atwater's family, was able to recover was \$100.

All Massachusetts funeral directors are required to file annual reports with the Board listing the number of new pre-need contracts, how and where contract funds are invested and the location of contract records. Massachusetts regulations also require that pre-need funeral contracts include a list of the rights and obligations of each party, and that the contract holder must inform the consumer in writing of any changes to the contract terms. Funeral

homes must also provide consumers entering into negotiations or discussions regarding pre-need contracts with a buyer's guide that is approved by the Board and that contains information on prices and services, financing options and consequences as well as cancellation rights.

Under certain circumstances, Massachusetts consumers can cancel a pre-need contract. If a contract is canceled within ten days after it is signed, the consumer can retrieve all money invested without penalties. If a consumer wants to cancel their contract after ten days and if the terms of the contract did not make it irrevocable, the consumer can get back the entire balance minus any bank fees or taxes paid by the funeral home.

All funeral trusts must follow investment, amendment, disclosure, access, disposition, transfer, and cancellation requirements. Furthermore, funeral directors are required to give notice of changes affecting the contracts and trusts, are obligated to locate the beneficiaries of the trusts, and must keep records on the funds. There are also specific requirements that money in a pre-need contract placed in an insurance policy or annuity must comply with all applicable state and federal laws.

A funeral home experiencing bankruptcy is required to notify all customers with pre-paid contracts and to advise them about possible arrangements to retrieve their money. Consumers have the option of getting a refund, transferring their money to another account with a new funeral home or leaving their money where it is.

Investigating Pre-Need Fund Mismanagement

In 2002, the state Attorney General's office initiated litigation against two funeral homes and their directors. Bick and Curry Funeral Home, Inc. of Beverly allegedly mishandled the pre-need contracts of approximately 14 consumers, worth a total of \$85,000. In addition, approximately 48 consumers of the Johnston Funeral Home of Bridgewater are missing about \$140,000 in pre-need contract deposits.

In the case against Bick and Curry Funeral Home, the funeral home owner had failed to provide records to the Board of Registration of Funeral Services on the funds consumers had invested. When the funeral home owner passed away, his estate could not account for approximately \$85,000 in pre-need contract deposits. A settlement was filed at the end of October that provided for the return of \$98,000 (the original deposits plus interest) to the consumers who had pre-paid for funeral arrangements.

In the second case, Johnston Funeral Home's director had also failed to provide records to the Board on its pre-paid contracts, and the Board decided to refer the case to the Office of the Attorney General because the Board could not determine whether the funds had been unlawfully used. In just these two cases, a total of approximately 62 consumers had lost at least \$225,000, exclusive of interest, on their deposits.

Other Massachusetts Concerns

Some other concerns have been raised regarding pre-need contracts and funeral homes in Massachusetts.

Bait and Switch

When consumers enter into pre-need contracts, most will not need the goods and services of the funeral home or director immediately. When the services are needed, the funeral home may have stopped providing a particular service that was originally agreed upon as a part of the contract or the good may not be manufactured anymore. This would make it necessary for a different service to be provided in place of the original service. Funeral homes are currently allowed to charge more money for these “new” services if the services requested in the pre-need contract are unavailable at the time of the consumer’s death. Thus, survivors can be faced with additional charges when they were led to believe that all expenses had been taken care of by the pre-need contract.

A Regulation Loophole

Pre-need funeral contract funds can be invested in a bank account or an insurance policy. Often, the funds are invested in funeral trust accounts. Current regulations allow the funds to be placed in other types of financial accounts, such as a standard savings account. However, despite the fact that such accounts are allowed, current Board regulations do not directly apply to some of these investment vehicles, such as the standard savings account. Consequently, a funeral home can place a consumer’s pre-need contract funds into an account that is not subject to the Board’s protective regulations.

Reporting Glitches

Massachusetts funeral home directors are required to submit an annual report to the Board detailing specific information about pre-need contracts under their jurisdiction. However, they are not required to submit the names of each consumer investing in pre-need services. Thus, when cases of fraud occur, the Board is often only aware of the problem if consumers come forward to complain about lost funds. It is possible that there may be victims of pre-need fraud and abuse who have lost money, but are too grief-stricken to notify the Board of their loss, or may not yet be aware that their money has been lost or misused.

Experiences in Other States

At least nine states have established consumer protection guarantees to ensure that pre-need investments are protected. States have chosen to provide these protections in a variety of ways, including: requiring funeral directors to pay a small fee for each funeral or contract to fund a guarantee account which would reimburse consumers for lost investments; requiring consumers to pay a fee for each contract they buy to fund a guarantee account; or, requiring funeral directors and cemetery associations to purchase a bond to guarantee the funds. If a victim needs to make use of a guarantee fund, some

states have provisions that allow a state entity to require the funeral director in question to repay the fund.

A Repayment Success Story

Elderly consumers entrusted Kenneth Sprague, a New Hampshire funeral director and, at the time, a part owner of Spadafora Funeral Home in Malden, Massachusetts, with thousands of dollars in advance payments for their funerals. However in 1997, according to press accounts, Sprague was caught storing corpses because he had already spent the pre-paid funeral contract money that the individuals had invested for their cremation. A total of \$160,000 in pre-need contract funds from 46 consumers was missing.

Sprague was charged with falsifying records and failing to deposit the money that he received for pre-paid funerals. He was sentenced to three years in prison. He was also required to pay into a fund set up by New Hampshire authorities to make restitution to the affected families.

One of the families who got caught in Sprague's scheme was from Massachusetts, and faced the loss of \$3,227 they had invested in a pre-need contract. The Massachusetts Board of Registration of Funeral Services was able to arrange for this family to be compensated from the New Hampshire fund.

State Initiatives:

- Indiana charges funeral directors an annual fee ranging from \$2.50 to \$10.00 for each new pre-need contract, depending on the value of each contract. The fee can be paid by the funeral director or charged to the purchaser. The money is then put into a Pre-Need Consumer Protection Fund that is administered by the state and used to reimburse consumers who have lost their pre-need contract investments due to fraud or mismanagement. When the account balance reaches \$1.5 million, payments are suspended until the balance is below that amount.
- In North Carolina, the state Board of Mortuary Science administers a Pre-Need Recovery Fund. Funeral homes that sell pre-need contracts must pay a fee to the Board of up to \$20 for each contract. In the event that a reimbursement is necessary, the Board is authorized to bring action against the responsible funeral home director to recover the lost money.
- Florida's Pre-Need Funeral Contract Consumer Protection Trust Fund is administered and regulated by the state Board of Funeral and Cemetery Services. Funeral directors with pre-need contracts must pay a per contract fee annually. For each contract less than or equal to \$1,500, the fee is \$2.50, and for each contract greater than \$1,500, the fee is \$5.00. If the balance of the account is greater than \$1 million, the Board can lower the fees to no less than \$1 per contract.

Bonds Can Protect Pre-Need Consumers

The North Dakota Securities Commissioner requires funeral directors and cemetery associations that use pre-need funeral contracts to place a bond with the Commission to protect against fraud. The bond amount covers 10% to 15% of the amount the funeral director has in outstanding funeral contracts, a number that is based on the average of the funeral director's last three years of sales. The minimum bond is \$3,000, and the maximum bond is \$20,000. The funeral provider must also report to the state annually on each individual pre-need contract.

The Connecticut Legislature's Select Committee on Aging proposed a bill in 2000 to protect consumers purchasing contracts for funeral services. The bill would require funeral home owners, before selling pre-paid contracts, to post a surety bond or a series of bonds in varying amounts. The amount of the bond would vary according to the number of homes the funeral director owns, ranging from \$50,000 for one to four homes to \$1,000,000 for 15 or more homes. Anyone damaged by the wrongful conversion of pre-paid funds would have the right to sue against the bonds to recover damages, including reasonable attorney fees.

Findings

- Thousands of consumers throughout the state have invested their money in pre-need funeral contracts to relieve their family members of future financial burdens and to protect them from the high and rising cost of funerals.
- There have been at least eight separate, documented cases over the past several years in which dozens of consumers in Massachusetts have been left empty-handed, stripped of the funds they have invested in pre-need funeral contracts. Yet, Massachusetts law and regulations, despite their strengths, do not provide adequate protection for consumers if their money disappears due to bad investment decisions or fraud and embezzlement schemes.
- At least nine states have established mechanisms to protect the money consumers invest in pre-need contracts.

Recommendations

Consumers deserve to know that the investments they make for their funerals are secure. The Board of Registration of Funeral Services should do the following:

- A financial safety net should be established so that victims of pre-need contract fraud or mismanagement will have the ability to regain lost funds. The Board should promulgate regulations establishing a protective mechanism, and should recommend to the Legislature any statutory changes that are necessary to accomplish this goal.
- Funeral homes should not be allowed to charge more money for “new” goods or services if the services requested in the contract are unavailable or the goods are no longer manufactured at the time of the consumer’s death. If portions of the contract cannot be honored, the consumer should receive comparable service at the same cost, or be reimbursed for that portion of the contract.
- Standard savings accounts and all other possible financial vehicles where pre-need funds can be held should be included under the Board’s regulations governing the use of the funds.
- Funeral homes should be required to submit the names of all people who hold pre-need contracts to the Board in their annual reports so that, in cases of fraud or abuse, the Board may notify each person who has been affected.