

COMMISSION AUTHORIZED

PRE-NEED FUNERAL TRUST FUND REQUIREMENTS

PREPARED STATEMENT OF
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BEFORE

COMMITTEE ON BUSINESS AND COMMERCE
HOUSE OF REPRESENTATIVES
THE GENERAL ASSEMBLY OF THE COMMONWEALTH OF PENNSYLVANIA

AUGUST 29, 1989

Good morning [afternoon] Mr. Chairman and members of the
Committee:

My name is Michael McNeely. I am an Assistant Director of the Federal Trade Commission's Bureau of Competition, and am in charge of the Licensed Occupations section. I thank you for the opportunity to present our views on House Bill No. 1140, which concerns the sale of pre-need funeral arrangements. At the outset, I should note that these comments represent staff views. They are not necessarily the views of the Federal Trade Commission itself or of any individual Commissioner.

The proposed bill would require sellers of pre-need cemetery or funeral goods or services to deposit into a trust fund 100 percent of the proceeds of any such sale. We appreciate that this escrow requirement aims to protect the consumer, and we are concerned only that it may deter some firms from deciding to offer those pre-need products, and may therefore reduce competition and unintentionally injure consumers.

We have a long-standing interest in this area and can suggest an alternative way of assuring consumer protection. The Federal Trade Commission seeks to promote competition among members of the professions to the maximum extent compatible with

other state and federal goals. For more than a decade, the Commission's staff has endeavored to identify restrictions on the business practices of professionals within a number of professions, including the funeral services profession, that limit competition and increase costs without providing countervailing benefits for consumers. The Commission staff has cautioned against proposed statutes and regulations in several states that would have unnecessarily restrained competition and limited consumer choice in the purchase of pre-need funeral plans.¹

We have also become familiar with the funeral industry as a result of our work on certain consumer protection rules. As you may know, the Commission's Trade Regulation Rule Concerning Funeral Industry Practices ("Funeral Rule"), 16 C.F.R. Part 453, became effective on April 30, 1984. This rule is intended to promote increased competition and consumer choice in the funeral industry by facilitating informed purchase decisions by consumers. Among other things, the Funeral Rule requires that

¹ We have submitted such comments to Virginia Delegate Franklin P. Hall (February 9, 1989); Oregon State Representative Chuck Sides (April 6, 1987); the Illinois Department of Registration and Education (May 9, 1986); Michigan State Senator Kirby Holmes (April 7, 1986); Kansas State Representative Ginger Barr (February 14, 1986); Alabama Representative Arthur Payne (January 16, 1986); and Illinois State Senator Judy Baar Topinka (May 31, 1985).

consumers be given detailed information about prices and the legal requirements applicable to funerals.²

It is my understanding that under Pennsylvania's current Funeral Director Law, 63 P.S. § 479.13(c), funeral directors who enter into contracts to render funeral services in the future, i.e., pre-need contracts, must deposit all money they receive into an escrow or trust account. However, under the currently effective Future Interment Law, 63 P.S. § 480.2(a), other vendors of pre-need contracts, such as cemeteries, need deposit only 70 percent of the money received. Pennsylvania Funeral Director's Ass'n v. Com. State Bd. of Funeral Directors, 494 A.2d 67 (Commonw. Ct. Pa. 1985), aff'd, 511 A.2d 763 (1986). House Bill 1140 would eliminate this disparity. It would amend section 2(a) of the Future Interment Law by increasing the deposit required of those other vendors to 100 percent as well.

It is also my understanding that pre-need sales of funeral goods and services have been increasing throughout the country in response to consumer demand. Consumers are able to shop and make purchase decisions without the time and emotional pressures generally associated with purchases made at the time of need. Pre-need purchases may also allow consumers to obtain a hedge against price increases by "locking in" the price of funeral

² The Commission is currently reviewing the Funeral Rule and will decide whether to leave the rule unchanged or to amend or repeal it. 53 Fed. Reg. 19864 (May 31, 1988).

goods and services as of the time of purchase. The growth in pre-need sales has increased the competitive pressure faced by funeral providers that sell at-need services.

One purpose of House Bill 1140 appears to be to "level the playing field" by subjecting all sellers of pre-need funeral contracts to the same trust fund requirements. Although we commend this effort, we are concerned that the bill, if enacted, may also have the effect of limiting the ability of pre-need sellers to enter or compete in the market, which could ultimately reduce competition and consumer choice in that market.

Applying different regulatory standards to competing sellers of the same goods and services can, in some circumstances, have anti-competitive consequences. The group subject to the more stringent standards will find it more difficult to compete. Depending upon the disparity in compliance costs, the ultimate effect may be to deny consumers the benefits of otherwise active competition from the disfavored group. That would only be warranted if there were some reason to believe that the disfavored group posed a different risk of consumer harm. House Bill 1140 appears to reflect a determination that there is no reason to impose such differential standards in the case of funeral directors.

If the legislature decides to subject all pre-need sellers to the same regulatory standards, it must still decide what uniform regulatory approach to adopt. The trust fund requirements now in force suggest that the legislature once determined that consumers need more protection against pre-need sellers' fraud and insolvency than the unregulated market would afford. If the legislature continues to believe that regulatory protection is necessary, one possible response is to impose a 100 percent trust fund requirement on all pre-need sellers, as House Bill 1140 would in effect do.

Although that approach would eliminate the disparity, we believe that it may risk doing other harm to consumers. A 100 percent trust requirement may have the unintended effect of retarding the introduction and development of innovative forms of competition and lower cost alternatives in the market for funeral products and services. Under such a provision, all funds paid by the consumer remain in the trust fund until death occurs. The seller cannot recover its financial outlay for overhead, selling, or administrative expenses until an uncertain and possibly distant future date. Some potential sellers may lack the capital or financing to cover this hiatus. As a result, the 100 percent trust requirement may discourage some competitors from entering the pre-need market. The presence of fewer sellers may in turn result in reduced competition, and this could cause injury to consumers by depriving them of the lowest prices for the goods

and services they wish to purchase, and of the full array of pre-need alternatives and pricing options that would otherwise be available.

A trust requirement of less than 100 percent is not necessarily the perfect solution either. Such a requirement may still raise concerns for consumers. Even a somewhat reduced trust requirement may still be buying consumers more protection than they would actually prefer. Since such protection costs money in the form of tied-up capital, it will have the effect of raising the price for pre-need goods and services. As a result, some consumers will be turned away from a product that they otherwise would have bought.

Ideally, if a trust requirement is to be imposed, it should be set at a level that will provide the appropriate protection at the least possible cost. However, a legislative determination of that level is difficult and uncertain, particularly since the appropriate terms may change as market conditions change.

As an alternative to attempting to determine legislatively an exact level of trust funding, the legislature may wish to consider a solution that relies in part on the play of competitive forces. In lieu of the trust requirement, you may wish to allow pre-need sellers to provide a performance bond in an amount up to the sale price of the contract. Under this

arrangement a third-party guarantor would agree to pay the pre-need purchaser an amount designed to make him whole in the event of non-performance by the seller. This alternative may provide a means of protecting consumers from seller default, but it does not involve the same inflexibility as trust fund requirements. Because guarantors compete among themselves for the performance bond business, the price and other terms of such bonds (for example, escrow arrangements) will be set in an efficient manner by the market. Guarantors should be able to determine requirements individually for each seller, thus providing adequate protection at the lowest cost.³

Other legislatures and courts have adopted this approach in similar settings. At least one state permits pre-need sellers of funeral goods and services to use performance bonds in lieu of trust funds.⁴ Several other states permit bonds in the closely analogous area of sales of cemetery goods and services.⁵ Moreover, in other industries where delivery is deferred or occurs over an extended time, performance bonds have been

³ One seller may be a better risk than another, for example, because of a large fixed-asset base. If the guarantor charges the lower-risk seller a lower premium for a performance bond, the seller can pass that savings along to consumers. In addition, it may be reasonable to put fewer restrictions on the lower-risk seller, for example, a lower escrow requirement. This can only be done by dealing with sellers individually.

⁴ Iowa Code Ann. § 523A.7 (1988).

⁵ E.g., South Carolina Code Ann. § 39-55-225(d) (1976); Illinois Stat. Ann. Title 21 ¶ 215 § 15(e) (Supp. 1989).

regarded as an effective means of protecting the consumer's investment. For example, in three cases the Commission charged health spa operators with, among others things, failing to fulfill their contracts with customers.⁶ The judgments in those cases prohibit the spa operators from accepting any payment for future membership services unless the operators have obtained performance bonds. The bond amount must be sufficient to provide refunds to all members in the event that the spa fails to open or closes before rendering all services due to customers.

Thus, we believe that permitting pre-need sellers to obtain performance bonds in lieu of a trust fund arrangement is a viable and procompetitive alternative that the legislature may wish to consider.

In conclusion, we believe that consumers can best be served if all sellers of pre-need funeral arrangements are required to meet the same regulatory standards. However, we also believe that the trust fund requirement in the proposed bill may restrict the sale of pre-need goods and services without providing sufficient countervailing consumer benefits. If this bill were adopted, consumers' ability to choose between purchasing pre-need or at-need funeral goods and services would be substantially

⁶ F.T.C. v. Lady Venus Center, Inc., No. 3-84-0158 (M.D. Tenn. Feb. 16, 1984); F.T.C. v. Tyler-Radcliffe Co., Inc., No. 3-84-0159 (M.D. Tenn. Feb. 16, 1984); F.T.C. v. Thor Enterprises, Inc., No. 84-2121-MA (W.D. Tenn. Feb. 16, 1984).

restricted. If the legislature believes that regulatory protection is necessary, it may wish to consider allowing pre-need sellers to post performance bonds as an alternative to maintaining trust funds.

We hope that our comments concerning the competitive and consumer protection aspects of certain types of pre-need trust requirements will assist you in your deliberations on House Bill 1140. Thank you again for this opportunity to present the Commission staff's views. I would be happy to attempt answers to any questions you may have.