

INDEPENDENCE HOLDING CO  
Form 10-Q  
August 11, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

---

**FORM 10-Q**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended **June 30, 2011**.

Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**

**58-1407235**

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

**96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT**

**06902**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(203) 358-8000**

**NOT APPLICABLE**

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
 No

**Class**

**Outstanding at August 5, 2011**

**Common stock, \$ 1.00 par value**

**15,833,215 Shares**

**INDEPENDENCE HOLDING COMPANY**

**INDEX**

**PART I**  
**FINANCIAL**  
**INFORMATION**

**PAGE**

**NO.**

Item 1. Financial  
Statements

C o n d e n s e d  
C o n s o l i d a t e d  
B a l a n c e S h e e t s -

4

June 30, 2011  
(unaudited) and  
December 31,  
2010

C o n d e n s e d  
C o n s o l i d a t e d  
S t a t e m e n t s o f  
O p e r a t i o n s -

5

Three Months and  
Six Months Ended  
June 30, 2011 and  
2010 (unaudited)

C o n d e n s e d  
C o n s o l i d a t e d  
S t a t e m e n t o f  
C h a n g e s i n E q u i t y  
-

6

Six Months Ended  
June 30, 2011  
(unaudited)

C o n d e n s e d  
C o n s o l i d a t e d  
S t a t e m e n t s o f C a s h  
F l o w s -

7

Six Months Ended  
June 30, 2011 and  
2010 (unaudited)

N o t e s t o  
C o n d e n s e d  
C o n s o l i d a t e d  
F i n a n c i a l  
S t a t e m e n t s  
(unaudited)

8

I t e m 2 .  
Management's  
Discussion and  
Analysis of  
Financial  
Condition

29

and Results of  
Operations

I t e m 3 .  
Quantitative and  
Qualitative  
Disclosures about  
Market Risk

43

Item 4. Controls  
and Procedures

44

**P A R T   I I   -**  
**O T H E R**  
**I N F O R M A T I O N**

Item 1. Legal  
Proceedings

45

Item 1A. Risk  
Factors

45

I t e m   2 .  
Unregistered  
Sales of Equity  
Securities and Use  
of Proceeds

45



Item 3. Defaults  
Upon Senior  
Securities

45

Item 4. Removed  
and Reserved

45

Item 5. Other  
Information

46

Item 6. Exhibits

46

Copies of the Company's SEC filings can be found on its website at [www.ihcgroup.com](http://www.ihcgroup.com).

### Forward-Looking Statements

*This report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. We have based our forward-looking statements on our current expectations and projections about future events. Our forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as the growth of our business and operations, our business strategy, competitive strengths, goals, plans, future capital expenditures and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, expect, intend, probably or similar expressions, we are making forward-looking statements.*

*Numerous risks and uncertainties may impact the matters addressed by our forward-looking statements, any of which could negatively and materially affect our future financial results and performance. We describe some of these risks and uncertainties in greater detail in Item 1A, Risk Factors, of IHC's annual report on Form 10-K as filed with Securities and Exchange Commission.*

*Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements that are included in this report, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved. Our forward-looking statements speak only as of the date made, and we will not update these forward-looking statements unless the securities laws require us to do so. In light of these risks, uncertainties and assumptions, any forward-looking event discussed in this report may not occur.*

**PART I - FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share data)**

**June 30, 2011**

**December 31, 2010**

**(Unaudited)**

**ASSETS:**

Investments:

Short-term investments

\$  
50

\$  
53

Securities purchased  
under agreements to  
resell

13,980

41,081

Fixed maturities,  
available-for-sale

817,257

793,656

Equity securities,  
available-for-sale

54,142

48,073

Other investments

37,731

36,864

Total investments

923,160

919,727

Cash and cash  
equivalents

11,309

11,426

Due from securities  
brokers

17,421

15,022

Deferred acquisition  
costs

42,466

43,465

Due and unpaid  
premiums

43,095

48,586



Due from reinsurers

156,067

154,243

Premium and claim  
funds

37,102

37,646

Notes and other  
receivables

17,494

16,766

Goodwill

51,713

51,713

Other assets

57,592

63,198

**TOTAL ASSETS**

\$

1,357,419

\$

1,361,792

**LIABILITIES AND  
EQUITY:**

**LIABILITIES:**

Insurance  
reserves-health

\$

182,064

\$

181,447

Insurance reserves-life  
and annuity

278,673

278,000

Funds on deposit

413,685

408,566

Unearned premiums

3,310

4,043

Policy claims-health

15,458

16,521

Policy claims-life

11,443

11,809

Other policyholders'  
funds

20,756

20,195

Due to securities  
brokers

18,338

32,469

Due to reinsurers

30,349

31,554

Accounts payable,  
accruals and other  
liabilities

66,966

70,497

Liabilities related to  
discontinued operations

-

771

Debt

7,500

7,500

Junior subordinated  
debt securities

38,146

38,146

**TOTAL  
LIABILITIES**

1,086,688

1,101,518



**EQUITY:**

**IHC  
STOCKHOLDERS'  
EQUITY:**

Preferred stock (none  
issued)

-

-

Common stock \$1.00  
par value, 20,000,000  
shares authorized;

16,080,270 and  
15,472,020 shares  
issued;

15,833,215 and  
15,232,865 shares  
outstanding

16,080

15,472

Paid-in capital

105,960

101,003

Accumulated other  
comprehensive income  
(loss)

5,393

633

Treasury stock, at cost  
247,055 and 239,155  
shares

(1,998)

(1,917)

Retained earnings

121,212

115,437

**TOTAL IHC  
STOCKHOLDERS  
EQUITY**

246,647

230,628

**NONCONTROLLING  
INTERESTS IN  
SUBSIDIARIES**

24,084

29,646

**TOTAL EQUITY**

270,731

260,274

**TOTAL  
LIABILITIES AND  
EQUITY**

\$

1,357,419

\$

1,361,792

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data) (Unaudited)**

**Three Months  
Ended**

**Six Months Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

**REVENUES:**

Premiums earned:

Health

\$

74,738

\$

75,822

\$

150,461

32



\$

137,664

Life and annuity

9,263

8,792

19,413

17,834

Net investment  
income

9,633

10,131

19,749

19,502

Fee income

8,328

9,681

15,705

17,241

Net realized  
investment gains

1,883

1,634

1,681

1,983

Other-than-temporary  
impairment losses

(165)

(1,039)

(468)

34

(2,665)

Equity income from  
AMIC

-

-

-

280

Gain on bargain  
purchase of AMIC

-

-

-

27,830

Other income

1,845

1,410

3,303

3,112

105,525

106,431

209,844

222,781

**EXPENSES:**

Insurance benefits,  
claims and reserves:

Health

50,503

53,252

101,079

96,815

Life and annuity

11,654

11,427

25,327

24,692

Selling, general and  
administrative  
expenses

36,331

36,390

72,317

67,825

Amortization of  
deferred acquisitions  
costs

1,758

1,720

3,449

3,038

Interest expense on  
debt

460

477

917

948

100,706

103,266

203,089

193,318

Income from  
continuing operations

before income taxes

4,819

3,165

6,755

29,463

Income taxes  
(benefits)

1,355

847

(509)

10,768

40



**Income from  
continuing  
operations**

3,464

2,318

7,264

18,695

**Discontinued  
operations:**

Loss from  
discontinued  
operations, net of tax

-

(55)

-

**Net income**

3,464

2,263

7,264

18,513

Less income from  
noncontrolling  
interests in  
subsidiaries

(424)

(565)

(1,040)

(781)

**NET INCOME  
ATTRIBUTABLE  
TO IHC**

	\$
	3,040
	\$
	1,698
	\$
	6,224
	\$
	17,732

**Basic income per  
common share:**

Income from  
continuing operations

\$

.19

\$

.11

\$

.40

\$

1.17

Loss from  
discontinued  
operations

-

-

-

(.01)

Basic income per  
common share

\$

.19

\$

.11

\$

.40

\$

1.16

**WEIGHTED  
AVERAGE  
SHARES  
OUTSTANDING**

15,835

15,266

15,658

15,303

**Diluted income per  
common share:**

Income from  
continuing operations



\$  
.19  
\$  
.11  
\$  
.40  
\$  
1.17

Loss from  
discontinued  
operations

-  
-  
-  
(.01)

Diluted income per  
common share

\$  
.19  
\$  
.11  
49

\$  
.40  
\$  
1.16

**WEIGHTED  
AVERAGE  
DILUTED  
SHARES  
OUTSTANDING**

15,848

15,268

15,667

15,306

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE  
HOLDING  
COMPANY AND  
SUBSIDIARIES**

**CONDENSED  
CONSOLIDATED  
STATEMENT OF  
CHANGES IN  
EQUITY  
(Unaudited)**

**SIX MONTHS  
ENDED JUNE 30,  
2010 (In thousands)**

**ACCUMULATED**

**NON-**

**OTHER**

**TREASURY**

**TOTAL IHC**

**CONTROLLING**

**COMMON**  
**PAID-IN**  
**COMPREHENSIVE**  
**STOCK,**  
**RETAINED**  
**STOCKHOLDERS'**  
**INTERESTS IN**  
**TOTAL**  
**STOCK**  
**CAPITAL**  
**INCOME (LOSS)**  
**AT COST**

**EARNINGS**

**EQUITY**

**SUBSIDIARIES**

**EQUITY**

**BALANCE AT**



**DECEMBER 31,  
2010**

\$

15,472

\$

101,003

\$

633

\$

(1,917)

\$  
115,437  
\$  
230,628  
\$  
29,646  
\$  
260,274

Net income

6,224

6,224

1,040

7,264

Net change in  
unrealized

gains (losses)

4,747

4,747

256

5,003

60

Total comprehensive

Income

10,971

1,296

12,267

Acquire noncontrolling

interests in American

Independence Corp.

600

4,430

63

5,043

(6,043)

(1,000)

Acquire noncontrolling



interests in Wisconsin

Underwriting  
Associates

391

391

(391)

-

Repurchase of  
common stock

(81)

(81)

-

(81)

Common Stock  
dividend

(\$0.025 Per share)

(396)

(396)

-

(396)

Share-based  
compensation

expenses and related

tax benefits

8

55

63

-

63

Distributions to  
noncontrolling

70

interests

-

(448)

(448)

Other capital  
transactions

81

(53)

28

24

52



**BALANCE AT**

**JUNE 30, 2011**

\$  
16,080  
\$  
105,960  
\$  
5,393  
\$  
(1,998)  
\$  
121,212  
\$  
246,647  
\$  
24,084  
\$  
270,731



**See the accompanying Notes to Condensed Consolidated Financial Statements.**



**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands) (Unaudited)**

**Six Months Ended  
June 30,**

**2011**

**2010**

**CASH FLOWS  
PROVIDED BY  
(USED BY)  
OPERATING  
ACTIVITIES:**

Net income

\$

7,264

\$

18,513

Adjustments to  
reconcile net income  
to net change in cash  
from

operating activities:

Gain on bargain  
purchase of AMIC

-

(27,830)

Loss from  
discontinued  
operations

-

182

Amortization of  
deferred acquisition  
costs

3,449

3,038

Net realized  
investment gains

(1,681)

(1,983)

80



Other-than-temporary  
impairment losses

468

2,665

Equity income from  
AMIC and other  
equity method  
investments

(714)

(487)

Depreciation and  
amortization

2,233

2,461

Share-based  
compensation  
expenses

351

348

Deferred tax (benefit)  
expense

250

12,811

Other

2,015

666

Changes in assets  
and liabilities:

Change in insurance liabilities

646

(21,980)

Additions to deferred acquisition costs, net

(3,786)

(2,170)

Change in net amounts due from and to reinsurers

(3,028)

11,075

Change in premium and claim funds

544

2,556

Change in income tax liability

2,888

(2,820)

Change in due and unpaid premiums

5,492

10,763

Change in other assets

(2,009)

1,400

Change in other liabilities

(3,379)

(11,182)

Net change in cash from operating activities of continuing operations

11,003

(1,974)

Net change in cash from operating activities of discontinued operations

-

(767)

Net change in cash  
from operating  
activities

11,003

(2,741)

**CASH FLOWS  
PROVIDED BY  
(USED BY)  
INVESTING  
ACTIVITIES:**

Change in net  
amount due from and  
to securities brokers

(16,530)

2,913

Net sales of securities  
under resale and  
repurchase  
agreements

27,101

17,376

Sales of equity  
securities

30,770

28,613

Purchases of equity  
securities

(35,386)

(17,022)

Sales of fixed  
maturities

244,277

379,878

Maturities and other  
repayments of fixed  
maturities

39,792

67,702

Purchases of fixed  
maturities

(301,198)

(473,161)



Additional  
investments in other  
investments, net of  
distributions

(153)

1,428

Cash acquired in  
acquisition of AMIC,  
net of cash paid

-

4,562

Cash paid in  
acquisitions of  
companies, net of  
cash acquired

-

(3,469)

Cash paid in  
acquisitions of  
noncontrolling  
interest in AMIC

(1,000)

-

Cash received in  
acquisition of policy  
blocks

-

1,192

Change in notes and  
other receivables

(727)

(705)

Other

(884)

(993)

Net change in cash  
from investing  
activities

(13,938)

8,314

**CASH FLOWS  
PROVIDED BY  
(USED BY)  
FINANCING  
ACTIVITIES:**

Repurchases of  
common stock

(81)

(1,591)

Excess tax expense  
from expired stock  
options and vesting  
of restricted stock

(164)

(22)

Proceeds of  
investment-type  
insurance contracts

3,390

1,587

Dividends paid

(375)

(386)

Other capital  
transactions

48

44

Net change in cash  
from financing  
activities

2,818

(368)

Net change in cash  
and cash equivalents

(117)

5,205

Cash and cash  
equivalents,  
beginning of year

11,426

7,394

Cash and cash  
equivalents, end of  
period

\$

11,309

\$

12,599

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

**Significant Accounting Policies and Practices**

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); (ii) its majority owned insurance company, Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Administrative Services, Inc., IHC Risk Solutions, LLC and its other managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ), Actuarial Management Corporation ( AMC ), MedWatch, LLC and Hospital Bill Analysis, LLC. These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." At June 30, 2011, IHC also owns a 63.0% interest in American Independence Corp. ( AMIC ).

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 52% of IHC's outstanding common stock at June 30, 2011.

**(B)**

**Basis of Presentation**

The Condensed Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The Condensed Consolidated Financial Statements include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The



preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying Condensed Consolidated Financial Statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and six months ended June 30, 2011 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

### **Recent Accounting Pronouncements**

#### ***Recently Adopted Accounting Standards***

In December 2010, the FASB issued guidance that clarifies the existing requirements for pro forma revenue and earnings disclosures, and expands the supplemental pro forma revenue and earnings disclosures, for public companies that have completed business acquisitions. The amendments in this guidance were effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The adoption of

this guidance, effective January 1, 2011, did not have a material effect on the Company's consolidated financial statements.

In December 2010, the FASB issued guidance that amends existing goodwill impairment test standards to include a requirement that entities perform Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts if it is more likely than not that an impairment exists. This guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The adoption of this guidance, effective January 1, 2011, did not have a material effect on the Company's consolidated financial statements.

In January 2010, the FASB issued standards requiring entities to provide the activity of Level 3 security purchases, sales, issuances, and settlements on a gross basis, which was effective for fiscal years beginning after December 15, 2010. The adoption of this guidance, effective January 1, 2011, did not have a material effect on the Company's consolidated financial statements.

#### ***Recently Issued Accounting Standards Not Yet Adopted***

In July 2011, the FASB issued guidance specifying that the liability for the fees paid to the Federal Government by health insurers as a result of recent healthcare reform legislation should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. The amendments in this Update are effective for calendar years beginning after December 31, 2013, when the fee initially becomes effective. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In June 2011, the FASB issued guidance that requires all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. For public entities, the amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In May 2011, the FASB issued guidance to achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. Some of the amendments in this update clarify the FASB's intent about the application of certain existing fair value measurement requirements and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. None of the amendments in this update require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. For public entities, this guidance is effective during interim and annual periods beginning after December 15, 2011. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In April 2011, the FASB issued guidance that amends existing standards with regards to transfers of financial assets under repurchase and other agreements that entitle and obligate the transferor to repurchase or redeem the assets prior to maturity. Specifically, with respect to assessing effective control in such agreements, the criteria that the transferor must have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even upon the transferee's default, has been eliminated; as has the corresponding criterion calling for the transferor to have obtained cash or other sufficient collateral to purchase replacement assets from a third party, which was required to demonstrate such ability. This guidance is effective for the first interim or annual period beginning after December 15, 2011. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In October 2010, the FASB issued guidance that specifies the accounting treatment for the costs incurred by insurance entities when acquiring new and renewal insurance contracts. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011 and should be applied prospectively upon adoption. The Company is currently evaluating the potential impact the amendments in this update will have on its consolidated financial statements.

(D)

### **Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company has evaluated all such events occurring subsequent to the balance sheet date herein of June 30, 2011. The effects of all subsequent events that provided additional evidence about conditions that existed at the date of the balance sheet, including estimates, if any, have been recognized in the accompanying Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Operations as of and for the three-month and six-month periods ended June 30, 2011.

### **Note 2.**

#### **American Independence Corp.**

AMIC is an insurance holding company engaged in the insurance and reinsurance business. AMIC does business with the Insurance Group, including reinsurance treaties under which Standard Security Life and Madison National Life cede to Independence American an average of 20% of their medical stop-loss business, 9% of a majority of their fully insured health business and 20% of their New York Statutory Disability business.

In January 2011, a subsidiary of IHC acquired 200,000 shares of AMIC common stock from a noncontrolling interest for \$1,000,000 cash. In February and March 2011, IHC acquired an aggregate 900,325 shares of AMIC common stock from noncontrolling interests in exchange for the issuance of an aggregate 600,218 shares of IHC's common stock in various private placements of unregistered securities under Section 4(2) of the Securities Act of 1933, as amended. Accordingly, the shares are "restricted securities", subject to a legend and will not be freely tradable in the United States until the shares are registered for resale under the Securities Act, or to the extent they are tradable under Rule 144 promulgated under the Securities Act or any other available exemption. As a result of these transactions, the Company: (i) recorded a \$95,000 credit to paid-in capital representing the difference between the fair value of the consideration paid and the carrying value of the noncontrolling interest; and (ii) increased its ownership interest in AMIC to 63.0%.

Subsequent to the balance sheet date, on July 15, 2011, IHC commenced an offer to exchange up to 908,085 shares of its common stock for properly tendered and accepted shares of common stock of AMIC (the Exchange Offer). IHC filed a Registration Statement on Form S-4 in connection with the Exchange Offer that was declared effective by the Securities and Exchange Commission on July 15, 2011. The Exchange Offer will expire on Friday, August 12, 2011, unless extended or earlier terminated by IHC. For each share of AMIC common stock accepted in accordance with the terms of the Exchange Offer, IHC will issue 0.625 of a share of IHC common stock. If IHC were to exchange all of the shares of IHC common stock offered in the Exchange Offer for shares of AMIC common stock, IHC's total ownership of AMIC would increase to 80%.

**Acquisition of AMIC in 2010**

In March 2010, IHC acquired a controlling interest in AMIC as a result of the purchase of AMIC common stock in the open market. The principal reasons for acquiring control were: (i) the low market price of the AMIC stock; (ii) the improved financial presentation for IHC resulting from the consolidation of financial reporting; and (iii) a closer relationship that will create greater long-term value for both companies. The acquisition furthers IHC's goal of creating efficiencies by integrating the back office operations of our MGUs and marketing companies. Share purchases of 27,668 shares, or \$141,000, through

March 5, 2010 (the "Acquisition Date"), totaling 0.33% of voting equity interest, brought the total of AMIC shares owned by the Company to more than 50% of AMIC's outstanding common stock and as a result, IHC has included AMIC's consolidated assets and liabilities and results of operations, subsequent to the Acquisition Date, in its condensed consolidated financial results.

In determining the bargain purchase gain with regard to the acquisition of the controlling interest in AMIC, IHC first recognized a gain of \$2,201,000 as a result of remeasuring its equity interest in AMIC to its fair value of \$22,013,000 immediately before the acquisition based on the closing market price of AMIC's common stock. Then, upon the acquisition of a controlling interest on March 5, 2010, the Company consolidated the net assets of AMIC. Accordingly, the Company determined the fair value of the identifiable assets acquired and liabilities assumed from AMIC on the Acquisition Date. The fair value of the net assets acquired exceeded the sum of: (i) the fair value of the consideration paid; (ii) the fair value of IHC's equity investment prior to the acquisition; and (iii) the fair value of the noncontrolling interests in AMIC, resulting in a bargain purchase gain of \$25,629,000. The total gain, amounting to \$27,830,000, pre-tax, is included in gain on bargain purchase of AMIC on the Company's Condensed Consolidated Statement of Operations. This gain is a result of the quoted market price of AMIC being significantly less than the fair value of the net assets of AMIC. This disparity is due to the low trading volume in AMIC shares, and a discount on the shares traded due to a lack of control by minority shareholders. The fair value of the noncontrolling interests in AMIC was based on the closing market price of AMIC's common stock on the Acquisition Date.

In connection with the acquisition, the Company recorded \$12,200,000 of intangible assets. Of this amount, \$1,700,000 represents the fair value of agent and marketing contracts and relationships, \$1,000,000 represents the fair value of a domain name, and \$2,000,000 represents the fair value of customer lists and all are amortizable over the life of the respective intangible asset. The remaining \$7,500,000 represents non-amortizable intangible assets consisting of the fair value of insurance licenses with indefinite lives. As the AMIC acquisition was accounted for as a bargain purchase, the Company did not record goodwill in connection with the transaction.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

The following table presents the identifiable assets acquired and liabilities assumed in the acquisition of AMIC on the Acquisition Date based on their respective fair values (in thousands).

Investments

\$

58,418

Cash and cash  
equivalents

4,761

Identifiable  
intangible assets

12,200

Deferred tax  
assets, net

10,654

Other assets

31,127

Total  
identifiable  
assets

117,160

Insurance  
liabilities

27,671

Other liabilities

19,023



Total liabilities

46,694

Net identifiable  
assets acquired

70,466

Purchase  
consideration

(71)

Fair value of  
equity  
investment prior  
to the  
acquisition

(22,013)

Noncontrolling  
interests in  
AMIC

(22,065)

Elimination of  
the fair value  
adjustment  
related to  
AMIC s

investment in  
Majestic

(688)

Gain on bargain  
purchase

25,629

Gain on fair  
value of equity  
investment prior  
to the  
acquisition

2,201

Total gain on  
bargain  
purchase of  
AMIC, pretax

27,830

Deferred  
income taxes

11,097

Total gain on  
bargain  
purchase of  
AMIC, after tax

\$

16,733

For the three months ended June 30, 2010, the Company's Condensed Consolidated Statement of Operations includes revenues and net income of \$23,788,000 and \$886,000, respectively, from AMIC.

For the period from the Acquisition Date to June 30, 2010, the Company's Condensed Consolidated Statement of Operations includes revenues and net income of \$31,404,000 and \$1,253,000, respectively, from AMIC.

The unaudited pro forma revenues and operating results, had the acquisition occurred as of the beginning of the three-month period ended June 30, 2010, were \$106,431,000 and \$2,304,000, respectively. The unaudited pro forma revenues and operating results, had the acquisition occurred as of the beginning of the six-month period ended June 30, 2010, were \$208,551,000 and \$2,292,000, respectively. The unaudited pro forma information presented is not indicative of the results of operations in future periods, nor does it necessarily reflect the results of operations that would have resulted had the acquisition been completed as of the beginning of the applicable period. Pro forma adjustments to revenues principally reflect the elimination of intercompany fee income, the elimination of the Company's equity income related to AMIC and the elimination of the gain resulting from the bargain purchase. Pro forma adjustments to net income principally reflect the elimination of the Company's equity income related to AMIC and the elimination of the gain resulting from the bargain purchase.

During the period from January 1, 2010 to the Acquisition Date (the Stub Period ), IHC recorded \$280,000 of equity income from its investment in AMIC, representing IHC's proportionate share of income based on its ownership interest during that period. AMIC paid no dividends on its common stock during the Stub Period.

The following disclosures summarize the effects of certain transactions between IHC and its subsidiaries with AMIC during the Stub Period. Subsequent to the Acquisition Date, the effects of these transactions are eliminated in consolidation. IHC and its subsidiaries recorded income of \$208,000 from service agreements with AMIC and its subsidiaries. These are reimbursements to IHC and its subsidiaries, at agreed upon rates including an overhead factor, for management services provided by IHC and its subsidiaries, including accounting, legal, compliance, underwriting and claims. The Company ceded premiums to AMIC of \$5,867,000. Benefits to policyholders on business ceded to AMIC were \$3,020,000. Additionally, AMIC subsidiaries market, underwrite and provide administrative services (including premium collection, medical management and claims adjudication) for a substantial portion of the Medical Stop-Loss business written by the insurance subsidiaries of IHC. IHC recorded gross premiums of \$8,452,000 and net commission expense of \$326,000 for these services. The Company also contracts for several types of insurance coverage (e.g. directors and officers and professional liability coverage) jointly with AMIC. The cost of this coverage is allocated between the Company and AMIC according to the type of risk, and IHC's portion is recorded in Selling, General and Administrative Expenses.

**Note 3.**

**Income Per Common Share**

Income per share calculations are based on income from continuing operations attributable to the common shareholders of IHC for the three-month and six-month periods ended June 30, 2011 and 2010, as shown below (in thousands):

**Three Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

Income from  
continuing  
operations

\$

3,464

\$

2,318

\$

7,264

\$

18,695

Less income  
f r o m  
noncontrolling  
interests



in subsidiaries

(424)

(565)

(1,040)

(781)

Income from  
continuing  
operations

attributable to  
I H C  
shareholders,  
net of tax

3,040

1,753

6,224

17,914

Loss from  
discontinued  
operations, net  
of tax

-

(55)

-

(182)

Net income  
attributable to  
I H C  
shareholders

\$

3,040

\$

1,698

\$

6,224

\$

Included in the diluted income per share calculations for the three months and six months ended June 30, 2011 are 13,000 and 9,000 of incremental shares, respectively, from; (1) the assumed exercise of dilutive stock options; (ii) the assumed vesting of dilutive restricted stock; and (iii) assumed share settlement of dilutive stock appreciation rights ( SARs ), computed using the treasury stock method. Included in the diluted income per share calculations for the three months and six months ended June 30, 2010 are 2,000 and 3,000 of incremental shares, respectively, from the assumed exercise of dilutive stock options and the assumed vesting of dilutive restricted stock computed using the treasury stock method.

**Note 4.**

**Investments**

The cost (amortized cost with respect to certain fixed maturities), gross unrealized gains, gross unrealized losses and fair value of investment securities are as follows:

**June 30, 2011**

**GROSS**

**GROSS**

**AMORTIZED**

**UNREALIZED**

**UNREALIZED**

**FAIR**

**COST**

**GAINS**

**LOSSES**

**VALUE**

**(In thousands)**

**FIXED MATURITIES**

**AVAILABLE-FOR-SALE:**

Corporate securities

\$  
324,161  
\$  
5,540  
\$  
(2,726)  
\$  
326,975

CMOs- residential <sup>(1)</sup>

41,204  
  
5,727  
  
(2,441)  
  
44,490  
  
119

CMOs - commercial

1,447

-

(713)

734

U.S. Government obligations

13,206

516

-

13,722

Agency MBS - residential <sup>(2)</sup>

9,199

315

120



-

9,514

GSEs <sup>(3)</sup>

67,868

803

(315)

68,356

States and political  
subdivisions

352,708

3,718

(2,960)

353,466

121

Total fixed maturities

\$
809,793
\$
16,619
\$
(9,155)
\$
817,257

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks

\$

7,385

\$

123

69

\$

(182)

\$

7,272

Preferred stock - perpetuals

32,242

796

(510)

32,528

Preferred stock - with  
maturities

12,305

2,045

(8)

14,342

124

Total equity securities

\$
51,932
\$
2,910
\$
(700)
\$
54,142

**December 31, 2010**

**GROSS**

**GROSS**

**AMORTIZED**

**UNREALIZED**

**UNREALIZED**

**FAIR**

**COST**

**GAINS**

**LOSSES**

**VALUE**

**(In thousands)**

**FIXED MATURITIES**

**AVAILABLE-FOR-SALE:**

Corporate securities

\$  
272,061  
\$  
3,595  
\$  
(3,661)  
\$  
271,995

CMOs - residential <sup>(1)</sup>

58,829  
6,662  
(1,847)  
63,644

CMOs - commercial

1,447  
-  
(639)  
128



808

U.S. Government obligations

16,617

351

-

16,968

Agency MBS - residential <sup>(2)</sup>

10,069

206

(51)

10,224

GSEs <sup>(3)</sup>

70,199

129

510

(182)

70,527

States and political  
subdivisions

365,578

2,070

(8,158)

359,490

Total fixed maturities

\$
794,800
\$
13,394
\$
(14,538)
\$
793,656

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks

\$

4,600

\$

167

\$

(98)

\$

4,669

Preferred stock - perpetuals

31,530

1,065

(315)

32,280

Preferred stock - with  
maturities

9,790

1,334

-

11,124

Total equity securities

\$  
45,920  
\$  
2,566  
\$  
(413)  
\$  
48,073

(1)

Collateralized mortgage obligations ( CMOs ).

(2)

Mortgage-backed securities ( MBS ).

(3)

Government-sponsored enterprises ( GSEs ) which are the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Federal Home Loan Banks. GSEs are private enterprises established and chartered by the Federal Government.

Unrealized gains (losses) on certain preferred stocks with maturities at June 30, 2011 and December 31, 2010 include \$1,763,000 related to the non-credit related component of other-than-temporary impairment losses recorded in accumulated other comprehensive income in prior periods.

The amortized cost and fair value of fixed maturities at June 30, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

**% OF**

**AMORTIZED**

**FAIR**

**TOTAL FAIR**

**COST**

**VALUE**

**VALUE**

**(In thousands)**

Due in one year  
or less



\$

7,130

\$

7,312

.9%

Due after one  
year through  
five years

179,047

181,967

22.3%

Due after five  
years through  
ten years

175,451

177,093

21.6%

Due after ten  
years

334,743

334,349

40.9%

696,371

700,721

85.7%

CMO and MBS

15 year

60,613

63,610

7.8%

20 year

873

879

.1%

30 year

51,936

52,047

6.4%

\$

809,793

\$

817,257

100.0%

The following tables summarize, for all securities in an unrealized loss position at June 30, 2011 and December 31, 2010, respectively, the aggregate fair value and gross unrealized loss by length of time those securities that have continuously been in an unrealized loss position:

**Less than 12  
Months**

**12 Months or  
Longer**

**Total**

**Fair**

**Unrealized**

**Fair**

**Unrealized**

**Fair**

**Unrealized**

**June 30, 2011**

**Value**

**Losses**

**Value**

**Losses**

**Value**

**Losses**

**(In thousands)**

C o r p o r a t e  
s e c u r i t i e s

\$

130,726

\$

2,579

\$

8,125

\$

147

\$

138,851

\$

2,726

C M O s -  
r e s i d e n t i a l

144



11,142

936

7,251

1,505

18,393

2,441

C M O ' s -  
commercial

-

-

734

145

713

734

713

GSEs

45,042

296

3,371

19

48,413

315

States and  
political

146

subdivisions

131,142

2,194

34,741

147

766

165,883

2,960

**Total fixed  
maturities**

318,052

6,005

54,222

3,150

372,274

9,155

148

Common stocks

3,906

182

-

-

3,906

182

Preferred  
stocks-perpetual

16,365

490

149

975

20

17,340

510

Preferred stocks  
with

maturities

2,508

8

-

-

2,508

8

T o t a l  
temporarily

i m p a i r e d  
securities

\$

340,831

\$

6,685

\$

55,197

\$

3,170



\$  
396,028  
\$  
9,855

**Less than 12  
Months**

**12 Months or  
Longer**

**Total**

**Fair**

**Unrealized**

**Fair**

**Unrealized**

**Fair**

**Unrealized  
December 31,  
2010**

**Value**

**Losses**

**Value**

**Losses**

**Value**

**Losses**

**(In thousands)**

C o r p o r a t e  
s e c u r i t i e s

\$

103,247

\$

3,404

\$

12,253

\$

257

157

	\$
	115,500
	\$
	3,661
C M O s - residential	
	12,494
	476
	16,979
	1,371
	29,473
	1,847
C M O s - commercial	
	-
	158

-

808

639

808

639

Agency MBS (2)  
residential

5,085

51

-

159

-

5,085

51

GSEs

32,481

170

1,389

12

33,870

182

States and  
political

160



subdivisions

195,589

5,292

37,655

161

2,866

233,244

8,158

Total fixed  
maturities

348,896

9,393

69,084

5,145

417,980

14,538

Common stocks

162

999

98

-

-

999

98

Preferred  
stocks-perpetual

14,845

315

-

163

-

14,845

315

T o t a l  
temporarily

i m p a i r e d  
securities

\$  
364,740

\$  
9,806

\$  
69,084

\$  
5,145

\$  
433,824

\$  
14,951

At June 30, 2011 and December 31, 2010, a total of 102 and 117 fixed maturities, respectively, and 18 and 13 equity securities, respectively, were in a continuous unrealized loss position for less than 12 months. At June 30, 2011 and December 31, 2010 a total of 24 and 27 fixed maturities, respectively, and 1 and nil equity securities, respectively, had continuous unrealized losses for 12 months or longer.

Substantially all of the unrealized losses on fixed maturities at June 30, 2011 and December 31, 2010 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. The unrealized loss on corporate securities and state and political subdivisions are due to wider spreads. Spreads have widened as investors shifted funds to US Treasuries in response to the current market turmoil. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not

consider these investments to be other-than-temporarily impaired at June 30, 2011

At June 30, 2011, the Company had \$22,659,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 48.6% were in CMOs that originated in 2005 or earlier and 51.4% were in CMOs that originated in 2006. The unrealized losses on all other CMOs relate to prime rate CMOs and are primarily attributed to general disruptions in the credit market subsequent to purchase. The Company's mortgage security portfolio has no exposure to sub-prime mortgages.

#### ***Other-Than-Temporary Impairment Evaluations***

The Company reviews its investment securities regularly and determines whether other-than-temporary impairments have occurred. The factors considered by management in its regular review to identify and recognize other-than-temporary impairment losses on fixed maturities include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; subordinated credit support; whether the issuer of a debt security has remained current on principal and interest payments; current expected cash flows; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions including the effect of changes in market interest rates. If the Company intends to sell a debt security, or it is more likely than not that it would be required to sell a debt security before the recovery of its amortized cost basis, the entire difference between the security's amortized cost basis and its fair value at the balance sheet date would be recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. If a decline in fair value of a debt security is judged

by management to be other-than-temporary and; (i) the Company does not intend to sell the security; and (ii) it is not more likely than not that it will be required to sell the security prior to recovery of the security's amortized cost, the Company assesses whether the present value of the cash flows to be collected from the security is less than its amortized cost basis. To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost basis, a credit loss exists. For any such security, the impairment is bifurcated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations, establishing a new cost basis for the security. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income in the Condensed Consolidated Balance Sheet. It is reasonably possible that further declines in estimated fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further other-than-temporary impairments in the near term, which could be significant.

In assessing corporate debt securities for other-than-temporary impairment, the Company evaluates the ability of the issuer to meet its debt obligations and the value of the company or specific collateral securing the debt position. For mortgage-backed securities where loan level data is not available, the Company uses a cash flow model based on the collateral characteristics. Assumptions about loss severity and defaults used in the model are primarily based on actual losses experienced and defaults in the collateral pool. Prepayment speeds, both actual and estimated, are also considered. The cash flows generated by the collateral securing these securities are then determined with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issuer's position in the overall structure, to determine the cash flows associated with the mortgage-backed security held by the Company. In addition, the Company evaluates other asset-backed securities for other-than-temporary impairment by examining similar characteristics referenced above for mortgage-backed securities. The Company evaluates U.S. Treasury securities and obligations of U.S. Government corporations, U.S. Government agencies, and obligations of states and political subdivisions for other-than-temporary impairment by examining the terms and collateral of the security.

Equity securities may experience other-than-temporary impairment in the future based on the prospects for full recovery in value in a reasonable period of time and the Company's ability and intent to hold the security to recovery. If a decline in fair value is judged by management to be other-than-temporary or management does not have the intent or ability to hold a security, a loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. For the purpose of other-than-temporary impairment evaluations, preferred stocks with maturities are treated in a manner similar to debt securities. Declines in the creditworthiness of the issuer of debt securities with both debt and equity-like features requires the use of the equity model in analyzing the security for other-than-temporary impairment.

Subsequent increases and decreases, if not an other-than-temporary impairment, in the fair value of available-for-sale securities that were previously impaired, are included in other comprehensive income in the Condensed Consolidated Balance Sheet.





Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Based on management's review of the portfolio, which considered these factors, the Company recorded the following losses for other-than-temporary impairments in the Condensed Consolidated Statements of Operations for the three months and six months ended June 30, 2011 and 2010 (in thousands):

**Three Months  
Ended**

**Six Months Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

Other-than-temporary  
impairments:

Fixed maturities

\$

165

\$

1,039

\$

468

\$

2,665

170

For the three-month and six-month periods ended June 30, 2011, other-than-temporary impairments on fixed maturities of \$165,000 and \$468,000, respectively, consist of credit losses recorded as a result of expected cash flows of certain debt securities less than the debt securities' amortized cost. For the three-month and six-month periods ended June 30, 2010, \$1,039,000 and \$1,933,000, respectively, are credit losses resulting from expected cash flows of debt securities less than the debt securities' amortized cost. The six-month period ended June 30, 2010 also includes losses of \$732,000 as a result of the Company's intent to sell certain municipal debt securities prior to the recovery of their amortized cost bases. No losses for other-than-temporary impairments were recognized in other comprehensive income during the three months or six months ended June 30, 2011 and 2010.

At June 30, 2011 and December 31, 2010, cumulative credit losses for other-than-temporary impairments recorded on securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income was \$1,763,000.

Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalance in liquidity that exists in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

**Note 5.**

**Net Realized Investment Gains**

Net realized investment gains for the three months and six months ended June 30, 2011 and 2010 are as follows (in thousands):

**Three Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

Net realized  
investment gains  
(losses):

Fixed maturities
\$
1,778
\$
1,584
\$
283
\$
1,743

Common stocks
19
65
(26)
152
173

Preferred stocks

86

(15)

1,424

26

Total  
available-for-sale  
securities

1,883

1,634

1,681

1,921

Other

-

-

-

62

Net realized  
investment gains

\$

1,883

\$

175

1,634

\$

1,681

\$

1,983



For the three months and six months ended June 30, 2011, the Company realized gross gains of \$3,085,000 and \$6,617,000, respectively, and realized gross losses of \$1,202,000 and \$4,936,000, respectively, on sales of available-for-sale securities. For the three months and six months ended June 30, 2010, the Company realized gross gains of \$3,445,000 and \$5,181,000, respectively, and realized gross losses of \$1,811,000 and \$3,260,000, respectively, on sales of available-for-sale securities.

**Note 6.**

**Fair Value Disclosures of Financial Instruments**

For all financial and non-financial assets and liabilities accounted for at fair value on a recurring basis, the Company utilizes valuation techniques based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market expectations. These two types of inputs create the following fair value hierarchy:

**Level 1** - Quoted prices for identical instruments in active markets.

**Level 2** - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

**Level 3** - Instruments where significant value drivers are unobservable.

The following section describes the valuation methodologies we use to measure different assets at fair value.

**Investments in fixed maturities and equity securities:**

Available-for-sale securities included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, collateralized mortgage obligations, municipals, GSEs and certain preferred stocks that were priced with observable market inputs. Level 3 securities consist of CMO securities, primarily Alt-A mortgages. For these securities, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management's assumptions and available market information. Further we retain independent pricing vendors to assist in valuing certain instruments.



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

The following tables present our financial assets and liabilities measured at fair value on a recurring basis, at June 30, 2011 and December 31, 2010, respectively (in thousands):

**June 30, 2011**

**Level 1**

**Level 2**

**Level 3**

**Total**

**FINANCIAL  
ASSETS:**

Fixed maturities  
available-for-sale:

Corporate securities

\$

-

\$

326,975

\$

-

\$

326,975

CMOs - residential

-

19,211

25,279

44,490

CMOs -  
commercial

-

-

734

734

US Government  
obligations

-

13,722

-

13,722

Agency MBS -  
residential

-

9,514

-

9,514

GSEs

-

68,356

-

68,356

States and political  
subdivisions

-

353,466

-

353,466

Total fixed  
maturities

-

791,244

26,013

817,257



Equity securities  
available-for-sale:

Common stocks

7,272

-

-

7,272

Preferred stocks -  
perpetual

32,528

-

-

32,528

Preferred stocks -  
with maturities

14,342

-

-

14,342

Total equity  
securities

54,142

-  
-  
54,142

Total

\$  
54,142  
\$  
791,244  
\$  
26,013  
\$  
871,399

**December 31,  
2010**

**Level 1**

**Level 2**

**Level 3**

**Total**

**FINANCIAL  
ASSETS:**

Fixed maturities  
available-for-sale:

Corporate  
securities

\$

-

\$

271,995

\$

-

\$

271,995

CMOs -  
residential

-

26,187

37,457

63,644

CMOs -  
commercial

-

-

808

808

US Government  
obligations

-

16,968

-

16,968

Agency MBS -  
residential

-

10,224

-

10,224

GSEs

-

70,527



-

70,527

States and political  
subdivisions

-

359,490

-

359,490

Total fixed  
maturities

-

755,391

38,265

793,656

Equity securities  
available-for-sale:

Common stocks

4,669

-

-

4,669

Preferred stocks -  
perpetual

32,280

-

-

32,280

Preferred stocks -  
with maturities

11,124

-

-

11,124

Total equity  
securities

48,073

-

-

48,073

Total

\$  
48,073

\$  
755,391

\$  
38,265

\$  
841,729

It is the Company's policy to recognize transfers of assets and liabilities between levels of the fair value hierarchy at the end of a reporting period. At June 30, 2011, there were no transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy. No securities were transferred out of Level 2 and into the Level 3 category at June 30, 2011. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow. No securities were transferred out of the Level 3 category in 2011. The changes in the carrying value of Level 3 assets and liabilities for the six months ended June 30, 2011 are summarized as follows (in thousands):

**June 30, 2011**

**CMOs**

**Residential**

**Commercial**

**Total**

Beginning balance

\$

37,457

\$

808

\$

38,265

Gains (losses)  
included in earnings:

Net realized  
investment losses

(364)

-

(364)

Other-than-temporary  
impairments

(468)

-

(468)

Net unrealized gains  
(losses) included in



accumulated other  
comprehensive loss

(975)

(74)

(1,049)

Sales of securities

(8,075)

-

(8,075)

Repayments and  
amortization of fixed  
maturities

(2,296)

-

(2,296)

Balance at end of  
period

\$

25,279

\$

734

\$

26,013

The following methods and assumptions were used to estimate the fair value of financial instruments not disclosed elsewhere in the Notes to Condensed Consolidated Financial Statements:

**(A)**

**Policy Loans**

The fair value of policy loans is estimated by projecting aggregate loan cash flows to the end of the expected lifetime period of the life insurance business at the average policy loan rates, and discounting them at a current market interest rate.

**(B)**

## **Funds on Deposit**

The Company has two types of funds on deposit. The first type is credited with a current market interest rate, resulting in a fair value which approximates the carrying amount. The second type carries fixed interest rates which are higher than current market interest rates. The fair value of these deposits was estimated by discounting the payments using current market interest rates. The Company's universal life policies are also credited with current market interest rates, resulting in a fair value which approximates the carrying amount.

(C)

## **Debt**

The fair value of debt with variable interest rates approximates its carrying amount. The fair value of fixed rate debt is estimated by discounting the cash flows using current market interest rates.

The estimated fair values of financial instruments not disclosed elsewhere in the Notes to Condensed Consolidated Financial Statements are as follows:

**June 30, 2011**

**December 31,  
2010**

**Carrying**

**Fair**

**Carrying**

**Fair**

**Amount**

**Value**

**Amount**

**Value**

**(In thousands)**

**FINANCIAL  
ASSETS:**

Policy loans

\$  
23,164

\$  
28,239

\$  
23,216

\$  
28,298

**FINANCIAL**

**LIABILITIES:**

Funds on  
deposit

\$  
413,685

\$  
416,263

\$  
406,366

\$  
411,036

Debt and junior

subordinated  
debt



securities

45,646

45,646

45,646

45,646

**Note 7.**

**Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill and other intangible assets (included in other assets in the Condensed Consolidated Balance Sheets) for the first six months of 2011 is as follows (in thousands):

**Other  
Intangible  
Assets**

**Total**

**Other**

**Definitive**

**Indefinite**

**Intangible**

**Goodwill**

**Lives**

**Lives**

**Assets**

Balance at  
December 31,  
2010

\$

51,713

\$

12,081

\$

7,997

\$

20,078

Capitalized  
software  
development

	-
	79
	-
	79
Amortization expense	-
	(1,155)
	-
	(1,155)

Balance at June  
30, 2011

\$

51,713

\$

11,005

\$

7,997

\$

19,002

**Note 8.**

**Share-Based Compensation**

IHC and AMIC each have share-based compensation plans. The following is a summary of the activity pertaining to each of these plans. AMIC disclosures reflect the activity subsequent to the Acquisition Date.

A)

### **IHC Share-Based Compensation Plans**

Total share-based compensation was \$205,000 and \$143,000 for the three months ended June 30, 2011 and 2010, respectively, and was \$327,000 and \$322,000 for the six months ended June 30, 2011 and 2010, respectively. Related tax benefits of \$82,000 and \$57,000 were recognized for the three months ended June 30, 2011 and 2010, respectively, and were \$130,000 and \$128,000 for the six months ended June 30, 2011 and 2010, respectively.

Under the terms of IHC's stock-based compensation plans, option exercise prices are more than or equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three years for employee options. The Company may also grant shares of restricted stock, share appreciation rights ( SARs ) and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant and have a three year vesting period. Exercise

prices of SARs are more than or equal to the quoted market price of IHC shares at the date of the grant and have three year vesting periods. At June 30, 2011, there were 709,755 shares available for future stock-based compensation grants under IHC's stock incentive plans.

**Stock Options**

IHC's stock option activity for the six months ended June 30, 2010 is as follows:

<b>Shares</b>
<b>Weighted- Average</b>
<b>Under Option</b>
<b>Exercise Price</b>
<b>December 31, 2010</b>
756,480



\$

11.68

Expired

(66,740)

21.94

**June 30, 2011**

689,740

10.68

The following table summarizes information regarding IHC's outstanding and exercisable options as of June 30, 2011:

**Outstanding**

**Exercisable**

Number of options

689,740

381,872

Weighted average  
exercise price per  
share

\$

10.68

\$

11.24

Aggregate intrinsic  
value for all  
options

\$

203,000

\$

68,000

Weighted average  
contractual term  
remaining

2.9 years

2.4 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. No options were granted during the six months ended June 30, 2011. The weighted average grant-date fair-value of

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

options granted during the six months ended 2010 was \$1.57 per share. The assumptions set forth in the table below were used to value the stock options granted during the six-month period ended June 30, 2010:

Weighted-average  
risk-free interest  
rate

2.3%

Annual dividend  
rate per share

\$

0.05

Weighted-average  
volatility factor of  
the Company's  
common stock

45.0%

Weighted-average  
expected term of  
options

4.5 years

Compensation expense of \$61,000 and \$135,000 was recognized in the three months ended June 30, 2011 and 2010, respectively, and \$171,000 and \$254,000 was recognized in the six months ended June 30, 2011 and 2010, respectively, for the portion of the grant-date fair value of stock options vesting during those periods.

No options were exercised during the three months and six months ended June 30, 2011 or 2010.

As of June 30, 2011, the total unrecognized compensation expense related to non-vested stock options was \$363,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.5 years.

### **Restricted Stock**

No shares of restricted stock were issued by IHC during the first six months of 2011. IHC issued 2,250 shares of restricted stock during the six months ended June 30, 2010. The total fair value of restricted stock that vested during each of the first six months of 2011 and 2010 was \$23,000. Restricted stock expense was \$4,000 and \$7,000 for the three months ended June 30, 2011 and 2010, respectively, and was \$9,000 and \$19,000 for the six months ended June 30, 2011 and 2010, respectively.

The following table summarizes restricted stock activity for the six months ended June 30, 2011:

<b>No. of</b>
<b>Weighted-Average</b>
<b>Non-vested</b>
<b>Grant-Date</b>
<b>Shares</b>
<b>Fair Value</b>

December 31, 2010

4,500

\$

7.80

Vested

(2,250)

\$

8.67

June 30, 2011

2,250

\$

6.92

As of June 30, 2011, the total unrecognized compensation expense related to IHC's non-vested restricted stock awards was \$15,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.6 years.

### **SARs and Share-Based Performance Awards**

The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. For the three months ended June 30, 2011 and 2010, IHC recorded \$110,000 and \$(9,000), respectively, of compensation costs for these awards, and for the six months ended June 30, 2011 and 2010, recorded \$125,000 and \$18,000, respectively. No SARs were exercised during the six months ended June 30, 2011 or 2010. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheet at June 30, 2011 and December 31, 2010 are liabilities of \$204,000 and \$79,000, respectively, pertaining to SARs.

Other outstanding awards include share-based performance awards. Compensation costs for these awards are recognized and accrued as performance conditions are met, based on the current share price. For the three months ended June 30, 2011 and 2010, IHC recorded \$30,000 and \$10,000, respectively, of compensation costs for these awards, and for the six months ended June 30, 2011 and 2010, recorded \$21,000 and \$31,000, respectively. The intrinsic value of share-based performance awards paid during the six months ended June 30, 2011 and 2010 was \$47,000 and \$54,000, respectively. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheet at June 30, 2011 and December 31, 2010 are liabilities of \$49,000 and \$75,000, respectively, pertaining to share-based performance awards.

### **B.**

#### **AMIC Share-Based Compensation Plans**

Total AMIC share-based compensation expense was \$9,000 and \$19,000 for the three months ended June 30, 2011 and 2010, respectively, and was \$25,000 and \$26,000 for the six months ended June 30, 2011 and the period between the Acquisition Date and June 30, 2010, respectively. Related tax benefits of \$3,000 and \$7,000 were recognized for the three months ended June 30, 2011 and 2010, respectively, and were \$9,000 and \$10,000 for the six months ended June 30, 2011 and the period between the Acquisition Date and June 30, 2010, respectively.

Under the terms of the AMIC's stock-based compensation plan, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms are ten years; and vesting periods range from three to four years. AMIC may also grant shares of restricted stock, stock appreciation rights and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting

period. At June 30, 2011, there were 6,523,888 shares available for future stock-based compensation grants under the AMIC stock incentive plan.



**Stock Options**

AMIC's stock option activity for the six months ended June 30, 2011 is as follows:

**Shares**

**Weighted-  
Average**

**Under Option**

**Exercise Price**

**December 31,  
2010**

359,234

\$

9.95

Grants

13,334

5.85

Expired

(31,668)

4.50

Exercised

(11,389)

4.17

**June 30, 2011**

329,511

\$

10.51

The following table summarizes information regarding AMIC s outstanding and exercisable options as of June 30, 2011:

**Outstanding**

**Exercisable**

Number of  
options

329,511

307,288

Weighted  
average exercise  
price per share

\$

10.51

\$

10.88

Aggregate  
intrinsic value  
for all options

\$

16,001

\$

5,334

Weighted  
average  
contractual term  
remaining

3.53 years

3.10 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. The weighted average grant-date fair-value of options granted during the six months ended June 30, 2011 and during the period between the Acquisition Date and June 30, 2010 was \$3.24 and \$2.79 per share, respectively. The assumptions set forth in the table below were used to value the stock options granted during the periods:

**June 30,**

**2011**

**2010**

Weighted-average  
risk-free interest  
rate

	2.95%
	3.69%
Annual dividend rate per share	
	\$
	-
	\$
	-
Weighted-average volatility factor of the Company's common stock	
	37.07
	45.00
Weighted-average expected term of options	
	5 years
	5 years

Compensation expense of \$6,000 and \$14,000 was recognized for the three months ended June 30, 2011 and 2010, respectively, and was \$18,000 and \$19,000 for the six months ended June 30, 2011 and the period between the Acquisition Date and June 30, 2010, respectively, for the portion of the grant-date fair value of AMIC's stock options vesting during those periods.

AMIC received cash proceeds of \$48,000 upon the exercise of 11,389 options with an intrinsic value of \$8,000 during the six months ended June 30, 2011. AMIC received cash proceeds of \$45,000 upon the exercise of 10,000 options with an intrinsic value of \$1,000 during the period between the Acquisition Date and June 30, 2010.

As of June 30, 2011, the total unrecognized compensation expense related to AMIC's non-vested options was \$76,000 which will be recognized over the remaining requisite service periods.

### **Restricted Stock**

AMIC issued 12,000 restricted stock awards in the second quarter of 2008, with a weighted average grant-date fair value of \$6.92 per share. No restricted stock awards were issued in 2011 or 2010. The total

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

fair value of AMIC's restricted stock that vested during the six months ended June 30, 2011 and during the period between the Acquisition Date and June 30, 2010 was \$12,000 and \$13,000, respectively. Restricted stock expense was \$3,000 and \$5,000 for the three months ended June 30, 2011 and 2010, respectively, and was \$7,000 for both the six months ended June 30, 2011 and the period between the Acquisition Date and June 30, 2010, respectively.

The following table summarizes AMIC's restricted stock activity for the six months ended June 30, 2011:

<b>No. of</b>
<b>Weighted-Average</b>
<b>Non-vested</b>
<b>Grant-Date</b>
<b>Shares</b>
<b>Fair Value</b>

December 31, 2010

2,500

\$

6.92

Vested

(2,000)

\$

6.92

Forfeited

(500)

\$

6.92



June 30, 2011

-

\$

-

**Note 9.**

**Income Taxes**

The provision for income taxes shown in the Condensed Consolidated Statements of Operations was computed based on the Company's actual results which approximate the effective tax rate expected to be applicable for the balance of the current fiscal year in accordance with consolidated life/non-life group income tax regulations. Such regulations adopt a subgroup method in determining consolidated taxable income, whereby taxable income is determined separately for the life insurance company group and the non-life insurance company group.

The deferred income tax benefit for the six months ended June 30, 2011 allocated to stockholders' equity (principally for net unrealized losses on investment securities) was \$2,325,000, representing the decrease in the related deferred tax liability from \$360,000 at December 31, 2010 to \$2,685,000 at June 30, 2011.

Included in the \$509,000 benefit for income taxes recorded for the six months ended June 30, 2011 is a deferred income tax benefit of \$2,319,000 associated with IHC's investment in AMIC. As the result of management's intention to adopt tax planning strategies to recover IHC's investment in AMIC in a tax-free manner, the cumulative Federal and State deferred income tax liabilities established as of December 31, 2010 for temporary differences between IHC's book value and tax basis in AMIC became permanent. Accordingly, IHC released its previously recorded deferred income tax liabilities and will not record deferred income taxes in 2011 and future periods for any earnings or stockholders' equity adjustments relating to IHC's investment in AMIC.

At June 30, 2011, AMIC, had net operating loss carryforwards of approximately \$272,800,000 for federal income tax purposes which expire between 2019 and 2029. The federal deferred tax asset relative to AMIC included in other assets on IHC's Condensed Consolidated Balance Sheet at June 30, 2011 was \$9,362,000, net of a valuation allowance of \$85,817,000. AMIC continues to file its own separate income tax return and is not included in the consolidated tax return of IHC.

**Note 10.**

**Supplemental Disclosures of Cash Flow Information**

Tax refunds, net of tax payments, were \$3,957,000 and \$(436,000) during the six months ended June 30, 2011 and 2010, respectively.

Cash payments for interest were \$922,000 and \$938,000 during the six months ended June 30, 2011 and 2010, respectively.

**Note 11.**

**Comprehensive Income (Loss)**

The components of comprehensive income (loss) include: (i) net income or loss reported in the Condensed Consolidated Statements of Operations; (ii) the after-tax net unrealized gains and losses on investment securities available for sale, including the subsequent increases and decreases in fair value of available-for-sale securities previously impaired; and (iii) the non-credit related component of other-than-temporary impairments of fixed maturities, net of tax.

The comprehensive income for the three months and six months ended June 30, 2011 and 2010 is summarized as follows (in thousands):

**Three Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

Net income

\$

3,464

\$

2,263

\$

7,264

\$

18,513

Unrealized  
gains arising

during the  
period, net of  
income taxes

5,128

4,507

5,003

8,931

Comprehensive  
income

8,592

6,770

12,267

27,444

L e s s  
comprehensive  
i n c o m e  
attributable to

noncontrolling  
interests

(711)

(565)

(1,296)

(781)

Comprehensive  
i n c o m e  
attributable to  
IHC

\$

7,881

\$  
6,205  
\$  
10,971  
\$  
26,663

Included in accumulated other comprehensive income at June 30, 2011 and December 31, 2010 are after-tax adjustments of \$1,132,000 related to the non-credit related component of other-than-temporary impairment losses recorded in prior years. No losses for other-than-temporary impairments of fixed maturities were recognized in other comprehensive income during the six months ended June 30, 2011.



**Note 12.**

**Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months and six months ended June 30, 2011 and 2010 is presented below (in thousands):

**Three Months  
Ended**

**Six Months Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

**Revenues:**

Medical Stop-Loss  
(A)

\$

30,145

\$

37,446

\$

60,780

\$

242

65,346
Fully Insured Health (B)
44,079
37,478
87,318
68,352
Group disability, life, annuities and DBL (C)
15,186
16,632
30,443
33,790
Individual life, annuities and other
14,817
14,074
243

29,960

28,169

Corporate

(420)

206

130

27,806

103,807

105,836

208,631

223,463

Net realized  
investment gains

1,883

244

1,634

1,681

1,983

Other-than-temporary  
impairment losses,  
net

(165)

(1,039)

(468)

(2,665)

\$

105,525

\$

106,431

\$

209,844

\$

222,781

**Income Before  
Income Taxes:**

Medical Stop-Loss  
(A)

\$

1,934

\$

1,859

\$

1,907

\$

2,452

Fully Insured  
Health<sup>(B)</sup> <sup>(D)</sup>

1,579

(75)

4,942

1,079

Group disability, life,  
annuities and DBL <sup>(C)</sup>

1,772

1,829

247

1,588

1,314

Individual life,  
annuities and other

330

761

344

894

Corporate

(2,054)

(1,327)

(2,322)

25,354

3,561

248



	3,047
	6,459
	31,093
Net realized investment gains	
	1,883
	1,634
	1,681
	1,983
Other-than-temporary impairment losses, net	
	(165)
	(1,039)
	(468)
	(2,665)
	249

Interest expense

(460)

(477)

(917)

(948)

\$

4,819

\$

3,165

\$

6,755

\$

250

**(A)**

The amount includes equity income from AMIC (prior to its acquisition) of \$14,000 for the six months ended June 30, 2010.

**(B)**

The amount includes equity income from AMIC (prior to its acquisition) of \$244,000 for the six months ended June 30, 2010.

**(C)**

The amount includes equity income from AMIC (prior to its acquisition) of \$22,000 for the six months ended June 30, 2010.

**(D)**

The Fully Insured Health segment includes amortization of intangible assets recorded as a result of purchase accounting for the recent acquisitions. Total amortization expense was \$604,000 and \$669,000 for the three months ended June 30, 2011 and 2010, respectively, and \$1,212,000 and \$1,160,000 for the six months ended June 30, 2011 and 2010, respectively. Amortization expense for the other segments is insignificant.

**Note 13.****Subsequent Event**

On July 1, 2011, a subsidiary of IHC amended its amortizing term loan with a commercial bank and increased its outstanding debt from \$7,500,000 to \$10,000,000. The amortizing term loan, as amended: (i) matures on July 1, 2016; (ii) bears a variable interest rate of Libor plus 3.35%; and (iii) requires annual principal payments in the amount of \$2,000,000 commencing on July 2012 through maturity. The Company

simultaneously entered into an interest rate swap with the commercial bank lender, for a notional amount equal to the amortizing debt principal amount, under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate of 1.60%. As a result of the interest rate swap, interest payments on this debt will be fixed at 4.95%. It is anticipated that there will be no hedge ineffectiveness on this swap, which will be accounted for as a cash flow hedge.

## ITEM 2.

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL**

### **CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

#### **Overview**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); (ii) its majority owned insurance company, Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Administrative Services, Inc., IHC Risk Solutions, LLC ( IHCRS ) and its other managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ), Actuarial Management Corporation ( AMC ), MedWatch, LLC and Hospital Bill Analysis, LLC. These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." At June 30, 2011, IHC also owns a 63.0% interest in American Independence Corp. ( AMIC ).

While management considers a wide range of factors in its strategic planning and decision-making, underwriting profit is consistently emphasized as the primary goal in all decisions as to whether or not to increase our retention in a core line, expand into new products, acquire an entity or a block of business, or otherwise change our business model. Management's assessment of trends in healthcare and morbidity, with respect to medical stop-loss, fully insured medical, disability and New York State short-term statutory disability benefit product ("DBL"); mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates

charged, deductibles and attachment points quoted, and the percentage of business retained. IHC also seeks transactions that permit it to leverage its vertically integrated organizational structure by generating fee income from production and administrative operating companies as well as risk income for its carriers and profit commissions. Management has always focused on managing the costs of its operations and providing its insureds with the best cost containment tools available.

*The following is a summary of key performance information and events:*

On March 5, 2010, IHC acquired a controlling interest in AMIC. Upon achieving control, AMIC's income and expense amounts became consolidated with IHC's results. Accordingly, the individual line items on the Condensed Consolidated Statement of Operations for 2010 include approximately four months of operations of AMIC.

The results of operations for the three months and six months ended June 30, 2011 and 2010 are summarized as follows (in thousands):

**Three Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

**2010**

Revenues

\$

105,525

\$

106,431

\$

209,844

\$

222,781

Expenses

100,706

103,266

203,089

193,318

Income from  
continuing  
operations

before income  
taxes

4,819

3,165

6,755



29,463

Income taxes  
(benefits)

1,355

847

(509)

10,768

**Income from  
continuing  
operations**

3,464

2,318

7,264

18,695

**Discontinued  
operations:**

Loss from  
discontinued  
operations

-

(55)

-

(182)

**Net income**

3,464

2,263

7,264

18,513

Less income  
from  
noncontrolling  
interests

in subsidiaries

(424)

(565)

(1,040)

(781)

**Net income  
attributable to  
IHC**

\$

3,040

\$

1,698

\$

6,224

\$

17,732

Income from continuing operations of \$.19 per share, diluted, for the three months ended June 30, 2011 compared to \$.11 per share, diluted, for the same period in 2010. Income from continuing operations of \$.40 per share, diluted, for the six months ended June 30, 2011, compared to \$1.17 per share, diluted, for the six months ended June 30, 2010. Net income for 2010 includes a \$16.7 million after-tax gain on the bargain purchase of AMIC;

Consolidated investment yields (on an annualized basis) of 4.2% and 4.3% for the three months and six months ended June 30, 2011 compared to 4.5% and 4.4% for the respective periods in 2010;

Released \$2.3 million of deferred income taxes relative to its investment in AMIC based on the Company's intention to adopt tax planning strategies to recover its investment in AMIC in a tax-free manner;

Increased ownership interest in AMIC to 63.0% and, in July 2011, commenced an offer to exchange up to 908,085 shares of IHC common stock for shares of AMIC common stock in an effort to further increase its ownership interest in AMIC to 80%; and

Book value of \$15.58 per common share, an increase of \$.44 per common share from December 31, 2010. The increase is primarily a result of current period net income and the acquisition of noncontrolling interests in AMIC, offset by the issuance of 600,218 shares of common stock during the period.

*The following is a summary of key performance information by segment:*

.

The Medical Stop-Loss segment reported income before taxes of \$1.9 million for each of the second quarters of 2011 and 2010, and reported income before taxes of \$1.9 million for the six months ended June 30, 2011 compared to \$2.5 million in the first six months of 2010. The decrease is primarily due to increased combined ratios in 2011 from certain non-owned MGUs;

o

Premiums earned decreased \$6.5 million and \$4.5 million for the three-month and six-month periods ended June 30, 2011, respectively, when compared to the same periods in 2010. The decrease in premiums earned is due to the cancellation of certain non-owned managing general underwriters in 2010.

o

Underwriting experience for the Medical Stop-Loss segment, as indicated by its GAAP Combined Ratios, are as follows for the periods indicated (in thousands):

**Three  
Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**



**2011**

**2010**

**2011**

**2010**

Premiums  
Earned

\$

27,421

\$

33,947

\$

55,316

\$

59,796

Insurance  
Benefits,  
Claims &  
Reserves

18,233

24,458

39,127

43,274

Expenses

8,351

8,633

16,602

15,409

Loss Ratio<sup>(A)</sup>

66.5%

72.0%

70.7%

72.4%

Expense  
Ratio <sup>(B)</sup>

30.4%

25.5%

30.0%

25.7%

Combined  
Ratio <sup>(C)</sup>

96.9%

97.5%

100.7%

98.1%

(A)

Loss ratio represents insurance benefits, claims and reserves divided by premiums earned.

(B)

Expense ratio represents net commissions (including profit commissions), administrative fees, premium taxes and other underwriting expenses divided by premiums earned.

(C)

Combined ratio is equal to the sum of the loss ratio and the expenses ratio.

.

The Fully Insured Health segment reported \$1.6 million of income before taxes for the three months ended June 30, 2011 as compared to break-even results for the comparable period in 2010, and reported \$4.9 million of income before taxes for the six months ended June 30, 2011 compared to \$1.1 million for the same period in 2010.

o

Fee and other income decreased \$.4 million and \$.7 million for the three months and six months ended June 30, 2011, respectively, as compared to the same periods in 2010.

o

Premiums earned increased \$7.0 million and \$19.7 million for the three months and six months ended June 30, 2011 over the comparable periods in 2010. The increase is primarily due to increased retentions in certain lines of this business.

o

Underwriting experience, as indicated by its GAAP Combined Ratios, for the Fully Insured segment are as follows for the periods indicated (in thousands):

**Three  
Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**2011**

**2010**

**2011**

2010

Premiums  
Earned

\$

36,452

\$

29,541

\$

73,247

\$

53,508

Insurance  
Benefits,  
Claims &  
Reserves

24,888

21,241

46,432

36,367

Expenses

10,662

8,048

22,219

15,338

Loss Ratio

68.3%



71.9%

63.4%

68.0%

Expense  
Ratio

29.2%

27.2%

30.3%

28.6%

Combined  
Ratio

97.5%

99.1%

93.7%

96.6%

o

The decrease in the loss ratio was primarily attributable to improved underwriting results on major medical business for groups and individuals, magnified by the increase in retention in this line, in 2011.

o

The underwriting expense ratio increased primarily as a result of an increase in general expenses.

.

Income before taxes from the Group disability, life, annuities and DBL segment remained relatively flat for the three months ended June 30, 2011 compared to the three months ended June 30, 2010, and increased \$.3 million for the six months ended June 30, 2011 primarily as a result of better loss ratios in the group term life and LTD lines partially offset by a decrease in the DBL line due to reduced volume and lower rates;

.

Income before taxes from the Individual life, annuities and other segment decreased \$.5 million and \$.6 million for the three-month and six-month periods ended June 30, 2011 over the respective periods in 2010;

.

Income before taxes from the Corporate segment decreased \$.7 million for the second quarter of 2011 compared to the second quarter of 2010. For the six months ended June 30, 2011, income before taxes from the Corporate segment decreased \$27.7 million primarily due to the inclusion, in 2010, of a \$27.8 million pre-tax gain as a result of the March 2010 acquired controlling interest in AMIC;

Net realized investment gains were \$1.9 million and \$1.7 million for the three months and six months ended June 30, 2011 compared to net realized investment gains of \$1.6 million and \$2.0 million for the three months and six months ended June 30, 2010. Other-than-temporary impairment losses for the three months and six months ended June 30, 2011 were \$.2 million and \$.5 million, respectively, and were \$1.0 million and \$2.7 million for the three months and six months ended June 30, 2010, respectively; and

Premiums by principal product for the three months and six months ended June 30, 2011 and 2010 are as follows (in thousands):

**Three  
Months  
Ended**

**Six Months  
Ended**

**June 30,**

**June 30,**

**Gross  
Direct and  
Assumed**

**Earned  
Premiums:**

**2011**

**2010**

**2011**

**2010**

Medical  
Stop-Loss

\$

35,655

\$

42,600

\$

70,830

\$

81,600

Fully  
Insured  
Health

51,854

54,212

103,776

103,546

Group  
disability,  
life,  
annuities  
and DBL

23,713

26,089

48,071

52,844

Individual,  
life,  
annuities  
and other

8,504

7,816

17,219

15,740

\$  
119,726  
\$  
130,717  
\$  
239,896  
\$  
253,730

**Three  
Months  
Ended**

**Six  
Months  
Ended**

**June 30,**

**June 30,**

**Net  
Premiums  
Earned:**

**2011**

**2010**

**2011**

**2010**

**Medical  
Stop-Loss**

\$

27,421

\$

33,947

\$

280



55,316

\$

59,796

Fully  
Insured  
Health

36,452

29,541

73,247

53,508

Group  
disability,  
life,  
annuities  
and DBL

12,594

14,272

25,662

28,596

Individual,  
life,  
annuities  
and other

7,534

6,854

15,649

281

13,598

\$  
84,001  
\$  
84,614  
\$  
169,874  
\$  
155,498

### **CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2010. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Reserves, Deferred Acquisition Costs, Investments, Goodwill and Other Intangible Assets, and Deferred Income Taxes* as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, *Critical Accounting Policies* in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2010. During the six months ended June

30, 2011, there were no additions to or changes in the critical accounting policies disclosed in the 2010 Form 10-K except for the recently adopted accounting standards discussed in Note 1(C) of the Notes to Condensed Consolidated Financial Statements.

**Results of Operations for the Three Months Ended June 30, 2011 Compared to the Three Months Ended June 30, 2010**

Information by business segment for the three months ended June 30, 2011 and 2010 is as follows:

**Benefits,  
Amortization  
Selling,**

**Net  
Fee and  
Claims  
of Deferred  
General**

**Premiums  
Investment  
Other**

**and**  
**Acquisition**  
**And**

**June 30, 2011**

**Earned**

**Income**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**

Medical Stop-Loss

\$

27,421

902

1,822

18,233

-

9,978

\$

1,934

Fully Insured Health

36,452

397

7,230

24,888

8

17,604

1,579

Group disability,

life, annuities

and DBL

12,594

2,560

32

9,748

133

3,533

1,772

Individual life,

287

annuities and

other

7,534

6,194

1,089

9,288

1,617

3,582

288



	330
Corporate	-
	(420)
	-
	-
	-
	1,634
	(2,054)
Sub total	
	\$
	84,001
	\$
	9,633
	\$
	10,173
	\$
	62,157
	\$
	1,758
	\$
	36,331
	3,561
	289

Net realized  
investment gains

1,883

Other-than-temporary  
impairment losses

(165)

Interest expense

(460)

Income from  
continuing operations  
before income taxes

4,819

Income taxes

1,355

Income from  
continuing operations

\$

3,464

**Benefits,  
Amortization  
Selling,**

**Net  
Fee and  
Claims  
of Deferred  
General**

**Premiums  
Investment  
Other  
and  
Acquisition  
And**

**June 30, 2010**

**Earned  
Income  
Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**

Medical Stop-Loss

\$

33,947

1,012

2,487

24,458

293

-
11,129
\$
1,859
Fully Insured Health
29,541
377
7,560
21,241
7
16,305
(75)
Group disability,

life, annuities

and DBL

14,272

2,411

(51)

10,278

125

4,400

1,829

Individual life,

annuities and

other

6,854

6,125

1,095

8,702

1,588

3,023

761

Corporate

-

206

-

-

-

1,533

296



(1,327)

Sub total

\$

84,614

\$

10,131

\$

11,091

\$

64,679

\$

1,720

\$

36,390

3,047

Net realized  
investment gains

1,634

Other-than-temporary  
impairment losses

(1,039)

Interest expense

(477)

Income from  
continuing operations  
before income taxes

3,165

298

Income taxes

847

Income from  
continuing operations

\$

2,318

**Premiums Earned**

The decrease is primarily due to: (i) a \$6.5 million decrease in the Medical Stop-Loss segment primarily due to the cancellation of non-owned managing general underwriters in 2010; and (ii) a \$1.7 million decrease in the Group disability, life, annuities and DBL segment primarily due to the point of service line which has been discontinued and decreases in the production of LTD, GTL and DBL businesses; partially offset by (iii) the Fully Insured Health segment which had a \$7.0 million increase in premiums in the second quarter of 2011 primarily as a result of increased retentions in the major medical business for groups and individuals, short term medical and limited medical lines of business and increased volume in the limited medical line, partially offset by a decrease in the student accident line as a result of the cancellation of a producer of this product; and (iv) an increase of \$.6 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the ceding and commutation of certain ordinary life and annuity business during 2010 in addition to premiums from a new final expense product with no comparable amounts in 2010.

**Net Investment Income**

Total net investment income decreased \$.5 million. The overall annualized investment yields were 4.2% and 4.5% (approximately 4.3% and 4.7%, on a tax advantaged basis) in the second quarter of 2011 and 2010, respectively. The overall decrease was primarily a result of decreased partnership income and a slight decrease in investment income on bonds, equities and short-term investments due to lower yields and the shorter duration of our portfolio. The annualized investment yields on bonds, equities and short-term investments were 4.3% and 4.4% in the second quarter of 2011 and 2010, respectively. IHC has approximately \$128.0 million in highly rated shorter duration securities earning on average 1.7%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

**Net Realized Investment Gains and Other-Than-Temporary Impairment Losses, Net**

The Company had net realized investment gains of \$1.9 million in 2011 compared to \$1.6 million of net realized gains in 2010. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

For the three months ended June 30, 2011 and 2010, the Company recorded \$.2 million and \$1.0 million, respectively, of other-than-temporary impairment losses, pre-tax, resulting from expected cash flows of debt securities that are less than the debt securities amortized cost.

**Fee Income and Other Income**

Fee income decreased \$1.4 million to \$8.3 million in the three months ended June 30, 2011 from \$9.7 million in the three months ended June 30, 2010 as a result of the lower volume of business in the Medical Stop-Loss segment and certain lines of the Fully Insured Health segment.

Total other income increased \$.4 million in the three months ended June 30, 2011 to \$1.8 million from \$1.4 million in the three months ended June 30, 2010.

**Insurance Benefits, Claims and Reserves**

The decrease in insurance benefits, claims and reserves is primarily attributable to: (i) a decrease of \$6.3 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; and (ii) a \$.6 million decrease in the Group disability, life, annuities and DBL segment largely as a result of

decreases in the volume of DBL and GTL lines and decreases in the point of service line which has been discontinued, partially offset by higher claims on the LTD line of business; (iii) an increase of \$3.7 million in the Fully Insured Health segment, principally due to the increase in premiums on the major medical business for groups and individuals, and limited medical lines of business partially offset by a decrease in the student accident line as a result of a lower volume of business; and (iv) a \$.6 million increase in the Individual life, annuity and other segment primarily resulting from an increase in ordinary life and annuities.

### **Selling, General and Administrative Expenses**

The decrease in selling, general and administrative expenses is primarily due to: (i) a \$1.2 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$.9 million decrease in the Group disability, life, annuities and DBL segment as a result of the lower volume of LTD and GTL lines in the second quarter; partially offset by (iii) a \$1.3 million increase in the Fully Insured Health segment largely due to an increase in commissions as a result of increased retentions in the major medical business for groups and individuals, short term medical and limited medical lines of business in 2011 combined with administrative expenses resulting from the increased volume of limited medical business; and (iv) a net increase of \$.7 million in the selling, general and administrative expenses of all other lines of business.

### **Income Taxes**

The effective tax rate for the three months ended June 30, 2011 was 29.2% compared to 25.0% in 2010. Due to management's intention to adopt tax planning strategies to recover its investment in AMIC in a tax-free manner, IHC did not record deferred taxes in 2011 relative to its share of earnings from its investment in AMIC, as it had in prior years. While this results in a lower effective tax rate, it was more than offset by a decrease, in 2011, of benefits derived from tax exempt interest and dividend received deductions as a result of the Company's investments in both state and political subdivisions and preferred securities.

**Results of Operations for the Six Months Ended June 30, 2011 Compared to the Six Months Ended June 30, 2010**

Information by business segment for the six months ended June 30, 2011 and 2010 is as follows:

**Equity**  
**Benefits,**  
**Amortization**  
**Selling,**  
  
**Net**  
**Income**  
**Fee and**  
**Claims**  
**of Deferred**  
**General**  
  
**Premiums**

**Investment**

**From**

**Other**

**and**

**Acquisition**

**And**

**June 30, 2011**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**



Medical Stop-Loss	
	\$
	55,316
	2,192
	-
	3,272
	39,127
	-
	19,746
	\$
	1,907
Fully Insured Health	
	73,247
	750
	-
	13,321
	46,432
	15
	305

35,929

4,942

Group disability,

life, annuities

-

and DBL

25,662

4,703

-

78

21,134

264

7,457

1,588

Individual life,

annuities and other

15,649

11,974

-

2,337

19,713

307

3,170

6,733

344

Corporate

-

130

-

-

-

-

2,452

(2,322)

Sub total

\$

169,874

\$

19,749

\$

-

\$

19,008

\$

126,406

\$

308

3,449

\$

72,317

6,459

Net realized  
investment gains

1,681

Other-than-temporary  
impairment losses

(468)

Interest expense

(917)

Income from  
continuing operations  
before income taxes

6,755

Income taxes

(509)

Income from  
continuing operations

310

\$

7,264

**Gain on**

**Bargain**

**Equity  
Purchase,  
Benefits,  
Amortization  
Selling,**

**Net  
Income  
Fee and  
Claims  
of Deferred  
General**

**Premiums  
Investment  
From  
Other  
and  
Acquisition  
And**



**June 30, 2010**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**

Medical Stop-Loss

\$

59,796

1,725

14

3,811

43,274

-

19,620

\$

2,452

Fully Insured Health

53,508

581

244

14,019

36,367

14

30,892

1,079

Group disability,

life, annuities

and DBL

28,596

4,800

22

372

23,552

248

8,676

315

1,314

Individual life,

annuities and other

13,598

12,420

-

2,151

18,314

2,776

6,185

894

Corporate

-

(24)

316

-

27,830

-

-

2,452

25,354

Sub total

\$

155,498

\$

19,502

\$

280

\$

48,183

\$

121,507

\$

3,038

\$

67,825

31,093

Net realized  
investment gains

1,983

Other-than-temporary  
impairment losses

(2,665)

Interest expense

(948)

Income from  
continuing operations  
before income taxes

29,463

Income taxes

10,768

Income from  
continuing operations

\$

18,695

319





**Acquisition of AMIC**

On March 5, 2010, IHC acquired a controlling interest in AMIC as a result of the purchase of AMIC common stock in the open market. In determining the bargain purchase gain with regard to the acquisition of the controlling interest in AMIC, IHC first recognized a gain of \$2.2 million as a result of remeasuring its equity interest in AMIC to its fair value of \$22.0 million immediately before the acquisition based on the closing market price of AMIC's common stock. Then, upon the acquisition of a controlling interest on March 5, 2010, the Company consolidated the net assets of AMIC. Accordingly, the Company determined the fair value of the identifiable assets acquired and liabilities assumed from AMIC on such date. The fair value of the net assets acquired exceeded the sum of: (i) the fair value of the consideration paid; (ii) the fair value of IHC's equity investment prior to the acquisition; and (iii) the fair value of the noncontrolling interests in AMIC, resulting in a bargain purchase gain of \$25.6 million. The total gain, amounting to \$27.8 million pre-tax, is included in gain on bargain purchase of AMIC on the Company's Condensed Consolidated Statement of Operations. This gain is a result of the quoted market price of AMIC being significantly less than the fair value of the net assets of AMIC. This disparity is due to the low trading volume in AMIC shares, and a discount on the shares traded due to a lack of control by minority shareholders. The fair value of the noncontrolling interests in AMIC was based on the closing market price of AMIC's common stock.

Prior to obtaining control, IHC recorded its investment in AMIC using the equity method. IHC recorded changes in its investment in AMIC in the Equity income from AMIC line in the Condensed Consolidated Statements of Operations. Upon achieving control, on March 5, 2010, AMIC's income and expense amounts became consolidated with IHC's results. Accordingly, the individual line items on the Condensed Consolidated Statement of Operations for 2010 reflect approximately four months of the operations of AMIC.

**Premiums Earned**

Premiums in the first six months of 2011 include six months of earned premiums from AMIC of \$35.4 million compared to four months of earned premiums from AMIC of \$25.5 million in 2010. Excluding these amounts, earned premiums increased \$4.5 million. The increase is primarily due to: (i) the Fully Insured Health segment which had a \$15.0 million increase in premiums in the first six months of 2011 primarily as a result of increased retentions in the major medical business for groups and individuals, short term medical and limited medical lines of business and increased volume in the major medical business for groups and individuals and limited medical lines, partially offset by a decrease in the student accident line as a result of the cancellation of a producer of this product; (ii) an increase of \$2.1 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the ceding and commutation of certain ordinary life and annuity business during 2010; partially offset by (iii) a \$9.2 million decrease in the Medical Stop-Loss segment primarily due to the cancellation of non-owned managing general underwriters in 2010; and (iv) a \$3.4 million decrease in the Group disability, life, annuities and DBL segment primarily due to the point of service line which has been discontinued.

**Net Investment Income**

Total net investment income increased \$.2 million. The overall annualized investment yields were 4.3% and 4.4% (approximately 4.5% and 4.6%, on a tax advantaged basis) in the first six months of 2011 and 2010, respectively. The overall increase was primarily a result of increased partnership income offset, in part, by a decrease in investment income on bonds, equities and short-term investments due to lower yields and the shorter duration of our portfolio. The annualized investment yields on bonds, equities and short-term investments were 4.2% and 4.4% in the first six months of 2011 and 2010, respectively. IHC has approximately \$128.0 million in highly rated shorter duration securities earning on average 1.7%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

**Net Realized Investment Gains and Other-Than-Temporary Impairment Losses, Net**

The Company had net realized investment gains of \$1.7 million in 2011 compared to \$2.0 million of net realized gains in 2010. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

For the six months ended June 30, 2011 and 2010, the Company recorded \$.5 million and \$2.7 million, respectively, of other-than-temporary impairment losses, pre-tax. Other-than-temporary impairment losses in 2011 consist of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost. In 2010, other-than-temporary impairment losses consist of \$1.9 million of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost and \$.7 million resulting from the Company's intent to sell certain municipal debt securities prior to the recovery of their amortized cost bases.

**Fee Income and Other Income**

Fee income decreased \$1.5 million to \$15.7 million in the six months ended June 30, 2011 from \$17.2 million in the six months ended June 30, 2010 as a result of the lower volume of business in the Medical Stop-Loss segment and certain lines of the Fully Insured Health segment.

Total other income increased \$.2 million in the six months ended June 30, 2011 to \$3.3 million from \$3.1 million in the six months ended June 30, 2010.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves in the first six months of 2011 includes six months of benefits, claims and reserves from AMIC of \$24.0 million compared to four months of benefits, claims and reserves from AMIC of \$18.1 million in 2010. Excluding these amounts, benefits, claims and reserves decreased \$1.0 million. The decrease is primarily attributable to: (i) a decrease of \$6.5 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; and (ii) a \$2.7 million decrease in the Group disability, life, annuities and DBL segment largely as a result of lower loss ratios on the GTL line of business and a decrease in the point of service line which has been discontinued; partially offset by (iii) an increase of \$6.8 million in the Fully Insured Health segment, principally due to the increase in premiums on the major medical business for groups and individuals, short term medical and limited medical lines of business partially offset by a decrease in the student accident line as a result of a lower volume of business; and (iv) a \$1.4 million increase in the Individual life, annuity and other segment primarily resulting from an increase in individual annuity contracts in 2011 and an increase in ordinary life and annuities.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses in first six months 2011 include six months of expenses from AMIC of \$17.2 million compared to four months of expenses from AMIC of \$11.6 million in 2010. Excluding these amounts, selling, general and administrative expenses decreased \$1.1 million. The decrease is primarily due to: (i) a \$3.6 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$1.4 million decrease in the Group disability, life, annuities and DBL segment; partially offset by (iii) a \$3.5 million increase in the Fully Insured Health segment largely due to an increase in commissions as a result of increased retentions in the major medical business for groups and individuals, short term medical and limited medical lines of business in 2011 combined with administrative expenses resulting from the increased volume of major medical business for groups and individuals and limited medical business; and (iv) a net decrease of \$.4 million in the selling, general and administrative expenses of all other lines of business.

### **Income Taxes**

In 2011, IHC eliminated \$2.3 million of previously recorded deferred income taxes due to management's intention to adopt tax planning strategies to recover its investment in AMIC in a tax-free manner. In addition, under the above assumptions, IHC did not record deferred taxes in 2011 relative to its share of earnings from its investment in AMIC, as it had in prior years, also resulting in a lower effective tax rate in the current year. Excluding this transaction, the effective tax rate for the six months ended June 30, 2011 was 26.5% compared to 36.6% in 2010. The high effective tax rate in 2010 is primarily attributable to higher jurisdictional tax rates on the gain related to the AMIC acquisition in 2010.

### **LIQUIDITY**

#### **Insurance Group**

The Insurance Group normally provides cash flow from: (i) operations; (ii) the receipt of scheduled principal payments on its portfolio of fixed maturities; and (iii) earnings on investments. Such cash flow is partially used to fund liabilities for insurance policy benefits. These liabilities represent long-term and short-term obligations.

#### **Corporate**

Corporate derives its funds principally from: (i) dividends from the Insurance Group; (ii) management fees from its subsidiaries; and (iii) investment income from Corporate liquidity. Regulatory constraints historically have not affected the Company's consolidated liquidity, although state insurance laws have provisions relating to the ability of the parent company to use cash generated by the Insurance Group. No dividends were declared or paid by the Insurance Group in the six months ended June 30, 2011 or 2010.

#### **Cash Flows**

The Company had \$11.3 million and \$11.4 million, respectively, of cash and cash equivalents as of June 30, 2011 and December 31, 2010.

Net cash provided by operating activities of continuing operations for the six months ended June 30, 2011 was \$11.0 million.

Net cash used by investing activities for the six months ended June 30, 2011 was \$13.9 million of which a net \$11.2 million was invested in securities under resale agreements, equity securities and fixed maturities held-for-sale in addition to \$1.0 million used to acquire additional shares of AMIC.

The Company has \$460.7 million of insurance reserves that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the six months ended June 30, 2011, cash received from the maturities and other repayments of fixed maturities was \$39.8 million.

The Company believes it has sufficient cash to meet its currently anticipated business requirements over the next twelve months including working capital requirements and capital investments.

**BALANCE SHEET**

The Company had net receivables from reinsurers of \$125.7 million at June 30, 2011. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at June 30, 2011.

The Company's health reserves by segment are as follows (in thousands):

**Total Health  
Reserves**

**June 30,**

**December 31,**

**2011**

**2010**

Medical Stop-Loss

\$

60,379

\$

64,338

Fully Insured  
Health

32,033

34,540

Group Disability

96,434

90,633

Individual A&H  
and Other

8,676

8,457



\$  
197,522  
\$  
197,968

Major factors that affect the Projected Net Loss Ratio assumption in reserving for medical stop-loss relate to: (i) frequency and severity of claims; (ii) changes in medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, the impact of new medical technology and changes in medical treatment protocols; and (iii) the adherence by the MGUs that produce and administer this business to the Company's underwriting guidelines. Changes in these underlying factors are what determine the reasonably likely changes in the Projected Net Loss Ratio.

The primary assumption in the determination of fully insured reserves is that historical claim development patterns tend to be representative of future claim development patterns. Factors which may affect this assumption include changes in claim payment processing times and procedures, changes in product design, changes in time delay in submission of claims, and the incidence of unusually large claims. The reserving analysis includes a review of claim processing statistical measures and large claim early notifications; the potential impacts of any changes in these factors are minimal. The time delay in submission of claims tends to be stable over time and not subject to significant volatility. Since our analysis considered a variety of outcomes related to these factors, the Company does not believe that any reasonably likely change in these factors will have a material effect on the Company's financial condition, results of operations, or liquidity.

The \$16.0 million increase in IHC's stockholders' equity in the first six months of 2011 is primarily due to \$6.2 million of net income, \$4.7 million of net unrealized gains on available-for-sale securities and the \$5.0 million acquisition of noncontrolling interests in AMIC.

**Asset Quality and Investment Impairments**

The nature and quality of insurance company investments must comply with all applicable statutes and regulations, which have been promulgated primarily for the protection of policyholders. Although the Company's gross unrealized losses on available-for-sale securities totaled \$9.9 million at June 30, 2011, approximately 97.0% of the Company's fixed maturities were investment grade and continue to be rated on average AA. The Company marks all of its available-for-sale securities to fair value through accumulated other comprehensive income or loss. These investments tend to carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At June 30, 2011, approximately 3.0% (or \$24.9 million) of the carrying value of fixed maturities was invested in non-investment grade fixed maturities (primarily mortgage securities) (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The



increase in non-investment grade securities is primarily due to the downgrades in credit ratings of certain Alt-A mortgage securities. The Company does not have any non-performing fixed maturities at June 30, 2011.

The Company reviews its investments regularly and monitors its investments continually for impairments. For the six months ended June 30, 2011, the Company recorded \$.5 million of losses for other-than-temporary impairments. The unrealized losses on all remaining available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at June 30, 2011. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at June 30, 2011 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

**Greater  
than**

**Greater  
than**

**3 months,**

**6 months,**

**Less than**

**less than**

**less than**

**Greater  
than**

**3 months**

**6 months**

**12 months**

**12 months**

**Total**

Fixed  
maturities

\$

-

\$

1,006

\$

-

\$

713

\$

1,719

Net unrealized gains were \$5.4 million and \$.6 million at June 30, 2011 and December 31, 2010, respectively. In 2011, the Company experienced an increase in net unrealized gains on available-for-sale securities of \$8.4 million which was offset by \$2.3 million of deferred taxes and \$1.3 million of deferred policy acquisition costs. From time to

time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalances in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

### **CAPITAL RESOURCES**

Due to its strong capital ratios, broad licensing and excellent asset quality and credit-worthiness, the Insurance Group remains well positioned to increase or diversify its current activities. It is anticipated that future acquisitions or other expansion of operations will be funded internally from existing capital and surplus and parent company liquidity. In the event additional funds are required, it is expected that they would be borrowed or raised in the public or private capital markets to the extent determined to be necessary or desirable.

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of June 30, 2011, is not materially different from that reported in the schedule of such obligations at December 31, 2010 which was included in Item 7 of the Company's Annual Report on Form 10-K.

## OUTLOOK

For 2011, we will continue to emphasize:

Preparing for health care reform by proactively adjusting our mix of Fully Insured Health products and distribution strategies to take advantage of changing market demands, while continuing to increase the efficiency of our fully insured administrative companies.

Leveraging our increased control over our medical stop-loss block and the efficiencies of scale arising from the formation of IHCRS to organically generate or acquire additional Medical Stop-Loss business while continuing to improve the profitability of the block. In addition, we will retain more risk on our business as a result of our increased capital base, which will increase our net retained premiums and our future profits starting next year.

Closely monitoring the experience in our Group disability, life annuities and DBL business.

The Company remained highly liquid in 2011 with a shorter duration portfolio. As a result, the yields on our investment portfolio were, and continue to remain, lower than in prior years and investment income may continue to be depressed for the balance of the year. IHC has approximately \$128.0 million in highly rated shorter maturity securities earning on average 1.7%; our portfolio as a whole is rated, on average, AA. The low duration of our portfolio enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income. A low duration portfolio such as ours also mitigates the adverse impact of potential inflation. IHC will continue to monitor the financial markets and invest accordingly.

At June 30, 2011, IHC owned approximately 63.0% of the outstanding common stock of AMIC. On July 15, 2011, IHC commenced an offer to exchange up to 908,085 shares of its common stock for properly tendered and accepted shares of common stock of AMIC (the Exchange Offer). If IHC were to exchange all of the shares of IHC common stock offered in the Exchange Offer for shares of AMIC common stock, IHC's total ownership of AMIC would increase to 80%.

We will continue to focus on our strategic objectives, including expanding our distribution network. However, the success of a portion of our Fully Insured Health business may be affected by the passage of the Patient Protection and Affordable Care and Education Reconciliation Act of 2010 signed by President Obama in March 2010, and its subsequent interpretations by state and federal regulators and its possible revision by the newly-elected Congress. The National Association of Insurance Commissioners has now issued its proposed regulations. The regulations proposed to-date (including those mandating minimum loss ratios) seem to have validated our strategy of pursuing niche lines

of business across many states utilizing multiple carriers. We have begun a comprehensive review of all the options for IHC and we are continuing a thorough evaluation of our options for those health insurance products that may be affected. Although the law will generally require insurers to operate with a lower expense structure for major medical plans in the small employer and individual markets, the law appears to make exceptions for carriers, such as ours, that have a minimal presence in any one state. Non-essential lines of business are not impacted by health care reform.

Our results depend on the adequacy of our product pricing, our underwriting and the accuracy of our reserving methodology, returns on our invested assets and our ability to manage expenses. Therefore, factors affecting these items, including unemployment and global financial markets, may have a material adverse effect on our results of operations and financial condition.

**ITEM 3.**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company manages interest rate risk by seeking to maintain an investment portfolio with a duration and average life that falls within the band of the duration and average life of the applicable liabilities. Options may be utilized to modify the duration and average life of such assets.



The Company monitors its investment portfolio on a continuous basis and believes that the liquidity of the Insurance Group will not be adversely affected by its current investments. This monitoring includes the maintenance of an asset-liability model that matches current insurance liability cash flows with current investment cash flows. This is accomplished by first creating an insurance model of the Company's in-force policies using current assumptions on mortality, lapses and expenses. Then, current investments are assigned to specific insurance blocks in the model using appropriate prepayment schedules and future reinvestment patterns.

The results of the model specify whether the investments and their related cash flows can support the related current insurance cash flows. Additionally, various scenarios are developed changing interest rates and other related assumptions. These scenarios help evaluate the market risk due to changing interest rates in relation to the business of the Insurance Group.

The expected change in fair value as a percentage of the Company's fixed income portfolio at June 30, 2011 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2010 included in Item 7A of the Company's Annual Report on Form 10-K.

In the Company's analysis of the asset-liability model, a 100 to 200 basis point change in interest rates on the Insurance Group's liabilities would not be expected to have a material adverse effect on the Company. With respect to its liabilities, if interest rates were to increase, the risk to the Company is that policies would be surrendered and assets would need to be sold. This is not a material exposure to the Company since a large portion of the Insurance Group's interest sensitive policies are burial policies that are not subject to the typical surrender patterns of other interest sensitive policies, and many of the Insurance Group's universal life and annuity policies were acquired from liquidated companies which tend to exhibit lower surrender rates than such policies of continuing companies. Additionally, there are charges to help offset the benefits being surrendered. If interest rates were to decrease substantially, the risk to the Company is that some of its investment assets would be subject to early redemption. This is not a material exposure because the Company would have additional unrealized gains in its investment portfolio to help offset the future reduction of investment income. With respect to its investments, the Company employs (from time to time as warranted) investment strategies to mitigate interest rate and other market exposures.

#### **ITEM 4.**

#### **CONTROLS AND PROCEDURES**

IHC's Chief Executive Officer and Chief Financial Officer supervised and participated in IHC's evaluation of its disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in IHC's periodic reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon that evaluation, IHC's Chief Executive Officer and Chief Financial Officer concluded that IHC's disclosure

controls and procedures are effective.

There has been no change in IHC's internal control over financial reporting during the six months ended June 30, 2011 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1.**

#### **LEGAL PROCEEDINGS**

We are involved in legal proceedings and claims that arise in the ordinary course of our businesses. We have established reserves that we believe are sufficient given information presently available related to our outstanding legal proceedings and claims. We do not anticipate that the result of any pending legal proceeding or claim will have a material adverse effect on our financial condition or cash flows, although there could be such an effect on our results of operations for any particular period.

### **ITEM 1A.**

#### **RISK FACTORS**

There were no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 in Item 1A to Part 1 of Form 10-K.

### **ITEM 2.**

#### **UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

##### **Private Placements**

In the first quarter of 2011, IHC acquired an aggregate 900,325 shares of AMIC common stock from noncontrolling interests in exchange for the issuance of 600,218 shares of common stock as private placements of unregistered securities under section 4(2) of the Securities Act. Accordingly, the shares will be restricted securities, subject to legend and will not be freely tradable in the United States until the shares are registered for resale under the Securities Act, or to the extent they are tradable under Rule 144 promulgated under the Securities Act or any other available exemption. Information pertaining to the Company's common stock is provided in Note 15 of the Notes to Consolidated Financial Statements included in Item 8 of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

##### **Share Repurchase Program**

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In January 2010, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC's common stock, inclusive of prior authorizations, under the 1991 plan. As of June 30, 2011, 285,700 shares were still authorized to be repurchased under the plan. Share repurchases during the second quarter of 2011 are summarized as follows:

**2011**

**Maximum Number**

**Average Price**

**Of Shares Which**

**Month of**

**Shares**

**of Repurchased**

**Can be**

**Repurchase**

**Repurchased**

**Shares**

**Repurchased**

April

-

-

293,600

May

-

-

293,600

June

7,900

\$

10.23

285,700

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**ITEM 4.**

**(REMOVED AND RESERVED)**

Not applicable

**ITEM 5.**

**OTHER INFORMATION**

Not applicable

**ITEM 6.**

**EXHIBITS**

31.1

Certification of the Chief Executive Officer and President Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2

Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**INDEPENDENCE HOLDING COMPANY**

(REGISTRANT)

By:

/s/Roy T. K. Thung\_\_\_\_\_

Date:

August 10, 2011

Roy T.K. Thung

Chief Executive Officer and President

By:

/s/Teresa A. Herbert\_\_\_\_\_

Date:



August 10, 2011

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer