

SUNSET EVALUATION REPORT
CEMETERIES, MORTUARIES, PRE-NEED
FUNERAL AUTHORITIES AND SALESMEN
Chapter 441, Hawaii Revised Statutes

A Report to the Governor and the Legislature of the State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii

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FOREWORD

Under the "sunset law," licensing boards and commissions and regulated programs are terminated at specified times unless they are reestablished by the Legislature. Nationally, the first sunset law was passed in 1976. Within three years, 30 more states had enacted similar legislation. The rapid spread of sunset legislation reflects increasing public concern with what it sees as unwarranted government interference in everyday activities.

Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, terminated 38 occupational licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of cemeteries, mortuaries, pre-need funeral authorities and salesmen under Chapter 441, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate cemeteries, mortuaries, pre-need funeral authorities and salesmen to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed.

Our approach to the evaluation of the regulation of cemeteries, mortuaries, pre-need funeral authorities and salesmen is described in Chapter 1 of this report under "Framework for Evaluation." That framework will also serve as the framework for conducting subsequent evaluations. We used the policies enunciated by the Legislature in the Sunset Law to develop our framework for evaluation. The first and basic test we applied was whether there existed an identifiable potential danger to public health, safety, or welfare arising from the conduct of the occupation or profession being regulated. Then the other criteria for evaluation were applied.

We acknowledge the cooperation and assistance extended to our staff by the Department of Regulatory Agencies and other officials contacted during the course of our examination.

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February 1981

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Chapter 1

INTRODUCTION

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 state licensing boards and commissions over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. In 1980, the Legislature further amended the law to require the Legislative Auditor to evaluate the effectiveness and efficiency of the licensing program, even if he determines that the program should not be reenacted.

Objective of the Evaluation

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 441.

Scope of the Evaluation

This report examines the history of the statute on licensing of cemeteries, mortuaries, pre-need authorities and salesmen and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

Organization of the Report

This report consists of three chapters: Chapter 1, this introduction and the framework developed for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendation.

Framework for Evaluation

Hawaii's Regulatory Licensing Reform Act of 1977, or Sunset Law, reflects rising public antipathy toward what is seen as unwarranted government interference in citizens' lives. The Sunset Law sets up a timetable terminating various occupational licensing boards. Unless reestablished, the boards disappear or "sunset" at a prescribed moment in time.

In the Sunset Law, the Legislature established policies on the regulation of professions and vocations. The law requires that each occupational licensing program be assessed against these policies in determining whether the program should be reestablished or permitted to expire as scheduled. These policies, as amended in 1980, are:

1. The regulation and licensing of professions and vocations by the State shall be undertaken only where reasonably necessary to protect the health, safety, or welfare of consumers of the services; the purpose of regulation shall be the protection of the public welfare and not that of the regulated profession or vocation.

2. Where regulation of professions and vocations is reasonably necessary to protect consumers, government regulation in the form of full licensure or other restrictions on the professions or vocations should be retained or adopted.

3. Professional and vocational regulation shall be imposed where necessary to protect consumers who, because of a variety of circumstances, may be at a disadvantage in choosing or relying on the provider of the services.

4. Evidence of abuses by providers of the services shall be accorded great weight in determining whether government regulation is desirable.

5. Professional and vocational regulation which artificially increases the costs of goods and services to the consumer should be avoided.

6. Professional and vocational regulation should be eliminated where its benefits to consumers are outweighed by its costs to taxpayers.

7. Regulation shall not unreasonably restrict entry into professions and vocations by all qualified persons.

We translated these policy statements into the following framework for evaluating the continuing need for the various occupational licensing statutes.

Licensing of an occupation or profession is warranted if:

1. There exists an identifiable potential danger to public health, safety, or welfare arising from the operation or conduct of the occupation or profession.
2. The public that is likely to be harmed is the consuming public.
3. The potential harm is not one against which the public can reasonably be expected to protect itself.
4. There is a reasonable relationship between licensing and protection of the public from potential harm.
5. Licensing is superior to other optional ways of restricting the profession or vocation to protect the public from the potential harm.
6. The benefits of licensing outweigh its costs.

The potential harm. For each regulatory program under review, the initial task is to identify the purpose of regulation and the dangers from which the public is intended to be protected.

Not all potential dangers warrant the exercise of the State's licensing powers. The exercise of such powers is justified only when the potential harm is to public health, safety, or welfare. "Health" and "safety" are fairly well understood. "Welfare" means well-being in any respect and includes physical, social, and economic well-being.

This policy that the potential danger be to the public health, safety, or welfare is a restatement of general case law. As a general rule, a state may exercise its police power and impose occupational licensing requirements only if such requirements tend to promote the public health, safety, or welfare. Under particular fact situations and statutory enactments, courts have held that licensing requirements for paperhangers, housepainters, operators of public dancing schools, florists, and private land surveyors could not be justified.¹ In Hawaii, the State Supreme Court in 1935 ruled that legislation requiring photographers to be licensed bore no reasonable relationship to public health, safety, or welfare and constituted an unconstitutional encroachment on the right of individuals to pursue an innocent profession.² The court held that mere interest in

1. See discussion in 51 *American Jurisprudence*, 2d., "Licenses and Permits", Sec. 14.

2. *Terr. v. Fritz Kraft*, 33 Haw. 397.

maintaining honesty in the practice of photography or in ensuring quality in professional photography did not justify the use of the State's licensing powers.

The public. The Sunset Law states that for the exercise of the State's licensing powers to be justified, not only must there be some potential harm to public health, safety, or welfare, but also the potential harm must be to the health, safety, or welfare of that segment of the public consisting mainly of consumers of the services rendered by the regulated occupation or profession. The law makes it clear that the focus of protection should be the consuming public and not the regulated occupation or profession itself.

Consumers are all those who may be affected by the services rendered by the regulated occupation or profession. Consumers are not restricted to those who purchase the services directly. The provider of services may have a direct contractual relationship with a third party and not with the consumer, but the criterion set forth here may be met if the provider's services ultimately flow to and adversely affect the consumer. For example, the services of an automobile mechanic working for a garage or for a U-drive establishment flow directly to his employer, but his workmanship ultimately affects the consumer who brings a car in to his employer for repairs or who rents a car from his employer. If all other criteria set forth in the framework are met, the potential danger of poor workmanship to the consuming public *may* qualify an auto mechanic licensing statute for reenactment or continuance.

Consumer disadvantage. The consuming public does not require the protection afforded by the exercise of the State's licensing powers if the potential harm is one from which the consumers can reasonably be expected adequately to protect themselves. Consumers are expected to be able to protect themselves unless they are at a disadvantage in selecting or dealing with the provider of services.

Consumer disadvantage can arise from a variety of circumstances. It may result from a characteristic of the consumer or from the nature of the occupation or profession being regulated. Age is an example of consumer characteristic which may cause the consumer to be at a disadvantage. Highly technical and complex nature of the occupation is an illustration of occupational character that may result in the consumer being at a disadvantage. Medicine and law fit into the latter illustration. Medicine and law were the first occupations to be licensed on the theory that the general public lacked sufficient knowledge about medicine and law to enable them to make judgments about the relative competencies of doctors and lawyers and about the quality of services provided them by the doctors and lawyers of their choice.

However, unless otherwise indicated, consumers are generally assumed to be knowledgeable and able to make rational choices and to assess the quality of services being provided them.

Relationship between licensing and protection. Occupational licensing cannot be justified unless it reasonably protects the consumers from the identified potential harm. If the potential harm to the consumer is physical injury arising from possible lack of competence on the part of the provider of service, the licensing requirement must ensure the competence of the provider. If, on the other hand, the potential harm is the likelihood of fraud, the licensing requirements must be such as to minimize the opportunities for fraud.

Alternatives. Depending on the harm to be protected against, licensing may not be the most suitable form of protection for the consumers. Rather than licensing, the prohibition of certain business practices, governmental inspection, or the inclusion of the occupation within some other existing business regulatory statute may be preferable, appropriate, or more effective in providing protection to the consumers. Increasing the powers, duties, or role of the consumer protector is another possibility. For some programs, a nonregulatory approach may be appropriate, such as consumer education.

Benefit-costs. Even when all other criteria set forth in this framework are met, the exercise of the State's licensing powers may not be justified if the costs of doing so outweigh the benefits to be gained from such exercise of power. The term, "costs," in this regard means more than direct money outlays or expenditure for a licensing program. "Costs" includes opportunity costs or all real resources used up by the licensing program; it includes indirect, spillover, and secondary costs. Thus, the Sunset Law asserts that regulation which artificially increases the costs of goods and services to the consumer should be avoided; and regulation should not unreasonably restrict entry into professions and vocations by all qualified persons.

Chapter 2

BACKGROUND

Chapter 441, Hawaii Revised Statutes, regulates cemeteries, mortuaries, preneed funeral authorities, and salespersons of cemetery plots, preneed interment or funeral services. The regulation of the funeral industry has occurred in phases. Cemeteries and cemetery salespersons were first to be regulated in 1967. Preneed funeral authorities and their salespersons came under regulation in 1969, and mortuaries were added in 1975.

Cemeteries

Act 199 in 1967 required cemeteries¹ and cemetery salespersons to be licensed. According to news articles in 1967 there had been considerable fraud and misrepresentation in sales of cemetery plots and niches by newly established commercial cemeteries in the Islands. Testimony was presented to a legislative committee regarding the "mismanagement and misappropriation of consumers' money," and the committee expressed concern that "fly by night" enterprises may sell fake burial plots then leave the State.²

Act 199 established a cemetery board to license both cemetery firms and salespersons. The board was given authority to make rules "for the protection of the general public in its acquisitions of cemetery property." It set licensing requirements which included bonds running to the State for consumer claims. It mandated the establishment of a perpetual care fund by each cemetery and specified the minimum amounts of each sale to be deposited into the fund to finance the maintenance of the cemetery. Each cemetery authority is required to dedicate its property to cemetery purposes, and file a copy of this dedication, maps and plats of property, and county approval of the cemetery with the Bureau of Conveyances or the Land Court. The law specifies conditions under which encumbered property may be sold and reserves to the authorities the right to encumber property.

1. In 1968, the law was amended to exempt cemeteries operated by churches, private fraternal or charitable associations which were not actively selling cemetery plots for profit from the bond and license fee requirements.

2. Standing Committee Report No. 458, Committee on Housing and Consumer Protection, 1967 General Session.

Preneed Funeral Authorities

In 1969, by Act 242, the Legislature amended the chapter to include regulation of preneed funeral sales and interment space sales and to mandate trust funds for sales income because “[t]here have been instances of abuse and misuse of funds”³

Persons arranging and paying for funeral or burial services and commodities in advance of death (that is, preneed purchases) are disadvantaged for several reasons. *First*, business transactions with payments made to a merchant for goods and services to be provided at an indefinite time in the future are susceptible to abuses. The prepaid funds collected by the seller may not be sufficient to pay for the products and services at the time of death. The customer also has no way of making certain that the seller will not misappropriate or mismanage the funds. *Second*, customers can be misled by salesperson’s representations regarding the terms of the contract. Sales contracts are detailed and difficult to understand, leaving the customers to rely on verbal representations of salespersons. This places such groups as the elderly and non-English-speaking customers in a vulnerable position.

Mortuaries

Mortuaries became subject to the licensing statute in 1975 to “[h]elp protect the general public in its acquisition of at-need funeral services.”⁴ The public is at a disadvantage when purchasing funeral services and commodities at the time of need. The customer is usually under extreme pressures of sorrow and time and is not familiar with funeral arrangements and prices. People making funeral arrangements have little knowledge of what is necessary, what the alternatives are, or what are reasonable prices. Arrangements must be made immediately and there is little time or inclination to shop around. Such conditions make the customer especially vulnerable to possible economic exploitation.

Act 23 enacted in 1980 requires mortuaries to provide itemized price lists and written estimates to prospective purchasers and prohibits mortuaries from charging more than the written and signed estimate unless the customer requests an additional item and

3. Standing Committee Report No. 940, Senate Committee on Consumer Protection and Criminal Code Revisions, 1969 Regular Session.

4. Standing Committee Report No. 88, Senate Committee on Judiciary, 1975 Regular Session.

approves the higher price. According to a committee report,⁵ mandatory disclosure of prices would give the consumer a better opportunity to make an informed choice at a time when the person may be too grief stricken to ask for a price list or itemized cost.

Trust Funds

Cemeteries and sellers of preneed funeral plans must establish trust funds. With regard to cemeteries, every cemetery is required to establish a perpetual care fund to finance the continued maintenance and care of the cemetery. With regard to preneed funeral plans and preneed interment services, a preneed trust must be established for the portion of a contract sales price which is to be applied to claims for cemetery or funeral expenses at a future date.

The trusts may be administered by a nonprofit corporation, a trust company authorized to do business in the State, or a board of trustees appointed by the governing body of the cemetery or preneed funeral authority. In the case of a nonprofit corporation or board of trustees, a majority of the members are prohibited from being affiliated with the organization which creates the fund. The administrator of the fund is not required to inquire into the propriety of expenditures made by the cemetery or preneed funeral authority and cannot be held responsible for payments made to the authority based upon vouchers submitted by the authority. Any administrator of the fund, other than a trust company, is subject to inspection, supervision, and regulation by the Cemetery and Mortuary board, and the administrator is required to annually file an account with the board.

Investment of the monies in the funds are governed by the standards set forth for trust companies acting as fiduciaries. This means that the trust administrator “[m]ay acquire and retain every kind of property, real, personal, or mixed and every kind of investment”⁶ The instrument creating the trust may reserve to the cemetery or preneed funeral authority the right to approve investments.

Statutory provisions relating specifically to each type of fund are described below.

5. Standing Committee Report No. 568-80, Senate Committee on Consumer Protection and Commerce, 1980 Regular Session.

6. Sections 441-41 and 406-22, HRS.

Perpetual care fund. The law specifies minimum amounts for deposit in a perpetual care fund: \$1 per square foot of interment space, \$50 for each mausoleum crypt, and \$15 for each niche.

A cemetery authority is required to transfer the amount due to the perpetual care fund no later than 30 days after receipt of the final payment of the purchase price. The principal of the fund is required to be invested and cannot be reduced. Only so much of the earnings of the fund as can be reasonably be shown to be necessary are to be paid to cover the costs of perpetual care of the cemetery and reasonable administrative costs. A reserve can be created to take care of principal losses and future maintenance, repair, or restoration of property. Any surplus income or net gain from investments not set aside in reserve becomes a part of the principal of the fund.

Preneed trusts. For preneed trusts the law permits the seller's retention of the lesser of 30 percent of the contract price or the difference between the contract price and the cost of preneed interment or preneed services. The balance of the contract price is required to be deposited into the trust within 30 days of receipt. The principal of the preneed trust funds cannot be diminished or withdrawn except in payment for the services contracted, or for refund to the purchaser. The statute is silent regarding the disposition of the net earnings of the trust fund.

The Board and Licensing Requirements

The board. A cemetery and mortuary board is authorized to examine applicants; grant, suspend, or revoke licenses; and to establish and enforce rules and regulations.

The board is composed of seven persons—three public members and four industry representatives. Two must be cemetery administrators for no less than three years prior to their appointment, and two must be mortuary administrators for not less than three years. Among the industry members, no two can be associated with the same cemetery or mortuary. The board is placed in the Department of Regulatory Agencies for administrative purposes.

The licensing requirements. Mortuaries, cemeteries, and preneed funeral authorities must meet the following standards to conduct business in the State: (1) have a good reputation for honesty, financial integrity, and fair dealing; (2) be a religious institution, corporation, county, or any association with a "perpetual existence"; and (3) post a bond running to the State for \$50,000 if the gross income of the business for the previous year was \$50,000 or more, and \$5,000 if the income was less than \$50,000.

An applicant for a salesperson's license must: (1) be of good character; (2) have a reputation for honesty, truthfulness, and fair dealing; (3) be at least 18 years of age; and (4) post a \$5000 bond.

Copies of sales contracts, brochures, etc. The board's rules require the submission to the board of copies of sales contracts, brochures, rules and regulations of the organization, and detailed descriptions of merchandise and services with pictures and current price lists for products.

Grounds for revocation, suspension, and refusal to renew licenses. The board may discipline cemetery, mortuary, or preneed authority licensees for certain dishonest and fraudulent business practices, including misrepresentations, selling or offering to sell property or services based on speculation and promise of profit from resale, and comingling money or property of others with the licensee's own money or property.

The basis for disciplinary action against salespersons are similar to those for the businesses, but include, in addition, a prohibition on representing an authority other than the person's employer and failure to file the name of the authority by whom the person is employed.

Chapter 3

EVALUATION OF THE REGULATION OF CEMETERIES, MORTUARIES, AND PRENEED FUNERAL AUTHORITIES

This chapter contains our evaluation and findings of the regulation of cemeteries, mortuaries, preneed funeral authorities, and cemetery and funeral preneed salespersons. We determine whether the conduct of business in the funeral services industry requires regulation; whether the current regulation of the industry is effective and efficient; and make recommendations concerning regulation.

Summary of Findings

Our findings are:

1. There is sufficient potential harm to the public health, safety, or welfare to justify the regulation of cemeteries, mortuaries, and preneed funeral authorities.
2. The nature of potential harm associated with mortuaries, however, does not require licensing. A less restrictive alternative is appropriate.
3. Chapter 441 is seriously deficient, especially with regard to perpetual care and preneed trusts, and does not provide sufficient protection to the public.
4. A cemetery and mortuary board is not the appropriate body to oversee regulation. The board does not possess the technical skills needed to carry out the responsibilities placed on the board.
5. The board has granted and renewed licenses despite failure of applicants and licensees to comply with the licensing requirements and has not properly monitored the trust funds.

Need for Regulation

The reasons for enactment of state laws regulating cemetery, mortuary, and preneed funeral authorities are still valid. Those in the funeral industry who might be unscrupulous could cause economic harm to consumers through misappropriation of funds and misrepresentation.

Because the potential harm and characteristics of mortuaries differ from cemeteries and preneed funeral authorities, we discuss them separately.

Mortuaries. The licensing of mortuaries is not necessary for public protection from the potential harm they pose—unfair sales merchandising which results in economic exploitation. Less restrictive laws can discourage such practices in funeral sales at the time of need.

The basic licensing requirements—the bond and financial integrity—were designed to protect consumers engaged in preneed purchases of cemetery space and preneed funeral plans. When mortuaries were later included in Chapter 441, they became subject to these same standards although the nature of their business is different. The business of mortuaries does not entail risks of misappropriation of funds since mortuaries provide services and products prior to billing their customers.

Act 23, SLH 1980, by itself, provides the appropriate form of regulation. It requires that a mortuary provide each prospective customer with: (1) a current price list with separately stated prices for each type of service or item which is part of the funeral services, and (2) a written estimated price for the services and commodities the prospective purchaser desires to buy. The customer must approve and sign the estimate, and the mortuary may not charge a price higher than the signed estimate unless the purchaser requests an additional item and approves the higher price.

According to legislative committee reports, this “mandatory disclosure law” would give the consumer “[a] better opportunity to make an informed choice during this emotional time when he may be too grief stricken or plagued with guilt to ask for a price list or itemized cost,”¹ and would be “[c]onsistent with the intent of consumer protection laws to prevent unfair and deceptive business practices.”²

1. Standing Committee Report 568–80, Senate Committee on Consumer Protection and Commerce, 1980 Regular Session.

2. Standing Committee Report 762–80, House Committee on Consumer Protection and Commerce, 1980 Regular Session.

The provisions of Act 23, now part of Chapter 441, should be retained, but the licensing requirements relating to a bond and financial integrity for mortuaries, required by other sections of Chapter 441, should be removed.

Cemetery and Preneed Funeral Authorities

The major regulatory provisions applying to both cemeteries and preneed funeral authorities are the trust fund, financial integrity, bond, and sales practices requirements. These provisions are weak, misleading to the public, and do not provide sufficient protection to the consuming public from the potential harm of economic loss. The deficiencies of the statute are discussed in this section.

Trust funds. Chapter 441 requires every cemetery or preneed funeral authority engaging in preneed sales to establish preneed trusts. Cemeteries must also have a perpetual care fund.

The preneed trusts and perpetual care funds are subject to the same laws regarding the role of the administrator of the trust and investments of the funds in the trusts. These laws stipulate (1) who may act as an administrator of the trust fund; (2) the limitations on responsibilities of the administrator; and (3) the standard governing the investment of trust funds and the approval authority on investments.

There are different requirements for preneed trusts and perpetual care funds for (1) the portion of each sales contract which must be deposited into the trust fund, (2) the disposition of the principal and earnings of the trust fund, and (3) the time in which payments must be made to the trust.

We discuss, *first*, the deficiencies relating to the administrator and investment standards; *second*, the deficiencies of the amount required to be deposited in the trust funds and use of principal and earnings guidelines; and *third*, the weakness of the laws enforcing timely deposits to the trust.

Use of term "trust" misleading. The use of the term "trust" in Chapter 441 is very misleading. This term, because of its technical meaning, implies the existence of a trustee who acts primarily in the interest of consumers and whose responsibility is to protect and preserve the assets of the trust.

In technical terms, a trust is a "fiduciary relationship in which one person is the holder of the title to property subject to an equitable obligation to keep or use the property for the benefit of another." A trust usually involves three parties: a settlor, the trustee or trustees, and the beneficiary or beneficiaries. In establishing a trust, the settlor transfers legal title to his or her property to the trustee who manages or uses it for the beneficiary. The trustee has the highest duty of loyalty to the beneficiary. The beneficiary of a trust is the person for whose benefit the trust is created and who is equitably entitled to its advantages.³

The statute, however, does not establish a fiduciary relationship between the trustee and the beneficiary. Instead, it allows the preneed cemetery or funeral authority to exercise substantial control over the management of trust funds. *First*, persons affiliated with the preneed cemetery or funeral authority are allowed to be members of the board governing the trust. *Second*, the preneed cemetery or funeral authority has the right to approve investments. *Third*, the administrator of a trust fund does not have control over and is not responsible for the expenditures of the fund.

Authority may be trust administrator. By statute, the trust fund administrator may be a nonprofit corporation, a board of trustees, or a regulated trust company. If the fund administrator is a nonprofit corporation or a board of trustees, the principals of the cemetery or preneed funeral authority may be trustees, but these principals may not constitute a majority of the trustees. Under these conditions, the trustees are not completely independent of the cemetery or preneed funeral authority and they may not be able to act solely in the interest of consumers, as trustees must.

According to financial reports submitted to the cemetery and mortuary board in 1980, four preneed funeral authorities maintain their preneed trusts with regulated trust companies and three use boards of trustees. Nine cemeteries use boards of trustees for their perpetual care funds and six use regulated trust companies.

No control over investments. Section 441-41 provides that "[t]he instrument creating the fund may reserve to the cemetery authority⁴ the right to approve investments."

3. The discussion in this paragraph is drawn from: George Gleason Bogert and George Taylor Bogert, *Handbook of the Law of Trusts*; Fifth Edition, Hornbook Series, West Publishing Company, St. Paul, Minnesota, 1973.

4. This section also applies to preneed funeral authorities.

With this condition, a trustee is unable to serve in a fiduciary capacity regarding investments when his decisions can be overturned or are required to be approved by another person. To provide consumers with the proper protection, trustees should be completely independent of the preneed cemetery or funeral authorities and should be given sole responsibility for investment management.

No control and responsibilities over expenditures. The statute also specifies that the administrator shall not be required to inquire into the propriety of expenditures made by the authority, and shall not be held responsible for payments made from the fund to the authority. This provision has the effect of leaving the controls over the disbursement of trust funds in the hands of the authority, and placing almost no responsibility on the administrator. An administrator thus serves more as an agent for the authority, rather than in a fiduciary capacity of a trustee.

Deposit amounts and use of principal and earnings. Chapter 441 specifies the portion of each sales contract which must be deposited into a preneed trust or perpetual care fund and, for a perpetual care fund (but not preneed trust), it specifies the disposition of earnings of the trust fund. It is questionable whether these provisions alone can ensure sufficient funds for future claims.

Arbitrary amounts set aside for trusts.

(1) *Preneed trusts.* Chapter 441 provides that every cemetery or preneed funeral authority is required to deposit in a trust fund “[a]ll payments received after the recovery of acquisition costs, which shall be the *lesser* of thirty per cent of the contract price or the difference between the contract price and the cost of the pre-need interment or pre-need funeral services contracted to be provided.”⁵

In practice, preneed authorities simply keep a set percentage, usually 25 or 30 percent, of the contract price without regard to the actual acquisition costs. The preneed authorities apparently consider the amount retained as their compensation. This is illustrated by a provision in the contract of one of the preneed authorities which states, “[a]ll payments made hereunder by Purchaser to Life Plan up to an amount equal to thirty percent (30%) of the selling price . . . shall be retained by Life Plan as its compensation.”

5. Section 441-2, Hawaii Revised Statutes.

Whether the amounts retained by the preneed authorities are no more than the acquisition costs is not determinable. This is because the cost components of "acquisition costs" have not been identified in the statutes or in the rules and regulations of the cemetery and mortuary board. Preneed authorities thus conveniently use the 25 or 30 percent retainage amount.

The other difficulty with the statutory provision is that there appears to be no rationale for setting 30 percent as the maximum that can be retained by the preneed authorities. We were unable to find any documentation or discussion regarding the basis for the 30 percent retainage. Compared with other states, Hawaii is among the least demanding in terms of the amount required to be transferred to a trust. Thirty of the 43 states regulating preneed funeral sales require 100 percent of the contract price to be deposited in a trust. Only two states require less than Hawaii.

(2) *Perpetual care fund.* A cemetery authority, by law, must deposit into the perpetual care fund, for each sale, no less than \$1 per square foot of interment space; \$50 for each mausoleum crypt; and \$15 for each niche. These minimum amounts, though specific enough, may have no relationship to the costs of cemetery upkeep, now or in the future.

Statute silent on disposition of income of preneed trusts. The statute is silent on the disposition of income of the preneed trusts. A review of trust agreements between the purchaser and preneed authority reveals that the net income of a trust goes to the preneed funeral authority.

The preneed trusts are presumably necessary to ensure that sufficient funds are available at the time of need. To allow the withdrawal of income and thus diminish the amount available runs contradictory to a trustee's basic responsibility to preserve and protect the assets under the trustee's custody. Moreover, the accumulated earnings may be needed to meet the continuing increase in costs of merchandise and services. Again, as a matter of comparison with other states, 30 of the 43 states require all of the earnings to remain in the trust funds.

The manner in which the income of a cemetery perpetual care trust fund can be disposed of provides a sharp contrast with the preneed trust funds. The statute provides that the income of a perpetual care trust fund is to be used to pay for the cost of care of the cemetery. If there is any surplus income, or net capital gains from investments,

such excess (or portion of it) may be set aside to cover any loss in principal or for future maintenance, repair or restoration of property or embellishments in the cemetery. Any surplus income or net capital gains not so set aside in reserve becomes a part of the principal of the fund. The principal amount cannot be withdrawn.

It is unclear as to why the statute is silent on the disposition of income regarding preneed trusts, and so specific as it relates to cemetery perpetual care trust funds. We can find no rational basis for treating the two funds differently.

Timely deposits to trust funds. Chapter 441 states that transfer of funds due to a perpetual care fund shall be made no later than 30 days after receipt of the final payment on the purchase price of a plot, niche, or crypt sold, and for a preneed trust, all payments received after retention of the lesser of acquisition costs or 30 percent, shall be deposited in the trust within 30 days of receipt. Our review of the records maintained by the Department of Regulatory Agencies (DRA) revealed that deposits into the trust funds have been delinquent, and in some cases, no monies were transferred to the trust funds.

The law lacks firm provisions to ensure that deposits are made in compliance with the law. The board is authorized to examine the books and records of authorities and inspect the trust administrators' records, but Hawaii's provisions, in comparison with those of other states', are weak.

The Florida laws regulating cemeteries, for example, authorize the regulator (the Department of Banking and Finance) to audit the cemetery at the expense of the cemetery and to take proper court action if a shortage in the trust fund is discovered and the deficiency is not satisfied within 30 days. "Proper court action" for failing to make proper deposits includes a broad range of remedies, including impounding and appointing a receiver for the property and cemetery, recovery proceedings, and felony criminal charges.⁶

Value of future claims not reflected in financial statements. Preneed authorities are required to submit annual financial statements to the board. The financial statements show the assets, liabilities, and equity or fund balance of the authority and trust, and the revenues and expenses of the authority and trust. The financial statements presumably provide the board with the basis to ascertain compliance with the statute and evaluate the financial soundness of the preneed authorities and related trusts.

6. Senate Committee on Governmental Operations, A Review of Chapter 559, Part IV, Florida Statutes, Florida Cemetery Act, Prepared Pursuant to the Regulatory Reform Act, January 1980.

However, the financial statements of preneed trusts are deficient. The financial statements do not show the value of the future cost of claims of existing preneed plan holders. The statements reflect as a liability only the portion of the contract price of the preneed sales which were transmitted to the trust by the authority. In other words, if a preneed authority transmits 70 percent of the contract price of a preneed plan to the trust (and retains the other 30 percent), the trust will show the 70 percent amount as a liability to the preneed plan holder. When the claim is made in the future, however, the actual cost may very well exceed the amount shown as a liability. Thus, an evaluation of the financial soundness of a preneed authority and trust must take into consideration the liability of the authority and trust at the time of claim.

Therefore, the financial statements should be required to show the present value of the future claims on the preneed plans that have been sold. This would require actuarial computation because of the variables involved. These variables include the future costs of services and merchandise, and the time (that is, the year) that the services will be claimed.

Insufficient bonds for authorities. The statute requires the posting of a surety bond of \$50,000 by each cemetery, mortuary, or preneed funeral authority with gross income of \$50,000 or more in the previous year. Businesses with gross income less than \$50,000 for the previous year must post a bond of \$5,000.

The use of the previous year's gross income in setting the bond amount lacks justification. In addition, the bond amounts are insufficient. The use of gross sales figures for one year and disregarding the total consumer obligations of the trust funds as a determinant of the bond requirement is inappropriate. Most of the trust fund obligations far exceed \$50,000 and several exceed \$1 million, including one over \$4 million. The present bond amounts cannot adequately protect the consumers' financial interest. The bond requirement should bear a relationship with the total obligations of a trust.

Sales practices. The principal statutory provisions relating to sales practices are the licensing and bonding of salespeople; prohibitions against the making of false promises, misrepresentations or misleading statements; and the requirement that salespeople, upon signing of a sales contract, give the purchaser a copy of the sales contract. The board's rules also call for the submission of such items as copies of sales literature and contracts. These provisions, for the most part, have not effectively deterred misrepresentations or served as grounds to penalize offenders.

Plain language sales contracts. Many of the cases of misrepresentation involve alleged false statements by salespeople on the terms of the sales contracts, especially the trust fund and refund provisions. The statute should require plain language in readable type and a disclosure of each service, merchandise, and related cost covered under the contract considered necessary.

Salesperson's bond unnecessary. The statute requires salespersons to carry a bond of \$5000 running to the State. This bond requirement is unnecessary since an aggrieved consumer can and will more than likely look to the company for restitution. The requirement should be deleted from the statute. Since the bond is the primary requirement for the salesperson's license, licensing is also unnecessary. Control over sales practices can be accomplished by assigning clear responsibility to the authorities for their sales representatives.

Penalties. The present penalty for violation or failure to comply with any provision of Chapter 441 is a fine of not more than \$1000. Considering the diversity of the laws and possible offenses, ranging from sales misrepresentation to misappropriation of funds, a single penalty does not seem appropriate. For example, the penalty seems too lenient considering the seriousness of offenses related to the trust regulations. The penalty for financial institutions, e.g., banks, trust companies, fiduciary companies, violating state provisions is a misdemeanor with a fine of not more than \$50,000, imprisonment of not more than a year, or both.⁷ For these financial institutions, the commission of any offense with the intent to defraud is a felony punishable by a maximum fine of \$100,000 or imprisonment for not more than one year, or both.⁸ We suggest that the Legislature consider stricter penalties for trust violations of Chapter 441 and different penalties for other types of violations.

Form of Regulation

Regulation of the funeral industry by a board is not appropriate. The statute has its rationale in a business regulation statute, not an occupational licensing statute. There is no examination to test competency nor should there be any. Moreover, there are no special considerations which would require a group of people, such as a board, to assess

7. Section 401-20, Hawaii Revised Statutes.

8. Section 401-21, Hawaii Revised Statutes.

the qualifications of applicants. Instead, the requirements are general business-type requirements, to-wit: Good reputation for honesty, financial integrity, and fair dealing; posting a surety bond with DRA; and an organization of "perpetual existence."

The most important function of the board is the assessment of the financial soundness of the businesses and the mandatory trust funds. Several board members have acknowledged their shortcomings in performing this function. The inability of the board to properly discharge its responsibilities may expose the board and the State to legal suits from the public should consumers suffer financial losses from the actions or inactions of the board.

There are only 14 states regulating cemeteries with regulatory boards and only 12 states with boards for prepaid funeral plans. A number of states either forbid preneed plans entirely or do not regulate these businesses, but a majority of the states assign the regulatory functions to state bank examiners, insurance commissioners, comptrollers, or legal departments.

Alternative to a board. Responsibility for licensing and monitoring preneed cemetery and funeral authorities should be with a properly trained regulator. The state bank examiner is the likeliest official for this function. The state bank examiner currently oversees financial institutions such as trust companies, fiduciary companies, industrial loan and investment companies, and banks. The statutory duties of the bank examiner and his appointees reflect the scope of their expertise:

"The bank examiner or a duly appointed examiner shall visit every such bank, company, association, or licensee in every calendar year unless otherwise provided by law and whenever the bank examiner deems it necessary or expedient, and makes a complete and careful examination of the condition and resources of the bank, company, association, or licensee, the mode of managing its or his business and conducting its or his affairs, the action of its officers and directors, if a corporation, in the investment, management, and disposition of its funds, the disposition of funds and securities entrusted to it or him in any fiduciary capacity, the safety and prudence of its or his management, its or his policy of transacting business, the security afforded to persons dealing therewith, and whether the bank, company, association, or licensee is complying with the laws of the State."⁹

9. Section 401-3, Hawaii Revised Statutes.

The bank examiner is also authorized to administer oaths to officers and agents of the business being examined and may order or cause the production of all books of account, papers, documents, and securities under their possession and control.

Regulatory Operations

The cemetery and mortuary board has not properly performed its two major functions, the licensing of authorities and the monitoring of the trust funds.

License applications and renewals. The board has granted licenses to applicants failing to provide evidence of the required bond, trust agreements, and other documents.

No bond. All licensees must have a bond running to the State for consumer claims. There are two licensees who have been operating for years without a bond. In November 1980, the board recommended that the cases go to hearing for suspension or revocation of the license.

No trust agreement. Cemetery and preneed funeral authorities are required to submit a copy of the instruments creating the trust or trusts.

Our review of the DRA files revealed that several of the preneed funeral and cemetery authorities lacked copies of trust agreements for preneed and perpetual care trusts. None of the twelve cemeteries held trust agreements for merchandise trusts. Some of the cemeteries may not sell preneed merchandise or services, but others are known to conduct such sales and should have merchandise trusts.

Without the trust agreements, the board could not have determined if the required trusts had been established and if they were consistent with the requirements of Chapter 441.

Other documents not in file. The DRA records of licensees are incomplete. Maps of cemeteries, price lists, and contracts which should have been submitted with the initial and renewal applications or as changes occurred appear only sporadically in the files. Whether these requirements were initially met by licensees could not be determined.

Prior to November 1979, the board did not enforce the required submission of sales contract forms, brochures, literature, and detailed price lists and descriptions of merchandise and services. As of March 1980, all but two licensees had submitted price lists in compliance with a November 1979 request of the board. The board did not ask for any of the other documents.

Monitoring of trust funds. The board, although authorized to inspect the books and records of the authorities and their trust funds, has not performed this function. The board has also failed to enforce the required submission of financial reports of businesses and trust funds at the time of license renewals, with the exception of the 1980 renewals.

Recommendations

We recommend the following:

1. *Chapter 441 be retained, but modified to place fiduciary responsibilities on the administrator of the trust funds, and to remove the authorities from involvement in the management of trust funds. Specifically, principals of cemetery and preneed funeral authorities should not be allowed to be trustees of preneed trusts. The administrator should be responsible for ascertaining the propriety of the claims made by the authority on the trust. The authority should not be given the right to approve investments; instead, this should be reserved to the board governing the trust. If the fiduciary responsibilities recommended here are not adopted, we suggest that the provisions relating to "trusts" in Chapter 441 be deleted.*

2. *The Legislature review the statutory provision which permits the retention of the lesser of 30 percent of the contract price or acquisition costs by the preneed authority and the adequacy of the amount required to be deposited into a perpetual care fund, and if appropriate, amend the provisions to provide greater protection to the public.*

3. *Chapter 441 be amended to require the present value of future claims to be ascertained and shown on the financial statements of the preneed trusts.*

4. *The Legislature review the bond requirement of cemeteries and preneed authorities, and if appropriate, set the bond at a higher amount.*

5. *Chapter 441 be amended to: (a) delete the bond and financial integrity requirements for mortuaries; (b) delete the licensing and bond requirements for salespersons; (c) impose stricter penalties and authorize legal action for violations of the trust provisions of Chapter 441; and (d) require sales contracts to be in plain language and include a disclosure of all necessary items and costs.*

6. Chapter 441 be amended to delete the board, and assign responsibility for regulating commercial cemeteries, mortuaries, preneed funeral authorities to the director of DRA. The state bank examiner should be assigned the responsibility for examining the records and reports of the regulated businesses and related trust funds. If the board is retained, the board should secure the necessary technical services to discharge its responsibilities properly.

7. DRA enforce compliance by applicants and licensees with the licensing requirements. This includes the timely submission of financial and other required reports, the bond, and such documents as the trust agreements, certificate of dedication of land, maps of cemeteries, sales contract forms, detailed price lists, detailed description of merchandise and services offered, and sales brochure and literature. If the board is retained, this recommendation is directed at the board.

APPENDIX
AFFECTED AGENCIES

REQUEST FOR AGENCY RESPONSES

The two principal agencies affected by this Sunset Evaluation Report are the Cemetery and Mortuary Board and the Department of Regulatory Agencies. On February 13, 1981, we transmitted this report to the affected agencies and invited them to respond to the recommendations in our report by February 23, 1981. A copy of the transmittal letter to the board is included as Attachment 1. A similar letter was sent to the department. The department did not comment on the report. The Cemetery and Mortuary Board's response is included as Attachment 2.

In its response, the Cemetery and Mortuary Board agrees with our recommendations to: delete the board and assign regulatory responsibility to the director of the Department of Regulatory Agencies; have the Legislature review the bond requirement and, if appropriate, set it at a higher amount; delete the bond and financial integrity requirements for mortuaries; delete the licensing and bond requirement for salespersons; impose stricter penalties and authorize legal action for violations of the trust provision of Chapter 441; and require sales contracts to be in plain language and include a disclosure of all necessary items and costs.

The board also agrees with our recommendation that the department enforce compliance with the licensing requirements, but it feels that our suggestion for continued submission of documents and literature is unduly burdensome. The board suggests that submissions be limited to the financial report, bond, trust agreement, trust fund report, certificate of dedication of land and the initial cemetery map or file plans number, and for other items, price lists, sales brochures, etc., the department conduct "spot" investigations at the facilities annually. This alternative seems reasonable.

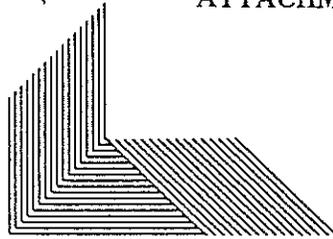
The board disagrees with our recommendation that the chapter be "[m]odified to place fiduciary responsibilities on the administrator of the trust funds, and to remove the authorities from involvement in the management of trust funds." The board says, "The pre-need trust should be treated like any other trust established in the State, instead of being singled out or penalized as a special or different trust." However, the latter is not our intent. On the contrary, we believe that perpetual care and preneed trusts should be structured and administered in accordance with the state laws which apply generally to all trusts.

We also recommended that the financial statements of preneed trusts show the present value of future claims on preneed plans that have been sold, so that the financial soundness of the trusts can be evaluated. The board's view is that the "soundness of . . . [preneed] plans can only be ascertained by submitting actuarial studies on all of them," and that Chapter 441 could be amended to require such studies annually. We agree that soundness of plans should be assessed by periodic actuarial analysis, but not necessarily annually.

As an overall view, the board feels that the "[L]egislative Auditor's Office has unjustly criticized the effectiveness of the board . . . and some of the blame for the ineffectiveness of the Board should be shouldered by the Staff of the Department of Regulatory Agencies." We agree that the effectiveness of this board, as with other boards, is dependent on good staff support.

ATTACHMENT 1

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813
(808) 548-2450



CLINTON T. TANIMURA
AUDITOR
RALPH W. KONDO
DEPUTY AUDITOR

February 13, 1981

Mr. Manual Cabral, Chairman
Cemetery and Mortuary Board
Department of Regulatory Agencies
State of Hawaii
Honolulu, Hawaii

COPY

Dear Mr. Cabral:

Enclosed are seven copies of our *Sunset Evaluation Report, Cemeteries, Mortuaries, Pre-Need Funeral Authorities and Salesmen*. We invite your response to the recommendations contained in the report. The Acting Director of the Department of Regulatory Agencies has also been furnished copies of the report and has been invited to respond to the recommendations.

The report has been submitted on this date to the Governor, the Director of Finance, and the State Legislature. Should you decide to respond to the recommendations, we ask for your cooperation in doing so by February 23, 1981. We will then transmit to the Legislature a copy of any response received.

Thank you for your assistance and cooperation.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures



GEORGE R. ARIYOSHI
GOVERNOR

MARY G. F. BITTERMAN
~~HANAKOHI~~
DIRECTOR

DICK H. OKAJI
LICENSING ADMINISTRATOR

CEMETERY AND MORTUARY BOARD

STATE OF HAWAII
PROFESSIONAL & VOCATIONAL LICENSING DIVISION
DEPARTMENT OF REGULATORY AGENCIES
P. O. BOX 3469
HONOLULU, HAWAII 96801

February 24, 1981

RECEIVED

FEB 25 11 15 AM '81

OFF. OF THE AUDITOR
STATE OF HAWAII

Mr. Clinton T. Tanimura
Legislative Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

Thank you for your letter of February 13, 1981, inviting our written comments on the recommendations presented in your report to the Governor, the Director of Finance, and to the State Legislature entitled, "Sunset Evaluation Report - Cemeteries, Mortuaries, Pre-Need Funeral Authorities and Salesmen - Chapter 441, Hawaii Revised Statutes."

Our opening comment to the report is that the Legislative Auditor's Office has unjustly criticized the effectiveness of the Board. The Board has performed its job and duties in accordance with Chapter 441, HRS, and some of the blame for the ineffectiveness of the Board should be shouldered by the staff of the Department of Regulatory Agencies. On some occasions, the Department of Regulatory Agencies issued licenses or approved applications despite the Board's request not to do so until the applicant submitted a bond or other necessary documents.

The Board has also been frustrated in effectively enforcing the cemetery and mortuary law because of the Administrative Procedures Act. When the Board requested that a license be revoked or suspended, we had to refer this request to the State Attorney General's Office. By the time we got our reply as to when we would conduct a hearing, either the unlicensed cemetery or mortuary complied with the law during this interim or we never received an answer from the Attorney General's Office.

By nature, the Cemetery and Mortuary Board does create "headlines", which does make interesting reading. However, as a result of Chapter 441, HRS, the industry has had relatively few complaints from the public.

Our comments to the recommendations are as follows:

Recommendation #1

The Board disagrees with this recommendation and feels that the authorities and/or principals of the cemetery and pre-need funeral authority should be allowed to be trustees of pre-need trusts and be involved in the management of the trusts. We do not mean the principals holding a controlling or majority interest, but at least minority interest as a member of the board of trustees. The administrator may not know anything about trusts, investments, or the operation of a cemetery.

The criticism that arises, as to the propriety of expenditure of the cemetery and pre-need authority, has in the past been discussed. At one time, when these provisions were set up, numerous trust officers testified that since the nature of the business entailed the maintenance and care of the cemetery as an entity, no one administrator would be able or willing to be responsible for the expenditures. Since the cemetery authority is actually the party that receives complaints from the customer if the cemetery is not properly maintained, the responsibility for such maintenance should remain with the cemetery authority and the same applies to the expenditure of income from the pre-need trusts. In one particular firm, part of the earnings of the trust is used to pay claims to take care of the inflation cost incurred on these pre-need plans. Some of these pre-need funeral trusts, by contract, engaged mortuaries to provide these services, under contract for the amount set aside in the trust, whether it be 75 percent or 70 percent. This is one reason why the law stipulates no more than 30 percent can be used for acquisition costs in the sale of pre-need plans. This particular firm, at the present time, operates with 25 percent acquisition cost. No one questions what the acquisition cost is for insurance companies.

The Board also feels that more research and information from persons familiar with trusts are needed to clarify and understand fully the functions of trusts and the fiduciary responsibilities of the administrator of the trust funds. The pre-need trust should be treated like any other trust established in the State, instead of being singled out or penalized as a special or different trust.

Recommendation #2 and #3

First of all, the Board finds the second recommendation confusing and clarification is therefore needed since it refers to the 30 percent acquisition costs by the pre-need authority, and then, in the same sentence, to the adequacy of the amount deposited into a perpetual care fund. Since both type of funds are different, perhaps perpetual care fund should be changed to mean pre-need fund instead.

As to the question of whether or not the funds will be adequate to provide the services at the time of death, this can only be properly ascertained by amending Chapter 441 to require that all pre-need funds be subject to an annual actuary study.

We find that funeral homes can operate more efficiently when there is a bigger volume of business. This benefit flows directly to the consumer when a funeral home aggressively sells pre-need funeral trust, which then gives them a bigger market share thus lowering their cost per case. For example: A funeral home doing 100 cases a year would immediately establish (1) the basic cost of the owner's salary, should he elect to pay himself \$30,000 a year, then (2) the cost per case, whether a simple cremation or burial, which would be \$300 in order to insure that salary. However, if he was doing 200 cases a year, then the cost per case would be \$150. This is a simple illustration to demonstrate the nature of the business. Also, there are other costs to consider which will be allocated on the same basis.

The pre-need concept is in the best interest of the consumer because (1) it gives the consumer a chance to choose, without emotional stress; (2) it locks in the price; and, (3) it gives the funeral operator a fair share of the market which, in turn, lowers his cost. In this particular business, one must keep in mind that there is no way a funeral home, besides selling pre-need funeral plans, can increase his business. By his operating on the basis of pre-need, he is actually telling the public the options they have when death occurs in the family. Reference was made by the Legislative Auditor's report, regarding other states not allowing funeral trusts. This occurred because the state involved failed to effectively address the need for pre-need plans to the general public and as a result there were abuses; and in other cases, the funeral industry themselves blocked the sale of funeral plans which left them in an advantageous position in dealing with the general public because the choice was made at the last minute. The attached Federal Trade Commission Report, dated August 15, 1980, contains this finding. Chapter 441, HRS, was amended in 1975 to include mortuaries in order to fulfill the need for some control over mortuaries accepting pre-payment of funerals. It has been common practice for mortuaries to accept money and hold said funds until the death of certain persons. However, should the owner of the mortuary give up his business or die, there will be some danger as to what happens to these funds. The Board agrees that this problem can be effectively dealt with without licensing and bonding of mortuaries provided they are not in the pre-need business. In 1969 when the Legislature amended Chapter 441, HRS, to include the registration of pre-need funeral plans and maintenance of funeral trusts, the industry at that time saw the need for this regulation to prevent abuse.

Therefore, the answer to the soundness of these plans can only be ascertained by submitting actuary studies on all of them. The same problem arises as to what is adequate to set aside for the perpetual care of cemeteries. The law specifies a minimum amount. The problem as to what is the proper amount of perpetual care for the cemetery is a little different in nature and scope. The adequacy of these funds lies solely with the cemetery authority. Today, on a national level, more and more funds and grants are being made available to boost up the perpetual care funds of some old cemeteries which lack adequate funds.

Recommendation #4

The Board agrees that the Legislature should review the bond requirement of cemeteries and pre-need authorities, and if appropriate, set the bond at a higher amount. The Board has already introduced a bill, this 1981 session, to amend Chapter 441, HRS, by deleting the \$5,000 bond and requiring all authorities to file and maintain a bond of not less than \$50,000 regardless of the amount of gross income received.

However, in reference to the bonding requirements for the authorities, one must bear in mind that should the statutes require bonds to cover the entire amount of the trust, we feel that it would be an unjustified expense. A check of other trusts in the State of Hawaii have revealed that they are not required to post such a bond. The bonding is to insure that the various transactions take place, not the total amount that is in trust. The Board is in favor of following the ERISA requirement that the bond be in the amount of 10 percent of the market value of the trust at the end of the previous fiscal year.

Recommendation #5

The Board agrees with this recommendation that Chapter 441 be amended to: (a) delete the bond and financial integrity requirements for mortuaries; (b) delete the licensing and bond requirement for salespersons; (c) impose stricter penalties and authorize legal action for violations of the trust provisions of Chapter 441; and (d) require sales contracts to be in plain language and include a disclosure of all necessary items and costs.

Recommendation #6

Except for one Board member who favored retention of the Board, the majority of the members agreed with this recommendation that Chapter 441 be amended to delete the Board, and assign responsibility for regulating commercial cemeteries, mortuaries, pre-need funeral authorities to the director of the Department of Regulatory Agencies. The State bank examiner should be assigned the responsibility for examining and monitoring the records and reports of the regulated

February 24, 1981

businesses and related trust funds. If the Board is retained, then it should be the Department of Regulatory Agencies' responsibility to see that each member is trained properly in the necessary technical services to discharge its responsibilities properly.

Recommendation #7

The Board agrees with this recommendation that the DRA enforce compliance by applicants and licensees with the licensing requirements. One effective way of enforcing compliance with any regulation is "spot" inspections at the facilities annually. The requirement, however, for submitting many of the required documents and reports from the authorities is burdensome and tends to only accumulate in the DRA's files. Most of these files become obsolete in a short period of time.

Price lists change frequently because of increased yearly costs. These are required to be changed constantly in order to update the profit margin for authorities. Maps of cemeteries change frequently as burials are performed. Description of merchandise changes frequently with the manufacture of new equipment. Service costs increase each year with inflation because of increased cost of labor equipment and material. Sales brochures are updated frequently to keep up with modern trends and to enhance competition. Most of this literature accumulates as unnecessary files. The literature just mentioned can be easily maintained with the authorities. The only requirement which appears justified for submission to the Board are the financial report, bond, trust agreement, trust fund report, certificate of dedication of land, and the initial cemetery map or the file plan number when the map is recorded with the Bureau of Conveyances.

Very truly yours,


Manuel P. Cabral, Chairman
Cemetery and Mortuary Board

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

BUREAU OF
CONSUMER PROTECTION

August 15, 1980

Honorable Charles P. Miller
801 High Street
Burlington, Iowa 52601

Dear Senator Miller:

We are pleased to respond to your invitation to comment on the pre-need legislation which you are preparing to submit to the Iowa legislature. Last year we responded to a similar invitation from a state representative in Illinois. We are incorporating portions of that letter in response to your current inquiry. We hope that our comments will be useful to you in your efforts to devise effective pre-need legislation. We must stress that the views we express in this letter are those of the staff of the Federal Trade Commission's Bureau of Consumer Protection and do not necessarily reflect the views of the Commission or any Commissioner.

As you are undoubtedly aware, the Federal Trade Commission has actively investigated funeral industry practices. In 1975, after a nonpublic investigation, the Commission authorized the initiation of a trade regulation rule proceeding. In 1976, public hearings were held in six cities.

One of the issues addressed in the rulemaking proceeding was whether the availability of pre-need funeral arrangements has been restricted by state laws which unduly hamper competition.

We believe that the issues which were raised during our rulemaking proceeding will be of interest to you and be of some assistance to you in making a determination about the proposed bill upon which you have asked us to comment. We do not feel that it is appropriate for us to recommend particular solutions to the problems addressed by the bill or to offer comments concerning the specific bill before you. We simply would like to bring to your attention some of the general issues that were discussed during the rulemaking proceeding so that you will be in a better position to judge the effect of the bill.

Pre-need sales can take a variety of forms. Sometimes funeral merchandise and services are purchased and paid for in advance of need at a fixed price which will not increase at death. In other cases, consumers merely make payments to the seller and make funeral arrangements in advance of need but no prices are set. In either case, under state law, the proceeds of these sales, sometimes including interest, or a portion of the proceeds must be deposited in a trust account until the time of death, when the merchandise is delivered or the services performed.

Most of the evidence at the hearings focused on the anticompetitive impact of state 100% trust fund laws. Under these laws, all of the sale proceeds, including interest, must be deposited in a trust fund until death. Obviously, under these circumstances, the seller will have no funds to pay overhead, including salaries and commissions, until a distant future date, when death occurs and the merchandise is delivered. Some evidence indicates that the average delivery period is 29 years. The evidence indicates that most, if not all, potential sellers are unwilling or unable to subsidize these sales for so many years. Since sellers can recover neither their expenses nor a competitive rate of return within a reasonable period of time, these laws may severely inhibit, if not completely prevent, pre-need sellers from entering the market.

Preneed sellers repeatedly alleged that restrictive state trust laws were designed and sponsored by the funeral industry with the express intent of eliminating competition from pre-need sellers. Whether or not these allegations were conclusively proven, the evidence did show clearly that the organized funeral industry long opposed pre-need sales. There was some evidence showing that the funeral industry feared that pre-need sales would result in loss of business to at-need funeral directors. At the same time, the at-need funeral industry is the strongest supporter of the 100% trust laws. Many consumer groups expressed their opposition to these laws because they restrict consumer choice.

More importantly, however, it must be determined how consumers can best be protected from abuse while at the same time allowing the competitive market to function effectively and allowing consumers the fullest range of options. If these 100% trust laws do, in fact, effectively eliminate pre-need sales, as the evidence indicates, then the question is whether pre-need sales are so inherently fraught with incurable abuse that they should be banned entirely or whether consumers will best be served by laws which limit abuses but allow them the choice of making pre-need purchases.

Pre-need sales may provide benefits for those consumers who desire this alternative to at-need funeral purchases. With pre-need purchases, the consumer is free of the debilitating effects of bereavement and of the time constraints of the at-need purchase decision; rational decision-making and shopping around are much more feasible. The concept of pre-need sales receives strong support from most consumer groups, especially memorial societies, which are non-profit organizations set up to help consumers arrange funerals. The significant number of pre-need sales which are made in those states where it is economically feasible indicates that there is consumer demand for these sales.

Most importantly, however, our free-market competitive economy is based on the principle of free choice by consumers. Wherever possible, the role of government should be to enhance that freedom, not to curtail it by restraining or eliminating competition.

Other less restrictive remedies to curb abuses should receive serious consideration before a measure is accepted which seriously inhibits business from competing in the marketplace. For example, some states have adopted trust laws which require pre-need sellers to put a significant portion of the sales proceeds in trust but allow them to keep enough of the proceeds to pay expenses and obtain a competitive profit. Licensing, certification, auditing, bonding and reporting requirements are also examples of consumer protection measures adopted by some states for pre-need sales. While these measures, particularly licensing, could also have anti-competitive effects, especially if drafted to restrict entry into the field, these laws could be drafted to ensure the fiscal responsibility of pre-need sellers. State laws could also provide a cooling-off period for buyers, similar to the three day cooling-off period for in-home sales provided by the FTC's rule. During the cooling-off period, consumers would be free to cancel the pre-need contract and receive their money back. States could also require full disclosure of all the terms and conditions of the contracts. Before reaching the conclusion that pre-need sales are inherently too fraught with abuse to be allowed, the legislature might consider the example of the insurance industry. In both these industries, large sums are collected, held and invested by the industry for many years. Although the potential for abuse exists in the insurance business, the industry is carefully regulated to control these abuses without unduly restricting the industry from doing business.

I regret that my schedule does not permit me to appear at your hearings to make a presentation on this matter. You

might be interested to know, however, that during the FTC rulemaking proceedings, witnesses from several trade associations offered testimony on the subject of pre-need legislation. You might care to communicate directly with one of the following organizations for the purpose of receiving their views.

Pre-arrangement Internment Association of America
c/o Lapin and Levine, Ltd.
2780 Harris Bank Building
115 South La Salle Street
Chicago, Illinois 60603

National Funeral Directors Association
135 West Wells Street
Milwaukee, Wisconsin 53203

I hope that these comments concerning the possible anticompetitive effects of consumer protection legislation in this area will be considered in the deliberations of this bill. We sincerely appreciate the opportunity to present our views for your consideration.

Sincerely yours,

Robert A. M. Schick

Robert A.M. Schick
Acting Program Advisor
Funeral Industry Project

BCP:RS:br