

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT – CHANCERY DIVISION

CALVERT FUNERAL HOMES, LTD.,
CLANCY-GERNON FUNERAL HOMES,
INC., AARON TODD DEAN D/B/A BASS
PATTON DEAN FUNERAL HOME AND
TOBERMAN-DEAN FUNERAL HOME,
FRED C. DAMES FUNERAL HOMES, INC.,
MCCRACKEN-DEAN FUNERAL HOME,
INC., KNAPP FUNERAL HOMES, INC.,
DERIVATIVELY ON BEHALF OF THE
ILLINOIS FUNERAL DIRECTORS
ASSOCIATION AND I.F.D.A. SERVICES,
INC.

Plaintiffs,

-AGAINST-

ROBERT W. NINKER, PAUL G. DIXON,
KEVIN BURKE, ROB KONZELMANN, JAMES
D. BOSMA, GEOFFREY W. HURD, CHARLES
S. CHILDS, JR., BRENT M. DAVIS, DEREK S.
JOHNSON, JACK R. KYNION, KING SUTTON,
RANDALL L. EARL, DAVID M.
MCREYNOLDS, DENNIS R. DAVISON,
RICHARD D. YURS, ERIC R. TRIMBLE,
CHRIS WOOLDRIDGE, DONALD
HENDERSON, STEVEN DAWSON,
MICHELLE HARRISON, MICHAEL SAYLES,
VICKIE DIEDRICH, LINDA ALLAN, MARK K.
CULLEN, AND SORLING, NORTHRUP,
HANNA, CULLEN & COCHRAN, LTD.,

Defendants,

-AND-

ILLINOIS FUNERAL DIRECTORS
ASSOCIATION, I.F.D.A. SERVICES, INC.,

Nominal Defendants.

Civil Action No. 09 CH 03624

SECOND AMENDED
DERIVATIVE COMPLAINT

PROBATION DIVISION
FILED
2010 JUN 22 PM 3:47

TABLE OF CONTENTS

INTRODUCTION	1
JURISDICTION AND VENUE	6
THE PARTIES.....	6
SUBSTANTIVE ALLEGATIONS	13
I. IFDA, IFDA SERVICES, THE PRENEED TRUST AND PRENEED CONTRACTS.....	13
A. Summary of IFDA and Its Members.	13
B. Creation Of IFDA Services And The Preneed Trust.	14
1. IFDA Services Is Established.	14
2. IFDA Services Creates The Preneed Trust.	14
3. The Preneed Trust Tax-Exempt Fund Is Created.	15
C. The Administration of The Preneed Trust.	16
1. Funeral Directors Sign Participating Member Firm Agreements.....	16
2. Guaranteed Versus Non-Guaranteed Preneed Contracts.	17
II. IFDA SERVICES WAS THE TRUSTEE OF THE PRENEED TRUST.....	18
A. Summary of IFDA Services’ Obligations As Trustee of The Preneed Trust.....	18
B. IFDA Services Engages The Schainker Group And The Merrill Lynch Defendants	21
III. PLAINTIFFS AND OTHER IFDA MEMBERS WERE UNAWARE OF THE LIFE INSURANCE ENTERPRISE AND THE RESULTING DEFICITS.	23
IV. THE LIFE INSURANCE ENTERPRISE.....	26
A. Basic Summary of The Life Insurance Enterprise.....	26
B. The Necessary Due Diligence Was Not Conducted With Respect To The Life Insurance Enterprise.....	28
V. THE LIFE INSURANCE ENTERPRISE BEGINS TO CAUSE DAMAGE WHILE THOSE RESPONSIBLE BEGIN TO REAP UNJUST REWARDS.	31

A.	The Schainker Group, Merrill Lynch PFS and MLLA Coordinated The Life Insurance Enterprise.....	31
B.	The Schainker Group, The Merrill Lynch Defendants And The Insurer Defendants Reap Huge Rewards.	31
VI.	THE LIFE INSURANCE ENTERPRISE IMPLODES AND IFDA SERVICES IS STRIPPED OF ITS TRUSTEE POSITION.	34
A.	The Life Insurance Enterprise’s First Signs of Trouble.....	34
B.	ML Trust Was Approached By IFDA And Schainker In 2007 To Take Over As Trustee, But Declined The Offer.	35
C.	Regions Was Courted As Trustee But Was Rejected Once It Took The Position That The Life Insurance Policies Must Be Liquidated.	37
VII.	THE LIFE INSURANCE ENTERPRISE WREAKED HAVOC AND HAS CAUSED ENORMOUS DAMAGES.	41
A.	The Credited Rates Had No Relationship to Actual Earnings.....	43
B.	The Life Insurance Enterprise Was Riddled With Flaws.	43
1.	There Is a Finding That The Life Insurance Policies Have No Insurable Interest.....	45
VIII.	IFDA’S LONG-TIME CORPORATE LEGAL COUNSEL BREACHED THEIR DUTIES AND OBLIGATIONS TO IFDA.	48
A.	Cullen and Sorling Knew the Life Insurance Enterprise Did Not Comply With IFDA Services’ Investment Goals.	48
B.	Cullen and Sorling’s Represented IFDA, IFDA Services and the Individual Director and Officer Defendants; A Clear Conflict of Interest.....	50
C.	Cullen and Sorling Negligently Advised their Clients that the Life Insurance Policies Were Backed By an Insurable Interest.....	50
D.	Cullen and Sorling Failed to Notify Insurance Carriers of Claims Against IFDA and IFDA Services, Putting Valuable Insurance Coverage at Risk.	51
E.	Cullen and Sorling Helped the Director and Officer Defendants Conceal the True State of Affairs from Funeral Directors.....	54
IX.	THE DIRECTOR AND OFFICER DEFENDANTS AND CULLEN BREACHED THEIR DUTIES OF CARE TO IFDA AND ITS MEMBERS.	55
A.	The First Write-Down To The Preneed Trust.....	58

B.	The Write-Down Did Not Stop The Damages To The Preneed Trust.....	59
C.	The Situation Today.....	60
X.	IFDA AND IFDA SERVICES HAVE SUFFERED DAMAGES SEPARATE AND APART FROM THOSE SUFFERED BY THE PRENEED TRUST.....	61
	FUTILITY OF DEMAND.....	62
	CAUSES OF ACTION.....	67
	COUNT I.....	67
	BREACH OF FIDUCIARY DUTIES AGAINST THE DIRECTOR AND OFFICER DEFENDANTS.....	67
	COUNT II.....	68
	NEGLIGENCE AGAINST THE DIRECTOR AND OFFICER DEFENDANTS.....	68
	COUNT III.....	68
	VIOLATION OF ILLINOIS' TRUSTS AND TRUSTEES ACT, 760 ILCS 5/1, <i>ET SEQ.</i> , AGAINST THE DIRECTOR AND OFFICER DEFENDANTS.....	68
	COUNT IV.....	69
	NEGLIGENCE BROUGHT DERIVATIVELY ON BEHALF OF IFDA AND IFDA SERVICES, INC. AGAINST CULLEN AND SORLING.....	69
	COUNT V.....	71
	BREACH OF FIDUCIARY DUTY BROUGHT DERIVATIVELY ON BEHALF OF IFDA AND IFDA SERVICES, INC. AGAINST CULLEN INDIVIDUALLY.....	71
	COUNT VI.....	72
	AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY BROUGHT DERIVATIVELY ON BEHALF OF IFDA AND IFDA SERVICES, INC. AGAINST CULLEN INDIVIDUALLY AND SORLING.....	72
	PRAYER FOR RELIEF.....	73
	JURY DEMAND.....	75

Plaintiffs Calvert Funeral Homes, Ltd., Clancy-Gernon Funeral Homes, Inc., Aaron Todd Dean d/b/a Bass Patton Dean Funeral Home and Toberman-Dean Funeral Home, Fred C. Dames Funeral Homes, Inc., McCracken-Dean Funeral Home, Inc., and Knapp Funeral Homes, Inc. (collectively “Plaintiffs”), derivatively on behalf of the Illinois Funeral Directors Association (“IFDA”)¹ and I.F.D.A. Services, Inc. (“IFDA Services”), bring this lawsuit against Robert W. Ninker, Paul G. Dixon, Kevin Burke, Rob Konzelmann, James D. Bosma, Geoffrey W. Hurd, Charles S. Childs, Jr., Brent M. Davis, Derek S. Johnson, Jack R. Kynion, King Sutton, Randall L. Earl, David M. McReynolds, Dennis R. Davison, Richard D. Yurs, Eric R. Trimble, Chris Wooldridge, Donald Henderson, Steven Dawson, Michelle Harrison, Michael Sayles, Vickie Diedrich, Linda Allan,² Mark K. Cullen (“Cullen”),³ and Sorling, Northrup, Hanna, Cullen & Cochran, Ltd. (“Sorling”) (collectively, “Defendants”). For their Second Amended Derivative Complaint (“Complaint”), Plaintiffs allege as follows:

INTRODUCTION

1. Plaintiffs are long-standing family-owned Illinois funeral homes and members of IFDA, which is a not-for-profit funeral directors association with a current membership of approximately 750 funeral directors. Plaintiffs provide Illinois consumers the opportunity to pre-arrange and pre-finance their funeral and burial services through the use of Preneed Contracts. Preneed Contracts are valuable tools allowing people to plan and pay for their

¹ Hereinafter IFDA and IFDA Services shall be collectively referred to as “IFDA” unless otherwise indicated.

² Hereinafter these Defendants shall be collectively referred to as the “Director and Officer Defendants.”

³ Cullen is named as a Defendant in his capacity as corporate legal counsel to IFDA and IFDA Services, and/or in his capacity as Managing Staff Director of IFDA. Because of his role as IFDA’s Managing Staff Director, Cullen is also included in the Director and Officer Defendants.

funerals and burial services in advance, thereby eliminating many of the difficult decisions and financial burdens facing family and friends at that time.

2. In 1979, IFDA Services, a wholly-owned subsidiary of IFDA, established the IFDA Preneed Trust (the “Preneed Trust”). The Preneed Trust was designed to provide an effective vehicle for those seeking to plan ahead for their funerals (“preneed customers”) to finance their Preneed Contracts. The investment objective of the Preneed Trust was to invest the deposited funds in a manner providing optimum growth plus safety of principal, which typically meant municipal bonds or other safe investments. In 1986, the Preneed Trust was supplemented to include a tax-exempt portion, which was to provide preneed customers with the opportunity to have their preneed account grow on a tax-free basis (the “Preneed Trust Tax-Exempt Fund”). It is the damage suffered by IFDA and IFDA services in the wake of the massive deficit in the Preneed Trust Tax-Exempt Fund – estimated at more than \$100 million – that is the focus of this derivative action. Thus, unless otherwise indicated, references hereinafter to the Preneed Trust mean the Preneed Trust Tax-Exempt Fund.

3. The staggering Preneed Trust deficit is the result of a dreadful investment strategy carried out with Preneed Trust funds. The strategy’s admitted architect is Edward Schainker (“Schainker”), a Merrill Lynch Pierce, Fenner & Smith (“Merrill Lynch PFS”) employee and agent, as well as an insurance producer for Merrill Lynch Life Agency (“MLLA”) and Merrill Lynch Life Insurance (“ML Life”). Since the filing of this lawsuit, the Illinois Department of Financial and Professional Regulation (“IDFPR”), Division of Insurance,⁴ has revoked Schainker’s license as an Illinois insurance producer and fined him \$100,000. The DOI found that Schainker “demonstrated incompetence, untrustworthiness, and financial irresponsibility.”

⁴ The Division of Insurance became the stand-alone Department of Insurance (“DOI”) (instead of a division of the IDFPR) on June 3, 2009.

In addition, the Illinois Secretary of State has suspended Schainker's license as a registered representative and securities salesperson, and he is party to additional regulatory proceedings and investigations.

4. Rather than comply with the investment objectives of the Preneed Contracts and the Preneed Trust or follow the law governing the Preneed Trust, the Illinois Funeral or Burial Funds Act, 225 ILCS 45/1 *et seq.* (the "Burial Act"), Schainker – with the Director and Officer Defendants and Cullen's endorsement, advise and approval - concocted an investment scheme whereby Preneed Trust funds would be almost exclusively invested in life insurance policies. The conduct of all of the Defendants, as alleged herein, including the conduct with respect to the investment of Preneed Trust funds in life insurance policies, shall be generally referred to as the "Life Insurance Enterprise." Unfortunately for the funeral directors that deposited funds in the Preneed Trust for almost 50,000 Illinois preneed customers, the Life Insurance Enterprise turned out to be disastrous.

5. The Life Insurance Enterprise was fatally flawed from the outset. The life insurance policies dramatically failed to meet the objectives of the Preneed Trust or the obligations required by applicable law and the Preneed Contracts themselves. Liquidity and preservation of principal of Preneed Trust investments are paramount to the Preneed Trust and the fulfillment of Preneed Contracts so that funeral directors can timely access the monies to pay for the services and merchandise selected by their preneed customers. Yet, the life insurance policies were and are not easily convertible to cash and do not confer a fixed death benefit, but rather offer a pay-out depending on the performance of the life insurance policies' subaccounts. What is more, many of the life insurance policies are subject to a 10% excise tax if the policies are terminated or if funds are borrowed or withdrawn before the insured reaches

59 ½ years old. Moreover, additional taxes were applied to the deferred gains within the policies' subaccounts when the policies were liquidated prior to the death of the insureds. Given the liquidity and tax constraints (in what were supposed to be tax-free investments) and the uncertainty of the investment values, the Life Insurance Enterprise that was employed was inappropriate for the Preneed Trust funds.

6. Nevertheless, the Life Insurance Enterprise did reap significant rewards for those involved. IFDA, IFDA Services, and the Preneed Trust paid Schinker, Paul W. Felsch ("Felsch") and Mark A. Summer ("Summer"), fellow employees or agents of Merrill Lynch PFS and/or MLLA (collectively, the "Schinker Group"), Merrill Lynch PFS, MLLA and ML Life millions of dollars in commissions, provided them with a continuous stream of "trailing commissions," administrative fees and mortality charges, and were locked in as a long-term client because the life insurance policies were so illiquid. The insurance companies received more than \$90 million in insurance premiums despite extremely questionable underwriting practices.

7. The Director and Officer Defendants failed IFDA and its members by falling for Schinker's pitch that the Life Insurance Enterprise was safe and secure, and his rosy projections that such investments would endow IFDA and the Preneed Trust for many years to come. The Director and Officer Defendants were also derelict upon learning of the grievous problems with the Preneed Trust, as they failed to take corrective action and ignored red flag after red flag.

8. Likewise, Cullen and Sorling failed their clients IFDA and IFDA Services because they should have adequately advised clients to prevent them from getting into this predicament in the first place and, even once it began, counseled them away from an illegal

course of conduct which would only increase and accumulate their clients' damages and liability. Instead, Cullen was part and parcel of the Life Insurance Enterprise, a conflicted attorney who repeatedly failed to protect his clients' interests.

9. The Life Insurance Enterprise was also predicated on IFDA's members receiving misinformation – to the extent they received any information at all. Indeed, Plaintiffs and the vast majority of other Illinois funeral directors had no inkling there was a deficit in the Preneed Trust until the news broke in 2007. The Director and Officer Defendants and Cullen had known for years that this deficit existed and was growing by leaps and bounds, but continued to encourage IFDA members to deposit monies in the Preneed Trust. The Illinois Office of the Comptroller ("IOC") estimated that, as of May 2005, the Preneed Trust deficit was approximately \$38 million. However, Defendants failed to take timely, if any, corrective measures, resulting in a further dramatic diminution in the value of the Preneed Trust.

10. In 2007, the IOC finally stripped IFDA Services of its license *ab initio* to act as trustee of the Preneed Trust. While this was the first warning sign to funeral directors that something was amiss, the Director and Officer Defendants, with Cullen's knowledge, continued to encourage funeral directors to deposit their monies in the Preneed Trust.

11. The diminished state of the Preneed Trust, and the scandal surrounding what caused its downfall, have in turn caused IFDA and IFDA Services to suffer significant reputational damage, lost revenue and foreseeable losses flowing directly from IFDA's many legal and regulatory problems.

12. By this lawsuit, Plaintiffs seek to recover damages commensurate with the harm IFDA and IFDA Services have suffered at the hands of its officers, directors and trusted legal

advisors. Since initiating this lawsuit, Plaintiffs have been inundated with words of support from fellow aggrieved IFDA funeral directors.

JURISDICTION AND VENUE

13. This Court has jurisdiction over this derivative action under 735 ILCS 5/2-209(a), 5/2-209(b) and 5/2-209(c) of the Illinois Code of Civil Procedure. Plaintiffs are businesses registered or incorporated under the laws of Illinois, and all Defendants are Illinois corporations, residents, and/or have otherwise submitted to the jurisdiction of this Court by transacting business in Illinois, acting as a fiduciary in Illinois, breaching a fiduciary duty in Illinois, or acting as a director or officer of an Illinois corporation.

14. Venue is proper in this Court under 735 ILCS 5/2-101(1) and (2) because Defendants Charles S. Childs, Jr., Michelle Harrison, and Jack Kynion are located in this judicial district. In addition, a portion of the transactions from which the causes of action arose took place in this judicial district.

THE PARTIES

15. Plaintiff Calvert Funeral Homes, Ltd. is an Illinois corporation with its principle office in Clinton, DeWitt County, Illinois; it operates six funeral homes in DeWitt, Piatt and Macon Counties, Illinois. Calvert Funeral Homes, Ltd. is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

16. Plaintiff Clancy-Gernon Funeral Homes, Inc. is an Illinois corporation operating four funeral homes across the state of Illinois, with its headquarters in Bourbonnais, Kankakee County, Illinois. Clancy-Gernon Funeral Homes, Inc. is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

17. Plaintiff Aaron Todd Dean operates Bass Patton Dean Funeral Home as a sole proprietorship in Hillsboro, Montgomery County, Illinois. The Bass Patton Dean Funeral

Home is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed customers' funds in the Preneed Trust. Mr. Dean also operates the Toberman-Dean Funeral Home as a sole proprietorship in Coffeen, Montgomery County, Illinois. The Toberman Dean Funeral Home is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

18. Plaintiff Fred C. Dames Funeral Homes, Inc. is an Illinois corporation that operates a funeral home in Joliet, Will County, Illinois, where it also maintains its headquarters. It also operates another funeral home in Morris, Grundy County, Illinois. Fred C. Dames Funeral Homes, Inc. is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

19. Plaintiff McCracken-Dean Funeral Home, Inc. is an Illinois corporation that operates a funeral home and maintains its headquarters in Pana, Christian County, Illinois. McCracken-Dean Funeral Home, Inc. is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

20. Plaintiff Knapp Funeral Homes, Inc. is an Illinois corporation operating eight funeral homes across the state of Illinois, and maintains its headquarters in Watseka, Iroquois County, Illinois. Knapp Funeral Homes is a member of IFDA, was a participant in the IFDA Preneed Trust program, and has deposited preneed funds in the Preneed Trust.

21. Nominal Defendant IFDA is an Illinois not-for-profit corporation headquartered in Sangamon County, Illinois. Its street address is: 215 South Grand Avenue West, Springfield, Illinois 62704. IFDA is one of the largest state funeral directors associations in the country, with over 750 members statewide when this lawsuit was first filed. Each member of IFDA's Board of Directors is also on the Board of Directors of its subsidiary IFDA Services.

22. Nominal Defendant IFDA Services is an Illinois corporation with its headquarters in Sangamon County, Illinois. Its street address is: 215 South Grand Avenue West, Springfield, Illinois 62704. IFDA Services offers funeral directors services including the IFDA Preneed Trust program, for which it acted as trustee until late 2007 or early 2008, when it was found to be without a valid license. IFDA Services is a wholly owned subsidiary of IFDA. IFDA Services' Board of Directors is made up of the same individuals as IFDA's Board of Directors.

23. Defendant Robert W. Ninker ("Ninker") was the Executive Director of IFDA from approximately 1971 to 1998, and is currently believed to be a resident of both Springfield, Sangamon County, Illinois and Marco Island, Collier County, Florida.

24. Defendant Paul G. Dixon ("Dixon") was the Executive Director of IFDA from approximately 1998 to January of 2008, when he either resigned or was terminated from IFDA. Dixon is a resident of Springfield, Sangamon County, Illinois.

25. Defendant Kevin Burke ("Burke") is a Certified Public Accountant and was IFDA's Controller from approximately 1999 to 2001 and from 2007 to mid-2008. Upon information and belief, Burke is no longer employed by IFDA. Burke is a resident of Chatham, Sangamon County, Illinois.

26. Defendant Rob Konzelmann ("Konzelmann") is a Certified Public Accountant and was IFDA's Controller from approximately 2001 to 2007. Konzelmann is a resident of Williamsville, Sangamon County, Illinois.

27. Defendant James D. Bosma ("Bosma") is the current Board Member and was President of IFDA and IFDA Services' Board of Directors, from June 2008 until June 30, 2009. Bosma was a member of the Preneed Trust Committee from June 2007 to June 2008, and was

present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Bosma is a resident of Morrison, Whiteside County, Illinois.

28. Defendant Geoffrey W. Hurd (“Hurd”) was the President of IFDA and IFDA Services’ Board of Directors from June 2007 to June 2008 and served on the IFDA Audit Committee. Hurd was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Hurd is a resident of Knox County, Illinois.

29. Defendant Charles S. Childs, Jr. (“Childs”) is a current Board Member and was President of IFDA and IFDA Services’ Board of Directors from June 2006 to June 2007. He was a member of the IFDA Trust Committee from June 2007 to June 2008, and was a member of the IFDA Audit Committee beginning in June 2007. Childs was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Childs is a resident of Chicago, Cook County, Illinois.

30. Defendant Brent M. Davis (“Davis”) was President of IFDA and IFDA Services’ Board of Directors from June 2005 to June 2006, and was a member of the IFDA Audit Committee beginning in June 2006. Davis was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Davis is a resident of Carlinville, Macoupin County, Illinois.

31. Defendant Derek S. Johnson (“Johnson”) was President of IFDA and IFDA Services’ Board of Directors from June 2004 to June 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Johnson is a resident of Benton, Franklin County, Illinois.

32. Defendant Jack R. Kynion (“Kynion”) was President of IFDA and IFDA Services’ Board of Directors from June 2003 to June 2004, was a member of the IFDA

Investment Committee from June 1999 to June 2000, and the IFDA Audit Committee from June 1999 to June 2000 and since June 2006. Kynion is a resident of Northbrook, Cook County, Illinois.

33. Defendant King Sutton (“Sutton”) was President of IFDA and IFDA Services’ Board of Directors from June 2002 to June 2003, and was a member of the IFDA Audit and Investment Committees from June 1999 to June 2000. Sutton is a resident of Paris, Edgar County, Illinois.

34. Defendant Randall L. Earl (“Earl”) was President of IFDA and IFDA Services’ Board of Directors from June 2001 to June 2002, and was a member of the IFDA Audit and Investment Committees from June 1999 to June 2000. Earl is a resident of Decatur, Macon County, Illinois.

35. Defendant David M. McReynolds (“McReynolds”) was the President of IFDA and IFDA Services’ Board of Directors from June 2000 to June 2001, was a member of IFDA Audit and Investment Committees from June 1999 to June 2000, and was on the IFDA Audit Committee beginning in June 2006. McReynolds was a member of the Preneed Trust Committee from June 2007 to June 2008. McReynolds was also present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. McReynolds is a resident of Marion, Williamson County, Illinois.

36. Defendant Dennis R. Davison (“Davison”) was President of IFDA and IFDA Services’ Board of Directors from June 1998 to June 1999, and was a member of the IFDA Audit and Investment Committees from June 1999 to June 2000, and from June 2006 to June 2008. Davison is a resident of Decatur, Macon County, Illinois.

37. Defendant Richard D. Yurs (“Yurs”) was President of IFDA and IFDA Services’ Board of Directors from June 1991 to June 1992, and was a member of the IFDA Audit Committee from June 2006 to June 2007. Yurs is a resident of Geneva, Kane County, Illinois.

38. Defendant Eric R. Trimble (“Trimble”) was a member of IFDA’s Audit Committee from June 2006 to June 2007, and the IFDA Trust Committee from June 2007 to June 2008. Trimble is a resident of Moline, Rock Island County, Illinois.

39. Defendant Chris Wooldridge (“Wooldridge”) was the Vice President of IFDA’s Board of Directors from June 2007 to June 2008, and served as President Elect until June 30, 2009, when he took over as the new President. Wooldridge resigned from this position in December, 2009. Wooldridge was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Wooldridge is a resident of Brighton, Jersey County, Illinois.

40. Defendant Donald Henderson (“Henderson”) was a Regional Director on IFDA’s Board of Directors beginning in 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Henderson is a resident of Pekin, Tazewell County, Illinois.

41. Defendant Steven Dawson (“Dawson”) was a Regional Director on IFDA’s Board of Directors beginning in 2005 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Dawson is a resident of Franklin Park, Cook County, Illinois.

42. Defendant Michelle Harrison (“Harrison”) was a Regional Director on IFDA’s Board of Directors and was present at the June 25, 2008 meeting in which Plaintiffs made a

demand upon the IFDA Board of Directors. Harrison is a resident of Blue Island, Cook County, Illinois.

43. Defendant Michael Sayles (“Sayles”) is currently the Vice President of IFDA’s Board of Directors and was previously a Regional Director since approximately 2006. Sayles present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Sayles is believed to be a resident of Joliet, Will County, Illinois.

44. Defendant Vickie Diedrich (“Diedrich”) has been a Regional Director on IFDA’s Board of Directors since 2007 and was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Diedrich is a resident of Springfield, Sangamon County, Illinois.

45. Defendant Linda Allan (“Allan”) is currently the President of IFDA’s Board of Directors, and was previously a Regional Director since 2007. Allan was present at the June 25, 2008 meeting in which Plaintiffs made a demand upon the IFDA Board of Directors. Allan is a resident of Collinsville, Madison County, Illinois.

46. Defendant Cullen of Sorling, Northrup, Hanna, Cullen & Cochran, Ltd. is and has been corporate legal counsel to IFDA, IFDA Services and the Preneed Trust for many years, possibly for over two decades. Cullen was regularly asked to, and did, advise the Board of Directors of IFDA and IFDA Services on matters relating to the operation of the Preneed Trust, including potential liability for IFDA or the Directors related to its operation.

47. Cullen is a resident of Springfield, Sangamon County, Illinois. In addition to acting as corporate legal counsel, Cullen was appointed IFDA’s in-house Managing Staff Director as of February 29, 2008, and served in that capacity for an unknown period of time extending, upon information and belief, at least until the end of June 2008:

Effective immediately, the IFDA Board of Directors announces the appointment of Mark K. Cullen, the IFDA's long time legal and trust counsel, as the Managing Staff Director for the purposes of overseeing the conversion of the IFDA Preneed Trust to an institutional fiduciary as required by the Illinois Comptroller. Mr. Cullen will also be providing staff leadership as IFDA works with Regions Morgan Keegan Trust on the form of future offerings, while also resolving issues involving the distribution of any future key man insurance death benefits currently being disallowed by the Comptroller as plan assets.

Feb. 29, 2008 Announcement, IFDA Announces Interim Trust and Program Management Strategy.

48. Defendant Sorling is an Illinois limited liability corporation and law firm based in Springfield, Illinois with another office in Peoria, Illinois. Cullen is a named partner and has practiced law at Sorling since 1991. Upon information and belief, Sorling attorneys (in addition to Cullen) and staff regularly performed legal work for IFDA, IFDA Services and/or the Preneed Trust.

SUBSTANTIVE ALLEGATIONS

I. IFDA, IFDA SERVICES, THE PRENEED TRUST AND PRENEED CONTRACTS.

A. Summary of IFDA and Its Members.

49. IFDA is a not-for-profit corporation that was originally founded in 1881. It is currently one of the largest state funeral directors associations in the country, with over 750 members statewide when this lawsuit was first filed. Its stated goal is to provide resources to support its members and make them professionally, ethically, and operationally superior, and to advocate for the funeral service profession.

50. Each of the Plaintiffs, like other IFDA members in good standing, is a member of IFDA with voting rights and other benefits. As members of IFDA, Plaintiffs were eligible to and did participate in the Preneed Trust program offered by IFDA Services.

51. The Illinois General Not-For-Profit Corporation Act of 1986 contemplates derivative suits by members on behalf of such corporations:

Nothing in this Act shall be construed to affect any pre-existing common law *right of a voting member to bring an action in this State in the right of such corporation*, nor shall this Act be construed to create any such right that did not exist prior to the effective date of this Act.

In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or, to the extent provided for by Section 107.80 of this Act . . . , *through a member in a representative suit*, against the officers or directors of the corporation for exceeding their authority...

805 ILCS 105/107.80 (2008)(emphasis added); 805 ILCS 105/103.15 (emphasis added).

B. Creation Of IFDA Services And The Preneed Trust.

1. IFDA Services Is Established.

52. IFDA Services was incorporated in 1976, and is a wholly-owned subsidiary of IFDA. It is a for-profit corporation that offers funeral directors services targeted to the needs of their business. IFDA Services' mission statement is to "demonstrate competence, reliability, integrity, and professionalism in developing creative solutions which exceed member expectations."

2. IFDA Services Creates The Preneed Trust.

53. In 1979, IFDA Services established the Preneed Trust, then solely in a taxable form, intending to provide an effective vehicle for preneed customers to finance their Preneed Contracts. IFDA Services was licensed to be the trustee of the Preneed Trust on April 11, 1980 by the Illinois State Comptroller at that time, Roland W. Burris. Subsequently, on July 1, 1983, IFDA Services signed a Trust Agreement to act as trustee. In 1986, the Preneed Trust program

was supplemented by the creation of the Preneed Trust Tax-Exempt Fund, which was to provide clients with the option of having their preneed account grow on a tax-free basis.

54. IFDA Services acted as trustee of the Preneed Trust for decades until, in September 2007, the IOC *ab initio* stripped IFDA Services of its license to act as a trust business, and on May 30, 2008, the IDFPR issued IFDA Services an Order to Cease and Desist, on the grounds that it was unauthorized to conduct a trust business. Shortly thereafter, Merrill Lynch Bank & Trust Co. FSB (“ML Trust”) took over as temporary trustee, a position that became permanent on or about November 3, 2008.

55. While IFDA Services’ license was revoked by the IOC *ab initio* (meaning void from the beginning), it at all times acted as a trustee, agent and/or fiduciary to the Preneed Trust and, as such, separate and apart from the formal license which was ultimately revoked, it always owed all applicable duties to the Preneed Trust and its beneficiaries and depositors. Furthermore, the license revocation was purportedly with respect to IFDA Services’ status as seller of Preneed Contracts, not as a trustee and, therefore, its status as a trustee, for which it was duly licensed in 1980, was not legally affected by the IOC’s revocation action. Moreover, IFDA Services had all of the rights and responsibilities that flowed from this position. This included the ability to retain, contract with and/or rely on other experts, service providers and advisors.

3. The Preneed Trust Tax-Exempt Fund Is Created.

56. The Preneed Trust Tax-Exempt Fund was created in 1986 for the purpose of allowing preneed customers to have their trust accounts grow tax-free. Unlike the taxable portion of the Preneed Trust, “[s]ince the tax-exempt program requires long-term commitments by IFDA Preneed Trust, *your deposit commitment must be for a minimum of five years*, unless

the client dies or requests a withdrawal in writing.” December 1999 IFDA Preneed Trust letter to IFDA members (emphasis in original).

57. One of the benefits of the Preneed Trust Tax-Exempt Fund was to avoid reminding the preneed customers of their own mortality with an annual mailing of an interest reporting form (Form 1099). The mortality concept has always been critical to the satisfaction of preneed customers insofar as it allowed choices to be made by the customers while sparing their survivors the emotional and financial obligations associated with a funeral. The tax-exempt option was and remains the preferred choice for approximately 75% of preneed customers.

C. The Administration of The Preneed Trust.

1. Funeral Directors Sign Participating Member Firm Agreements.

58. To facilitate and participate in funeral pre-planning programs, Plaintiffs and approximately 600-650 other IFDA members signed Participating Member Firm Agreements (“PMF Agreements”) with IFDA Services during its time as trustee. According to at least one version of the PMF Agreement, each funeral home was an authorized agent of IFDA Services. At all times, however, Plaintiffs and other similarly situated funeral homes were authorized to accept Preneed Contracts on behalf of IFDA.

59. The Preneed Contracts, which were created by IFDA Services as trustee and signed by participating funeral homes and their preneed customers, provided that the funds would be held in the Preneed Trust until the beneficiary’s death. At that time, the Preneed Contract required that the funeral home “provide a funeral with the [specified] merchandise and services.” The Burial Act provides that the trustee and funeral directors are entitled to certain administrative fees and compensation. 225 ILCS 45/1b, 45/5.

2. Guaranteed Versus Non-Guaranteed Preneed Contracts.

60. During the time IFDA Services acted as trustee of the Preneed Trust, it offered two principal kinds of contracts: guaranteed and non-guaranteed.

61. As explained by the IOC:

A guaranteed contract is a pre-need contract in which you pay for the goods and services you have selected in full at the same time you sign the contract. This ensures that the price you have paid is fixed, and that there will be no additional charges at the time of need, provided you do not add any goods or services in the future. Though the seller does absorb the interest earned on this money between the time it is paid and the time it is needed, he/she also absorbs the increasing cost of the goods and services, which typically rise over time.

A non-guaranteed contract is a pre-need contract in which prices are not fixed. Since this contract does not lock in specific prices, any money paid on it is simply a deposit to be applied to the total bill at the time of need. If the money paid on the contract exceeds the cost of the goods and services contracted for, the excess funds are returned to the consumer.

<http://www.ioc.state.il.us/office/CCBT/index.cfm?Fuseaction=showPage&PageID=90>).

62. In the case of a non-guaranteed contract, monies deposited would be applied toward the purchase price of the funeral, although the total price for the goods and services was not guaranteed. Typically, in the case of a non-guaranteed contract, merchandise and services were selected by the legal next of kin when the customer actually passed away. Any excess funds were then transferred to the decedent's estate, or if the preneed funds were insufficient to pay for the merchandise and services, the decedent's family would pay the difference.

63. For guaranteed contracts, the intention was that regardless of inflation, the principal and accrued interest would pay for the entire funeral. Similarly, for non-guaranteed contracts, they would pay a portion, if not all, of the funeral costs, depending on the amount deposited by the preneed customer and the accumulated interest.

II. IFDA SERVICES WAS THE TRUSTEE OF THE PRENEED TRUST.

A. Summary of IFDA Services' Obligations As Trustee of The Preneed Trust.

64. IFDA Services' Board of Directors, which was comprised of the same individuals who served on IFDA's Board of Directors, were charged with acting as trustee of the Preneed Trust and supposedly investing the Preneed Trust funds. In that capacity, IFDA Services (and thus its Board of Directors) was required to "exercise the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital." Burial Act, 225 ILCS 45/4a. Similar duties and requirements are set forth in Illinois' Trusts and Trustees Act, also applicable to IFDA Services. 760 ILCS 5/5 (1), (2), (3), (5), (6).

65. As the IFDA Manual makes clear, IFDA's directors and officers also owed and owe the corporation and its parents, agents, and members fiduciary duties of care and loyalty. They were at all relevant times and are obligated to, *inter alia*, act with the level of care an ordinary prudent person in a like position would exercise under similar circumstances and to always put the interests of those to whom they owed their duties first.

66. Cullen appeared at Board meetings on several occasions to address the Board regarding their roles and responsibilities, including their duties of care, loyalty and obedience. At a 2001 meeting, Board members were provided with a document called "10 questions directors should ask themselves when evaluating their performance," which asked them the following:

- (1) Can you say that your independence is never compromised by a need for prestige or income derived from board membership, or by loyalty to an individual who invited you to join the board?

(2) Does the CEO know your concerns about the corporation and his or her administration?

* * *

(4) Do you question the reasonableness of the corporation's plans and projections?

(5) Do you spend enough time understanding the corporation and its industry to be challenging and helpful to management?....

67. Furthermore, IFDA's own written policies clearly set out the responsibilities of the Board of Directors:

The Board of Directors of the Illinois Funeral Directors Association is fundamentally responsible for defining the organization's mission and what it strives to accomplish. In addition, general responsibilities include: select the chief executive and assess his or her performance; ensure effective ongoing strategic planning and monitoring of strategic objectives; ensure sufficient development and proper allocation of resources; determine and monitor the organization's results; assess its own performance; enhance the organization's public standing; and, ensure legal and ethical integrity and maintain accountability.

IFDA Official Statement of Policy, Mar. 8, 2001.

68. At all relevant times, IFDA's directors and officers were responsible for the supervision and implementation of investment policy relating to the Preneed Trust, and in doing so they were obligated to adhere to the "prudent investor" rule. Burial Act, 225 ILCS 45/4(a). The directors and officers could, however, hire an investment advisor, and could delegate the investment responsibility to another. In fact, except for Cullen, most of the Director and Officer Defendants are themselves funeral directors who had their own businesses to run.

69. The Illinois Trust and Trustees Act specifically authorizes a trustee to "appoint attorneys, auditors, financial advisers and other agents." 760 ILCS 5/4.09. Furthermore, [i]f the trustee uses reasonable care, skill, and caution in the selection of the agent, the trustee may

rely upon the advice or recommendation of the agent without further investigation.” *Id.* IFDA’s directors and officers did in fact rely on the advice of their professional advisors. They have “admit[ted] that they relied on the professionals they retained and employed to design, invest, administer and conduct the Preneed Trust.” IFDA Answer, ¶7.

70. However, the Director and Officer Defendants and Cullen have long been on notice that Schainker demonstrated “incompetence, untrustworthiness, and financial irresponsibility,” (as the DOI noted in his license revocation). Had they complied with their duties to IFDA and IFDA Services, they would never have relied on Schainker and other Merrill Lynch PFS advisors who recommended an illegal investment program that had no relationship to the needs of the Preneed Trust in the first instance, and would have sought other opinions and qualified help once the red flags began appearing instead of unquestioningly following Schainker’s clearly flawed advice.

71. As one example of the many opportunities the Director and Officer Defendants and Cullen squandered, in March 1999, Robert Ninker, who had announced six months prior that he would be resigning in 3-5 months, told the Board, after an extensive discussion of the Trust and insurance policies, that “[t]he guaranteed trust is the greatest storehouse of wealth you will ever have.” Just over a year later, in June 2000, with the Trust looming on the verge of deficit, the Board entrusted Mark Cullen to shepherd and present for their review proposals from six different financial advisors, in addition to Merrill Lynch. In August 2000, the IFDA staff reviewed and discussed the proposals with the Board, recommending no change in the management of the investments of the IFDA Preneed Trust. Unknown to Plaintiffs, by the end of 2000, the Tax Exempt Trust was in the red.

**B. IFDA Services Engages The Schainker Group
And The Merrill Lynch Defendants**

72. Upon information and belief, Schainker has been involved with the Preneed Trust since its inception, or at the latest since 1987. Using Schainker's own words, IFDA summarized his role as follows in a March 15, 2007 letter to Scott Clarke of the IDFPR:

Mr. Schainker provides advice on investments and strategies aimed at accomplishing the stated goals of each entity. Mr. Schainker makes recommendations, including on fixed income and equity markets, as they pertain to both the taxable and tax-exempt investments of IFDA Preneed Trust. Assets are reviewed and rebalanced on a routine basis in an effort to adhere to the stated investment policies. Assets may be adjusted to manage risk and reflect the tenor of the markets. Research is used in the area of asset allocation, modeling, sector weighting, fixed income duration, maturity, credit quality, and capitalization levels.

There are no written contracts between Ed Schainker and these entities. Mr. Schainker and Merrill Lynch are bound by the laws and regulations of the Securities and Exchange Commission and the National Association of Securities Dealers, which require them to 'know their client' and to make appropriate recommendations based upon the risk tolerance and objectives of their client. Standard new account forms and Merrill Lynch Cash Management Account forms are on file with Merrill Lynch. (Emphasis added).

73. What Schainker failed to mention in this synopsis is that – with the Director and Officer and Cullen's knowledge - he was also acting as a life insurance agent and broker, seeking out and procuring life insurance policies not only for Merrill Lynch PFS and MLLA, but for the insurance companies as well, and ML Life in particular. In a July 21, 2006 letter to the IOC, IFDA Services describes "Merrill Lynch" as IFDA Services' "investment advisor, insurance agent."

74. During the relevant time period, Schainker often attended IFDA Board meetings, made presentations to its members and committees, and occasionally communicated with IFDA

members. Felsch often attended Board meetings with Schainker, as did other individuals associated with Merrill Lynch PFS and MLLA, to discuss the life insurance policies.

75. Limited discovery has shown that the Schainker Group Merrill Lynch PFS and MLLA's association with IFDA did not have the indicia of a broker-dealer or trading relationship with their customer. In fact, it appears that their dealings were specifically designed to avoid the typical broker-dealer and customer relationship. Instead, the relationship went outside these boundaries, with the Schainker Group, Merrill Lynch PFS and MLLA acting, not as brokers or traders, but as life insurance agents selling policies for ML Life Insurance and the other insurance companies. These policies, which were the so-called investments, were not even held at Merrill Lynch PFS. Instead, the policies were held at the First Bank of Springfield, now known as U.S. Bank. Accordingly, U.S. Bank was the depository trustee for these policies.

76. That this was not a typical broker-dealer relationship is confirmed by the fact that, upon information and belief, MLLA was established as a wholly-owned subsidiary of Merrill Lynch PFS specifically to sell insurance products. This was something that Merrill Lynch PFS could not do itself because of the general prohibition on the payment of insurance commissions to entities not licensed as insurance agents and most state laws do not allow a non-domestic corporation or a corporation not primarily engaged in insurance sales to be licensed as an insurance agent. Further, all insurance transactions conducted or orchestrated by MLLA were designed to occur and in fact occurred outside of the business of Merrill Lynch PFS.

77. Charged with acting on behalf of IFDA and IFDA Services, the Director and Officer Defendants breached their duties of care by, *inter alia*, permitting Schainker, MLLA, and Merrill Lynch PFS to initiate and perpetuate the Life Insurance Enterprise, despite its

failure to comply with Illinois law and its lack of an actuarial or any other relationship to the needs of the Preneed Trust; repeatedly ignoring the numerous and increasingly obvious red flags that disaster was ahead and failing to intervene to prevent the disaster; failing to adequately monitor, question, and supervise the financial and legal advisors they engaged to ensure that they were competent; failing to have a contract specifying the scope and authority of their financial advisors' engagement as required by Illinois law; and failing to protect the interests of IFDA's members.

III. PLAINTIFFS AND OTHER IFDA MEMBERS WERE UNAWARE OF THE LIFE INSURANCE ENTERPRISE AND THE RESULTING DEFICITS.

78. Based on IFDA and IFDA Services' representations, which upon information and belief were based on information obtained from their financial and legal advisors, Plaintiffs and other IFDA members were informed and reasonably believed that the Preneed Trust funds were invested in safe and tax-exempt investment vehicles such as laddered AAA municipal bonds. As set forth in at least one version of the PMF Agreement between IFDA Services and IFDA members, the Preneed Trust funds were to be placed in "high grade investments selected to provide earnings commensurate with safety of principal."

79. IFDA Services' December 1999 letter to IFDA members provides some of the many representations made by IFDA Services in connection with its role as trustee of the Preneed Trust:

[IFDA Services] will invest [the Preneed Trust] funds predominantly in quality, fixed income securities, such as U.S. Treasury securities, government agency obligations, certificates of deposit, corporate bonds, etc. A portion of these funds will also be placed in equities or mutual funds. These investments are used in an effort to enhance the yield available on fixed income securities. The mix of investments will change in accordance with financial and economic conditions.

Interest earnings will be based on projected rates specified for the time period in which the funds are received. Since 1980, when the [taxable Preneed Trust] program began, [IFDA Services has] been fortunate that the earnings always met projections, although that may not always be the case.

The designated rate of earning is projected for a one year period. At the end of the period, [IFDA Services, Inc. will notify participating members] of the anticipated rate which will be valid for the next investment period.

[IFDA Services] will provide a report on all trust accounts to you and to the Office of the Comptroller on an annual basis, so that you do not have to keep track of trust principal, interest, withdrawals and totals.

In summary, [the preneed funeral planning customer] has protection of the principal and the anticipated earnings, and [the participating funeral home is] released from much of the administrative responsibility.

80. These representations, which make no mention of the purchase or holding of life insurance policies, were in line with the objective shared by Plaintiffs and participating funeral homes of solving in advance many of the planning and financial concerns faced by preneed customers. The ability to provide for safety of principal and a reasonable rate of return to account for inflation were in line with how IFDA members believed their preneed customers' funds were being handled, and enabled them to ease the minds of their constituents.

81. IFDA members were further comforted by the quarterly, monthly and annual statements issued by IFDA Services which reflected the prospective rates of return for Preneed Trust funds for an anticipated period of time (referred to as "credited rates"). These credited rates were generally competitive in the market place for tax-exempt deposits. Indeed, the program worked much like purchasing a certificate of deposit at a financial institution.

82. In addition, funeral directors were comforted by repeated treasury reports at their conventions that said everything was "sound." Schainker himself attended conventions and

touted the Preneed Trust's "investments" to funeral directors. The fact that Schainker was a well-known financial adviser that had the backing of Merrill Lynch did not go unnoticed. Indeed, prior to its near collapse (and purchase by the Bank of America), Merrill Lynch was one of the most venerable brand name financial institutions.

83. The Director and Officer Defendants knew, or certainly should have known, that these representations were misleading and inaccurate, and that funeral directors would rely on these and similar representations when depositing funds in the Preneed Trust.

84. The following is an excerpt from a June 25, 1990 letter from IFDA's then-Executive Director Ninker to a funeral home owner inquiring about IFDA trust options, explaining the investment strategies of the Preneed Trust:

This is in response to your inquiry regarding IFDA Trusts, investment philosophy and protections for your taxable and tax-exempt deposits. For the last ten years, IFDA Services, Inc. has provided membership service for funeral director trusts. There are over 400 participating firms with over 63 million dollars of deposits in IFDA trust or IFDA Credit Union.

You inquired about FDIC protection. Your funds are in trust with First National Bank. While they have insurance against theft and similar concerns, the protection is in the investments themselves. We, and the First National Bank, are bound by the prudent person rule. But, your Board has an even more conservative approach. Our investments are more than 90% in pure U.S. Treasury Bonds or government backed agencies. We also have deposits in selected banks and savings and loans with no more the \$100,000 in deposits at any institution.

IFDA cannot guarantee trust income projections. They are dependent upon actual earnings. Yet, over the last decade, our estimates have always been accurate. The reason is that we base them upon the government portfolio which we select. We are protected, too, in that participants agree to leave their funds with us for five years except for the usual payouts when a death occurs. In this way, virtually all of our funds can be invested rather than having to hold large reserves for unanticipated payouts.

Incidentally, you may be interested in the free “key man” insurance policy we have on 80 participants. I note we don’t have you covered. The insurance is in exchange for you taking a physical exam and letting us take out an insurance policy on you under the tax-exempt program. If you want details, contact Karen or Mary Bonner.

85. In response to this letter, many long-time IFDA members from generations of funeral directors complied with this request, believing they were helping their long-time funeral directors association.

IV. THE LIFE INSURANCE ENTERPRISE.

A. Basic Summary of The Life Insurance Enterprise.

86. What Plaintiffs and IFDA members around the State of Illinois did not know was that, despite every duty to act to the contrary and protect the Preneed Trust funds, the Director and Officer Defendants, with Cullen and Sorling’s cooperation and approval, allowed the Preneed Trust to be tied up almost exclusively in unlawful and illiquid life insurance policies.

87. Specifically, in 1986, Schainker presented a plan to the IFDA Board of Directors to purchase variable universal life (“VUL”) insurance policies with Preneed Trust funds as the appropriate tax-exempt trust option. The IFDA Board of Directors approved this plan in 1986. In doing so, the IFDA Board of Directors lit the fuse on a time bomb that would ultimately explode and cause millions of dollars in damages to their funeral director members and their client families around Illinois. IFDA and IFDA Services would suffer reputational damage, lost revenue, and increased exposure to legal liability as a direct result of the harm caused to the Preneed Trust.

88. Schainker was a licensed Illinois insurance producer (215 ILCS 5/500-35) beginning in 1985. Notably, his producer license was revoked by the Department of Insurance (“DOI”) on May 18, 2009 upon a finding that with respect to the Life Insurance Enterprise,

Schinker “demonstrated incompetence, untrustworthiness, and financial irresponsibility.”
IDFPR May 18, 2009 Order at ¶ 20.

89. Illinois’ Secretary of State issued an Amended Notice of Hearing against Schinker outlining his numerous violations of Illinois’ securities laws, including his breach of fiduciary duty when he allowed IFDA Services to invest Preneed Trust funds in a way plainly prohibited by the Burial Act.

90. Ultimately, the Schinker Group, Merrill Lynch PFS, MLLA, and the insurance companies were able to sell over \$357 million worth of life insurance coverage (as calculated by total death benefits), which represented over 300 VUL policies sold and issued to IFDA including approximately 129 “Merrill Lynch Investor Life” ML Life policies. In total, these VUL policies generated nearly \$90 million in premiums for the insurance companies. These insurance policies were single premium policies which earned the highest commissions. In addition, Merrill Lynch PFS received significant fees on the investments underlying the insurance cash values.

91. Upon information and belief, Cullen and Sorling knew the intricacies of the Life Insurance Enterprise from the beginning, and, over the years, offered opinions and analysis on IFDA’s status as trustee, the use of life insurance policies as a purported investment tool for the Preneed Trust, and the existence of an insurable interest.

92. Many of the VUL life insurance policies are modified endowment contracts (“MECs”), which is critical. A VUL becomes a MEC once its value exceeds the premiums paid on the policy. So even if the policies added value, the “tax-exempt” status could be destroyed by earnings pursuant to applicable IRS rules.

93. Once a MEC, the tax-exempt status of the “investment” may be destroyed because it effectively forecloses the ability to access the value of the policies prior to the date of death of the insured. MECs are subject to an excise tax if they are terminated or if funds are withdrawn or borrowed before the insured reaches 59½ years old, in addition to the regular income tax that may be triggered upon accessing the policy proceeds before the death of the insured.

94. Such policies are also subject to the regular taxes that may be triggered on any deferred gain inside of the policies if they are liquidated for any reason before the death of the insureds. Among other problems, because of the tax consequences of such a transaction, this seriously impeded IFDA Services’ ability to liquidate the Preneed Trust investments to pay death claims or otherwise reinvest the funds in more appropriate investment vehicles. It has also caused substantial loss to the Preneed Trust as ML Trust engaged in a fire sale (known as a “surrender”) of the policies, incurring substantial tax liability in the second half of 2009. These life insurance policies were wholly inappropriate and needed to have constant monitoring – which did not occur.

B. The Necessary Due Diligence Was Not Conducted With Respect To The Life Insurance Enterprise.

95. The Director and Officers failed to establish the scope and specific terms of their delegation of investment duties to their investment advisors, failed to review their advisors’ investment actions, monitor their performance, and/or failed to consider whether the Life Insurance Enterprise was, and continued to be, reasonable and appropriate. Thus, the Director and Officer Defendants, with Cullen as their advisor, failed to comply with their duties to IFDA and cannot hide behind the egregious conduct of the Schainker Group, Merrill Lynch PFS, and

MLLA (which each had – and breached – their own heightened and affirmative duties to act with due diligence and care).

96. For instance, the Schainker Group, Merrill Lynch and MLLA never performed or commissioned actuarial or other financial analyses to determine if the purchases of the life insurance contracts, the continued holding of the life insurance contracts, and the payment of premiums to maintain the life insurance policies were suitable, lawful, or even in the best interests of IFDA, IFDA Services, and its members.

97. Similarly, the Schainker Group, Merrill Lynch and MLLA never determined or caused to be determined whether there was a correlation between the anticipated timing of the deaths of IFDA members insured by VUL policies and the anticipated timing of the deaths of preneed customers.

98. The Schainker Group, Merrill Lynch and MLLA did not determine or cause to be determined whether the Life Insurance Enterprise would or could provide in a timely manner the revenue necessary to cover the Preneed Trust's liabilities.

99. Frankly, there is no connection between the expected life spans of the insureds and the need for funds with which to pay the funeral expenses of preneed customers. For example, upon information and belief, the average age of the insureds currently is in the mid-60s and such average age was much lower when the Preneed Trust purchased the policies. On the other hand, the average time period from the date that funds are deposited into the Preneed Trust to the date of the customer's death is approximately 7 to 9 years. As a result, the timing of the "maturity" of the Preneed Trust assets (*i.e.*, the date of death of the insureds) did not, and foreseeably would not, match the timing of the Preneed Trust's liabilities (*i.e.*, paying for the funeral costs of the deceased preneed customers).

100. This is a common-sense mismatch that easily could have been avoided at the outset had Cullen and the Director and Officer Defendants commissioned an actuarial study or analysis. Damages could have likewise been avoided had Cullen and the Director and Officer Defendants immediately initiated an actuarial study upon receiving notice of the impending deficit in the Preneed Trust.

101. Cullen helped the Schainker Group, Merrill Lynch PFS, and MLLA paint these life insurance policies as being “key man policies,” but they were not. Key man insurance is life insurance in which an employer takes out a life insurance policy on the life or health of a key employee to reflect the hardship it would endure upon the death of the insured. This hardship may include locating and training a replacement employee, the loss of sales that would occur upon the death of a top salesperson, and similar expenses that reasonably flow from such a loss.

102. Notably, despite their affirmative duties to protect IFDA, neither the Director and Officer Defendants nor Cullen and Sorling raised these glaring omissions with the Schainker Group, Merrill Lynch PFS or MLLA, ever asked how this plan could possibly be an appropriate or reasonable investment scheme.

103. None of the foregoing bases for key man insurance existed, but the Schainker Group, Merrill Lynch PFS and MLLA needed lives to insure in order for the Life Insurance Enterprise to work. Accordingly, Schainker (with the IFDA Board of Directors’ knowledge) began soliciting unsuspecting funeral home directors across Illinois to allow IFDA Services to take out a life insurance policy on their lives, luring them with the promise that permitting themselves to be insureds would endow IFDA.

104. For example, in a February 28, 1992 letter on MLLA letterhead, Schainker stated:

On behalf of the Illinois Funeral Directors Association and Mr. Robert Ninker, I would like to ask your assistance in furthering the development of IFDA Tax Exempt PreNeed Trust program.... Your help comes by allowing the Trust to obtain an insurance policy, using you as the insured and the Trust as the owner of the policy. As a benefit for helping, the Trust will provide a \$25,000 term insurance policy on your life, with you naming the beneficiary with absolutely no cost to you.

V. THE LIFE INSURANCE ENTERPRISE BEGINS TO CAUSE DAMAGE WHILE THOSE RESPONSIBLE BEGIN TO REAP UNJUST REWARDS.

A. The Schainker Group, Merrill Lynch PFS and MLLA Coordinated The Life Insurance Enterprise.

105. In the end, Schainker was able to purchase over 300 life insurance policies on the lives of at least 120 IFDA members and others. He did this with the assistance, acquiescence, and knowledge of the Director and Officer Defendants and Cullen.

106. Not coincidentally, ML Life Insurance is believed to have issued approximately almost half of the insurance policies, including approximately 129 "Merrill Lynch Investor Life" VUL policies for which it has received \$32,016,116 in premiums. Upon information and belief, the Schainker Group and MLLA purchased ML Life Insurance policies almost exclusively until they had exhausted their opportunities and were forced to go to other insurance companies.

B. The Schainker Group, The Merrill Lynch Defendants And The Insurer Defendants Reap Huge Rewards.

107. The insurance policies purchased with Preneed Trust funds called for payments to be made to the insurance companies, the Schainker Group, Merrill Lynch PFS and MLLA for various policy fees, trailing commissions, and fund fees which diminished the Preneed Trust value by 3.5% each year. Thus, to the extent that the insurance policies did not earn at least 3.5% every year, the Preneed Trust would be behind at the end of each year, a cycle that could

– and did – snowball into a much bigger problem. And because these fees were wrapped inside the paper “earnings” of the insurance policies, they were not apparent.

108. The Schainker Group’s personal interests in pursuing this strategy are clear, even though it was contrary to the stated intentions and purposes of the Preeed Trust and should have been blatantly apparent to reasonably educated Board members and counsel. As salespeople, and advisors and/or insurance salesmen to the Preeed Trust, the Schainker Group, Merrill Lynch PFS, MLLA, ML Life Insurance, and others reaped significant commissions in connection with the sale of the insurance policies to the Preeed Trust. The Schainker Group, Merrill Lynch PFS and MLLA also received compensation for additional premium payments and longevity payments for those policies remaining in effect after a certain date.

109. Of course, Merrill Lynch PFS, MLLA and ML Life Insurance were likewise reaping substantial benefits through the Life Insurance Enterprise, with millions of dollars in premiums pouring in. The illiquidity of the VULs was just one of many other benefits of having IFDA locked in as a client.

110. The payment of premiums for these insurance policies held by IFDA (and Alabama Funeral Directors Association and Mississippi Funeral Directors Association) represented such a significant portion of the Schainker Group’s earnings that, on at least two occasions, Schainker requested that Merrill Lynch PFS waive its compensation guidelines to recognize the premium payments as “new production” for the purposes of bonus and award recognitions. In a November 14, 2006 e-mail, Summer, co-salesperson with Schainker on IFDA, AFDA and MFDA, stated:

As the 2006 FOG [Focus on Growth] campaign is drawing to a close, I wanted to take this opportunity to renew the discussion regarding our request to have the premiums from the variable universal life policies for the Illinois Funeral Directors Association

(IFDA) the Alabama Funeral Directors Association (AFDA) and the Mississippi Funeral Directors Association (MFDA) be considered as “net new annuitized” business. From 12/01/2005 through 09/01/2006, the following is a summary of the total YTD \$6,335,697 (with September, October and November premiums yet to be determined):

IFDA \$2,559,537
AFDA \$2,524,264
MFDA \$1,251,896

We were understandably shocked to discover that again in 2006 we were not receiving any of the appropriate credit. Ed [Schainker] and I both work very hard for Merrill Lynch and strongly feel that this is unfair. The funeral directors associations are an integral part of our current business, as well as our plans for future growth (and I might add significant revenue for Merrill).

111. Moreover, insurance products and VUL policies typically have higher rates of compensation for the salesperson than other financial products. As an added bonus to the Schainker Group, the continuous payment of premiums to maintain the contracts in force ensured a continued and reliable stream of income to the Schainker Group, Merrill Lynch PFS and MLLA.

112. The Director and Officer Defendants and Cullen reviewed and approved financial statements clearly demonstrating that IFDA Services received “insurance commission income” as a source of revenue, when at all relevant times, the practice of rebating or sharing an insurance agent’s commission was illegal under Illinois law. *See* 215 ILCS 5/151. Upon information and belief, IFDA Services has no other means of earning its own insurance commission income other than illegally sharing in the enormous commissions Schainker earned via the life insurance enterprise. These practices were not disclosed to funeral directors.

VI. THE LIFE INSURANCE ENTERPRISE IMPLODES AND IFDA SERVICES IS STRIPPED OF ITS TRUSTEE POSITION.

A. The Life Insurance Enterprise's First Signs of Trouble.

113. For almost three decades after issuing a license to IFDA Services, the IOC audited IFDA and IFDA Services routinely and reviewed relevant operating policies until at least 2001.

114. Sometime in 2005, the IOC conducted what it termed to be a “compliance audit” of the Preneed Trust. It then retained the public accounting firm of McGladrey & Pullen, LLP (“McGladrey”), to perform limited procedures (with the help of employees it borrowed from the firm of MS McGladrey) with respect to the Preneed Trust. The IOC generated, though it did not publicly disclose, a draft report of its “compliance audit” in September 2005, citing an approximate \$38 million deficit in the Preneed Trust.

115. As reported in one of the first State Journal-Register Articles on this issue, the IOC investigation led to the conclusion that “[IFDA Preneed Trust] had some assets-and-liabilities issues.... [The IOC] also suggested that [the Preneed Trust was a] bit larger than they're used to regulating.” Bruce Rushton, *Funeral Fund Runs a Deficit; Pre-need Trust Financed with Life Insurance*, The State Journal Register, 2/25/2008 (“State Journal Article”) (quoting Childs). The IOC also noted that in conducting the investigation, “[t]here were some things we saw that raised concerns.... One of them was a higher interest rate being paid out than what they were earning.” *Id.* (quoting Carol Knowles, spokeswoman for Illinois Comptroller Daniel W. Hynes).

116. On more than one occasion during this process, IFDA explicitly requested complete confidentiality of the purported audit, preliminary report, discussions, reports, and all ultimate findings issued by the IOC. Of utmost concern to IFDA was shielding this information from the public and, thus, its members and consumers across Illinois, to avoid any negative

impact such exposure might have. IFDA even went so far as to request that all audit-related materials be protected from otherwise lawful Freedom of Information Act requests.

117. The IOC's conclusions were kept quiet. Then, in September 2007, the IOC voided the license issued to IFDA Services by the IOC in 1980 *ab initio*. The IOC claimed to revoke IFDA Services' license because, among other reasons, the Burial Act only confers authority on its office to license *sellers* of Preneed Contracts (*e.g.* funeral homes) and provides no authority for the IOC to license a trust, much less one created for the entrustment and investment of over \$300 million in assets. The IOC affirmatively stated it had no idea why it had issued a license to IFDA Services in the first place.

118. Despite this serious turn of events, and even though Defendants in this case knew or should have known about the serious financial problems facing the Preneed Trust, on October 4, 2007, IFDA sent all members a letter informing them of the IOC's recent license revocation but promising that "there is no need for concern. All of the funds that Illinois funeral homes and their clients have placed into IFDA trust have been safely invested, and all of the money is accounted for." In fact, IFDA, through the Director and Officer Defendants, was recommending continued investment in the Preneed Trust through much of 2008.

119. From the fall of 2007 through the spring of 2008, Plaintiffs learned that the net asset value of the Preneed Trust actually began diminishing in 2001, a fact which was known but not acted upon by the IOC. The losses in the Preneed Trust have only accelerated dramatically since.

B. ML Trust Was Approached By IFDA And Schinker In 2007 To Take Over As Trustee, But Declined The Offer.

120. In early 2007, even before the IOC revoked IFDA Services' license *ab initio*, IFDA was engaged in discussions with ML Trust to take over as trustee for the Preneed Trust.

Not surprisingly, Schainker spearheaded these negotiations alongside IFDA executives. Upon information and belief, Schainker even drafted IFDA's responses to ML Trust's list of "Comments, Questions & Concerns Regarding Illinois Pre-Paid Funeral [Trust]." Schainker also acted as the go-between between ML Trust and IFDA, collecting relevant Preneed Trust information from IFDA and passing it on to ML Trust. As the architect of the Preneed Trust, it was clearly within Schainker's interests to have a Merrill Lynch-affiliated company continue on as trustee.

121. Schainker's orchestration of ML Trust's take-over as trustee continued through the fall of 2007, even after IFDA's trust license was revoked. The negotiations were far enough along such that ML Trust had proposals for replacing the crediting rate policy (although under one proposal even ML Trust planned to continue with credited rates for some unspecified time), segregating all new investments, and dealing with legal issues.

122. Also during this time, Schainker was again working closely with Felsch, of MLLA, to discuss exchanges or replacement of certain key man life insurance policies that had been identified for replacement. This, of course, would serve as yet more income for the Schainker Group, Merrill Lynch PFS and MLLA if it came to fruition.

123. On December 24, 2007, a representative of ML Trust terminated all discussions relating to ML Trust becoming IFDA Services' successor trustee, noting that "after a review of the memorandum of understanding in conjunction with the trust services MLTC typically provides, our existing investment platforms and our available resources, we have determined not to pursue the opportunity further."

124. Cullen and Schainker worked together and Schainker often brought in other related Merrill Lynch entities for advice. For example, in response to an e-mail from Cullen

indicating that Fifth Third Bank believed that transferring the life insurance policies to another trustee would cause a taxable event, Schainker stated that he would be “checking with Paul Felsch of [Merrill Lynch Insurance Group], Greg Gatesman of ML [Trust] who may have considered this during their due diligence, and ML Tax department....[but that he] did not believe, obviously, that there should be any taxable event....”

C. Regions Was Courted As Trustee But Was Rejected Once It Took The Position That The Life Insurance Policies Must Be Liquidated.

125. Cullen, acting as Managing Director and working along with IFDA’s then-president, Defendant Hurd, negotiated and represented IFDA in late 2007 through 2008 with respect to the search for a new trustee. Regions Morgan Keegan Trust (“Regions”) was the IFDA Board of Directors’ recommended successor trustee and, as such, it began doing its due diligence and expending considerable effort to ensure that it was ready and able to take the helm.

126. Part of this due diligence involved reviewing the Preneed Trust’s investments and financial health, which led to Regions concluding that it would not agree to become successor trustee without having IFDA surrender all of the life insurance policies held by the Preneed Trust. Regions determined that life insurance policies were ill-advised, imprudent, and would not generate the earnings needed by the Preneed Trust.

127. Regions ultimately refused to become the trustee because of the key man life insurance policies. While IFDA’s Board of Directors continued to insist that the life insurance policies provided a significant financial value to the Preneed Trust, Regions’ position was that, based on a sampling of the policies by an independent insurance consultant retained by Regions, the key man policies would have to have a planned liquidation before it would agree to become the trustee. Merrill Lynch PFS, MLLA and/or the Schainker Group conveyed to

