



Lessons from Takaful Could Spell Success for Fraternalists

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I'll never forget my indoctrination to the life insurance side of our business. I had just completed my initial training as a Mass Mutual agent and was firmly immersed in the “whole man” approach to the business. I had spent weeks listening to MDRT tapes that dealt as much with positive thinking, motivation, and the importance of family and giving back to the community as they did about sales, insurance and fiscal management. I believed unquestioningly that our products held the key to transforming lives and that my career had a purpose that was much bigger than just me. I had all of the single minded conviction of any soldier fresh out of boot camp (or the wide-eyed optimism of any new inductee into a cult!).

Although this well rounded perspective on work, family, and community is certainly not limited to just the insurance industry, one could argue that, given the nature of our products, there may be a heightened sensitivity in our industry for the plight of people during periods of tragedy or loss. At the very least, our industry is intimately involved in some respect of recovery whenever disaster strikes.

In fact – and I'm not looking to stake a claim on behalf of our industry for the humanitarian of the year award – the very existence of fraternal benefit societies sets our industry apart from virtually every other profession. These not-for-profit organizations provide insurance, but their primary purpose is to operate for “social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic, or religious purposes for the benefit of their members and the public”. Rather than just serving policyholders, fraternalists support the communities that their “members” live and work in. Volunteerism and community service is a huge part of the fraternal brand and is embraced equally by employees and customers alike.

The fact that insurance products can be so readily integrated into the fabric of a not-for-profit organization committed to serving the charitable needs of its members speaks volumes about our products. In addition, considering how many fraternal companies have survived for well over a century and are counted among the largest and most successful insurance companies of any kind is also a compelling endorsement of the fraternal approach to business.

The first fraternal in the US began in 1868 when John Upchurch and a group of railroad mechanics from Readville, Pennsylvania got together to form the Ancient Order of United Workmen at a time that life insurance was considered a luxury for the rich. Although there was adequate protection available

for basic funeral expenses for workers, few benefits existed to provide support for surviving spouses. Upchurch's original premise was to have each member contribute a dollar towards the support of the surviving spouse in the event of another member's death. Thus, the fraternal benefit model was born!

According to an excellent article in George Mason University's Humane Studies Review by Leslie Siddeley titled "The Rise and Fall of Fraternal Insurance Organizations", the idea caught on and by 1920 the National Fraternal Congress counted 200 member societies, although this was just the tip of the iceberg. Siddeley writes that "in 1918 alone there were 313 non-NFC fraternal organizations providing insurance to the immigrant poor in Chicago alone". In addition to trade oriented associations, ethnic fraternal were formed to help their members assimilate into their new country and religious fraternal were created to provide support that was ethically and morally consistent with a particular belief as well as to provide specific support for a congregation's community.

According to Siddeley, "fraternal organizations did not limit themselves to life insurance. Many provided protection against loss of income from sickness or accident. Some even provided medical care through "society doctors" on a fixed fee basis, much like today's HMO's. Also, many fraternal extended aid to their members even when there was no claim under the benefit rules, thus combining charity with mutual aid".

Eventually, this informal "passing the hat" method of meeting members' needs evolved into actuarially sound insurance products and is a contributing reason that so many fraternal have competed ably against traditional insurance companies for over a century. However, despite all of the advantages of the fraternal business model, overall membership has been declining. In fact, I had the privilege of speaking at the Canadian Fraternal Association's Annual Meeting in Ottawa earlier this year (where the *average* age of their member society was over 100 years) and there was a lot of discussion about how to make the fraternal message more meaningful to new members.

Siddeley's article explores a number of factors that have negatively affected fraternal including a decline in the cohesiveness of American communities and an increase in available government benefits. For example, many of the ethnic groups that formed the foundation of fraternal benefit societies are now assimilated into third and fourth generations and are less homogenous both culturally as well as geographically. In addition, food stamps, Medicaid, and social security have provided a safety net for a community's most needy that was previously provided by many religious organizations. Cultural changes have also impacted fraternal as their brands don't always resonate as much with the younger generation.

It's interesting to note that the primary challenge facing fraternal is one of communication rather than structure. The not-for-profit, community focused brand that is the foundation of a fraternal remains an extremely appealing way to differentiate their business and their products from traditional insurance companies. In fact, one only has to look at the success of Takaful -- a newly emerging business strategy that shares a number of similarities with the principles that formed the foundation of fraternal benefit societies -- for affirmation that a more charitable approach to our business can have mass appeal for ALL types of companies.

A report by LIMRA International Researcher Ruthine Williams-Baron titled "Takaful – An Alternative to Conventional Insurance", states that "Muslims account for about one fourth of the world's

population. However, a large portion of the Muslims remain uninsured or underinsured, mainly due to religious beliefs. Muslims believe that conventional insurance is against the teachings of Allah and is therefore sinful”.

Conventional insurance contains three primary elements that run contrary to Islamic beliefs – uncertainty, gambling, and interest – and is therefore inappropriate for use in the Muslim market. On the other hand, the Quran also references the principles of mutual cooperation, responsibility, protection, and assistance. Therefore, there is an obligation to provide support and protection for all people in a community, to the extent that these principles can be achieved consistent with Islamic Law.

Takaful was developed as an innovative alternative to conventional insurance that is still consistent with Islamic principles. There are a number of detailed discussions about how Takaful responds to the constraints of Quranic verse – and this article is not intended to be one of them. However, the similarities between the fundamental structure of a Takaful program and the original fraternal concept are too instructive to ignore.

According to Wikipedia, “theoretically, Takaful is perceived as cooperative insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not profits but to uphold the principle of “bear ye one another’s burden”.

The LIMRA report spells out the key principals of Takaful:

- Policyholders cooperate among themselves for their common good
- Every policyholder pays his subscription to help those that need assistance
- Losses are divided and liabilities spread according to the community pooling system
- Uncertainty is eliminated in respect of subscriptions and compensation
- It does not derive advantage at the cost of others.

In other words, Takaful involves “risk-sharing”, where traditional insurance involves “risk-transfer”.

Underlying this structure is the further requirement to establish a socially responsible investment policy that prohibits investment in companies engaged in forbidden activities or in securities that pay interest. Approved investments need to be asset-based and fixed priced and typically include certain equities, lease and rental instruments, and real estate.

From an insurance company’s perspective, since the risk is shared among participants rather than transferred to the insurance company, the company’s compensation would be derived from pre-determined management fees and in some cases, the opportunity to share in a pre-determined portion of any surplus.

It’s important to note that Takaful is not “window dressing” applied to a business transaction in order to convey the appearance of propriety. In order to be Sharia-compliant, all activities related to a Takaful

program need to be embedded in the wider principles that govern Islamic life. In fact, a Sharia board comprised of recognized Islamic scholars must certify each Takaful program to ensure that the company's operational model, profit distribution policies, product design and investment guidelines comply with Islamic law.

Fortunately, this article isn't intended to delve into the difficult details that Takaful companies have to contend with in order to be compliant. Instead, I'd like to focus on some of the key elements that make Takaful so appealing.

First, the mutual cooperation and "risk-sharing" approach is tremendously attractive. There is a communal element that puts a personal face on an insurance transaction when the primary motivation is to help your neighbors at the same time you're protecting yourself. This is very different from paying a premium to an impersonal corporation whose sole perceived motivation is to make a profit. This approach is also light-years removed from the cynical "you have to die in order to win" opinion that many people express about life insurance policies.

Second is the transparency. In order to eliminate the sin of uncertainty, everything in a Takaful program is determined up front. People know what they stand to receive, how it will be calculated and divided up, and under what circumstances. They also know what the insurance company's potential compensation will be and what they will do in order to earn it. And perhaps most importantly, participants know that at the very least, they can expect to receive their contributions back (less expenses).

And finally, the socially responsible component that underlies a Takaful program inspires trust and confidence to a broad audience regardless of religious beliefs. From a branding perspective, there is an element of satisfaction derived from communicating that contributions are being used to support wholesome activities that are consistent with general moral principles.

To fully appreciate the powerful attractiveness of these simple elements, one only has to look at the amount of Takaful that is sold to non-Muslims. In the March 17, 2008 issue of *The Guardian*, Barry Stowe, CEO of Prudential Corporation Asia, states that "half of Prudential's Takaful sales are to non-Muslims" This is an especially insightful statistic given that one of the biggest hurdles Takaful providers face is the stigma that Takaful is "Muslim insurance" and is therefore not relevant to a broader audience. The fact that despite this misconception, Prudential Asia has been able to inspire such significant sales outside of their initial demographic is testimony to the appeal of the simplicity and ethical stance of these products. This is further supported by the 20% per year projected growth in worldwide Takaful sales from 2007 to 2015.

The success of Takaful has tremendous implications for the insurance industry in general, but especially for fraternal. The basic elements that make Takaful so broadly appealing can be easily applied to a new form of "cooperative benefit" product for general sale in the domestic market without the added complexity of having to be Sharia compliant. These products could differentiate themselves from traditional insurance by emphasizing risk sharing rather than risk transferring while still utilizing sound actuarial models. As a result, insurance company profits could be generated more from predictable pre-determined administration fees rather than mortality management. In addition, the products could be marketed with an emphasis on their simplicity, guarantees, and ethical stance rather

than the confusing suspicion that consumers often reserve for our products.

Fraternal would be ideally suited to distribute these types of products by leveraging their non-profit status and focusing the ethical aspect of their branding to appeal to whatever social, religious, or ethnic membership they serve. In addition, the more predictable income stream produced by these policies may be more suitable for smaller fraternal who may not have the capital to support the fluctuating uncertainty of mortality guarantees. Equally compelling is the fact that cooperative benefits formed the foundation of the original fraternal business model and therefore uniquely positions fraternal to reclaim the legacy that they originally inspired.

It is often said that the more things change, the more they stay the same. Certainly many of the basic elements that make Takaful an attractive innovation in the insurance marketplace bears a remarkable resemblance to long standing fraternal traditions. Whether one is motivated by the desire to “bear ye one another’s burden” for the purpose of principle rather than profits, or to “pass the hat” in support of non-profit community programs, it’s clear that both approaches have tremendous appeal in current markets. Smart companies – of all types – would do well to consider how to leverage the power of transparency, simplicity, mutual cooperation, and ethical branding as a means to capitalize on these opportunities.