

The Floodgates

Dan Isard Argues Against the Guarantee – Again

PRENEED

Imagine you woke one day to find you were a funeral director. Your heart would race because you would not know anything about the funeral business, and you'd really start to worry once you realized that 90 percent of your net worth was tied up in this business and 95 percent of your income came from it.

Now, further imagine how you'd feel after learning that you had personally guaranteed notes to lenders for more than a million dollars. This is not a nightmare; this would be your reality.

To be a successful funeral home owner, you must understand how to run the business. You need to decide what's best for your firm without paying attention to what your parents did or others choose to do.

Together, let's make one decision today – one that deals with preneed. The question you must ask yourself is, "Do I guarantee that I will accept

the value of the account as payment in full when a consumer dies?"

As a now elder statesman of this business, let me tell you that in 1984 when I first heard the word "preneed," I did not know what it was, or if it was one word, two words, or a hyphenated phrase. So, I studied it. Frankly, after having written a 500-page book about the subject, I can tell you that preneed is a simple concept. Preneed is nothing more than knowing that your lifetime is limited and planning a ceremonial event to mark your death.

Somewhere along the way, a bunch of people got together and took this simple concept and made it complex by saying, "Do you want to prepay for the services and merchandise?" If I answer in the negative, there is nothing more to deal with. The preneed idea has remained simple.

However, if I say, "Gee that sounds like a snazzy idea," I'm opening the floodgates for numerous questions, which are dictated by state law and federal tax law. Now, in order to make decisions as a consumer I need guidance from my



When I debate this concept I hear, "Dan, you don't understand, the consumer *wants* the guarantee!" Yes, the consumer might. I would love to have my car dealer guarantee my trade-in value and the future resale price of a new car. Consumers *like* guarantees. Who doesn't? The question is, "Can you afford to grant that guarantee?"

funeral director as well as a lawyer, accountant and financial adviser from a bank or insurance company.

Likewise, if a funeral home is looking out for its best interest, it is going to need an economist, product experts, financial specialists, accountants, lawyers in consumer affairs and financial services, an actuary and marketing experts. When a meeting takes place and it cannot be held in a Volkswagen, you know it is a complex matter.

The preneed is not the problem; the funding is the start of the problem. And it's the guarantee that is the most difficult problem, which I focused on in a 1986 article. I tried to highlight back then that the problem with the guarantee is that funeral home owners must balance three things that are totally out of their control. Funeral managers must balance:

1. The inflationary cost of providing services and merchandise.
2. The return on the money being held to provide for the funeral.
3. The length of time that this matter needs to be managed.

The inflationary cost of providing merchandise is a problem. For example, a casket that you would have bought in 2013 has gone up in price for delivery in 2014. That increase is about 5 percent. Did your preneed funds increase that much between 2013 and 2014? No, they did not. I don't care whether we are talking about caskets, vaults or other merchandise – we have a shortfall.

The inflationary cost of providing services is a problem. Most funeral home managers raise prices on service fees in January. However, they do not raise them by the proper amount. Many hear a blurb about the Consumer Price Index, and they raise their prices by this same amount. That is like me looking at a parked car and using its speedometer as an indicator of my speed in a moving auto.

CPI covers so many things that a funeral home does not deal with. We

do not sell lamb chops or other groceries. While the inflationary effect upon the price of automobiles and health insurance are factors in the CPI, when a business has these expenses it is at a far greater number. For example, if the price of cars goes up 2 percent, CPI factors in one car, yet the typical funeral home has four or more cars. If health insurance goes up 5 percent, CPI factors that as one policy, but a funeral home might have five or more people covered. These additional users compound the costs.

I have studied the inflation rate of funeral homes going back almost four decades. In almost every case the funeral service inflation rate is about 100 percent or more that of CPI. So, when you factor the

stated that there was no way with a 10 percent money market return that preneed *could ever* have shortfalls. History is a cruel judge and in this case, I was right and Bob was wrong.

The length of time from the time of the contract until the time of the consumer's death is a major factor in dealing with the problems associated with the preneed guarantee. For example, there are four types of funding:

- i) Insurance single payment
- ii) Insurance installment payment
- iii) Trust single payment
- iv) Trust installment payment

Trust installment payments are extremely rare, but they do exist. However, we have learned a great deal about the single payment versus the installment payment.

Single Payment		Installment Payment
78	Average Age at Issue	72
20%	Mortality in Year 1 and 2	10%
8 years	First 50% Mortality Reached	15 years
13 years	Average Span for Second 50% Mortality	13 years

increasing costs of service and the increasing cost of products, there is no way that the compounding effect of invested money can keep up.

Today we are in a low interest rate environment. Most preneed trusts are netting about 2 percent, and most preneed insurance companies are crediting a 2 percent return on their death benefit. But this is not just a 2014 issue. In 1986, when I had that article published on preneed, Robert Ninker, then the executive director of the Illinois Funeral Directors Association, wrote a letter to the editor. He strongly disagreed with my conclusion that we were going to have huge preneed shortfalls. He

We know that people buy single payment at an older age than installment payment. We know that single payment has a 20 percent first two-year mortality and installment payment about half of that. We know that 50 percent of those paying a single payment will have died within eight years, and those that do not die in the first 50 percent, will die within nine to 21 years. Contrast that to installment payment who have a 50 percent mortality in about 15 years, and those that do not die within the first 15 years will die between years 16 to 28.

How are you supposed to guarantee that you can invest your

money at a rate equal to the costs within and outside of your control for 21 to 28 years?

So, back to my premise of your awakening into this business: Someone comes to you and says, "Do we want to guarantee our preneeds?" What would you say? I think you would reach the same conclusion I reached in 1986 and say, "No."

When I debate this concept I hear, "Dan, you don't understand, the consumer *wants* the guarantee!" Yes, the consumer might. I would love to have my car dealer guarantee my trade-in value and the future resale price of a new car. Consumers *like* guarantees. Who doesn't? The question is, "Can you afford to grant that guarantee?"

If consumers want a guarantee, then let us ask them to pay for it. If a funeral is \$5,000 and it is not a guaranteed preneed, let the consumer

put aside an amount of money that both sides feel should be sufficient to provide that coverage. Several years ago I wrote an article on how to do that. It was based upon simple math but if someone wants this protection, you can allow him or her to pay a premium for that – as long as your state allows it.

You may even be afraid to risk the entire dialogue on the guarantee. So, let's present preneed so that the consumer doesn't want the guarantee. Train your preneed people properly. When they get ready to write the preneed, let them ask one additional question, "If there is an excess amount in your account when your death occurs, do you want this excess to go to your family or to the funeral home?" Most people will answer, "My family." Then the counselor says, "OK, that is called our final expense preneed contract. If there is an excess, it will go to your

family. If there is a shortfall, your family can either make up the slight difference or purchase fewer flowers or make other slight changes to merchandise. That's fair enough, isn't it?" We think this will eliminate the problem.

If the guarantee does not exist, then it doesn't matter whether we use trust or insurance. It does not matter what means of trust taxation we choose. It does not matter if someone pays in installments or by lump sum. Whoever started the guarantee should be remembered for taking a simple matter and making it complicated.

Start your year off right, and change the way you handle the preneed guarantee. If your state law mandates a guarantee, then seek to change the law. There is no guarantee of a return on state run lotteries so why should there be on preneed policies? •



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