

INDEPENDENCE HOLDING CO  
Form 10-Q  
November 10, 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 **September 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**

(State or other jurisdiction of incorporation or organization)

**58-1407235**

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

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

**06902**

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

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

**Outstanding at November 7, 2011**  
**16,415,671 Shares**

**INDEPENDENCE HOLDING COMPANY**

**INDEX**

<b><u>PART I - FINANCIAL INFORMATION</u></b>	<b>PAGE NO.</b>
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets - September 30, 2011 (unaudited) and December 31, 2010	4
Condensed Consolidated Statements of Operations - Three Months and Nine Months Ended September 30, 2011 and 2010 (unaudited)	5
Condensed Consolidated Statement of Changes in Equity - Nine Months Ended September 30, 2011 (unaudited)	6
Condensed Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2011 and 2010 (unaudited)	7
Notes to Condensed Consolidated Financial Statements (unaudited)	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3. Quantitative and Qualitative Disclosures about Market Risk	43
Item 4. Controls and Procedures	44
<b><u>PART II - OTHER INFORMATION</u></b>	
Item 1. Legal Proceedings	45
Item 1A. Risk Factors	45
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 3. Defaults Upon Senior Securities	45

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Item 4. Removed and Reserved	45
Item 5. Other Information	46
Item 6. Exhibits	46
Signatures	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)

	<b>September 30, 2011 (Unaudited)</b>	<b>December 31, 2010</b>
<b>ASSETS:</b>		
Investments:		
Short-term investments	\$ 50	\$ 53
Securities purchased under agreements to resell	17,352	41,081
Fixed maturities, available-for-sale	822,766	793,656
Equity securities, available-for-sale	43,558	48,073
Other investments	37,247	36,864
Total investments	920,973	919,727
Cash and cash equivalents	14,205	11,426
Due from securities brokers	27,435	15,022
Deferred acquisition costs	41,309	43,465
Due and unpaid premiums	45,639	48,586
Due from reinsurers	157,981	154,243
Premium and claim funds	38,007	37,646
Notes and other receivables	15,137	16,766
Goodwill	51,713	51,713
Other assets	55,224	63,198
<b>TOTAL ASSETS</b>	<b>\$ 1,367,623</b>	<b>\$ 1,361,792</b>
<b>LIABILITIES AND EQUITY:</b>		
<b>LIABILITIES:</b>		
Insurance reserves-health	\$ 179,856	\$ 181,447
Insurance reserves-life and annuity	278,395	278,000
Funds on deposit	416,107	408,566
Unearned premiums	2,647	4,043
Policy claims-health	14,892	16,521
Policy claims-life	12,153	11,809
Other policyholders' funds	20,737	20,195
Due to securities brokers	16,536	32,469
Due to reinsurers	37,454	31,554
Accounts payable, accruals and other liabilities	63,481	70,497
Liabilities related to discontinued operations	-	771
Debt	10,000	7,500

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Junior subordinated debt securities	38,146	38,146
<b>TOTAL LIABILITIES</b>	<b>1,090,404</b>	<b>1,101,518</b>
<b>EQUITY:</b>		
<b>IHC STOCKHOLDERS' EQUITY:</b>		
Preferred stock (none issued)	-	-
Common stock \$1.00 par value, 20,000,000 shares authorized; 16,774,210 and 15,742,020 shares issued; 16,464,541 and 15,232,865 shares outstanding	16,774	15,472
Paid-in capital	112,369	101,003
Accumulated other comprehensive income (loss)	8,957	633
Treasury stock, at cost 309,669 and 239,155 shares	(2,515)	(1,917)
Retained earnings	124,749	115,437
<b>TOTAL IHC STOCKHOLDERS' EQUITY</b>	<b>260,334</b>	<b>230,628</b>
<b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>	<b>16,885</b>	<b>29,646</b>
<b>TOTAL EQUITY</b>	<b>277,219</b>	<b>260,274</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 1,367,623</b>	<b>\$ 1,361,792</b>

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)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>REVENUES:</b>				
Premiums earned:				
Health	\$ 76,326	\$ 74,071	\$ 226,787	\$ 211,735
Life and annuity	8,904	9,188	28,317	27,022
Net investment income	9,235	11,136	28,984	30,638
Fee income	7,118	8,102	22,823	25,343
Net realized investment gains	924	4,030	2,605	6,013
Total other-than-temporary impairment losses	(385)	(132)	(853)	(2,797)
Portion of losses recognized in other comprehensive income	278	-	278	-
Net impairment losses recognized in earnings	(107)	(132)	(575)	(2,797)
Equity income from AMIC	-	-	-	280
Gain on bargain purchase of AMIC	-	-	-	27,830
Other income	1,259	1,480	4,562	4,592
	103,659	107,875	313,503	330,656
<b>EXPENSES:</b>				
Insurance benefits, claims and reserves:				
Health	45,560	48,494	146,639	145,309
Life and annuity	11,094	12,826	36,421	37,518
Selling, general and administrative expenses	38,958	37,182	111,275	105,007
Amortization of deferred acquisitions costs	1,844	1,678	5,293	4,716
Interest expense on debt	516	499	1,433	1,447
	97,972	100,679	301,061	293,997
Income from continuing operations before income taxes	5,687	7,196	12,442	36,659
Income taxes	1,676	2,145	1,167	12,913
<b>Income from continuing operations</b>	<b>4,011</b>	<b>5,051</b>	<b>11,275</b>	<b>23,746</b>
<b>Discontinued operations:</b>				
Loss from discontinued operations, net of tax	-	(21)	-	(203)
<b>Net income</b>	<b>4,011</b>	<b>5,030</b>	<b>11,275</b>	<b>23,543</b>
Less income from noncontrolling interests in subsidiaries	(457)	(610)	(1,497)	(1,391)
<b>NET INCOME ATTRIBUTABLE TO IHC</b>	<b>\$ 3,554</b>	<b>\$ 4,420</b>	<b>\$ 9,778</b>	<b>\$ 22,152</b>



**Basic income per common share:**

Income from continuing operations	\$	.22	\$	.29	\$	.62	\$	1.46
Loss from discontinued operations		-		-		-		(.01)
Basic income per common share	\$	.22	\$	.29	\$	.62	\$	1.45

<b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>		16,173		15,233		15,831		15,279
--	--	--------	--	--------	--	--------	--	--------

**Diluted income per common share:**

Income from continuing operations	\$	.22	\$	.29	\$	.62	\$	1.46
Loss from discontinued operations		-		-		-		(.01)
Diluted income per common share	\$	.22	\$	.29	\$	.62	\$	1.45

<b>WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING</b>		16,178		15,233		15,839		15,282
--	--	--------	--	--------	--	--------	--	--------

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



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Other capital transactions		765			(70)		695
<b>BALANCE AT SEPTEMBER 30, 2011</b>	16,774\$	112,369\$	8,957\$	(2,515)\$	124,749 \$		260,334 \$

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands) (Unaudited)

	Nine Months Ended September 30,	
	2011	2010
<b>CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:</b>		
Net income	\$ 11,275	\$ 23,543
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	-	203
Amortization of deferred acquisition costs	5,293	4,716
Net realized investment gains	(2,605)	(6,013)
Net impairment losses recognized in earnings	575	2,797
Equity income from AMIC and other equity method investments	(1,512)	(927)
Depreciation and amortization	3,183	3,609
Share-based compensation expenses	395	574
Deferred tax expense	774	14,730
Other	3,162	1,408
Changes in assets and liabilities:		
Net purchase of trading securities	-	(1,355)
Change in insurance liabilities	(2,265)	(27,244)
Additions to deferred acquisition costs, net	(5,814)	(4,952)
Change in net amounts due from and to reinsurers	2,162	15,934
Change in premium and claim funds	(361)	3,702
Change in income tax liability	3,514	(3,175)
Change in due and unpaid premiums	2,948	10,655
Change in other assets	(3,123)	79
Change in other liabilities	(7,040)	(9,732)
Net change in cash from operating activities of continuing operations	10,561	722
Net change in cash from operating activities of discontinued operations	-	(975)
Net change in cash from operating activities	10,561	(253)
<b>CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:</b>		
Change in net amount due from and to securities brokers	(28,346)	10,093
Net sales of securities under resale and repurchase agreements	23,729	9,951
Sales of equity securities	52,826	49,295
Purchases of equity securities	(50,135)	(37,719)
Sales of fixed maturities	284,390	535,848
Maturities and other repayments of fixed maturities	138,875	96,178
Purchases of fixed maturities	(435,757)	(657,028)

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Additional investments in other investments, net of distributions	1,129	2,070
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 interests	(1,450)	-
Cash paid in acquisition of policy blocks	-	(2,791)
Change in notes and other receivables	1,629	844
Other	(1,390)	(1,581)
Net change in cash from investing activities	(14,500)	6,253
<b>CASH FLOWS PROVIDED BY (USED BY) FINANCING ACTIVITIES:</b>		
Proceeds of debt	2,500	-
Repayment of long-term debt	-	(1,500)
Repurchase of common stock	(598)	(1,591)
Excess tax expense from expired stock options and vesting of restricted stock	(164)	(22)
Proceeds of investment-type insurance contracts	5,700	118
Dividends paid	(777)	(767)
Other capital transactions	57	(15)
Net change in cash from financing activities	6,718	(3,777)
Net change in cash and cash equivalents	2,779	2,223
Cash and cash equivalents, beginning of year	11,426	7,394
Cash and cash equivalents, end of period	\$ 14,205	\$ 9,617

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, its full service direct writer of medical stop-loss insurance for self-insured employer groups, and the managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ) and Actuarial Management Corporation ( AMC ). 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 September 30, 2011, IHC also owns a 76% interest in American Independence Corp. ( AMIC ).

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 50.5% of IHC's outstanding common stock at September 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 nine months ended September 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 September 2011, the FASB issued guidance related to evaluating goodwill for impairment. The new guidance provides entities with the option to perform a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before applying the quantitative two-step goodwill impairment test. If an entity concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the quantitative two-step goodwill impairment test. Entities also have the option to bypass the assessment of qualitative factors for any reporting unit in any period and proceed directly to performing the first step of the quantitative two-step goodwill impairment test, as was required prior to the issuance of this new guidance. An entity may begin or resume performing the qualitative assessment in any subsequent period. This guidance is 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 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 adoption of this guidance is not expected to have a material effect on the Company's 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 September 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 nine-month periods ended September 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%.

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 and expired on Friday, August 12, 2011. Pursuant to the Exchange Offer, IHC acquired 1,109,225 shares of AMIC common stock in consideration of 693,228 newly issued shares of IHC common stock plus a de minimis amount of cash paid in-lieu of

fractional shares. As a result of the exchange, the Company (i) recorded a \$196,000 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 76.0%.

In the third quarter of 2011, AMIC acquired an additional 27.8% ownership interest in its subsidiary, Independent Producers of America, LLC ( IPA ) from noncontrolling interests for cash consideration of \$450,000, thereby increasing its ownership in IPA to 78.8% at September 30, 2011. As a result of this transaction, and giving effect to noncontrolling interests in AMIC, the Company (i) reduced noncontrolling interests by \$1,127,000; and (ii) recorded a \$677,000 credit to paid-in capital representing the difference between the fair value of the consideration paid and the carrying value of the noncontrolling interests.

### **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 September 30, 2010, the Company's Condensed Consolidated Statement of Operations includes revenues and net income of \$21,803,000 and \$1,000,000, respectively, from AMIC.

For the period from the Acquisition Date to September 30, 2010, the Company's Condensed Consolidated Statement of Operations includes revenues and net income of \$53,207,000 and \$2,253,000, respectively, from AMIC.

The unaudited pro forma revenues and operating results, had the acquisition occurred as of the beginning of the nine-month period ended September 30, 2010, were \$316,426,000 and \$7,323,000, 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 nine-month periods ended September 30, 2011 and 2010, as shown below (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Income from continuing operations	\$ 4,011	\$ 5,051	\$ 11,275	\$ 23,746
Less income from noncontrolling interests in subsidiaries	(457)	(610)	(1,497)	(1,391)
Income from continuing operations attributable to IHC shareholders, net of tax	3,554	4,441	9,778	22,355
Loss from discontinued operations, net of tax	-	(21)	-	(203)
Net income attributable to IHC shareholders	\$ 3,554	\$ 4,420	\$ 9,778	\$ 22,152

Included in the diluted income per share calculations for the three-months and nine-months ended September 30, 2011 are 5,000 and 8,000 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 nine-months ended September 30, 2010 are nil 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:

	<b>September 30, 2011</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
	(In thousands)			
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Corporate securities	\$ 352,043	\$ 8,376	\$ (2,400)	\$ 358,019
CMOs- residential <sup>(1)</sup>	38,865	5,502	(2,143)	42,224
CMOs - commercial	1,448	-	(904)	544
U.S. Government obligations	12,464	701	-	13,165
Agency MBS - residential <sup>(2)</sup>	8,754	368	-	9,122
GSEs <sup>(3)</sup>	74,393	1,313	(228)	75,478
States and political subdivisions	318,219	7,254	(1,259)	324,214
Total fixed maturities	\$ 806,186	\$ 23,514	\$ (6,934)	\$ 822,766
<b>EQUITY SECURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Common stocks	\$ 8,258	\$ 16	\$ (783)	\$ 7,491
Preferred stock - perpetuals	19,513	244	(311)	19,446
Preferred stock - with maturities	15,527	1,285	(191)	16,621
Total equity securities	\$ 43,298	\$ 1,545	\$ (1,285)	\$ 43,558
	<b>December 31, 2010</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
	(In thousands)			
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

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)		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		510		(182)		70,527
States and political subdivisions		365,578		2,070		(8,158)		359,490
<b>Total fixed maturities</b>	<b>\$</b>	<b>794,800</b>	<b>\$</b>	<b>13,394</b>	<b>\$</b>	<b>(14,538)</b>	<b>\$</b>	<b>793,656</b>

**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
<b>Total equity securities</b>	<b>\$</b>	<b>45,920</b>	<b>\$</b>	<b>2,566</b>	<b>\$</b>	<b>(413)</b>	<b>\$</b>	<b>48,073</b>

(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 available-for-sale securities (a residential CMO and certain preferred stocks with maturities) include \$1,954,000 and \$1,763,000 at September 30, 2011 and December 31, 2010, respectively, related to the non-credit related component of other-than-temporary impairment losses, pre-tax, recognized in accumulated other comprehensive income.

The amortized cost and fair value of fixed maturities at September 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.

	<b>AMORTIZED COST</b>		<b>FAIR VALUE</b>	<b>% OF TOTAL FAIR VALUE</b>
	(In thousands)			
Due in one year or less	\$ 5,090		\$ 5,126	.6%
Due after one year through five years	175,516		178,490	21.7%
Due after five years through ten years	199,599		205,660	25.0%
Due after ten years	308,805		312,788	38.0%
	689,010		702,064	85.3%
CMO and MBS				
15 year	60,352		63,469	7.7%
20 year	860		869	.1%
30 year	55,964		56,364	6.9%
	\$ 806,186		\$ 822,766	100.0%

The following tables summarize, for all securities in an unrealized loss position at September 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 Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2011	(In thousands)					
Corporate securities	\$ 86,733	\$ 2,369	\$ 6,086	\$ 31	\$ 92,819	\$ 2,400
CMOs - residential	10,643	462	7,534	1,681	18,177	2,143
CMO's - commercial	-	-	544	904	544	904
GSEs	36,966	152	3,787	76	40,753	228

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

States and political subdivisions	49,200	622	37,383	637	86,583	1,259
Total fixed maturities	183,542	3,605	55,334	3,329	238,876	6,934
Common stocks	6,964	783	-	-	6,964	783
Preferred stocks-perpetual	7,350	38	5,641	273	12,991	311
Preferred stocks with maturities	7,513	191	-	-	7,513	191
Total temporarily impaired securities	\$ 205,369	\$ 4,617	\$ 60,975	\$ 3,602	\$ 266,344	\$ 8,219

December 31, 2010	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Corporate securities	\$ 103,247	\$ 3,404	\$ 12,253	\$ 257	\$ 115,500	\$ 3,661
CMOs - residential	12,494	476	16,979	1,371	29,473	1,847
CMOs - commercial	-	-	808	639	808	639
Agency MBS - residential	5,085	51	-	-	5,085	51
GSEs	32,481	170	1,389	12	33,870	182
States and political subdivisions	195,589	5,292	37,655	2,866	233,244	8,158
Total fixed maturities	348,896	9,393	69,084	5,145	417,980	14,538
Common stocks	999	98	-	-	999	98
Preferred stocks-perpetual	14,845	315	-	-	14,845	315
Total temporarily impaired securities	\$ 364,740	\$ 9,806	\$ 69,084	\$ 5,145	\$ 433,824	\$ 14,951

At September 30, 2011 and December 31, 2010, a total of 57 and 117 fixed maturities, respectively, and 20 and 13 equity securities, respectively, were in a continuous unrealized loss position for less than 12 months. At September 30, 2011 and December 31, 2010 a total of 23 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 September 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. With the exception of the securities for which an other-than-temporary impairment was recorded in other comprehensive income, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2011 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.

At September 30, 2011, the Company had \$20,672,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 45.0% were in CMOs that originated in 2005 or earlier and 55.0% 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 recognized the following losses for other-than-temporary impairments in the Condensed Consolidated Statements of Operations for the three months and nine months ended September 30, 2011 and 2010 (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Other-than-temporary impairments:				
Fixed maturities	\$ 107	\$ 132	\$ 575	\$ 2,797

For the three-month and nine-month periods ended September 30, 2011, other-than-temporary impairment losses on fixed maturities recognized in earnings of \$107,000 and \$575,000, respectively, consist of credit losses recorded as a result of expected cash flows of certain debt securities less than the debt securities' amortized cost. The Company also recognized \$278,000 of other-than-temporary losses on fixed maturities as a result of factors other than credit losses, in other comprehensive income, for the three-month and nine-month periods ended September 30, 2011. For the three-month and nine-month periods ended September 30, 2010, \$132,000 and \$2,065,000, respectively, are credit losses resulting from expected cash flows of debt securities less than the debt securities' amortized cost. The nine-month period ended September 30, 2010 also includes losses of \$732,000 recognized 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 nine months ended September 30, 2010.

For the nine months ended September 30, 2011 and 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 were as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Balance at beginning of year	\$ 1,763	\$ 2,394
Credit portion of other-than-temporary impairment losses recognized during period	107	-
Securities sold	(86)	(631)
Balance at end of period	\$ 1,784	\$ 1,763

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 nine months ended September 30, 2011 and 2010 are as follows (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Net realized investment gains (losses):				
Fixed maturities	\$ 2,252	\$ 5,104	\$ 2,535	\$ 6,847
Common stocks	(696)	(210)	(722)	(58)
Preferred stocks	(632)	490	792	516
Total available-for-sale securities	924	5,384	2,605	7,305
Sales of trading securities	-	(1,355)	-	(1,355)
Other	-	1	-	63
Net realized investment gains	\$ 924	\$ 4,030	\$ 2,605	\$ 6,013

For the three months and nine months ended September 30, 2011, the Company realized gross gains of \$3,112,000 and \$9,730,000, respectively, and realized gross losses of \$2,188,000 and \$7,125,000, respectively, on sales of available-for-sale securities. For the three months and nine months ended September 30, 2010, the Company realized gross gains of \$6,220,000 and \$11,400,000, respectively, and realized gross losses of \$836,000 and \$4,095,000, respectively, on sales of available-for-sale securities.

**Note 6.****Derivative Instruments**

In connection with its outstanding \$10,000,000 amortizing term loan, a subsidiary of IHC entered into an interest rate swap on July 1, 2011 with the commercial bank lender, for a notional amount equal to the 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% in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. As a result of the interest rate swap, interest payments on this debt were fixed at 4.95%. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge. At September 30 2011, the fair value of the interest rate swap was \$589,000 which is included in other liabilities on the accompanying Condensed Consolidated Balance Sheet. See Note 7 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap. For the three-month and nine-month periods ended September 30, 2011, the Company recorded \$354,000

of losses on the effective portion of the interest rate swap in accumulated other comprehensive income on the accompanying Condensed Consolidated Balance Sheet, net of related tax benefits of \$235,000.

**Note 7.**

**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.

**Interest rate swap:**

The financial liability included in Level 2 consists of an interest rate swap on IHC debt. It is valued using market observable inputs including market price, interest rate, and volatility within a Black Scholes model.

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

**September 30, 2011**

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>FINANCIAL ASSETS:</b>				
Fixed maturities available-for-sale:				
Corporate securities	\$ -	\$ 358,019	\$ -	\$ 358,019
CMOs - residential	-	18,780	23,444	42,224
CMOs - commercial	-	-	544	544
US Government obligations	-	13,165	-	13,165
Agency MBS - residential	-	9,122	-	9,122
GSEs	-	75,478	-	75,478
States and political subdivisions	-	324,214	-	324,214
Total fixed maturities	-	798,778	23,988	822,766

Equity securities available-for-sale:

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Common stocks	7,491	-	-	7,491
Preferred stocks - perpetual	19,446	-	-	19,446
Preferred stocks - with maturities	16,621	-	-	16,621
Total equity securities	43,558	-	-	43,558

Total	\$ 43,558	\$ 798,778	\$ 23,988	\$ 866,324
-------	-----------	------------	-----------	------------

**FINANCIAL LIABILITIES:**

Interest rate swap	\$ -	\$ 589	\$ -	\$ 589
--------------------	------	--------	------	--------

**December 31, 2010**

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>FINANCIAL ASSETS:</b>				
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 September 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 September 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 nine months ended September 30, 2011 are summarized as follows (in thousands):

	<b>September 30, 2011</b>		
	<b>CMOs</b>		<b>Total</b>
	<b>Residential</b>	<b>Commercial</b>	
Beginning balance	\$ 37,457	\$ 808	\$ 38,265
Gains(losses) included in earnings:			
Net realized investment losses	(16)	-	(16)
Other-than-temporary impairments	(575)	-	(575)
Net unrealized gains (losses) included in			
accumulated other comprehensive income	(830)	(264)	(1,094)
Non-credit portion of other-than-temporary impairments			
included in other comprehensive income	(278)	-	(278)



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Sales of securities	(9,196)	-	(9,196)
Repayments and amortization of fixed maturities	(3,118)	-	(3,118)
Balance at end of period	\$ 23,444	\$ 544	\$ 23,988

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:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
<b>FINANCIAL ASSETS:</b>				
Policy loans	\$ 23,104	\$ 28,168	\$ 23,216	\$ 28,298
<b>FINANCIAL LIABILITIES:</b>				
Funds on deposit	\$ 416,017	\$ 418,751	\$ 406,366	\$ 411,036
Debt and junior subordinated debt securities	48,146	48,146	45,646	45,646

**Note 8.****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 nine months of 2011 is as follows (in thousands):

	<b>Other Intangible Assets</b>			
	<b>Goodwill</b>	<b>Definitive Lives</b>	<b>Indefinite Lives</b>	<b>Total Other Intangible Assets</b>
Balance at December 31, 2010	\$ 51,713	\$ 12,081	\$ 7,997	\$ 20,078
Capitalized software development	-	116	-	116
Amortization expense	-	(1,719)	-	(1,719)
Balance at September 30, 2011	\$ 51,713	\$ 10,478	\$ 7,997	\$ 18,475

**Note 9.**

**Debt**

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. (Refer to Note 6 for more information on the interest rate swap).

**Note 10.**

**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 \$34,000 and \$208,000 for the three months ended September 30, 2011 and 2010, respectively, and was \$361,000 and \$530,000 for the nine months ended September 30, 2011 and 2010, respectively. Related tax benefits of \$14,000 and \$83,000 were recognized for the three months ended September 30, 2011 and 2010, respectively, and were \$144,000 and \$211,000 for the nine months ended September 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 September 30, 2011, there were 700,380 shares available for future stock-based compensation grants under IHC's stock incentive plans.

**Stock Options**

IHC's stock option activity for the nine months ended September 30, 2011 is as follows:

	<b>Shares Under Option</b>	<b>Weighted- Average Exercise Price</b>
<b>December 31, 2010</b>	756,480	\$ 11.68
Expired	(66,740)	21.94
<b>September 30, 2011</b>	689,740	10.68

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

	<b>Outstanding</b>	<b>Exercisable</b>
Number of options	689,740	381,872
Weighted average exercise price per share	\$ 10.68	\$ 11.24
Aggregate intrinsic value for all options	\$ -	\$ -
Weighted average contractual term remaining	2.6 years	2.1 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

valuation model. No options were granted during the nine months ended September 30, 2011. The weighted average grant-date fair-value of options granted during the nine 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 nine-month period ended September 30, 2010:

Weighted-average risk-free interest rate		2.3%
Annual dividend rate per share	\$	.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 \$120,000 was recognized in the three months ended September 30, 2011 and 2010, respectively, and \$231,000 and \$374,000 was recognized in the nine months ended September 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 nine months ended September 30, 2011 or 2010.

As of September 30, 2011, the total unrecognized compensation expense related to non-vested stock options was \$303,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.5 years.

**Restricted Stock**

IHC issued 6,750 and 2,250 shares of restricted stock during the nine months ended September 30, 2011 and 2010, respectively. The total fair value of restricted stock that vested during each of the first nine months of 2011 and 2010 was \$23,000. Restricted stock expense was \$9,000 and \$5,000 for the three months ended September 30, 2011 and 2010, respectively, and was \$18,000 and \$24,000 for the nine months ended September 30, 2011 and 2010, respectively.

The following table summarizes restricted stock activity for the nine months ended September 30, 2011:

	<b>No. of Non-vested Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
December 31, 2010	4,500	\$ 7.80
Granted	6,750	10.82

Vested	(2,250)	\$	8.67
September 30, 2011	9,000	\$	9.85

As of September 30, 2011, the total unrecognized compensation expense related to IHC's non-vested restricted stock awards was \$80,000 which is expected to be recognized over the remaining requisite weighted-average service period of 2.4 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 September 30, 2011 and 2010, IHC recorded \$43,000 and \$54,000 respectively, of

compensation costs for these awards, and for the nine months ended September 30, 2011 and 2010, IHC recorded \$82,000 and \$72,000, respectively. No SARs were exercised during the nine months ended September 30, 2011 or 2010. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010 are liabilities of \$161,000 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 September 30, 2011 and 2010, IHC recorded \$8,000 and \$29,000, respectively, of compensation costs for these awards, and for the nine months ended September 30, 2011 and 2010, recorded \$29,000 and \$60,000, respectively. The intrinsic value of share-based performance awards paid during the nine months ended September 30, 2011 and 2010 was \$53,000 and \$54,000, respectively. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010 are liabilities of \$52,000 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 \$18,000 for the three months ended September 30, 2011 and 2010, respectively, and was \$34,000 and \$44,000 for the nine months ended September 30, 2011 and for the period between the Acquisition Date and September 30, 2010, respectively. Related tax benefits of \$3,000 and \$8,000 were recognized for the three months ended September 30, 2011 and 2010, respectively, and were \$12,000 and \$18,000 for the nine months ended September 30, 2011 and for the period between the Acquisition Date and September 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 September 30, 2011, there were 6,517,221 shares available for future stock-based compensation grants under the AMIC stock incentive plan.

**Stock Options**

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

<b>Shares</b>	<b>Weighted- Average</b>
---------------	--------------------------



	<b>Under Option</b>		<b>Exercise Price</b>
<b>December 31, 2010</b>	359,234	\$	9.95
Grants	20,001		5.52
Expired	(31,668)		4.50
Exercised	(13,611)		4.24
<b>September 30, 2011</b>	333,956	\$	10.43

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

	<b>Outstanding</b>		<b>Exercisable</b>
Number of options	333,956		306,177
Weighted average exercise price per share	\$ 10.43	\$	10.90
Aggregate intrinsic value for all options	\$ 2,000	\$	400
Weighted average contractual term remaining	3.37 years		2.83 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 nine months ended September 30, 2011 and during the period between the Acquisition Date and September 30, 2010 was \$3.02 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:

	<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>
Weighted-average risk-free interest rate	3.11%	3.69%
Annual dividend rate per share	\$ -	\$ -
Weighted-average volatility factor of the Company's common stock	36.89	45.00
Weighted-average expected term of options	5 years	5 years

Compensation expense of \$9,000 and \$14,000 was recognized for the three months ended September 30, 2011 and 2010, respectively, and was \$27,000 and \$33,000 for the nine months ended September 30, 2011 and for the period between the Acquisition Date and September 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 \$57,000 upon the exercise of 13,611 options with an intrinsic value of \$11,000 during the nine months ended September 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 September 30, 2010.

As of September 30, 2011, the total unrecognized compensation expense related to AMIC's non-vested options was \$88,000 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 fair value of AMIC's restricted stock that vested during the nine months ended September 30, 2011 and during the period between the Acquisition Date and September 30, 2010 was \$12,000 and \$13,000, respectively. Restricted stock expense was \$0 and \$4,000 for the three months ended September 30, 2011 and 2010, respectively, and was \$7,000 and \$11,000 for the nine months ended September 30, 2011 and the period between the Acquisition Date and September 30, 2010, respectively.

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

	<b>No. of Non-vested Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
December 31, 2010	2,500	\$ 6.92
Vested	(2,000)	\$ 6.92
Forfeited	(500)	\$ 6.92
September 30, 2011	-	\$ -

**Note 11.**

**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 expense for the nine months ended September 30, 2011 allocated to stockholders' equity (principally for net unrealized losses on investment securities) was \$3,967,000, representing the increase in the related deferred tax liability from \$360,000 at December 31, 2010 to \$4,327,000 at September 30, 2011.

Included in the \$1,167,000 of income taxes recorded for the nine months ended September 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 September 30, 2011, AMIC, had net operating loss carryforwards of approximately \$271,836,000 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 September 30, 2011 was \$8,837,000, net of a valuation allowance of \$85,622,000. AMIC continues to file its own separate income tax return and is not included in the consolidated tax return of IHC.

**Note 12.**

**Supplemental Disclosures of Cash Flow Information**

Tax refunds, net of tax payments, were \$3,751,000 and \$(467,000) during the nine months ended September 30, 2011 and 2010, respectively.

Cash payments for interest were \$1,420,000 and \$1,431,000 during the nine months ended September 30, 2011 and 2010, respectively.

**Note 13.**

**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.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Net income	\$ 4,011	\$ 5,030	\$ 11,275	\$ 23,543
Net change in unrealized gains (losses):				
Unrealized gains arising				
during the period, net of income	3,709	8,678	8,712	17,609
taxes				
Net change in non-credit portion of other-than-				
temporary impairment losses,	(115)	(410)	(115)	(410)
net of tax				
Comprehensive income	7,605	13,298	19,872	40,742
Less comprehensive income attributable to				
noncontrolling interests	(591)	(610)	(1,887)	(1,391)
Comprehensive income attributable to IHC	\$ 7,014	\$ 12,688	\$ 17,985	\$ 39,351

Included in accumulated other comprehensive income at September 30, 2011 and December 31, 2010 are after-tax impairments losses of \$1,247,000 and \$1,132,000, respectively, related to the non-credit related component of other-than-temporary impairment losses.

**Note 14.**

**Segment Reporting**

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Revenues:</b>				
Medical Stop-Loss <sup>(A)</sup>	\$ 32,668	\$ 34,187	\$ 93,448	\$ 99,533
Fully Insured Health <sup>(B)</sup>	42,388	37,629	129,706	105,981
Group disability, life, annuities and DBL <sup>(C)</sup>	14,986	16,626	45,429	50,416
Individual life, annuities and other	13,924	15,858	43,884	44,027

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Corporate	(1,124)	(323)	(994)	27,483
	102,842	103,977	311,473	327,440
Net realized investment gains	924	4,030	2,605	6,013
Net impairment losses recognized in earnings	(107)	(132)	(575)	(2,797)
	\$ 103,659	\$ 107,875	\$ 313,503	\$ 330,656
<b>Income Before Income Taxes:</b>				
Medical Stop-Loss <sup>(A)</sup>	\$ 2,691	\$ 955	\$ 4,598	\$ 3,407
Fully Insured Health <sup>(B)</sup> <sup>(D)</sup>	2,355	888	7,297	1,967
Group disability, life, annuities and DBL <sup>(C)</sup>	3,285	3,704	4,873	5,018
Individual life, annuities and other	308	754	652	1,648
Corporate	(3,253)	(2,504)	(5,575)	22,850
	5,386	3,797	11,845	34,890
Net realized investment gains	924	4,030	2,605	6,013
Net impairment losses recognized in earnings	(107)	(132)	(575)	(2,797)
Interest expense	(516)	(499)	(1,433)	(1,447)
	\$ 5,687	\$ 7,196	\$ 12,442	\$ 36,659

**(A)**

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

**(B)**

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

**(C)**

The amount includes equity income from AMIC (prior to its acquisition) of \$22,000 for the nine months ended September 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 \$592,000 and \$611,000 for the three months ended September 30, 2011 and 2010, respectively, and \$1,804,000 and \$1,771,000 for the nine months ended September 30, 2011 and 2010, respectively. Amortization expense for the other segments is insignificant.

**Note 15.**

**Subsequent Event**

Subsequent to September 30, 2011, the Company sold its 51% interests in MedWatch LLC and Hospital Bill Analysis, LLC.

**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 ), its full service direct writer of medical stop-loss insurance for self-insured employer groups, and the managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ) and Actuarial Management Corporation ( AMC ). 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 September 30, 2011, IHC also owns a 76% 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 seven months of operations of AMIC.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Revenues	\$ 103,659	\$ 107,875	\$ 313,503	\$ 330,656
Expenses	97,972	100,679	301,061	293,997
Income from continuing operations before income taxes	5,687	7,196	12,442	36,659
Income taxes	1,676	2,145	1,167	12,913
<b>Income from continuing operations</b>	<b>4,011</b>	<b>5,051</b>	<b>11,275</b>	<b>23,746</b>
<b>Discontinued operations:</b>				
Loss from discontinued operations	-	(21)	-	(203)
<b>Net income</b>	<b>4,011</b>	<b>5,030</b>	<b>11,275</b>	<b>23,543</b>
Less income from noncontrolling interests in subsidiaries	(457)	(610)	(1,497)	(1,391)
<b>Net income attributable to IHC</b>	<b>\$ 3,554</b>	<b>\$ 4,420</b>	<b>\$ 9,778</b>	<b>\$ 22,152</b>

Income from continuing operations of \$.22 per share, diluted, for the three months ended September 30, 2011 compared to \$.29 per share, diluted, for the same period in 2010. Income from continuing operations of \$.62 per share, diluted, for the nine months ended September 30, 2011, compared to \$1.46 per share, diluted, for the nine months

ended September 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 4.0% and 4.2% for the three months and nine months ended September 30, 2011 compared to 4.9% and 4.6% 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 76.0%;

Book value of \$15.81 per common share, an increase of \$.67 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 1,302,190 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 \$2.7 million for the third quarter of 2011 compared to \$1.0 million for the third quarter of 2010, and reported income before taxes of \$4.6 million for the nine months ended September 30, 2011 compared to \$3.4 million in the first nine months of 2010. The increase is primarily due to improved underwriting results in 2011;

o

Premiums earned decreased \$.4 million and \$4.8 million for the three-month and nine-month periods ended September 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

The Company recorded a decrease in the loss ratio in the medical stop-loss line of business for the three months and nine months ended September 30, 2011 due to improved profitability. The medical stop-loss results for the third quarter of 2011 have begun to show improved profit margins primarily as a result of business written in 2010 performing better than that written in the comparable period of 2009 and the run-out of poorly performing business by non-owned MGUs which were previously cancelled.

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):

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>September 30,</b>		<b>September 30,</b>	
<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Premiums Earned	\$ 30,342	\$ 30,730	\$ 85,658	\$ 90,526
Insurance Benefits, Claims & Reserves Expenses	19,562	22,081	58,689	65,355
	9,228	8,700	25,830	24,109
Loss Ratio <sup>(A)</sup>	64.5%	71.9%	68.5%	72.2%
Expense Ratio <sup>(B)</sup>	30.4%	28.3%	30.2%	26.6%
Combined Ratio <sup>(C)</sup>	94.9%	100.2%	98.7%	98.8%

(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 \$2.4 million of income before taxes for the three months ended September 30, 2011 as compared to \$.9 million for the comparable period in 2010, and reported \$7.3 million of income before taxes for the nine months ended September 30, 2011 compared to \$2.0 million for the same period in 2010.

o

Premiums earned increased \$4.7 million and \$24.5 million for the three months and nine months ended September 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):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Premiums Earned	\$ 35,619	\$ 30,920	\$ 108,866	\$ 84,428
Insurance Benefits, Claims & Reserves Expenses	21,616	21,004	68,048	57,371
	11,563	9,168	33,782	24,506
Loss Ratio	60.7%	67.9%	62.5%	68.0%
Expense Ratio	32.5%	29.7%	31.0%	29.0%
Combined Ratio	93.2%	97.6%	93.5%	97.0%

o

The decrease in the loss ratio was primarily attributable to improved underwriting results due to a shift to more limited plans, lower utilization and claims and less exposure to large groups.

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 decreased \$.4 million for the three months ended September 30, 2011 compared to the three months ended September 30, 2010, and remained relatively flat for the nine months ended September 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 \$.9 million for the three-month and nine-month periods ended September 30, 2011 over the respective periods in 2010 primarily due to lower investment income;

Income before taxes from the Corporate segment decreased \$.8 million for the third quarter of 2011 compared to the third quarter of 2010. For the nine months ended September 30, 2011, income before taxes from the Corporate segment decreased \$28.5 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 \$.9 million and \$2.6 million for the three months and nine months ended September 30, 2011 compared to net realized investment gains of \$4.0 million and \$6.0 million for the three months and nine months ended September 30, 2010. Other-than-temporary impairment losses recognized in earnings for the three months and nine months ended September 30, 2011 were \$.1 million and \$.6 million, respectively, and were \$.1 million and \$2.8 million for the three months and nine months ended September 30, 2010, respectively; and

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

<b>Gross Direct and Assumed Earned Premiums:</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Medical Stop-Loss	\$ 38,472	\$ 40,440	\$ 109,301	\$ 122,040
Fully Insured Health	53,276	52,139	157,052	155,685
Group disability, life, annuities and DBL	23,098	25,744	71,169	78,588
Individual, life, annuities and other	7,921	8,655	25,140	24,395
	\$ 122,767	\$ 126,978	\$ 362,662	\$ 380,708

<b>Net Premiums Earned:</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Medical Stop-Loss	\$ 30,342	\$ 30,730	\$ 85,658	\$ 90,526
Fully Insured Health	35,619	30,920	108,866	84,428
Group disability, life, annuities and DBL	12,416	14,127	38,078	42,723
Individual, life, annuities and other	6,853	7,482	22,502	21,080
	\$ 85,230	\$ 83,259	\$ 255,104	\$ 238,757

### **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 nine months ended September 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 September 30, 2011 Compared to the Three Months Ended September 30, 2010**

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

<b>September 30, 2011</b> <b>(In thousands)</b>	<b>Premiums</b> <b>Earned</b>	<b>Net</b> <b>Investment</b> <b>Income</b>	<b>Fee and</b> <b>Other</b> <b>Income</b>	<b>Benefits,</b> <b>Claims</b> <b>and</b> <b>Reserves</b>	<b>Amortization</b> <b>of Deferred</b> <b>Acquisition</b> <b>Costs</b>	<b>Selling,</b> <b>General</b> <b>And</b> <b>Administrative</b>	<b>Total</b>
Medical Stop-Loss	\$ 30,342	1,487	839	19,562	-	10,415	\$ 2,691
Fully Insured Health	35,619	367	6,402	21,616	8	18,409	2,355
Group disability, life, annuities and DBL	12,416	2,528	42	7,520	133	4,048	3,285
Individual life, annuities and other	6,853	5,977	1,094	7,956	1,703	3,957	308
Corporate	-	(1,124)	-	-	-	2,129	(3,253)
Sub total	\$ 85,230	\$ 9,235	\$ 8,377	\$ 56,654	\$ 1,844	\$ 38,958	5,386
Net realized investment gains							924
Net impairment losses recognized in earnings							(107)
Interest expense							(516)
Income from continuing operations before income taxes							5,687
Income taxes							1,676
Income from continuing operations							\$ 4,011

<b>September 30, 2010</b> <b>(In thousands)</b>	<b>Premiums</b> <b>Earned</b>	<b>Net</b> <b>Investment</b> <b>Income</b>	<b>Fee and</b> <b>Other</b> <b>Income</b>	<b>Benefits,</b> <b>Claims</b> <b>and</b> <b>Reserves</b>	<b>Amortization</b> <b>of Deferred</b> <b>Acquisition</b> <b>Costs</b>	<b>Selling,</b> <b>General</b> <b>And</b> <b>Administrative</b>	<b>Total</b>
Medical Stop-Loss	\$ 30,730	1,407	2,050	22,081	-	11,151	\$ 955
Fully Insured Health	30,920	384	6,325	21,004	7	15,730	888
Group disability, life, annuities and DBL	14,127	2,455	44	7,855	125	4,942	3,704
Individual life, annuities and other	7,482	7,213	1,163	10,380	1,546	3,178	754
Corporate	-	(323)	-	-	-	2,181	(2,504)

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Sub total	\$ 83,259	\$ 11,136	\$ 9,582	\$ 61,320	\$ 1,678	\$ 37,182	3,797
Net realized investment gains							4,030
Net impairment losses recognized in earnings							(132)
Interest expense							(499)
Income from continuing operations before income taxes							7,196
Income taxes							2,145
Income from continuing operations						\$	5,051

**Premiums Earned**

The increase in premiums earned is primarily due to: (i) the Fully Insured Health segment which had a \$4.7 million increase in premiums in the third quarter of 2011 primarily as a result of increased retentions in the major medical business for groups and individuals 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; partially offset by (ii) a \$.4 million decrease in the Medical Stop-Loss segment primarily due to the cancellation of non-owned managing general underwriters in 2010; (iii) \$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 and DBL businesses; and (iv) a decrease of \$.6 million of earned premiums in the Individual life, annuities and other segment primarily as a result of a decrease in the production of annuity contracts slightly offset by premiums from a new final expense product with no comparable amounts in 2010.

**Net Investment Income**

Total net investment income decreased \$1.9 million. The overall annualized investment yields were 4.0% and 4.9% (approximately 4.1% and 5.2%, on a tax advantaged basis) in the third quarter of 2011 and 2010, respectively. The overall decrease was primarily a result of decreased partnership income and 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 4.3% and 4.8% in the third quarter of 2011 and 2010, respectively. IHC has approximately \$148.6 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 \$.9 million in 2011 compared to \$4.0 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 both the three months ended September 30, 2011 and 2010, the Company recorded \$.1 million, of other-than-temporary impairment losses in earnings, 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 \$1.0 million to \$7.1 million in the three months ended September 30, 2011 from \$8.1 million in the three months ended September 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 decreased \$.2 million in the three months ended September 30, 2011 to \$1.3 million from \$1.5 million in the three months ended September 30, 2010.

**Insurance Benefits, Claims and Reserves**

The decrease in insurance benefits, claims and reserves is primarily attributable to: (i) a decrease of \$2.5 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned partially offset by improved loss ratios in 2011; (ii) a \$.4 million decrease in the Group disability, life, annuities and DBL segment largely as a result of decreases in LTD claims and decreases in the point of

service line which has been discontinued, partially offset by higher loss ratios in the GTL line of business; (iii) a \$2.4 million decrease in the Individual life, annuity and other segment primarily resulting from a decrease in claims and reserves of ordinary life and annuities and reduced production of other annuity contracts; offset by (iv) an increase of \$.6 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 short term medical claims and a decrease in the student accident line as a result of a lower volume of business.

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

The increase in selling, general and administrative expenses is primarily due to: (i) a \$.8 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 the LTD line and the discontinued point of service line; partially offset by (iii) a \$2.7 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 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 September 30, 2011 was 29.8% compared to 29.2% 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 Nine Months Ended September 30, 2011 Compared to the Nine Months Ended September 30, 2010**

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

<u>September 30, 2011</u> (In thousands)	<u>Premiums Earned</u>	<u>Net Investment Income</u>	<u>Equity Income From AMIC</u>	<u>Fee and Other Income</u>	<u>Benefits, Claims and Reserves</u>	<u>Amortization of Deferred Acquisition Costs</u>	<u>Selling, General And Administrative</u>	<u>Total</u>
Medical Stop-Loss Fully Insured Health Group disability, life, annuities and DBL	\$ 85,658	3,679	-	4,111	58,689	-	30,161	\$ 4,598
Individual life, annuities and other	108,866	1,117	-	19,723	68,048	23	54,338	7,297
Corporate	-	(994)	-	-	-	-	4,581	(5,575)
Sub total	\$ 255,104	\$ 28,984	\$ -	\$ 27,385	\$ 183,060	\$ 5,293	\$ 111,275	11,845
Net realized investment gains								2,605
Net impairment losses recognized in earnings								(575)
Interest expense								(1,433)
Income from continuing operations before income taxes								12,442
Income taxes								1,167
Income from continuing operations								\$ 11,275

<u>September 30, 2010</u> (In thousands)	<u>Premiums Earned</u>	<u>Net Investment Income</u>	<u>Equity Income From AMIC</u>	<u>Gain on Bargain Purchase, Fee and Other Income</u>	<u>Benefits, Claims and Reserves</u>	<u>Amortization of Deferred Acquisition Costs</u>	<u>Selling, General And Administrative</u>	<u>Total</u>
	\$ 90,526	3,132	14	5,861	65,355	-	30,771	\$ 3,407

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-Q

Medical Stop-Loss Fully Insured Health Group disability, life, annuities and DBL	84,428	965	244	20,344	57,371	21	46,622	1,967
Individual life, annuities and other	21,080	19,633	-	3,314	28,694	4,322	9,363	1,648
Corporate	-	(347)	-	27,830	-	-	4,633	22,850
Sub total	\$ 238,757	\$ 30,638	\$ 280	\$ 57,765	\$ 182,827	\$ 4,716	\$ 105,007	34,890
Net realized investment gains								6,013
Net impairment losses recognized in earnings								(2,797)
Interest expense								(1,447)
Income from continuing operations before income taxes								36,659
Income taxes								12,913
Income from continuing operations								\$ 23,746

**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 seven months of the operations of AMIC.

### **Premiums Earned**

Premiums in the first nine months of 2011 include nine months of earned premiums from AMIC of \$54.6 million compared to seven months of earned premiums from AMIC of \$43.4 million in 2010. Excluding these amounts, earned premiums increased \$5.1 million. The increase is primarily due to: (i) the Fully Insured Health segment which had a \$19.2 million increase in premiums in the first nine 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 \$1.4 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the ceding of certain ordinary life and annuity business during 2010, in part offset by reduced production of annuity contracts; partially offset by (iii) a \$10.5 million decrease in the Medical Stop-Loss segment primarily due to the cancellation of non-owned managing general underwriters in 2010; and (iv) a \$5.0 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 decreased \$1.6 million. The overall annualized investment yields were 4.2% and 4.6% (approximately 4.3% and 4.8%, on a tax advantaged basis) in the first nine months of 2011 and 2010, respectively. The overall decrease was primarily a result of lower 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 4.6% in the first nine months of 2011 and 2010, respectively. IHC has approximately \$148.6 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 \$2.6 million in 2011 compared to \$6.0 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 nine months ended September 30, 2011 and 2010, the Company recorded \$.6 million and \$2.8 million, respectively, of other-than-temporary impairment losses in earnings, pre-tax. In 2011, other-than-temporary impairment losses recognized in earnings 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 recognized in earnings consist of \$2.0 million of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost and \$.8 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 \$2.5 million to \$22.8 million in the nine months ended September 30, 2011 from \$25.3 million in the nine months ended September 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 for the nine months ended September 30, 2011 remained comparable to other income for the nine months ended September 30, 2010.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves in the first nine months of 2011 includes nine months of benefits, claims and reserves from AMIC of \$36.1 million compared to seven months of benefits, claims and reserves from AMIC of \$29.9 million in 2010. Excluding these amounts, benefits, claims and reserves decreased \$5.9 million. The decrease is primarily attributable to: (i) a decrease of \$8.8 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; (ii) a \$3.0 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; and (iii) a \$1.0 million decrease in the Individual life, annuity and other segment primarily resulting from a decrease in individual annuity contracts in 2011 and an increase in ordinary life and annuities; partially offset by (iv) an increase of \$6.9 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.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses in first nine months 2011 include nine months of expenses from AMIC of \$21.2 million compared to seven months of expenses from AMIC of \$16.4 million in 2010. Excluding these amounts, selling, general and administrative expenses increased \$1.5 million. The increase is primarily due to: (i) a \$2.3 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 \$2.2 million decrease in the Group disability, life, annuities and DBL segment; partially offset by (iii) a \$5.1 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 increase of \$.9 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 nine months ended September 30, 2011 was 28.2% compared to 35.1% 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. For the nine months ended September 30, 2011 and 2010, Madison National Life paid dividends of \$2.0 million and \$3.5 million, respectively.

#### **Cash Flows**

The Company had \$14.2 million and \$11.4 million, respectively, of cash and cash equivalents as of September 30, 2011 and December 31, 2010.

Net cash provided by operating activities of continuing operations for the nine months ended September 30, 2011 was \$10.6 million.

Net cash used by investing activities for the nine months ended September 30, 2011 was \$14.5 million of which a net \$14.4 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 \$458.3 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 nine months ended September 30, 2011, cash received from the maturities and other repayments of fixed maturities was \$138.9 million.

Cash flows provided by financing activities include \$2.5 million of proceeds on debt.

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 \$120.5 million at September 30, 2011. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2011.

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

	<b>Total Health Reserves</b>	
	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Medical Stop-Loss	\$ 60,945	\$ 64,338
Fully Insured Health	32,657	34,540
Group Disability	92,426	90,633
Individual A&H and Other	8,720	8,457
	<b>\$ 194,748</b>	<b>\$ 197,968</b>

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 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 \$29.7 million increase in IHC's stockholders' equity in the first nine months of 2011 is primarily due to \$9.8 million of net income, \$8.2 million of net unrealized gains on available-for-sale securities and the \$11.5 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 \$8.2 million at September 30, 2011, approximately 97.4% 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 September 30, 2011, approximately 2.6% (or \$21.5 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 September 30, 2011.

The Company reviews its investments regularly and monitors its investments continually for impairments. For the nine months ended September 30, 2011, the Company recorded \$.9 million of losses for other-than-temporary impairments consisting of \$.6 million of credit losses recognized in earnings and \$.3 million of impairment losses recognized in other comprehensive income representing the non-credit related component. 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 September 30, 2011. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at September 30, 2011 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

		<b>Less than 3 months</b>	<b>Greater than 3 months, less than 6 months</b>	<b>Greater than 6 months, less than 12 months</b>	<b>Greater than 12 months</b>	<b>Total</b>
Fixed maturities	\$	1,802	-	227	905	2,934
Equity securities		342	-	-	-	342
	\$	2,144	-	227	905	3,276

Net unrealized gains were \$9.0 million and \$.6 million at September 30, 2011 and December 31, 2010, respectively. In 2011, the Company experienced an increase in net unrealized gains on available-for-sale securities of \$15.2 million which was offset by a \$.2 million pre-tax change in the non-credit portion of other-than-temporary impairment losses recorded in other comprehensive income, \$4.0 million of deferred taxes and \$2.6 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 September 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 \$148.6 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 September 30, 2011, IHC owned approximately 76% of the outstanding common stock of AMIC.

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 September 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 nine months ended September 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 September 30, 2011, 233,786 shares were still authorized to be repurchased under the plan. Share repurchases during the third quarter of 2011 are summarized as follows:

Month of Repurchase	2011		Average Price of Repurchased Shares	Maximum Number Of Shares Which Can be Repurchased
	Shares Repurchased			
July	-		-	285,700
August	24,514		8.66	261,186
September	27,400		\$ 7.47	233,786

**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:

November 10, 2011

Roy T.K. Thung

Chief Executive Officer and President

By:

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

Date:

November 10, 2011

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer