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Survival Strategies for the "Smaller" Fraternal Benefit Societies

By Howard W. Heidorn, Jr.

Is the End Inevitable?

In his article in the June 2001 issue of the ***Fraternal Monitor***, David Brummond, General Counsel of the NFCA, suggests that fraternal benefit societies "are predominately 19th Century institutions." In addition he speculates that "there is a risk that the fraternal benefit system will become a relic of the past."

Are we nearing the inevitable end of the fraternal benefit system as we know it today? The answer is a resounding "Maybe!" The costs of merely complying with all of the increased regulations could very well drive some of the very small societies right out of business.

This article does not present any "quick fix" solutions to this survival dilemma. It does indicate that many of the decisions that need to be made to stay in business will be extremely difficult to make. However, assuming that a fraternal benefit society, especially a "smaller" society, sincerely believes it can survive in today's (and tomorrow's) economy, perhaps some of the following strategies might help it avoid becoming a "relic of the past."

A Few Clarifications

A fraternal benefit society by definition is really involved in two businesses—the fraternal business that binds its membership together and for which it receives its favorable tax treatment, and the business of insurance. From a historical financial perspective, it has been the business of insurance that has allowed the fraternal business to operate.

Who are the "smaller" fraternal benefit societies? For purposes of this article, any society having less than $500,000,000 in assets might be considered small—especially when considered in light of the recent proposed merger of the two largest fraternal benefit societies. However, some of the following strategies will apply more particularly to those fraternal benefit societies having less than $100,000,000 in assets.

Now let's consider this "business" of insurance as it applies to fraternal benefit societies. Perhaps the following strategies will prove helpful to survival:

Understand the Business of Insurance

The senior officers of many fraternal benefit societies became senior officers through an election process. The members who politic the most are the ones elected. In a changing economic world, these senior officers will be expected to run both the fraternal aspects and the insurance aspects of the business. However, it takes a certain amount of specialized business savvy to run an insurance organization. If elected Presidents, Vice Presidents, Secretaries, Treasurers, and others do not possess this specialized business expertise, these officers should make sure they hire someone who does. And from a continuity perspective, it would make good sense not to change these hired people every time new officers are elected.

Consolidate or Share Computerized Administration

In this rapidly moving economy, even the smallest fraternal benefit societies need to have computerized administration systems. These systems can generate billing notices, pay commissions, calculate cash values and reserves, and manage policyholder relations. If the cost of obtaining a computerized administration system is too high, perhaps a "smaller" society or a group of "smaller" societies might consider seeking a single administrator (a third party administrator (TPA), or a larger fraternal) that would handle the computerized administration of their businesses. However, they should be prepared to pay a monthly fee for the administration of their business, and they should know that such monthly costs will most likely increase in the future!

Cut the Dead Weight

Assuming a fraternal benefit society has already acquired a more sophisticated computerized administration system, what is a major implication? These systems do much of the work that used to be done by certain "old time" employees. Thus, there may be at least some employees who do not have as much work to do as they did before computerization. However, because it considers itself a "fraternal" in all respects, a society might believe that firing a non- or under-performing employee is not a very "fraternal" thing to do. Because there are a myriad of other expenses over which a society has no control (for example, expenses associated with new regulations), it makes good business sense to exercise the society's rights in areas where it does have such control. The decisions are difficult, but they must be made. The society must address the problem of any staff members who are not performing up to expectations—and perhaps even fire them!

Try New Marketing Schemes

Among those schemes that have met with some success and that have reasonable implementation costs are direct mail marketing and marketing through a newspaper. These suggestions may be particularly applicable to the "smallest" of the fraternal benefit societies, since many of them do not have professional sales staffs.

Note that there is a certain target market that all societies currently "own"—their own members as of any point in time. It has been the author's experience that specifically directed mail marketing programs to existing members have produced response rates as high as 20% to 25%. Such rates are much higher than those generally experienced by commercial organizations. The "trick," however, is to continuously develop new methods of approaching existing members through the mails—and to do so at a reasonable cost.

There is also at least one "smaller" fraternal benefit society that reaches its target market using inserts in newspapers. The insert is a glossy brochure describing the society and the product offered. In addition, it contains a table of premiums applicable to each issue age and each face amount offered. This brochure also contains an application to be returned to the society, but the product itself is a guaranteed issue product. Although response rates in this case more closely resemble those experienced by commercial insurance organizations' mass marketing efforts, this particular society does quite well with its approach!

Manage Fraternal and Other Expenses

Costs of regulation are increasing. Several years ago, an audited financial report was not needed. Now one is required of all fraternal benefit societies by June 1, at costs that almost certainly range in excess of $6,000 per year. At the current regulatory pace, cash flow testing, or some other form of asset adequacy analysis, will need to be performed for all life and health insurance organizations within the next year or two. In addition, a multiple page report describing what the actuary did will also have to be prepared. Could costs related to the actuary's activities be as low as the audit costs? Not likely!

Since regulatory costs are increasing, expenses in other areas will need to be better managed, or perhaps cut, in order for the "smaller" society to stay in business. Perhaps the society will decide that the costs of the fraternal side of the business will need to be decreased. Yet it is precisely the fraternal aspect of its business that distinguishes the fraternal benefit system from the commercial life and health insurance business!

KISS (Keep It Simple—Societies!)

The "smallest" of the "smalls" should keep both their insurance product portfolios simple and also their asset portfolios simple. As the sizes of societies increase, so also can the complexity of their product offerings and their assets. However, it does not make economic sense to develop a complex insurance product, say a re-entry term product, for example, that is expected to be sold by the same lodge secretaries that have sold whole life-type products for the last 30 years. Similarly, it does not make economic sense to invest in the more esoteric assets (CMOs or other asset backed securities, for example) that might develop an extra 25 basis points of investment earnings unless these additional investment earnings more than offset the increased costs of asset management and administration and any additional cash flow testing costs.

Merge

If all of the above suggestions seem unattainable, then it would be wise to seek a merger candidate (partner???) while the society still has sufficient surplus with which to bargain. A "fire sale" will not be as beneficial to a society's members as a sale based from strength. If the two largest fraternal benefit societies believe this strategy is necessary for their own survival, is it not also a viable alternative for many others?

Conclusion

For many of the "smaller" fraternal benefit societies, the decision to remain an independent viable society is not a decision that has been actively made in the past. However, if this "smaller" society is to remain viable in the future, it must proactively address its future.

Where will your society be four years from now???