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ICCFA Magazine author spotlight

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How can you stop losing money on preneed contracts? Just look at the numbers, and you'll see that the answer is simple, though it's one some funeral directors don't want to hear.

Why and how to sell preneed products without a price guarantee

In 1984, I learned about preneed. I had a decade in the financial services world selling insurance. Some of the policies I started selling were "final expense" policies. So when I learned there was a funeral preneed and it could be funded by insurance or a trust, I felt like I was at home in this profession. What I couldn't get my head around was the "guarantee."

I spoke to many preneed selling clients and learned all the reasons they gave for giving the guarantee. Remember, this was 1984. Let me remind you what the financial world was like in 1984:

- The average casketed funeral cost about $2,517 (according to Federated Funeral Directors of America).
- The average profit per funeral was 11.17 percent.
- By my estimate, about 10 percent of all funerals were paid for by prearranged contracts.
- The FTC was requiring, under The Funeral Rule, itemized pricing of goods and services.
- By my estimate, about 65 percent of all deposits for funeral preneeds were placed into a state or privately managed trust.
- A new investment called money market accounts was flourishing and the average yield on these accounts was above 11.5 percent.

In 1984, the Orwellian year, there was no way to lose money on servicing preneed. The guarantee was a no-brainer. Or was it as simple as that?

The problem of decreasing profits is not a new one

No, it was not as simple as that. It was not simple because as yields rise on bonds/certificates, the cost of money goes up. As the cost of money goes up, the cost of goods and services increases. This inflationary cycle causes business overhead to increase.

The cost of caskets went up in 1984 and 1985 by about 5.26 percent and 5.84 percent, respectively. The cost of overhead went up about 6 percent each year. While consumers increased their spending by about 6.31 percent, the overhead and merchandise costs increased more than consumer spending, therefore profit went down about 0.21 percent in 1984 and again in 1985 by another 0.82 percent.

So consumers were spending more, preneed trusts were going up about 10 percent per year, but I saw profits decreasing, year after year.

I wrote my second article for the funeral service profession explaining this observation and, of course, someone much wiser than I wrote a letter to the editor. This wise man explained that I was wrong. He said that no one would ever suffer a loss on a preneed contract. The 10 percent yield on money market accounts would last forever, and was far greater than any alleged inflation.

That writer went on to be the executive director of a state funeral directors association, and under his supervision his state lost more than $300 million in its preneed trust. I guess I was right and he was very wrong.

Shortly after 1984, I started to track funeral service inflation rates. I went back to 1980 and tracked the profit versus overhead. I compared it to the consumer price index (CPI). I have found that in the 34 years from 1980 to 2013, in only one year was CPI equal to or greater than funeral service inflation (FSI). Most years, FSI was double CPI.

For the last few years, I have studied FSI two ways: casketed and non-casketed services. Casketed services are what I have studied all the way back to 1980. I've only been examining non-casketed services since 2000.

When we take the casket and other merchandise risk out of the equation, the

I have found that in the 34 years from 1980 to 2013, in only one year was CPI equal to or greater than funeral service inflation (FSI). Most years, FSI was double CPI.

FSI rate goes down dramatically. This is because most funeral directors are very good at controlling their own costs, including salaries, utilities, etc. But the cost of items purchased from suppliers is totally out of the control of funeral directors.

Funeral accounting packages have added a new line item, "preneed shortfalls." This is the difference between at-need pricing and payments made preneed.

There are only two types of funeral homes:

1. Those that *have had* preneed losses and

2. Those that *will have* preneed losses.

So you must ask yourself how you can protect your firm against preneed losses. The answer is simple: You can only get rid of preneed losses if you get rid of the preneed guarantee.

Even today, though we have a very low-interest crediting rate and we have a low inflation rate, we still have preneed losses. If you use insurance, some people will tell you to add the commission to the crediting rate and see your gain, but that is akin to saying, "Death isn't that bad; after all, it was Patrick Henry's second choice!" The guarantee is the problem.

What to say to sell preneed without a price guarantee

But can you do away with the price guarantee and still sell preneed? Yes, it can be done. Just retrain your preneed salespeople. Train them to interject one final question as they are getting the application filled out. Train them to say:

"Mr. Consumer, I have two ways I can set up this preneed fund. To determine which way you desire it to be set up, I need to ask you one last question. The question is, if there is an overage in the account when your death occurs, do you want this excess to go to your family or to the funeral home?" Then wait.

Invariably, the consumer will say, "I want the excess to go back to my family!"

The salesperson's reply: "That's fine; this is called a non-guaranteed preneed. If there is excess, it will go to your family. If there is a shortfall, your family can make up the difference or choose to spend less on flowers or buy a less expensive casket."

Then your salesperson starts filling in the forms.

There are a few states that have require funeral preneed contracts to be guaranteed. If you are reading this article in one of those states, work with your state association to get that law changed—it's a terrible law.

If you must guarantee, you should be keeping the excess. You can't run a casino—or any other business—without the gains offsetting the losses. Insurance companies don't have a gain on each policy they issue, but they do have gains in the aggregate.

If you can't organize your state to change the law, then I recommend you overfund trusts, setting them up so there is an excess. For example, if a funeral would cost $7,500 today, get the consumer to fund it at $9,000. The excess after at-need cost—if there is any—would presumably go to the deceased's estate.

The risks of not changing the way you sell preneed

The key is this: You cannot afford to take the risk involved in guaranteed preneed contracts. And there are many risks, including:

1. The risk caused by not knowing what interest rates will be. The risk that the yield on investments will be less than FSI. Even if you fund via insurance, the risk is the same, as insurance companies invest their money (including the money they get from you) in the financial markets.

2. The risk of inflation. As we study funeral service inflation, we see that it is a problem every year, and the only way to hedge the difference between the inflation rate and the interest rate is to shrink profit.

3. The risk of changing mortality rates. We see people living longer. The longer someone lives after signing a preneed contract, the longer you are subjected to the risks of inflation and interest rates. This is the compounding factor of the price guarantee.

The bottom line: If you want to be profitable in preneed servicing, you have to get rid of the guarantee. ❒