# Poor timing leaves insurer's future in doubt

A losing bet on a faltering mortgage industry could cost Shenandoah Life its future.

By Jeff Sturgeon | The Roanoke Times

JEANNA DUERSCHERL *The Roanoke Times*

While Shenandoah Life's policies remain viable, policyholders looking to cash out are unable to do so — at least for now.

Ill-timed investments in a declining mortgage industry a year ago set Shenandoah Life Insurance Co. on a perilous path that now places the Roanoke firm in a state receivership with an uncertain future.

Some now question the wisdom of company officials' decision in the first quarter of 2008 to invest nearly $50 million in Fannie Mae and Freddie Mac, companies whose stock was already devalued by the subprime lending crisis.

By fall, that investment had shrunk to just $2.6 million, according to an analysis by The Roanoke Times. That and other investment losses blew a hole in critical capital reserves, leading to a concern about the company's long-term viability.

Now a state regulator is sitting at the chief executive's desk, his role to guard the money that's left and find a way to preserve the business, if possible.

If not, he could shut it down and Roanoke would lose a leading corporate citizen founded in 1914. Awaiting word are scores of agents who sell company policies for their livelihoods, nearly 300 employees and people across the country who hold about 200,000 policies still in effect.

The company is making good on its policies, paying life insurance proceeds to survivors of the deceased, health and disability benefits and annuity payments in certain categories.

That said, it has banned the practice of cashing in policies, and that's devastated some individuals who want their money for vital expenses.

The so-called "Great Recession" has produced rapid and severe economic devastation -- both at the corporate and individual level. Shenandoah Life is the Roanoke Valley's most-visible corporate example.

Just seven months ago, the company was an A-rated insurer having its most profitable year ever.

Now it's a low-rated firm in need of a bailout. The wait for a resolution could be weeks or months. Until then, the company is in a holding pattern -- open, but in limbo.

Company officials said this is not a tale of victims and villains, however. They say many firms and individuals lost on stock last year and warn against using hindsight to judge investment results. When the firm was passed over for part of the federal dollars going to ailing financial corporations, it found itself exposed.

## Related

### Your thoughts

- Share your thoughts on Shenandoah Life's current situation.

### Documents

- Shenandoah Life questions and answers (PDF, 34 KB)
- Virginia SCC news release (PDF, 79 KB)
- Richmond Circuit Court action appointing the Virginia SCC as receiver (PDF, 725 KB)
- Virginia SCC action following the court's decison (PDF, 552 KB)

### Recent coverage

- Shenandoah Life cancels bonus trips (March 3, 2009)
- State hopes to revamp Roanoke-based Shenandoah Life (Feb.14, 2009)
- Roanoke-based Shenandoah Life Insurance is now under state control (Feb.13, 2009)
- Shenandoah Life insurance company proposes merger with Indiana firm (Nov. 19, 2008)
- Shenandoah Life's ratings slip a notch (Sept. 27, 2008)
- Virginia companies feel effects of banking crisis (Sept. 18, 2008)

"It just like getting struck by lightning," said Hank Wolf, chairman of the company's board of directors.

## Investment trouble

The company's problems began to develop after executives moved a portion of its financial nest egg from higher-risk investments to what it thought were safer ones -- the preferred stock of mortgage giants Freddie Mac and Fannie Mae.

The stock later plummeted in conjunction with the federal government seizing those two entities to prevent their collapse.

Raman Kumar, a finance professor at Virginia Tech who reviewed company financial records at the request of The Roanoke Times, said some of the stock was already in a downward slide of at least several months at the time of purchase. That was driven by perceptions that Freddie Mac and Fannie Mae would face significant losses because of falling house prices and subprime mortgage defaults.

"What made them think that this was a good investment when the market was clearly telling them otherwise?" Kumar asked.

Wolf said executives could not have predicted events that led up to the stock's collapse. He is not alone in calling those events unprecedented because of the extreme nature of federal intervention in the private sector.

In September, the U.S. Treasury pledged to recapitalize the ailing mortgage giants with up to $100 billion each. In return for a cash infusion, the government took title to a new class of preferred stock made senior to existing preferred stock, whose dividend was canceled. Because preferred stock is valued in part for its dividend, share prices fell severely.

Accounting rules forced Shenandoah Life to lower the value of its investment portfolio and its surplus -- the amount by which assets exceed liabilities. On Sept. 30, the surplus stood at $78.3 million, down 39 percent from $127.9 million on June 30.

In response, an independent rating agency, A.M. Best Co. of Oldwick, N.J., lowered Shenandoah Life's publicly available financial strength score from A for excellent to B for good. Because consumers tend to give their business to the highest-rated insurers, the rating loss put Shenandoah Life at a major competitive disadvantage.

Multiple attempts to quickly restore the surplus failed.

U.S. Rep. Bob Goodlatte, R-Roanoke County, spoke to former U.S. Treasury Secretary Henry Paulson in hopes of getting Shenandoah Life some relief. Officials said no.

Nobody has raised any questions about Shenandoah Life's products. The troubles lie entirely on the investment side of the company, which functions to make money off premiums to help pay claims and overhead.

The company, which is small by industry standards, had $1.66 billion invested in stocks, bonds and other instruments on Sept. 30, the last day for which financial information has been released.

Regulators have blocked the release of more recent financial information, even though all Virginia insurers were due to report financial results March 1.

## Shenandoah still solvent

In what looked like a breakthrough, OneAmerica, an Indiana insurance company 10 times Shenandoah Life's size, agreed in November to merge with Shenandoah Life. It agreed to put up cash to restore beleaguered reserves. About three months passed, and OneAmerica pulled out without public explanation.

That occurred Feb. 11.

That night, Shenandoah Life's board of directors met by phone and agreed to state intervention.

The worry was that policyholders would be spooked by OneAmerica's decision to back away; everyone predicted the ratings agency would respond with another reduction.

Some policyholders had funded annuities with their own money, while others owned life insurance with cash value. If they asked to cash out en masse, Shenandoah Life would find itself unable to meet demands for cash, similar to a bank run.

On the morning of Feb. 12, a Richmond Circuit Court judge named the Virginia State Corporation Commission as receiver of Shenandoah Life. The commission empowered Alfred Gross, the state insurance commissioner, to seize the company. Gross responded almost immediately with sweeping powers to limit cash withdrawals and put the company in a holding pattern. The process is similar to the start of a bankruptcy proceeding, though Shenandoah Life never filed bankruptcy.

Don Beatty, a senior commission attorney and veteran insurance regulator, promptly left Richmond for Roanoke and reached company headquarters at 4 p.m. In his role as on-site manager for the commission, he assumed the power of the chief executive and board on the spot.

A.M. Best dropped the company's rating to E, one notch above the level for a failed company.

Robert Clark, former chief executive officer, said the preferred stock company officials bought was "highly rated" at the time of purchase. He echoed Wolf's sentiments that the company had no way to anticipate the unprecedented steepness of the market collapse and invasive federal intervention.

"Who would have thought that the entire banking industry is at the point right now where it's in crisis?" Clark asked, noting that the environment is a challenging one for even large, established banks such as Wachovia Corp. "There is no villain here."

Wachovia neared collapse and undertook a search for outside capital like Shenandoah Life. Wells Fargo & Co. bought it. Others firms received a lifeline from the federal government, which Clark and many economic observers outside the company have characterized as the government picking winners and losers -- choosing which firms would survive the crisis and which would fail.

Saving Shenandoah Life will require money.

Clark was asked if the company needs about the same amount as what it lost. "Yeah," Clark replied. He said he doesn't know for sure.

Whatever happens, the company must be solid enough to satisfy the rating agency. Without a high rating "the business goes away pretty quickly," Clark said. He retired from the company a few days after the receiver took over, saying he wanted to leave regulators to their work. The board, too, has no further role at Shenandoah Life.

One possibility is that Beatty, who now uses Clark's office, will line up another company to buy part or all of Shenandoah Life. Officials are mum about any specific strategies, but say policies could be transferred without disruption to a new owner.

Officials emphasize that Shenandoah Life remains solvent, meaning the money in hand exceeds estimates of what the company owes. In addition, a state guaranty fund would pay policyholders, up to coverage limits, if the company faces a shortfall.

Agents, customers in limbo

Agents are getting their commissions on policies that remain in effect but, under a special ruling last month by regulators, can no longer write new policies. The company, which offers life, health, and annuity plans, is licensed in 31 states and Washington, D.C.

Its fortunes appear to be waning as the new policy moratorium enters its sixth week on Monday. Other insurers are moving to snap up Shenandoah Life's clients. Agents say they have no choice but to accommodate those customers who choose to switch.

"There's nothing magic about what Shenandoah had," said Dennie Denison of the Denison Insurance Agency in Roanoke.

He is sad that Shenandoah Life has stumbled. "When you drive by the building every week, you have a certain feeling about a hometown company. I know I do," he said.

Employees, 280 the last time a number was made public, are reporting for duty at the brick-and-limestone headquarters on Brambleton Avenue in a show of determination and support.

A retired businessman is among those who are rooting for the company.

"I just hope that Shenandoah Life can remain either independent or be absorbed in its current operating state and stay in Roanoke as a corporate citizen and employer," said Jack Loeb, a retired Roanoke Valley contractor and developer.

The downside for policyholders is, if the company isn't making money, they aren't either. Shenandoah Life is policyholder-owned, and policy benefits remain viable -- unless you are a policyholder looking to promptly cash out.

Shenandoah Life customers John and Patsy Heffernan of Roanoke entrusted the company years ago with cash for their son, Matt, to attend college.

He's off at college, and John Heffernan had been receiving monthly withdrawals from his Shenandoah Life annuity -- funded with an inheritance in 1992 -- to pay tuition, books, room and board.

Then, state regulators seized Shenandoah Life. Company officials have declined to release additional funds. With a tuition payment due to the University of Northwestern Ohio at the end of March or early April, the couple has appealed the decision to the company on the grounds of hardship. If they lose, they will need a loan, they said.

Patsy Heffernan has a Shenandoah Life annuity funded with a portion of her income from years of teaching. Less than two weeks before the receivership began, she reached the age necessary to make penalty-free withdrawals. Sorry, the receiver said, you'll have to wait. The couple owns three life insurance policies with cash value, but none of it is available at this time, either.

"You got the money, but you can't get to it," John Heffernan said. "You feel helpless."