FINANCE 301

BY DANIEL M. ISARD

My Knowledge Transfer Plan

Chapter 3: A Preneed Game Plan

In last month's column, I outlined the questions you must address for preneed to serve as a positive part of your business and planning. As noted at the end of that article, I intend to answer those many questions in this month's article, so please, read on.

Today, between 20% and 30% of the average funeral home's annual calls originate from preneed. Now, if you thought that one person in your community would account for 20% to 30% of all your calls in a given year, would you be cavalier about the financial status of this person? Of course not. You would want to know their net worth, their ability to pay in the future, etc.

The concept of preneed involves getting consumers to make advance directives, thereby informing their loved ones and the funeral home of the services and merchandise they want. *You* play a key role in that consumer's plan. In fact, when I've spoken with consumers about their prearrangements, most of the conversations have focused on the phone call they make to their kids immediately after setting the plan in place. They inform them, "I just met with the funeral director, and everything is taken care of." From there, the kids either ask follow-up questions or treat the subject matter as an uncomfortable moment in time. Regardless, they remember, "Everything is taken care of."

But often only a small part of the plan has been taken care of. Thus, you must make sure you are equipped to make the plan executable. The decisions you make on the following 12 questions will impact how effectively you will be able to fulfill consumers' prearrangement choices.

1. Are we funding the money up front or not? Funding makes the preneed contract easily executable. If the consumer pays for your services, then you can make promises of delivery. But, as pointed out last month, funding also increases the probability that someone (either the consumer or the funeral home) will encounter a problem.

Therefore, be careful. While you can control some issues affecting overhead for your services, you have no control over matters of merchandise. Unless required by state law, do not build cash advances into a preneed contract. And if you are required by state law to do so, please work to change that law.

> **You must make the preneed plan executable. The decisions you make on these 12 questions will impact how effectively you will be able to fulfill consumers' prearrangement choices.**

2. If we are funding, are we paying a lump sum or over time? Lump-sum funding is best for you, the provider. You need to know that the money is in place because the kids think, "Everything is taken care of." Even the cemetery is adversely affected if the cemetery choices are not funded. Many cemeteries will accept payment for the interment rights and merchandise, for instance, but will not accept payment for opening/closing costs. Yet when the preneed contracts go at-need and the kids want a funeral, *you* will be the one who must tell them that more money must be paid (and even more if they want a weekend interment).

To effectively fulfill your preneed contracts in the future, there must be more than just a funding account and a goods and services agreement. There must be something that links the two and spells out the exceptions or the unfunded issues. You don't want to get caught up in a conflict between the kids' memory or expectations and the actual preneed goods and services selected and funded.

3. If we are funding, is the provider going to take the money now and put it in trust or invest it via an insurance company? Insurance is the best financial tool for families wanting to pay over time because it is self-completing (assuming there is no underwriting).

For those who want to pay a lump sum, a properly managed trust with competitive fees will generally provide more money due to compounding than a single-pay insurance policy, in my experience.

4. If we are funding and putting the money in a trust, are we putting all the money in a trust or just some of it? Lump sum is easiest for single deposit, and most preneed accounts are lump sum funded. Again, lump-sum accounts should be trusted, while installment-funded accounts should use insurance.

5. If we are funding and putting the money in a trust, how are we investing the money while it's in the trust? You aren't! You are a funeral director, so hire a professional who knows preneed. Set reasonable goals. Don't play the market. Be patient.

6. If we are funding and putting the money in a trust, who will be taxed on the earnings – the consumer, the trust or someone else? The taxation of earnings can be at the individual level or at the trust level. Personally, I like the individual tax level because roughly 2-in-3 preneed consumers do not have a tax bill due because they have too little taxable income. If you have the trust pay the tax, however, that depletes the assets you have working for you, which ultimately impacts the ability to pay your bill and that of other parties upon the consumer's death.

7. If we are funding and putting the money in insurance, and a license is required to sell insurance to consumers, who will be the salesperson and what licensure do they need to sell a prefunded arrangement? When possible, hire a third party to sell insurance and let funeral directors be funeral directors. By the way, a walk-in is an unsolicited sale that should go to the insurance agent. The funeral director did nothing to make that sale occur, and you are already paying the funeral director a salary to be on duty. You don't pay a commission on at-need arrangements, do you?

8. If we are using insurance, which insurance company should we choose? This is a complex question, but there are two key components. The first involves the "operating criteria," of which the most important factor is the rate of growth on the insurance face amount. Many people think the commission rate is the most important factor here, but it is not.

Marketing and sales support make up another operating criterion, but what good is hiring someone to sell a lot of preneed for you if the death benefit doesn't rise and you are left servicing preneed contracts that are less than fully funded?

The second key component involves "company stability." During my career, I have seen many preneed insurance companies leave the preneed space, some by choice and some due to financial failure. When selecting an insurance company, there are several key indicators to look at, including:

a) *Capital and surplus ratio,* which is the margin for error for an insurer

b) *Operating profit,* which is the degree to which the insurer is profitable

c) *Return on investment,* which is either the interest earnings or the total return (the face amount of the investment plus interest)

d) *New business issued,* which shows if the company is successful in writing new business. You don't want a company that lives off its past successes.

9. If someone is funding, do we lock in today's price regardless of the costs when someone dies, or do prices continue to change over time? I hate offering to guarantee prices and have never understood it. A guarantee is a consumer benefit, and most consumer benefits involve a cost. I suggest charging a premium if someone wants or needs a guarantee.

You can control some issues involving overhead for your services but not matters of merchandise. Unless required by state law, do not build cash advances into a preneed contract. If you are required to do so, please work to change that law.

10. If we lock in prices and the funds are more than the total cost, who gets the excess? This is the crux of the answer to #9. If you take the risk and there is excess, then you should retain the excess to cover those times when there is a shortage. In the long run, though, the excesses you retain will not be greater than the shortfalls. There will always be more shortfalls.

If the decedent qualified for Supplemental Security Income (SSI), however, any excess should go to the state of domicile, not to the family. The preneed consumer was technically "a ward of the state."

11. If a consumer makes a preneed arrangement while living in one state but wants to move to another, is the account transferable? Many people live in the North but retire and then die in the South. Because most of them will not be repatriated to the place where they spent most of their lives, those preneed accounts might either go "unused" or need to be transferred to the servicing funeral home. Because of the state law where that preneed contract originated, however, it's possible that not all the prefunded monies will be transferred to the servicing firm. Personally, I suspect this issue will eventually trigger some sort of federal preneed regulation.

12. If the preneed arrangement is funded, does this affect the consumer's ability to qualify for Supplemental Security Income? Each state sets a threshold on the amount of assets a person seeking to qualify for SSI can set aside in a preneed account; some allow depositing more into a preneed account than others. Similarly, some states require a longer transfer time before an individual can qualify for SSI. You should know your state's requirements.

Preneed is not an easy subject. It blends economics, actuarial sciences, investing, marketing and sales. It is confusing. During my career, I have rarely seen a funeral home handle it properly.

Dan Isard is founder of The Foresight Companies, which has served thousands of funeral homes nationwide for the past four decades. The articles in this series can be found on the Insights section of theforesightcompanies.com. *Contact Isard at 602-274-6464 or danisard@theforesightcompanies.com.*

Financial, legal or tax advice contained in this article is for informational purposes only and is neither a legal interpretation nor a statement of NFDA policy and may or may not apply to your individual position. Readers are strongly encouraged to seek the counsel of qualified advisors before undertaking any action based on this information. Reference to any specific product or entity does not constitute an endorsement or recommendation by NFDA. The views expressed by authors are their own, do not necessarily reflect the views of NFDA and do not imply an endorsement of them or any products or entities mentioned or represented.