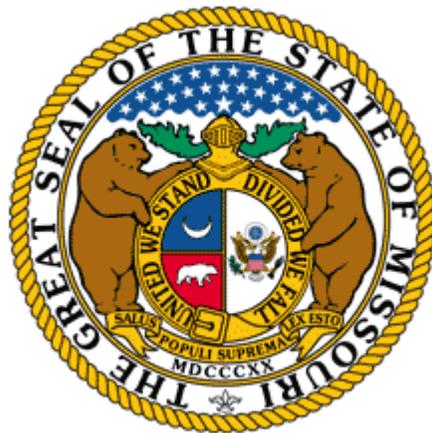


**Department Recommendations
Submitted to the Joint Committee on
Pre-Need Funeral Contracts**



Submitted by:

**Missouri Department of Insurance,
Financial Institutions
& Professional Registration
and
Miller Leonard**

September 8, 2008

The Missouri Department of Insurance, Financial Institutions and Professional Registration (The Department) is investigating NPS/Lincoln Memorial Life Insurance Company. The investigation is being conducted by Special Counsel and a limited team of investigators hired by the Department.

The investigation is being handled pursuant to the Department's authority under § 374.190, R.S.Mo. The Team reviewed available sources of information on business transactions of NPS and Lincoln Memorial Life Insurance Company related to their preneed and life insurance business in Missouri. The information reviewed by the investigative team at this time is confidential pursuant to §374.071 R.S.Mo and agreements in place between the Department and other agencies and entities.

The investigation has led to a greater understanding of the mishandling of the preneed business by NPS and Lincoln Memorial Life Insurance Company. The investigation has also provided a greater appreciation of what needs to be fixed in the current statutory structure to try and assure that what happened with NPS and Lincoln Memorial Life Insurance Company does not occur again.

This report was prepared by Special Counsel in cooperation with the Department to provide recommendations for legislative changes in response to the passage of §21.840 and the creation of a Joint Committee on Preneed Contracts in SB 788.

In order to achieve substantive changes in law that will help protect Missouri citizens and consumers, Special Counsel deliberately sought to work in cooperation with the State Board of Embalmers and Funeral Directors. The Department and Special Counsel met with the State Board of Embalmers and Funeral Directors. All three parties agreed to work toward uniformity in their recommendations as much as was possible. Thus, this report is an attempt to add commentary to the Chapter 436 Working Group recommendations as submitted September 1, 2008.

The Chapter 436 working group recommendations are thorough and the result of a series of open sessions in which various experts and professionals who work in the preneed funeral contracting business and various state regulatory agencies participated in order to achieve workable and necessary changes to Chapter 436. After Special Counsel's investigation of NPS and Lincoln Memorial Life Insurance Company, Special Counsel and the Department support a majority of the recommendations of the working group. We have not provided comment on all components of the working group's recommendations. If we do not mention or comment on a specific section or recommendation it can be assumed we generally support the working group's recommendations or we have no opinion. In areas where we differ, we have pointed those out and provided an explanation as to why we disagree or differ.

In order to maintain continuity of documents being received by the Joint Committee on Preneed Funeral Contracts, Special Counsel and the Department arranged this report to parallel the report submitted by the Chapter 436 working group.

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GENERAL REGULATORY AUTHORITY

SPECIAL COUNSEL AND THE DEPARTMENT AGREE THAT:

- Regulatory authority over Chapter 436 and preneed licensing should remain with the Board. Regulatory authority should not be transferred to another agency.

In particular, it should be recognized that the State Board of Embalmers and Funeral Directors has the requisite expertise needed to regulate Chapter 436.

- The Missouri Attorney General should be granted concurrent jurisdiction with local prosecutors to prosecute violations of Chapter 436.

*Traditionally, local County Prosecutors are charged with enforcing the criminal laws of the State of Missouri. Local Prosecutors are either full time or part time, depending upon the size of the county and whether the given county has voted to make their elected Prosecutor a full time position. Even in counties with full time Prosecuting Attorneys, the majority of their time and resources are not devoted to “White-Collar” crime. In addition, most county Prosecuting Attorneys do not have the resources in order to conduct “White – Collar” criminal investigations which involve tremendous amounts of paper-work, investigative resources, and specialized expertise. As such, concurrent jurisdiction is necessary in order to allow the Missouri Attorney General the ability to prosecute violations of Chapter 436. There is more likely to be institutional knowledge/expertise regarding this area of law.

- The Board should be granted general rulemaking authority to administer Chapter 436 and to establish necessary fees.

- The Board should be authorized to hire legal counsel to assist in the enforcement of Chapter 436.

*** It is important that the State Board of Embalmers and Funeral Directors have the authority to hire independent, outside counsel, if needed, in order to allow the Board to achieve independent legal advice to further their statutory obligations.**

DEFINITIONS

Special Counsel and the Department concur with the working group's recommendations regarding the need to refine and/or update certain definitions as found in Chapter 436. Definitions are crucial to the effective enforcement of laws and the Legislature must give the enforcing authorities the tools in which to enforce the law. In general, proper and concise definitions provide clear direction to enforcement agencies in their role of regulating industry or individuals.

LICENSING / REGISTRATION

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE WORKING GROUP'S CONSENSUS RECOMMENDATIONS WITH FURTHER COMMENTS IN BOLD.

The working group agreed to the following consensus recommendations:

- A “license” should be required for all preneed providers/sellers/**agents**. Currently, sellers and providers are “registered” with the Board. A “license” denotes legal obligations and more accurately reflect the authorization being issued by the Board. **Licensing is further an assertion of control over the preneed provider/seller/agent process by the Board. This is especially crucial because the majority of contracts are sold or marketed to older individuals. It is well known that older individuals are more frequently targeted in consumer scams and fraudulent activities. The licensing process helps control the preneed provider/seller/agent pool.**
- Individuals selling preneed for or on behalf of a preneed seller should be licensed by the Board as a preneed agent. As a condition of licensure, preneed agents should successfully pass a Missouri licensing examination. Missouri licensed funeral directors should not be required to take an additional examination.
- To be eligible for licensure/renewal, preneed agents, providers and sellers must be of good moral character, remit a licensing fee and have a high school diploma or the equivalent. Corporation, licensure/renewal requirements should be applicable to each officer, director, manager or controlling shareholder. **In addition, each individual should be subject to a background check and no person should be allowed to hold a license if they have been convicted or found guilty or plead guilty to a crime of violence, a crime involving the violations of a sex crime or a crime of moral turpitude. Again, as most contracts are sold and marketed to older Missourians, it makes sense to ensure the good moral character of those seeking a license.**
- All preneed sellers or providers operating as business entities must be properly registered with the Missouri Secretary of State and authorized to conduct business in the state.
- Chapter 436 should be clarified to exempt endowed care cemetery operators governed by Chapter 214 from the provisions of Chapter 436. However, preneed contracts sold by cemetery operators should be subject to Chapter 436 if the contract includes services that may be lawfully provided only by a licensed funeral director or embalmer.

- Chapter 436 should clearly provide that the provisions of the Chapter are inapplicable to contracts of insurance. However, Chapter 436 should apply to any preneed contract sold in conjunction with insurance. The current statutory language regarding insurance assignments or beneficiary designations is unclear and should be modified in compliance with the recommendation. **The current statutory language causes confusion and, in some cases, problems when insurance contracts are used to fund a preneed contract during Medicaid spend-down.**
- Due to potential costs, preneed licensees should not be required to obtain bonding or any specific insurance. The working group suggested that increasing consumer protections and regulatory oversight would adequately address the need for additional insurance/bonding.

PRENEED CONTRACTS

SPECIAL COUNSEL AND THE DEPARTMENT CONCUR WITH THE RECOMMENDATIONS SUBMITTED BY THE WORKING GROUP

We would note that a standard contract form, as recommended by MFDEA, would help ensure that consumers are protected in the contracting process. Again, given the nature of the age of individuals who are the market group of preneed funeral contracts, more uniformity in the contracting process, will provide greater protection for consumers against fraud, misrepresentation, or deceptive business practices.

PRENEED PROVIDERS

SPECIAL COUNSEL AND THE DEPARTMENT HAVE NO RECOMMENDATIONS OTHER THAN THOSE PROPOSED BY THE WORKING GROUP REPORT.

PRENEED SELLERS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE WORKING GROUP'S RECOMMENDATIONS WITH FURTHER COMMENTS IN BOLD.

The working group adopted the following unanimous recommendations:

- For purposes of licensure, Chapter 436 should be clarified to provide that a preneed trust is not required if the seller is only selling joint-account or insurance-funded preneed plans.
- Preneed sellers should have the option to sell either trust-funded, joint-account funded or an insurance-funded preneed contract. Sellers should notify the Board of the type of contracts to be sold. **Individuals purchasing a trust-funded contract should be advised in writing, and such writing should be conspicuous, that they are purchasing a product that will have money placed in trust.**
- Sellers should report to the **Board** the name and address of its custodian of records and of all providers that have authorized the seller to name the funeral licensee as a provider. The **Board** should be notified by the seller in writing of any amendments or changes.
- The written agreement between the provider and seller should include:
 - Consent from the provider authorizing the seller to designate the funeral licensee as a provider.
 - Procedures for tracking preneed fund payments received by the provider.
- Sellers should maintain “adequate records” of preneed contracts for the duration of the contract and for no less than two (2) years after the final disposition of the beneficiary, cancellation of the contract, or after the facilities, services or merchandise have been provided. **Sellers who sell insurance funded preneed products must deliver a copy of such insurance to the purchaser of the preneed contract. In addition, trust-funded contract funds that utilize insurance as an investment tool, must have actual paper copies of the insurance policy as well as computer records of such insurance policies.**

***Our investigation of NPS/Lincoln Memorial Life Insurance Company revealed that many insurance policies were never generated in a hard copy format and were, instead, merely computer generated entries. This has made the paper trail for the NPS/Lincoln Memorial Life Insurance Company very difficult to follow for some preneed contracts.**

***It is worth noting that “adequate records” might mean different things to the seller, the provider and the Board. The Board should consider adopting regulations clearly identifying the records to be maintained by the parties to the contract and that such rules should be promulgated in the Code of State Regulations, thereby allowing for comment by all affected parties.**

TRUST FUNDED PRENEED PLANS

SPECIAL COUNSEL AND THE DEPARTMENT AGREES WITH THE FOLLOWING RECOMMENDATIONS OF THE WORKING GROUP.

The working group unanimously approved the following recommendations:

Sellers should be required to issue receipts to the purchaser for preneed payments received by the seller.

***This is a prudent requirement that will allow both the seller and the purchaser to track payments and will avoid payment disputes. This requirement further allows the Board to review payments by purchasers as well as deposits by sellers into trust accounts.**

As for the time period into which payment for trust-funded preneed contracts should be deposited into trust, the recommendation that such should occur within sixty (60) days seems too long. **There should be minimal delay in depositing funds of the purchaser into trust upon payment or completion of the sale.**

The percentage of face value that should or should not be allowed for seller expenses was not agreed upon by the working group. Our investigation and at least one current lawsuit revealed that the twenty (20) percent of face value amount, as currently allowed, appears to have been used by NPS to purchase reinsurance. Once the reinsurance money was received, the initial insurance policy was lapsed, leaving the reinsurance provider without a policy to collect upon. Neither Special Counsel nor the Department has taken a position on the appropriate percentage, if any, to be retained by the seller. Last, it appears that current business models of independent preneed sellers are based upon the current 80/20 statutory split. It would be prudent to investigate what the consequence would be to businesses who have operated within the law should there be a change to the percentage of the face value required to be deposited.

REGULATION OF TRUSTS & TRUSTEES

SPECIAL COUNSEL AND THE DEPARTMENT CONCUR WITH THE RECOMMENDATIONS OF THE WORKING GROUP.

(It is unclear if the final recommendation of the working group was changed on this issue. The 9/1/08 draft report indicated a unanimous vote on “conflict of interest” restrictions between the seller and the investment advisor (#10) and prohibition on investment in term life insurance (#15))

CONFLICT OF INTEREST:

In particular, **at no time**, should a trustee have any relationship with the seller of preneed contracts. In the NPS/Lincoln Memorial Life Insurance Company investigation, it appears that the trustee and the seller of the preneed contracts were, in essence, the same entity. The trustee must have clean hands, as they relate to the seller, and should not have any ties to the seller of the preneed contracts. Keeping the trustee and the seller separated makes good public policy and further protects consumers. A separate trustee, unrelated to the seller, has a duty to the trust that will benefit the purchaser, and is not subject to divided loyalties.

Special Counsel and the department reiterate the objections and comments of the department, the State Board, as well as the Missouri Attorney General’s Office. Seller approval of the investment advisor will **only reduce consumer protection**.

The Department of Insurance, Division of Finance, State Board and the Missouri Attorney General’s Office unanimously agree that seller approval of the investment advisor would hinder the independence of the investment advisor and threaten consumer protection. The suggestion proposed would allow the NPS concerns to occur again. Consumers should not, and cannot, be placed at continued risk of unscrupulous business practices. A trustee of a financial institution should be more than capable of selecting an investment advisor that would be adequate for the trust. Seller “approval” is not and should not be required.

INVESTMENT OF FUNDS:

SPECIAL COUNSEL AND THE DEPARTMENT STRONGLY SUPPORT THE FOLLOWING RECOMMENDATION OF THE WORKING GROUP ON THE INVESTMENT OF FUNDS:

- Trustees should be prohibited from investing trust funds in any term life insurance product.

*Trustee should be allowed to invest in insurance products so long as the insurance product is whole life insurance. Whole life insurance is a proven, reliable, and safe investment tool. Since the trustee is to ensure the payment of funeral services, whole life insurance can be a safe and effective tool if properly funded by the trust.

The Department initially disagreed with this position during the working group meetings. On further evaluation of this option, the Department would not be opposed to the purchase of whole life insurance by the trustee as long as there is no relationship of officers of the preneed company and the insurance company.

AT NO TIME SHOULD A TRUSTEE BE ALLOWED TO TAKE A LOAN OUT AGAINST THE PROCEEDS OF THE TRUST. SUCH ACTION NEEDS TO BE SPECIFICALLY OUTLAWED.

***Our investigation of NPS revealed wide scale loan activity against the proceeds of the trust.**

INSURANCE-FUNDED PRENEED PLANS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE WORKING GROUP'S ADOPTED UNANIMOUS RECOMMENDATIONS.

Further, Special Counsel and the department would reiterate that term life insurance should not be allowed to be used as a funding source for preneed contracts, either as insurance funded contracts or trust funded contracts whereby the trustee invests trust money in insurance.

JOINT ACCOUNT-FUNDED PRENEED CONTRACTS

SPECIAL COUNSEL AND THE DEPARTMENT HAVE NO ADDITIONAL RECOMMENDATIONS AS TO THIS SECTION OF THE WORKING GROUP'S RECOMMENDATIONS.

CANCELLATION/PORTABILITY

SPECIAL COUNSEL AND THE DEPARTMENT CONCUR WITH THE WORKING GROUP RECOMMENDATIONS

We would also like to state again our feeling that sellers should remit payment to providers within thirty (30) days after receiving a certificate of performance. Thirty (30) days should be sufficient time in which to remit payments.

This section of the Chapter 436 Working Group's report does not speak to the possibility of reinstatement of contracts. Special Counsel and the department feel this is something that should be considered by the legislators. Because these contracts are purchased by the elderly and the very real threat of dementia and alzheimers disease just to name a few, allowing for a period of reinstatement seems like a reasonable protection.

Reinstatement of a preneed contract should be allowed by **any** legal representative of the purchaser of the preneed contract if the preneed purchaser is not able to respond to the right to cure letter. Again, the law should recognize that the purchasers of preneed contracts are primarily elderly. It is far more likely for elderly individuals to have their affairs taken care of by guardians or agent's acting under a power of attorney. This would provide added consumer protection for the purchaser of a preneed product, especially should that purchaser become incapacitated after purchasing a preneed product.

PAYMENTS TO PROVIDERS

SPECIAL COUNSEL AND THE DEPARTMENT HAVE NO RECOMMENDATIONS AS TO THIS SECTION OF THE WORKING GROUP'S REPORT.

REPORTING REQUIREMENTS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE WORKING GROUP'S RECOMMENDATIONS THAT THE BOARD MUST HAVE ADDITIONAL POWERS TO REGULATE THE INDUSTRY.

To assist the Board in regulation, the working group unanimously recommended expanding the reporting requirements. By increasing the reporting requirements, the Board will have additional powers to regulate the industry. Such powers will strengthen consumer protection and help to avoid a repeat an NPS - like debacle.

CONSUMER REPORTING / NOTIFICATIONS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE RECOMMENDATIONS FOR REPORTING REQUIREMENTS.

In addition, we would like to reinforce that:

- Purchasers should be entitled to an annual report from the seller indicating the amount of funds paid by the purchaser during the reporting year, the name and address of the trustee, and the amount of funds deposited into the trust on behalf of the purchaser.
- Sellers should inform purchasers of a change in trustee within thirty (30) days after the change. Notification should include the name, address and phone number of the old and new trustee.
- Purchasers should be provided a receipt for each payment made by or on behalf of the purchaser. The receipt should be provided by the initial person receiving the payment (i.e.- the seller, provider or the agent).

*The above suggestions are prudent and minimal requirements that will aid in consumer protection. Although one of the comments suggested these requirements will add burdens to preneed sellers and increase costs to consumers, such steps are reasonable consumer protections devices. The benefits of these suggestions outweigh the costs.

Often cost is advanced as an argument against increased regulation. Surely the cost of industry regulation must be considered whenever new regulatory schemes are imposed. However, the cost argument seems to fail in light of the NPS/Lincoln Memorial Life Insurance Company failure. The costs associated with regulation are minimal compared to the costs to be born by the citizens of Missouri when large scale preneed providers/sellers fail, as in the case of NPS/Lincoln Memorial Life Insurance Company.

TERMINATION OF BUSINESS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE WORKING GROUP'S RECOMMENDATIONS.

The Board has experienced significant regulatory difficulty with ensuring that Missouri consumers are adequately protected when preneed providers and sellers cease doing business either voluntarily or involuntarily.

Special Counsel and the department would modify or add to the recommendations as follows:

PRENEED SELLERS:

- The Attorney General should be granted authority to enter the premises and access/take possession of the books and records of any preneed seller who ceases business without notification to the Board.
- This section should be expanded to allow any law enforcement officer, as defined by law, at the direction of the Attorney General, be allowed to enter the premises and access/take possession of the books and records any preneed seller who ceases business without notification to the Board. Further, the preneed seller's license should specifically and conspicuously indicate that this authority is granted to the Attorney General in order to avoid 4th Amendment issues.

PRENEED PROVIDERS:

- The Attorney General should be granted authority to enter the premises and access/take possession of the books and records of any preneed provider who ceases business without notification to the Board.
- This section should be expanded to allow any law enforcement officer, as defined by law, at the direction of the Attorney General, be allowed to enter the premises and access/take possession of the books and records any preneed seller who ceases business without notification to the Board. Further, the preneed provider's license should specifically and conspicuously indicate that this authority is granted to the Attorney General in order to avoid 4th Amendment issues.

AUDITS, INVESTIGATIONS AND EXAMINATIONS

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THE RECOMMENDATIONS OF THE WORKING GROUP.

- In order to enact these recommendations, an increase to the Board's budget should be considered, if the Board is to take on the added responsibilities of auditing. Audits are expensive and time consuming. Without adequate funding, auditing cannot occur. If auditing power is to have any real teeth, the Board will require additional funding by the legislature.
- The mere possibility of an audit can serve as a regulating force not currently available. If preneed sellers know the Board has the funds to conduct audits, they may not actually have to spend those funds to make that oversight component real.

DISCIPLINARY AUTHORITY

SPECIAL COUNSEL AND THE DEPARTMENT AGREE WITH THIS RECOMMENDATION.

The working group unanimously agreed that to effectively regulate Chapter 436, the Board's disciplinary process must be streamlined to allow for a more efficient and effective remedy. This would necessarily include, expanding the current grounds for discipline as well as the disciplinary tools available to the Board.

The suggested legislative change is needed in order to grant the Board effective and efficient disciplinary authority. Currently, the Board does not have any effective means to timely discipline bad actors. Under the current discipline scheme, bad actors may have years in which to appeal any disciplinary action. This scheme does not protect consumers and serves to undermine regulation of the industry. There is language in the current insurance regulation that allows the department to take immediate action when consumer harm is eminent providing for after-the-fact due process.

With expansion of the regulatory and disciplinary authority comes an increase in the need for sufficient funding to allow for the Board to adequately enforce the rules.

ENFORCEMENT AUTHORITY

CRIMINAL AUTHORITY

The working group unanimously recommended the following:

- Knowing and willful violations of Chapter 436 by incompetence, misconduct, gross negligence, fraud, misrepresentation or dishonesty should be deemed Class C felonies. *Comment: Violations are currently Class D felonies.*

SPECIAL COUNSEL COMMENTARY:

- Special Counsel doubts that increasing the range of punishment will deter malicious activity. The change from a D to a C felony means that instead a range of punishment of 1 day to 1 year in the county jail, and 1 year to 4 years in prison, as well as a fine of up to \$5000.00 (D Felony), the punishment would be increased to allow up to 7 years in prison.
- In order to deter criminal activity, it is necessary to conduct investigations into individuals and businesses intent on violating the preneed laws.
- Increasing the range of punishment for violations of Chapter 436 is window dressing and will not alleviate the problems that have occurred. Further, knowing and willful are very onerous *mens rea*, or mental elements of a crime. If the intent is to make criminal prosecution easier, it would make more sense to decrease the mental culpability required for conviction.
- In general, Missouri's criminal code is woefully inadequate and unable to deal with financial or white-collar crime. Further, Missouri's criminal code is in need of serious and substantive review.

FEES

While fees should be increased, and the Board should be allowed to increase fees in order to obtain funds for the purpose of industry regulation, this may not alleviate the need for additional funding by the State. Robust and effective regulatory enforcement requires adequate funding. This is especially true when the regulatory body is charged with the regulation of an industry that is white-collar and sophisticated. Increased fees alone may not give the Board sufficient funds to regulate Chapter 436.

CONCLUSION

Missouri needs to strengthen the laws that cover preneed sellers, agents and providers. The preneed industry is growing as the population ages and individuals seek out the services offered by the preneed industry. As the average consumer of preneed products is elderly, the preneed consumer represents a group subject to fraudulent dealing or misrepresentations. Consumer protection of Missouri's elderly should be of paramount importance to the State.

In addition to consumer protection, large scale debacles in the preneed industry can ripple through the entire State and perhaps across multiple states. Aside from the anxiety which is created in the consumer, economic failure of the preneed industry has the potential to destabilize the entire funeral industry. This is unacceptable as the funeral industry is vitally important to the State.

Regulation of any industry can be costly. The costs are passed to the consumer as well as to the State. However, the current preneed regulatory scheme is insufficient and antiquated. The State Board of Embalmers and Funeral Directors needs additional resources and power to adequately regulate the preneed industry. The recommendations made by the working group, Special Counsel and the department will aid the State Board of Embalmers and Funeral Directors, the department, as well as the Attorney General's Office in their regulatory mission.

While no laws will ever stop individuals intent on malicious activity, proper regulatory authority will deter bad actors and will allow regulatory authorities to investigate, discipline and halt unlawful activity before such activity spirals out of control. At present, the laws regulating the preneed industry are inadequate to deal with the changes that have occurred within the industry since the inception of the preneed statutes in 1982. The recommendations for change will give the Board, the department, and the Attorney General the ability to protect consumers, to conduct robust investigations and take enforcement actions.