

INDEPENDENCE HOLDING CO  
Form 10-K  
March 15, 2013

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012**

**COMMISSION FILE NUMBER 0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State of Incorporation)

**58-1407235**  
(I.R.S. Employer Identification No.)

**96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT**  
(Address of Principal Executive Offices)

**06902**  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:  
**NONE**

Securities registered pursuant to Section 12(g) of the Act:  
**COMMON STOCK, \$1.00 PAR VALUE PER SHARE**  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes \_\_\_

No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes \_\_\_ No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [  ]

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a 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 Act). Yes \_\_\_ No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of June 30, 2012 was \$77,470,000.

17,913,966 shares of common stock were outstanding as of March 6, 2013.

### **Documents Incorporated by Reference**

Portions of the Registrant's definitive proxy statement to be delivered (or made available, pursuant to applicable regulations) to stockholders in connection with the 2012 annual meeting of stockholders to be held in June 2013 are incorporated by reference in response to Part III of this Report.

**FORM 10-K CROSS REFERENCE INDEX**

<b>PART I</b>		<b>PAGE</b>
Item 1.	Business	4
Item 1A.	Risk Factors	15
Item 1B.	Unresolved Staff Comments	22
Item 2.	Properties	23
Item 3.	Legal Proceedings	23
Item 4.	Mine Safety Disclosures	23
 <b>PART II</b>		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	24
Item 6.	Selected Financial Data	27
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	53
Item 8.	Financial Statements and Supplementary Data	54
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	54
Item 9A.	Controls and Procedures	54
Item 9B.	Other Information	55
 <b>PART III</b>		
Item 10.	Directors, Executive Officers and Corporate Governance	55
Item 11.	Executive Compensation	55
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	56
Item 13.	Certain Relationships, Related Transactions and Director Independence	56
Item 14.	Principal Accounting Fees and Services	56
 <b>PART IV</b>		
Item 15.	Exhibits and Financial Statement Schedules	56

**Forward-Looking Statements**

*This report on Form 10–K 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 this report.*

*Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, 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. In light of these risks, uncertainties and assumptions, any forward-looking event discussed in this report may not occur. Our forward-looking statements speak only as of the date made, and we undertake no obligation to update or review any forward-looking statement, whether as a result of new information, future events or other developments, unless the securities laws require us to do so.*

## PART I

### ITEM 1. BUSINESS

#### Business Overview

Independence Holding Company is a Delaware corporation (NYSE: IHC) that was formed in 1980. We are a holding company principally engaged in the life and health insurance business with principal executive offices located at 96 Cummings Point Road, Stamford, Connecticut 06902. At December 31, 2012, we owned a 78.6% controlling interest in American Independence Corp. (NASDAQ:AMIC), which owns Independence American Insurance Company ("Independence American"), IHC Risk Solutions LLC ( Risk Solutions ), IHC Specialty Benefits, Inc. ( Specialty Benefits ), and controlling interests in two agencies.

Our website is located at [www.ihcgroup.com](http://www.ihcgroup.com). Detailed information about IHC, its corporate affiliates and insurance products and services can be found on our website. In addition, we make our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to such reports available, free of charge, through our website, as soon as reasonably practicable after they are filed with or furnished to the SEC. The information on our website, however, is not incorporated by reference in, and does not form part of, this Annual Report on Form 10-K.

IHC provides specialized life and health coverage and related services to commercial customers and individuals. We focus on niche products and/or narrowly defined distribution channels primarily in the United States. Our wholly owned insurance company subsidiaries, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life") market their products through independent and affiliated brokers, producers and agents. Independence American also distributes through these sources as well as to consumers through a dedicated controlled distribution company and through company-owned web sites.

Madison National Life, Standard Security Life and Independence American are sometimes collectively referred to as the "Insurance Group." IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or "IHC", or are implicit in the terms "we", "us" and "our".

In 2013 IHC will retain the vast majority of the risk that it underwrites, and will focus on the following lines of business:

.  
Medical excess (or "stop-loss")

.  
Multiple fully insured health lines, including pet insurance

.  
Group disability and life

.  
Individual life, primarily through block acquisitions

Standard Security Life, Madison National Life and Independence American are each rated A- (Excellent) by A.M. Best Company, Inc. ("Best"). Standard Security Life is domiciled in New York and licensed as an insurance company in all 50 states, the District of Columbia, the Virgin Islands and Puerto Rico. Madison National Life is domiciled in Wisconsin, licensed to sell insurance products in 49 states, the District of Columbia, the Virgin Islands and Guam, and is an accredited reinsurer in New York. Independence American is domiciled in Delaware and licensed to sell insurance products in all 50 states and the District of Columbia. We have been informed by Best that a Best rating is assigned after an extensive quantitative and qualitative evaluation of a company's financial condition and operating performance and is also based upon factors relevant to policyholders, agents, and intermediaries, and is not directed toward protection of investors. Best ratings are not recommendations to buy, sell or hold any of our securities.

Our administrative companies underwrite market, administer and/or price life and health insurance business for our owned and affiliated carriers, and, to a lesser extent, for non-affiliated insurance companies. They receive fees for these services and do not bear any of the insurance risk of the companies to which they provide services, other than through profit commissions or profit slides. During 2012, our principal administrative companies were: (i) IHC Health Solutions Inc. ( Health Solutions ), a full-service marketing, management and administrative services company that operates in the individual and small employer markets; (ii) IHC Risk Solutions LLC ( Risk Solutions ), a full-service direct writer of medical stop-loss insurance for self-insured employer groups in the middle to larger employer markets; and (iii) Specialty Benefits, a program management and distribution company that focuses on individual and consumer products; (iv) Actuarial Management Corporation, an actuarial consulting firm providing product development and valuation services for IHC's fully insured health segment.

In addition, AMIC owns controlling interests in IPA Family, LLC ("IPA") and Healthinsurance.org LLC. IPA is a national, career agent marketing organization. Healthinsurance.org LLC is an online marketing company that owns www.healthinsurance.org, a lead generation site for individual health insurance, including in 2012 those over age 65. Our general agencies earn commissions for selling life and health insurance products underwritten by IHC's owned and affiliated insurance companies and also by unaffiliated carriers.

For information pertaining to the Company's business segments, reference is made to Note 21 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

## **Our Philosophy**

Our business strategy consists of maximizing underwriting profits through a variety of niche life and health insurance products and through distribution channels that enable us to access specialized or underserved markets in which we believe we have a competitive advantage. Historically, our carriers have focused on establishing preferred relationships with producers who seek an alternative to larger, more bureaucratic health insurers, and on providing these producers with personalized service, competitive compensation and a broad array of products. A growing portion of our business comes from direct-to-consumer initiatives. While our 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. We seek relationships that will generate fee income and profit commissions for our administrative companies as well as risk income for our insurance carriers thereby permitting us to leverage IHC's vertically integrated organizational structure.

As a result of our increased control of distribution through corporate acquisitions, we have strengthened our ability to respond to market cycles in the health insurance sector by deploying our insurance underwriting activity across a larger number of business lines. In recent years, we have emphasized writing stop-loss business through Risk Solutions and only a few select managing general underwriters ( MGUs ) with whom we have done business for many years, including TRU Services, LLC ( TRU ), in which we have an equity interest. This has allowed us to be more selective in order to achieve better stop-loss underwriting results by terminating all under-performing non-owned programs. While a substantial portion of our book of business is with smaller self-funded groups, we have recently focused on developing stop-loss solutions for plans with 100 or fewer employees. These plans are increasingly



looking for affordable health-financing alternatives as a result of federal health care reform.

As a result of the reorganization of Risk Solutions and an expansion in the demand for stop-loss insurance generally, we have seen an increase in our gross written stop-loss premiums. Net premiums have benefitted from this growth and higher retention. Our gross written fully insured health premiums have increased, but our net premiums have remained relatively flat. We have experienced decreases in administrative costs as a percentage of premiums in both our Fully Insured Health and Stop-Loss segments resulting from the consolidation and efficiency initiatives implemented in the last several years.

## DISTRIBUTION

### Medical Stop-Loss

Standard Security Life, Madison National Life and Independence American write approximately 75% of their medical stop-loss business through Risk Solutions and TRU with the balance written through three independent MGUs. Standard Security Life is the primary carrier for our employer medical stop-loss products although, in 2012, we also write business for Madison National Life, Independence American and for unaffiliated carriers. During 2012, IHC owned two managing general underwriters, Majestic Underwriters LLC ("Majestic") and Alliance Underwriters, LLC, which transferred their stop-loss blocks and employees to Risk Solutions as of January 1, 2012 in exchange for fee income based on the business transferred. They are responsible for underwriting accounts in accordance with guidelines formulated and approved by us, billing and collecting premiums, paying commissions to agents, third party administrators and/or brokers, and processing claims. With respect to those select MGUs with which we do business, we establish underwriting guidelines, maintain approved policy forms and oversee claims for reimbursement, as well as appropriate accounting procedures and reserves. In order to accomplish this, we audit the MGUs' underwriting, claims and policy issuance practices to assure compliance with our guidelines, provide the MGUs with access to our medical management and cost containment expertise, and review cases that require referral based on our underwriting guidelines. MGUs are non-salaried contractors that receive fee income, generally a percentage of gross premiums produced by them on behalf of the insurance carriers they represent, and typically are entitled to additional income based on underwriting results.

The agents and brokers that produce this business are non-salaried contractors that receive commissions.

### Fully Insured Health

The Fully Insured Health Segment includes the following lines of business (major medical health plans for small groups, individuals and families, dental/vision, short-term medical ("STM"), limited medical, pet insurance, and supplemental benefits, such as accident and critical illness plans) that are sold in the majority of states through multiple and varied distribution strategies. The largest line of business in this segment continues to be major medical for small employer groups (defined as employers with between two and fifty employees). The majority of our business in this segment is written (i) directly to agents through the Health Solutions telesales unit, (ii) through private-label arrangements managed by Health Solutions with non-affiliated third party administrators, (iii) through AMIC's captive agency relationships, and (iv) direct to consumers. We also market through general agents, agents and brokers.

The Fully Insured Health Segment is comprised of two major categories: (i) major medical essential health benefits ( EHB ) coverage (comprised of small-group major medical, major medical health plans for individuals and families

and small amount of large-group major medical) and (ii) non-EHB or supplemental benefits (including dental/vision, short-term medical, limited medical, pet insurance, critical illness, hospital indemnity, accident medical and non-subscriber occupational accident). Health Solutions performs marketing, sales, underwriting and administrative functions on the majority of our Fully Insured Health business. In addition, our carriers write a significant amount of Fully Insured Health business which is distributed and/or administered by independent third party administrators. In 2012 we formed Specialty Benefits to accelerate our growth into non-EHB or specialty lines of business by entering into several strategic relationships, most notably with a leading provider of pet insurance. We have also established a relationship with a leading provider of international health, life and disability plans for specialized niche markets, and invested in a joint venture to acquire third party administrators of non-subscriber occupational accident coverage in Texas.

The Fully Insured Health Segment has approximately 325 salaried employees performing all aspects of underwriting, risk selection and pricing, policy administration and management of fully insured

group and individual health insurance on behalf of IHC and other carriers, and management of approximately \$224 million of gross individual and group health premiums for multiple insurers.

The agents and brokers who produce the Fully Insured Health business are non-salaried contractors who receive commissions.

### **Other Products**

Our other products are primarily distributed by general agents, agents and brokers. The short-term statutory disability benefit product in New York State ("DBL") is marketed primarily through independent general agents who are paid commissions based upon the amount of premiums produced. Madison National Life's disability and group life products are primarily sold in the Midwest to school districts, municipalities and hospital employer groups through a managing general agent that specializes in these target markets. Madison National Life also reinsures and will begin writing life, disability and health products serving the needs of expatriates, third-country nationals and local nationals.

Madison National Life sells a whole-life product with an annuity rider to military personnel and civil service employees. Its subsidiary, IHC Financial Group, Inc. ( IHC Financial Group ), recruits agents to sell life and annuity products to state and federal employees. Since these products are currently not available through IHC's carriers, IHC Financial Group has contracted with highly rated insurance companies to sell their life and annuity products to these individuals. The income for IHC Financial Group is derived completely from commissions on the sale of the products of these other companies. The agents and brokers who produce this business are non-salaried contractors who receive commissions. We earned approximately \$0.7 million of revenue in 2012 and we anticipate increased growth as we continue to recruit new agents. We wrote about \$6.5 million of annualized premiums from our whole-life and annuity products in 2012 and expect to write about \$8.0 million of annualized premium in 2013. Madison National Life expects to write about \$3.7 million of annualized final expense whole life premium in 2013.

## **PRINCIPAL PRODUCTS**

### **Medical Stop-Loss**

The Company is a leading writer nationally of excess or stop-loss insurance for self-insured employer groups that desire to manage the risk of large medical claims ("Medical Stop-Loss"). Standard Security Life was one of the first carriers to market Medical Stop-Loss insurance, starting in 1987, and the Insurance Group is now one of the largest writers of this product in the United States. Medical Stop-Loss insurance provides coverage to public and private entities that elect to self-insure their employees' medical coverage for losses within specified ranges, which permits such groups to manage the risk of excessive health insurance costs by limiting specific and aggregate losses to predetermined amounts. This coverage is available on either a specific or a specific and aggregate basis, although the

majority of the Insurance Group's policies cover both specific and aggregate claims. Plans are designed to fit the identified needs of the self-insured employer by offering a variety of deductibles (i.e., the level of claims after which the medical stop-loss benefits become payable).

IHC experienced an increase in premiums in the Medical Stop-Loss line of business in 2012 primarily from the marketing efforts of Risk Solutions. We expect this trend to continue throughout 2013.

## **Fully Insured Health Products**

This line of business has two major categories: (i) Major Medical Essential Health Benefit ( EHB ) coverage, which had approximately \$131 million of gross premiums in 2012 and (ii) ancillary non-EHB plans, which had approximately \$93 million of gross premiums in 2012. Both categories are expected to grow in 2013, but the EHB category may shrink in 2014 and beyond as a result of the Patient Protection and Affordable Care Act, as amended ( ACA ).

### **Major Medical Essential Health Benefit Coverages**

This category is primarily comprised of group major medical insurance and major medical plans for individuals and families. Both products include consumer driven health plan ( CDHP ) products and are approved and currently sold in the majority of states.

Group major medical is sold primarily to small employers (two to 50 covered lives) in the majority of states. It is fully insured major medical coverage that is principally designed to work with health reimbursement accounts and health savings accounts which are implemented by employers that wish to provide this benefit as part of an employee welfare benefit plan. These plans are offered primarily as preferred provider organizations ("PPO") plans, and provide a variety of cost-sharing options, including deductibles, coinsurance and co-payment. CDHPs are designed to provide participants with economic incentives to be informed consumers of healthcare. In addition to small group, the Company offers a unique group medical plan to employers (small and large) who are contractors working on government-funded projects under the Davis-Bacon and Service Contract Acts (the Acts"), much of which is associated with current and future U.S. infrastructure improvements. This plan helps contractors meet the provisions of a "bona fide" fringe benefit for their hourly workers as required in the Acts. The Company experienced a significant increase in gross premiums in 2012 due to an improvement in the underwriting process at Health Solutions, and certain competitors decreasing their product availability, or in some instances leaving the market altogether, in response to the ACA. The company is expecting to continue growth into 2013, primarily through the addition of new programs and distributors.

The Company markets major medical plans for individuals and families that include CDHP products which are approved in the majority of states. This line of business grew slightly in 2012, and it is anticipated that there will be some contraction in premium in 2013 due to the decrease in the number of states in which we market as a result of the ACA.

### **Supplemental or Non-EHB Products**

This category is primarily comprised of dental/vision, STM, non-EHB supplemental plans for groups, individuals and families, and pet insurance. These are sold through multiple distribution strategies.

IHC sells group and individual dental products in all 50 states. We administer the majority of IHC's dental business and are also the primary distribution source of this line of business. The dental portfolio includes indemnity and PPO plans for employer groups of two or more lives and for individuals within affinity groups. Employer plans are offered on both employer paid and voluntary bases. As part of the distribution of our dental products, we also offer vision benefits. Vision plans will offer a flat reimbursement amount for exams and materials. Standard Security Life writes vision policies in the State of New York on behalf of national vision providers. IHC does not control the distribution or underwriting of the NY vision product, and therefore it does not retain its normal share of the risk and does not earn administrative fee income, other than the carrier fee. Gross dental premiums declined in 2012 due to pricing action taken to stabilize the underwriting results of the block. We expect the dental business to grow in 2013 as a result of new distribution relationships, new product offerings and possible block acquisitions. We anticipate a reduction in our vision business in New York.

IHC sells short-term medical products in the majority of states. STM is designed specifically for people with temporary needs for health coverage. Typically, STM products are written for a defined duration of twelve months or less. Among the typical purchasers of STM products are self-employed professionals, recent college graduates, persons between jobs, employed individuals not currently eligible for group insurance, and others who need insurance for a specified period of time less than 365 days. IHC's gross premium declined in this line of business in 2012 due to the termination of several non-owned distributors, however, during this period underwriting profits increased significantly. We anticipate modest growth in this line of business in 2013 in part due to increased demand for coverage that lasts until the guarantee issue provisions of the ACA begin in 2014, and new direct-to-consumer relationships.

The Company began to market supplemental products to individuals and families in 2010. These lines of business are generally used as either a supplement to a major medical plan or in lieu of major medical coverage for persons that do not qualify for or choose not to purchase such coverage. The main driver for growth in this line is that consumers are moving to higher-cost sharing on their individual major medical plans, and are looking for products to help them offset the additional risk of higher deductibles and out of pocket limits.

The product lines included in this supplemental grouping are hospital indemnity plans (HIP), limited benefit plans, critical illness and bundled packages of accident medical coverage, critical illness and life insurance. These products, which are available in most states, are not directly impacted by the ACA and are available through multiple distribution sources including Company owned direct-to-consumer websites and captive agents, general agents and on-line agencies.

IHC has medical benefit plans for employers who choose to offer non-EHB coverage to their employees. We offer a limited medical policy that offers affordable health coverage to hourly, part-time and/or seasonal employees, which is approved in a majority of states. Limited medical plans are a low cost alternative to major medical insurance that permit employees who do not otherwise have health insurance to begin to participate in the healthcare system. In 2012, the Company recorded an increase in gross premiums and projects continued growth in 2013 as employers use these products to create a benefit package to attract and retain part-time employees.

In 2012, the Company began marketing self-funded medical plans for employers between 10 and 50 employees. These plans, which are currently marketed in a limited number of states, appeal to employers that wish to participate in cost savings and wellness initiatives that will lower their claims costs. We expect that sales of the small group self-funded plans will grow in 2013 as we increase distribution and make the product available in additional states.

In 2012, the Company recorded about \$3.3 million of earned pet insurance premiums. In 2013, it is expected that we will record about \$17.0 million of earned pet insurance premiums through a national managing general underwriter with which the Company has a long-term agreement, and which is partially owned by the Company.



IHC entered into a reinsurance relationship with a leading producer of ex-patriot business, effective January 1, 2012, which provides employee benefit insurance, including medical, life, and disability, to ex-patriot employees of companies based in the United States. IHC, through its insurance subsidiaries, reinsures 15% of the risk on a quota share basis, or approximately \$4.9 million of earned premium in 2012. In addition, IHC has begun to file these policies in the United States on its carriers' paper for employers that wish to purchase a domestic policy to cover their employees. IHC expects growth in both insurance and reinsurance premiums in this line of business in 2013.

**Group Disability: Life, Annuities and DBL**

**Group Long-Term and Short-Term Disability**

The Company sells group long-term disability ("LTD") products to employers that wish to provide this benefit to their employees. Depending on an employer's requirements, LTD policies (i) cover between 40% and 90% of insurable salary; (ii) have elimination periods (i.e., the period between the commencement of the disability and the start of benefit payments) of between 30 and 730 days; and (iii) terminate after two, five or ten years, or extend to age 65 or the employee's Social Security normal retirement date. Benefit payments are reduced by social security, workers compensation, pension benefits and other income replacement payments. Optional benefits are available to employees, including coverage for partial or residual disabilities, survivor benefits and cost of living adjustments. The Company also markets short-term disability ("STD") policies that provide a weekly benefit to disabled employees until the earlier of: recovery from disability, eligibility for long-term disability benefits or the end of the STD benefit period. The Company experienced a decrease in sales to school districts and municipalities in 2012 as compared to 2011. We expect a slight increase in premiums in 2013.

**New York Short-Term Disability (DBL)**

Standard Security Life markets DBL. All companies with more than one employee in New York State are required to provide DBL insurance for their employees. DBL coverage provides temporary cash payments to replace wages lost as a result of disability due to non-occupational injury or illness. The DBL policy provides for (i) payment of 50% of salary to a maximum of \$170 per week; (ii) a maximum of 26 weeks in a consecutive 52 week period; and (iii) benefit commencement on the eighth consecutive day of disability. Policies covering fewer than 50 employees have fixed rates approved by the New York State Insurance Department. Policies covering 50 or more employees are individually underwritten. Standard Security Life's DBL premiums increased in 2012 due to increased marketing and expansion of sales through a new sales representative. The Company anticipates significant premium growth in 2013 due to continued marketing efforts and a major competitor exiting the market.

**Group Term Life and Annuities**

Madison National Life and Standard Security Life sell group term life products, including group term life, accidental death and dismemberment ("AD&D"), supplemental life and supplemental AD&D and dependent life. As with its group disability business, IHC anticipates modest growth in this line of business through expansion of its sales of these group term life products through existing distribution sources.

**Individual Life, Annuities and Other**

This category includes: (i) insurance products that are in runoff as a result of the Insurance Group's decision to discontinue writing such products; (ii) blocks of business that were acquired from other insurance companies; (iii) individual life and annuities written through Madison National Life's military and civilian government employee division and through its final expense distribution agency; (iv) blanket accident insurance sold through a specialized general agent; and (v) certain miscellaneous insurance products.

The Company markets a whole life product commonly referred to as a final expense life policy. This whole life product is sold to people in the 50 to 85 years old range. The face amounts can range from \$2,500 to \$50,000. We are currently averaging about \$13,500 per policy.

The following lines of Standard Security Life's in-force business are in runoff: individual accident and health, individual life, single premium immediate annuities, disability income, accidental medical, accidental death and AD&D insurance for athletes, executives and entertainers, and miscellaneous

insurance business. Madison National Life's runoff in this category consists of existing blocks of individual life, including pre-need (i.e., funeral expense) coverage, traditional and interest-sensitive life blocks which were acquired in prior years, individual accident and health products, annual and single premium deferred annuity contracts and individual annuity contracts.

### **ACQUISITIONS OF POLICY BLOCKS**

In addition to its core life and health lines of business distributed as described above, IHC's acquisition group has acquired blocks of existing life insurance, annuity and disability policies from other insurance companies, guaranty associations and liquidators. Most of the acquired blocks have been primarily life, annuities or disability policies. Not only have these transactions yielded a healthy rate of return on the investment, but the overall long-term nature of the policies acquired serves as a counterbalance to the bulk of the policies currently being written which are short-term in nature.

Other than the following two blocks, the Company did not acquire any significant policy blocks in the last five years.

During 2010, Madison National Life acquired a block of life insurance policies with approximately \$1.6 million of life reserves.

During 2008, Madison National Life acquired a block of life insurance policies with approximately \$64.4 million of life reserves. The block consists of approximately \$32.2 million of older, traditional life reserves and \$32.2 million of annuity reserves.

The Company does not anticipate acquiring any significant blocks in 2013.

### **REINSURANCE AND POLICY RETENTION LIMITS**

The Company's average retention of gross and assumed Medical Stop-Loss exposure was 83% in 2012, up from 78% in 2011, and 75% in 2010.

In 2012, IHC retained approximately 63% of gross and assumed Fully Insured Health exposure, compared to approximately 68% in 2011. Retentions on other lines of business remained relatively constant in 2011. The Company purchases quota share reinsurance and excess reinsurance in amounts deemed appropriate by its risk committee. The Company monitors its retention amounts by product line, and has the ability to adjust its retention as appropriate.

Reinsurance is used to reduce the potentially adverse financial impact of large individual or group risks, and to reduce the strain on statutory income and surplus related to new business. By using reinsurance, the Insurance Group is able to write policies in amounts larger than it could otherwise accept. The amount reinsured is the portion of each policy in excess of the retention limit on a particular policy.

Maximum net retention limits for Standard Security Life are: (i) \$210,000 per life on individual life and corresponding disability waiver of premium; (ii) no retention on accidental death benefits provided by rider to individual life policies; (iii) up to \$1,250,000 on any one medical stop-loss claim; (iv) \$5,000 of monthly benefits on disability income policies; and (v) up to \$1,250,000 for fully insured medical in a calendar year. Standard Security Life also maintains catastrophe reinsurance in order to protect against particularly adverse mortality which might occur with respect to its overall life business. Maximum net monthly retention limits on any one life for Madison National Life are: (i) \$8,600 per month on group long-term disability insurance; (ii) \$1,500 per week on group short-term disability insurance; (iii) \$150,000 per individual on group term life, accidental death benefits, including supplemental life and accidental death and dismemberment; (iv) \$125,000 on substandard ordinary life, group family life and individual ordinary life; (v) up to \$1,250,000 on any one medical stop-loss claim; (vi) individual monthly benefits from 1,000 to \$2,500 depending on recipient age and length of benefit

## Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

period for individual accident and health insurance; and (vii) up to \$1,250,000 for fully insured medical in a calendar year. Maximum net retention limits for Independence American are: (i) up to \$1,250,000 on any one medical stop-loss claim; and (ii) up to \$1,250,000 for fully insured medical in a calendar year.

Effective April 1, 2009, Madison National Life entered into a reinsurance treaty with an unaffiliated reinsurer to cede \$48.8 million of life reserves.

Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer effective January 26, 2012 and transferred approximately \$143 million of group annuity reserves in the first quarter of 2012.

The following reinsurers represent approximately 84% of the total ceded premium for the year ended December 31, 2012:

Munich Reinsurance America, Inc.	31%
RGA Reinsurance Company	20%
Fidelity Security Life Insurance Company	18%
National Insurance Company of Wisconsin, Inc.	5%
American Fidelity Assurance Company	5%
Gerber Life Insurance Company	5%
	84%

The Insurance Group remains liable with respect to the insurance in-force which has been reinsured in the unlikely event that the assuming reinsurers are unable to satisfy their obligations. The Insurance Group cedes business (i) to individual reinsurance companies that are rated "A-" or better by Best or (ii) upon provision of adequate security. The ceding of reinsurance does not discharge the primary liability of the original insurer to the insured. Since the risks under the Insurance Group's business are primarily short-term, there would be limited exposure as a result of a change in a reinsurer's creditworthiness during the term of the reinsurance. At December 31, 2012 and 2011, the Insurance Group's ceded reinsurance in-force was \$6.0 billion and \$6.2 billion, respectively.

For further information pertaining to reinsurance, reference is made to Note 20 of Notes to Consolidated Financial Statements included in Item 8.

## INVESTMENTS AND RESERVES

The Company's cash, cash equivalents and securities portfolio are managed by employees of IHC and its affiliates, and ultimate investment authority rests with IHC's in-house investment group. As a result of the nature of IHC's insurance liabilities, IHC endeavors to maintain a significant percentage of its assets in investment grade securities, cash and cash equivalents. At December 31, 2012, approximately 98.1% of the fixed maturities were investment grade and continue to be rated on average AA. The internal investment group provides a summary of the investment portfolio and the performance thereof at the meetings of the Company's board of directors.

As required by insurance laws and regulations, the Insurance Group establishes reserves to meet obligations on policies in-force. These reserves are amounts which, with additions from premiums expected to be received and with interest on such reserves at certain assumed rates, are calculated to be sufficient to meet anticipated future policy obligations. Premiums and reserves are based upon certain assumptions with respect to mortality, morbidity on health insurance, lapses and interest rates effective at the time the policies are issued. The Insurance Group also establishes appropriate reserves for substandard business, annuities and additional policy benefits, such as waiver of premium and accidental death. Standard Security Life and Madison National Life are also required by law to have an annual asset adequacy analysis, which, in general, projects the amount and timing of cash flows to the estimated

maturity date of liabilities, prepared by the certifying actuary for each insurance company. Standard Security Life, Madison National Life and Independence American invest their respective assets, which support the reserves and other funds in accordance with applicable insurance law, under the supervision of their respective board of directors. The Company manages interest rate risk seeking to maintain a portfolio with a duration and average life that falls within the band of the duration and average life of the applicable liabilities. The Company occasionally utilizes options to modify the duration and average life of the assets.

Under Wisconsin insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. With respect to the portion of an insurer's assets equal to its liabilities plus a statutorily-determined security surplus amount, a Wisconsin insurer cannot, for example, invest more than a certain percentage of its assets in non-amortizable evidences of indebtedness, securities of any one person (other than a subsidiary and the United States government), or common stock of any corporation and its affiliates (other than a subsidiary).

Under New York insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. For example, a New York life insurer cannot invest more than a certain percentage of its admitted assets in common or preferred shares of any one institution, obligations secured by any one property (other than those issued, guaranteed or insured by the United States or any state government or agency thereof), or medium and lower grade obligations. In addition, there are certain qualitative investment restrictions.

Under Delaware insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. In addition, there are qualitative investment restrictions.

The Company's total pre-tax investment performance for each of the last three years is summarized below, including amounts recognized in net income and unrealized gains and losses recognized in other comprehensive income or loss:

	2012	2011 (In thousands)	2010
<b>Consolidated Statements of Operations</b>			
Net investment income	\$ 33,356	\$ 39,788	\$ 41,801
Net realized investment gains	5,099	8,670	4,646
Other-than-temporary impairments in earnings	(704)	(1,523)	(3,819)
<b>Consolidated Statements of Comprehensive Income</b>			
Net unrealized gains on available-for-sale securities	10,827	11,345	12,309



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Total pre-tax investment performance	\$	48,578	\$	58,280	\$	54,937
--------------------------------------	----	--------	----	--------	----	--------

The above net unrealized gains on available-for-sale securities recognized through other comprehensive income, represent the net change in unrealized gains and losses on available-for-sale securities arising during the year, including any other-than-temporary impairments recognized in other comprehensive income, prior to deferred income taxes and noncontrolling interests. The Company does not have any non-performing fixed maturity investments at December 31, 2012.

## COMPETITION AND REGULATION

We compete with many large insurance companies, small regional health insurers and managed care organizations. Although most life insurance companies are stock companies, mutual companies also write life insurance in the United States. Mutual companies may have certain competitive advantages since profits inure directly to the benefit of the policyholders.

The health insurance industry tends to be cyclical, and excess products, such as medical stop-loss, tend to be more volatile than fully insured health products. During a soft market cycle, a larger number of companies offer insurance on a certain line of business, which causes premiums in that line to trend downward. In a hard market cycle, insurance companies limit their writings in certain lines of business following periods of excessive losses and insurance and reinsurance companies redeploy their capital to lines that they believe will achieve higher margins.

IHC is an insurance holding company; and as such, IHC and its subsidiary carriers and administrative companies are subject to regulation and supervision by multiple state insurance regulators, including the New York State Insurance Department (Standard Security Life's domestic regulator), the Wisconsin Department of Insurance (Madison National Life's domestic regulator) and the Office of the Insurance Commissioner of the State of Delaware (Independence American's domestic regulator). Each of Standard Security Life, Madison National Life and Independence American is subject to regulation and supervision in every state in which it is licensed to transact business. These supervisory agencies have broad administrative powers with respect to the granting and revocation of licenses to transact business, the licensing of agents, the approval of policy forms, the approval of commission rates, the form and content of mandatory financial statements, reserve requirements and the types and maximum amounts of investments which may be made. Such regulation is primarily designed for the benefit of policyholders rather than the stockholders of an insurance company or insurance holding company.

Certain transactions within the IHC holding company system are also subject to regulation and supervision by such regulatory agencies. All such transactions must be fair and equitable. Notice to or prior approval by the applicable insurance department is required with respect to transactions affecting the ownership or control of an insurer and of certain material transactions, including dividend declarations, between an insurer and any person in its holding company system. Under New York, Wisconsin and Delaware insurance laws, "control" is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person. Under New York law, control is presumed to exist if any person, directly or indirectly, owns, controls or holds, with the power to vote ten percent or more of the voting securities of any other person. In Wisconsin, control is presumed if any person, directly or indirectly, owns, controls or holds with the power to vote more than ten percent of the voting securities of another person. In Delaware, control is presumed if any person, directly or indirectly, owns, controls or holds with the power to vote ten percent or more of the voting securities of any other person. In all three states, the acquisition of control of a domestic insurer needs to be approved in advance by the Commissioner of Insurance. See Note 22 of Notes to Consolidated Financial Statements included in Item 8 for information as to restrictions on the ability of the Company's insurance subsidiaries to pay dividends.

Risk-based capital requirements are imposed on life and property and casualty insurance companies. The risk-based capital ratio is determined by dividing an insurance company's total adjusted capital, as defined, by its authorized control level risk-based capital. Companies that do not meet certain minimum standards require specified corrective action. The risk-based capital ratios for each of Standard Security Life, Madison National Life and Independence American exceed such minimum ratios.

## **DISCONTINUED OPERATIONS**

Effective December 31, 2007, the Company sold its credit life and disability segment by entering into a 100% coinsurance agreement with an unaffiliated insurer. The Company recorded a loss from discontinued operations of \$0.3 million for the year ended December 31, 2010, net of taxes, representing expenses and changes in claims and reserves related to the insurance liabilities for claims incurred prior to the aforementioned sale. No income (loss) from discontinued operations was recorded during the years ended December 31, 2012 or 2011.

## **EMPLOYEES**

At December 31, 2012, the Company, including its direct and indirect majority or wholly owned subsidiaries, collectively had approximately 580 employees.

### **ITEM 1A.**

#### **RISK FACTORS**

*Many of the factors that affect our business and operations involve risk and uncertainty. The risks and uncertainties described below are not the only ones that we face, but are those that we have identified as being the most significant factors. Additional risks and uncertainties that we do not know about, or that we deem less significant than those identified below, may also materially and adversely affect our business, financial condition or results of operations and the trading price of our common stock.*

#### **Risks related to our Business**

**Our investment portfolio is subject to various risks that may result in realized investment losses. In particular, decreases in the fair value of fixed maturities may greatly reduce the value of our investments, and as a result, our financial condition may suffer.**

We are subject to credit risk in our investment portfolio. Defaults by third parties in the payment or performance of their obligations under these securities could reduce our investment income and realized investment gains or result in the continued recognition of investment losses. The value of our investments may be materially adversely affected by increases in interest rates, downgrades in the preferred stocks and bonds included in our portfolio and by other factors that may result in the continued recognition of other-than-temporary impairments. Each of these events may cause us to reduce the carrying value of our investment portfolio.

In particular, at December 31, 2012, fixed maturities represented \$719.6 million or 88.7% of our total investments of \$811.4 million. The fair value of fixed maturities and the related investment income fluctuates depending on general economic and market conditions. The fair value of these investments generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us will generally increase or decrease in line with changes in market interest rates. In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations. An investment has prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. The impact of value fluctuations affects our Consolidated Financial Statements. Because all of our fixed maturities are classified as available for sale, changes in the fair value of our securities are reflected in our stockholders' equity (accumulated other comprehensive income or loss). No similar adjustment is made for liabilities to reflect a change in interest rates. Therefore, interest rate fluctuations and economic conditions could adversely affect our stockholders' equity, total comprehensive income and/or cash flows. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Although, at December 31, 2012, approximately 98.1% of the fixed

maturities were investment grade and continue to be rated on average AA, all of our fixed maturities are subject to credit risk. If any of the issuers of our fixed maturities suffer financial setbacks, the ratings on the fixed maturities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issuer defaults, we could have realized losses associated with the impairment of the securities.

We regularly monitor our investment portfolio to ensure that investments that are other-than-temporarily impaired are identified in a timely fashion, properly valued and any impairment is charged against earnings in the proper period. Assessment factors include, but are not limited to, the length of time and the extent to which the market value has been less than cost, the financial condition and rating of the issuer, whether any collateral is held and the Company's intent to sell, or be required to sell, debt securities before the anticipated recovery of its remaining amortized cost basis. However, the determination that a security has incurred an other-than-temporary decline in value requires the judgment of management. Inherently, there are risks and uncertainties involved in making these judgments. Therefore, changes in facts and circumstances and critical assumptions could result in management's decision that further impairments have occurred. This could lead to additional losses on investments, particularly those that management has the intent and ability to hold until recovery in value occurs.

**Our earnings could be materially affected by an impairment of goodwill.**

Goodwill represented \$50.3 million of our \$1.3 billion in total assets as of December 31, 2012. We review our goodwill annually for impairment or more frequently if indicators of impairment exist. We regularly assess whether any indicators of impairment exist, which requires a significant amount of judgment. Such indicators may include: a sustained significant decline in our share price and market capitalization; a decline in our expected future cash flows; a significant adverse change in the business climate; and/or slower growth rates, among others. Any adverse change in one of these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements. If we experience a sustained decline in our results of operations and cash flows, or other indicators of impairment exist, we may incur a material non-cash charge to earnings relating to impairment of our goodwill, which could have a material adverse effect on our results.

**If rating agencies downgrade our insurance companies, our results of operations and competitive position in the industry may suffer.**

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Standard Security Life, Madison National Life and Independence American are all rated "A-" (Excellent) by A.M. Best Company, Inc. Best's ratings reflect its opinions of an insurance company's financial strength, operating performance, strategic position, and ability to meet its obligations to policyholders and are not evaluations directed to investors. The ratings of our carriers are subject to periodic review by Best. If Best reduces the ratings of any of our carriers from current levels, our business would be adversely affected.

**Our loss reserves are based on an estimate of our future liability, and if actual claims prove to be greater than our reserves, our results of operations and financial condition may be adversely affected.**

We maintain loss reserves to cover our estimated liability for unpaid losses and loss adjustment expenses, where material, including legal and other fees, and costs not associated with specific claims but related to the claims payment functions for reported and unreported claims incurred as of the end of each accounting period. Because setting reserves is inherently uncertain, we cannot be sure that current reserves will prove adequate. If our reserves are insufficient to cover our actual losses and loss adjustment expenses, we would have to augment our reserves and incur a charge to our earnings, and these charges could be material. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what we expect the ultimate settlement and administration of claims will cost. These

estimates, which generally involve actuarial projections, are based on our assessment of known facts and circumstances. Many factors could affect these reserves, including economic and social conditions, frequency and severity of claims, medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, and changes in doctrines of legal liability and damage awards in litigation. Many of these items are not directly quantifiable in advance. Additionally, there may be a significant reporting lag between the occurrence of the insured event and the time it is reported to us. The inherent uncertainties of estimating reserves are greater for certain types of liabilities, particularly those in which the various considerations affecting the type of claim are subject to change and in which long periods of time may elapse before a definitive determination of liability is made. Reserve estimates are continually refined in a regular and ongoing process as experience develops and further claims are reported and settled and are reflected in the results of the periods in which such estimates are changed.

**Our inability to assess underwriting risk accurately could reduce our net income.**

Our success is dependent on our ability to assess accurately the risks associated with the businesses on which we retain risk. If we fail to assess accurately the risks we retain, we may fail to establish the appropriate premium rates and our reserves may be inadequate to cover our losses, requiring augmentation of the reserves, which in turn would reduce our net income.

Our agreements with our producers that underwrite on our behalf require that each such producer follow underwriting guidelines published by us and amended from time to time. Failure to follow these guidelines may result in termination or modification of the agreement. We perform periodic audits to confirm adherence to the guidelines, but it is possible that we would not detect a breach in the guidelines for some time after the infraction, which could result in a material impact on the Net Loss Ratio (defined as insurance benefits, claims and reserves divided by the difference between premiums earned and underwriting expenses) for that producer and could have an adverse impact on our operating results.

**We may be unsuccessful in competing against larger or better-established business rivals.**

We compete with a large number of other companies in our selected lines of business. We face competition from specialty insurance companies and HMOs, and from diversified financial services companies and insurance companies that are much larger than we are and that have far greater financial, marketing and other resources. Some of these competitors also have longer experience and more market recognition than we do in certain lines of business. In addition to competition in the operation of our business, we face competition from a variety of sources in attracting and retaining qualified employees. We cannot assure you that we will maintain our current competitive position in the markets in which we operate, or that we will be able to expand operations into new markets. If we fail to do so, our results of operations and cash flows could be materially adversely affected.

**We rely on reinsurance arrangements to help manage our business risks, and failure to perform by the counterparties to our reinsurance arrangements may expose us to risks we had sought to mitigate.**



We utilize reinsurance to mitigate our risks in various circumstances. Reinsurance does not relieve us of our direct liability to our policyholders, even when the reinsurer is liable to us. Accordingly, we bear credit risk with respect to our reinsurers. Our reinsurers may be unable or unwilling to pay the reinsurance recoverable owed to us now or in the future or on a timely basis. A reinsurer's insolvency, inability or unwillingness to make payments under the terms of its reinsurance agreement with us could have an adverse effect on our financial condition, results of operations and cash flows.

**We may be required to accelerate the amortization of deferred acquisition costs, which would increase our expenses and reduce profitability.**

Deferred acquisition costs, or DAC, represent certain costs which vary with and are primarily related to the sale and issuance of our insurance policies and investment contracts and are deferred and amortized over the estimated life of the related insurance policies and contracts. These costs include commissions in excess of ultimate renewal commissions and certain other sales incentives, solicitation and printing costs, sales material and other costs, such as underwriting and contract and policy issuance expenses. Under U.S. generally accepted accounting principles ("GAAP"), DAC is amortized through operations over the lives of the underlying contracts in relation to the anticipated recognition of premiums or gross profits.

Our amortization of DAC generally depends upon anticipated profits from investments, surrender and other policy and contract charges, mortality, morbidity and maintenance and expense margins. Unfavorable experience with regard to expected expenses, investment returns, mortality, morbidity, withdrawals or lapses may cause us to increase the amortization of DAC, resulting in higher expenses and lower profitability.

We regularly review our DAC asset balance to determine if it is recoverable from future income. The portion of the DAC balance deemed to be unrecoverable, if any, is charged to expense in the period in which we make this determination. For example, if we determine that we are unable to recover DAC from profits over the life of a book of business of insurance policies or annuity contracts, or if withdrawals or surrender charges associated with early withdrawals do not fully offset the unamortized acquisition costs related to those policies or annuities, we would be required to recognize the additional DAC amortization as a current-period expense. In general, we limit our deferral of acquisition costs to costs assumed in our pricing assumptions.

**The failure to maintain effective and efficient information systems could adversely affect our business.**

Our business depends significantly on effective information systems, and we have different information systems for our various businesses. We have committed and will continue to commit significant resources to develop, maintain and enhance our existing information systems and develop new information systems in order to keep pace with continuing changes in information processing technology, evolving industry and regulatory standards, and changing customer preferences. Our failure to maintain effective and efficient information systems could have a material adverse effect on our financial condition and results of operations.

**Failure to protect our policyholders' confidential information and privacy could adversely affect our business.**

In the conduct of our business, we are subject to privacy regulations and to confidentiality obligations. For example, the collection and use of patient data in our health insurance operations is the subject of national and state legislation, including the Health Insurance Portability and Accountability Act of 1996, or HIPAA, and certain other activities we conduct are subject to the privacy regulations of the Gramm-Leach-Bliley Act. We also have contractual obligations to protect certain confidential information we obtain from our existing vendors, partners and policyholders. These obligations generally include protecting such confidential information in the same manner and to the same extent as we protect our own confidential information. If we do not properly comply with privacy regulations and protect

confidential information, we could experience adverse consequences, including regulatory sanctions, such as penalties, fines and loss of license, as well as loss of reputation and possible litigation.

### **Risks Related to our Industry**

**Our industry is highly regulated and changes in regulations affecting our businesses may reduce our profitability and limit our growth.**

Our insurance subsidiaries are subject to state insurance laws and regulated by the insurance departments of the various states in which they are domiciled and licensed, which, among other things, conduct periodic examination of insurance companies. State laws grant insurance regulatory authorities broad administrative powers with respect to various aspects of our insurance businesses, including:

licensing companies and agents to transact business and regulating their respective conduct in the market; approving policy forms and premium rates;

requiring certain methods of accounting and prescribing the form and content of records of financial condition required to be filed;

calculating the value of assets to determine compliance with statutory requirements;

establishing statutory capital and reserve requirements, such as for unearned premiums and losses;

regulating certain premium rates and requiring deposits for the benefit of policyholders;

establishing maximum interest rates on insurance policy loans and minimum rates for guaranteed crediting rates on life insurance policies;

establishing standards of solvency, including risk-based capital measurements, which are a measure developed by the National Association of Insurance Commissioners (NAIC) and used by state insurance regulators to identify insurance companies that potentially are inadequately capitalized;

mandating certain insurance benefits and restricting the size of risks insurable under a single policy;

regulating unfair trade and claims practices, including the imposition of restrictions on marketing and sales practices, distribution arrangements and payment of inducements;

requiring the filing of annual and other reports relating to the financial condition of insurance companies, holding company issues and other matters;

approving changes in control of insurance companies;

restricting transactions between insurance companies and their affiliates, including the payment of dividends to affiliates; and

regulating the nature or types, concentration or amounts, quality and valuation of investments.

Currently, the U.S. federal government does not directly regulate the business of insurance. However, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ), which was signed into law in July 2010 by President Obama, created a Federal Insurance Office. While the office will not directly regulate domestic insurance business, it will monitor all aspects of the



insurance industry, including identifying gaps in the regulation of insurers that could contribute to a crisis in the insurance industry and/or the U.S. economy. Further, the Dodd-Frank Act authorizes the office to make recommendations that certain insurers be subject to more stringent regulation, and conduct a study on how to modernize and improve the system of insurance regulation in the United States. The Dodd-Frank Act also created the Consumer Financial Protection Bureau (CFPB). While the CFPB does not have direct jurisdiction over insurance products, it is possible that regulations promulgated by the CFPB may extend its authority more broadly to cover certain insurance products and thereby may adversely affect our results of operations. Additionally, federal legislation and administrative policies in other areas can significantly and adversely affect insurance companies, including general financial services regulation, securities regulation, privacy regulation, tort reform legislation, and taxation.

We are uncertain as to the impact that this new legislation and regulatory guidance will have on the Company and cannot assure that it will not adversely affect our financial condition and results of operations. In addition, compliance with applicable laws and regulations is time consuming and personnel-intensive, and changes in these laws and regulations may materially increase our direct and indirect compliance efforts and other expenses of doing business.

**Federal healthcare reform may adversely affect our business, cash flows, financial condition and results of operations.**

Although health insurance is generally regulated at the state level, recent legislative actions were taken at the federal levels that impose added restrictions on our business. The ACA was signed into law by President Obama in March 2010. Provisions of the ACA and related reforms have and will become effective at various dates over the next several years and will make sweeping and fundamental changes to the U.S. health care system that are expected to significantly affect the health insurance industry. Although we cannot predict or quantify the precise effects of the ACA on our business, the effects on our Company will include, in particular, a requirement that we pay rebates to customers if the loss ratios for some of our products lines are less than specified percentages; the need to reduce commissions and the consequent risk that insurance producers may sell less of our products than they have in the past; limits on lifetime and annual benefit maximums; a prohibition from imposing any pre-existing condition exclusion; limits on our ability to rescind coverage except for intentional fraud; increased costs to modify and/or sell our products; intensified competitive pressures that limit our ability to increase rates; significant risk of customer loss; new and higher taxes and fees to generate the revenues to implement the ACA; and the need to operate with a lower expense structure at both the business segment and enterprise level.

The consequences of these significant coverage expansions on the sales of our products are unknown and speculative at this point. A number of state governors have strenuously opposed certain of the ACA's provisions, such as the establishment of state-run exchanges, and initiated lawsuits that are pending final adjudication in several jurisdictions.

At this time, it remains unclear whether there will be any changes made to the ACA. We expect that the ACA, as well as other federal or state health care reform measures that may be adopted in the future, could have a material adverse effect on our industry generally and our ability to successfully commercialize our products. Furthermore, if the state-run exchanges mandated by the ACA are established in every state, and if the Company elects not to make its products available inside such exchanges, our revenues could be materially and adversely affected.

We will continue to monitor the implementation of ACA and reassess our business strategies accordingly. We have made, and are continuing to make, significant changes to our operations, products and strategy to adapt to the new environment. However, if our plans for operating in the new environment are unsuccessful or if there is less demand than we expect for our products in the new environment, our results could be adversely affected.

**Changes in state regulations, or the application thereof, may adversely affect our business, financial condition and results of operations.**

Some states have imposed time limits for the payment of uncontested covered claims and require health care and dental service plans to pay interest on uncontested claims not paid promptly within the required time period. Some states have also granted their insurance regulatory agencies additional authority to impose monetary penalties and other sanctions on health and dental plans engaging in certain unfair payment practices. If we were unable, for any reason, to comply with these requirements, it could result in substantial costs to us and could materially adversely affect our results of operations and financial condition.

State insurance regulators and the NAIC regularly re-examine existing laws and regulations applicable to insurance companies and their products. Changes in these laws and regulations or in interpretations thereof, are often made for the benefit of the consumer at the expense of the insurer and thus could have an adverse effect on our business. We cannot predict what impact, if any, the results of these studies or other such proposals, if enacted, may have on our financial condition, results of operations and cash flows.

**If we fail to comply with extensive state and federal regulations, we will be subject to penalties, which may include fines and suspension and which may adversely affect our results of operations and financial condition.**

A large portion of our business depends on our compliance with applicable laws and regulations and our ability to maintain valid licenses and approvals for our operations. Regulatory authorities have broad discretion to grant, renew, revoke or deny licenses and approvals. In some instances, we follow practices based on our interpretations of regulations, or interpretations that we believe to be generally followed by the industry, which may be different from the requirements or interpretations of regulatory authorities. If we do not have the requisite licenses and approvals and do not comply with applicable regulatory requirements, the insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our insurance-related activities or otherwise penalize us. That type of action could have a material adverse effect on our business. Also, changes in the level of regulation of the insurance industry (whether federal, state or foreign), or changes in laws or regulations themselves or interpretations by regulatory authorities, could have a material adverse effect on our business.

**Legal and regulatory investigations and actions are increasingly common in the insurance business and may result in financial losses and harm our reputation.**

We face a significant risk of litigation and regulatory investigations and actions in the ordinary course of operating our businesses, including the risk of class action lawsuits and individual lawsuits relating, among other things, to sales or underwriting practices, payment of contingent or other sales commissions, claims payments and procedures, product design, disclosure, administration, additional premium charges for premiums paid on a periodic basis, interest crediting practices, denial or delay of benefits and breaches of fiduciary or other duties to customers. Plaintiffs in class action and other lawsuits against us may seek very large or indeterminate amounts, including punitive and treble damages, which may remain unknown for substantial periods of time. We are also subject to various regulatory inquiries, such as information requests, subpoenas, market conduct exams and books and record examinations, from state and federal regulators and other authorities, which may result in fines, recommendations for corrective action or



other regulatory actions. Even if we ultimately prevail in the litigation, regulatory action or investigation, we could suffer significant reputational harm, which could have an adverse effect on our business.

**The effects of emerging claim and coverage issues on our business are uncertain.**

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended liability for claims and coverage may emerge. These changing conditions may adversely affect our business by either extending coverage beyond our underwriting intent or by

increasing the number or size of claims. In some instances, these changes may not become apparent until sometime after we have issued insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance or reinsurance contracts may not be known for a significant period after a contract is issued, and our financial position and results of operations may be materially adversely affected.

**Our results may fluctuate as a result of factors generally affecting the insurance and reinsurance industry.**

The results of companies in the insurance and reinsurance industry historically have been subject to significant fluctuations and uncertainties. The industry and our financial condition and results of operations may be affected significantly by:

.

Fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested capital;

.

Rising levels of actual costs that are not known by companies at the time they price their products;

.

Losses related to epidemics, terrorist activities, random acts of violence or declared or undeclared war;

.

Development of judicial interpretations relating to the scope of insurers' liability;

.

The overall level of economic activity and the competitive environment in the industry;

.

Greater than expected use of health care services by members;

.

New mandated benefits or other regulatory changes that change the scope of business or increase our costs; and

.

Failure of MGUs, agents, third-party administrators and producers to adhere to the underwriting guidelines, market-conduct practices and other requirements (as applicable) under their agreements with us.

The occurrence of any or a combination of these factors, which is beyond our control, could have a material adverse effect on our results.

**We may experience periods with excess underwriting capacity and unfavorable premium rates because the insurance and reinsurance business is historically cyclical, which could cause our results to fluctuate.**

The insurance and reinsurance business historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity, as well as periods when shortages of capacity permitted an increase in pricing and, thus, more favorable premium levels. An increase in premium levels is often, over time, offset by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Any of these factors could lead to a significant reduction in premium rates, less favorable policy terms and fewer opportunities to underwrite insurance risks, which could have a material adverse effect on our results of operations and cash flows.

**Failures elsewhere in the insurance industry could obligate us to pay assessments through guaranty associations.**

Virtually all states require insurers licensed to do business in that state to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. When an insurance company becomes insolvent, state insurance guaranty associations have the right to assess other insurance companies doing business in their state for funds to pay obligations to policyholders of the insolvent company, up to the state-specific limit of coverage. The total amount of the assessment is based on the number of insured residents in each state, and each company's portion is based on its proportionate share of premium volume in the relevant lines of business. The future failure of a large life, health or

annuity insurer could trigger assessments which we would be obligated to pay. Further, amounts for historical insolvencies may be assessed over many years, and there can be significant uncertainty around the total obligation for a given insolvency. Existing liabilities may not be sufficient to fund the ultimate obligations of a historical insolvency, and we may be required to increase our liability, which could have an adverse effect on our results of operations.

**ITEM 1B.**

**UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2.**

**PROPERTIES**

**IHC**

IHC has entered into a renewable short-term arrangement with Geneve Corporation, an affiliate, for the use of 6,750 square feet of office space as its corporate headquarters in Stamford, Connecticut.

**Standard Security Life**

Standard Security Life leases 13,000 square feet of office space in New York, New York as its corporate headquarters.

**Madison National Life**

Madison National Life leases 28,060 square feet of space in Madison, Wisconsin as its corporate headquarters.

**IHC Administrative Services**

IHC Administrative Services leases 49,117 square feet of office space in Phoenix, Arizona as its corporate headquarters.

**ITEM 3.**

**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 relating 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 4.**

**MINE SAFETY DISCLOSURES**

Not applicable.

**PART II****ITEM 5.****MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED****STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

The Company's common stock trades under the symbol IHC on the New York Stock Exchange. The following table shows for the periods indicated the high and low sales prices for IHC's common stock as reported by the New York Stock Exchange.

		<b>HIGH</b>		<b>LOW</b>
<b>QUARTER ENDED:</b>				
	December 31, 2012	\$ 10.31	\$	7.55
	September 30, 2012	10.50		9.04
	June 30, 2012	10.79		8.24
	March 31, 2012	10.68		7.44
<b>QUARTER ENDED:</b>				
	December 31, 2011	\$ 8.27	\$	6.19
	September 30, 2011	10.09		6.19
	June 30, 2011	9.90		6.82
	March 31, 2011	7.99		6.91

IHC's stock price closed at \$9.52 on December 31, 2012.

**Holders of Record**

At March 6, 2013 the number of record holders of IHC's common stock was 2,016. The number of record owners was determined from the Company's stockholder records maintained by the Company's transfer agent.

**Dividends**

IHC declared a cash dividend of \$.035 per share on its common stock on each of May 22, 2012 and November 19, 2012 for a total annual dividend of \$.07 per share.

IHC declared a cash dividend of \$.0227 per share on its common stock on each of June 24, 2011 and December 27, 2011 for a total annual dividend of \$.045 per share.

IHC declared a cash dividend of \$.0227 per share on its common stock on each of June 24, 2010 and December 28, 2010 for a total annual dividend of \$.045 per share.

### **Private Placements**

In 2011, IHC acquired an aggregate 900,325 shares of AMIC common stock from noncontrolling interests in exchange for the issuance of an aggregate 660,240 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 (the Securities Act). 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.



**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 550,000 shares of IHC's common stock, inclusive of prior authorizations, under the 1991 plan. As of December 31, 2012, 99,297 shares were still authorized to be repurchased under the plan. Share repurchases during the fourth quarter of 2012 are summarized as follows:

	<b>2012</b>		
<b>Month of Repurchase</b>	<b>Shares Repurchased</b>	<b>Average Price of Repurchased Shares</b>	<b>Maximum Number Of Shares Which Can be Repurchased</b>
October	-	\$ -	113,673
November	-	\$ -	113,673
December	14,376	\$ 9.46	99,297

**Performance Graph**

Set forth below is a line graph comparing the five year cumulative total return of IHC's common stock with that of the Russell 2000 Index and the S & P SmallCap Life & Health Insurance index. The graph assumes that dividends were reinvested and is based on a \$100 investment on December 31, 2007. Indices data was obtained from Research Data Group, Inc. The performance graph represents past performance and should not be considered to be an indication of future performance.



**ITEM 6.****SELECTED FINANCIAL DATA**

The following is a summary of selected consolidated financial data of the Company for each of the last five years.

**Year Ended December 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Income Data:</b>					
Total revenues	\$ 428,061	\$ 417,996	\$ 435,368	\$ 354,838	\$ 353,687
Income (loss) from continuing operations	22,611	14,766	23,669	(7,433)	(24,578)
<b>Balance Sheet Data:</b>					
Total investments	811,356	932,945	919,727	831,081	761,093
Total assets	1,262,308	1,358,859	1,361,792	1,304,476	1,273,894
Insurance liabilities	793,628	927,746	920,581	927,212	951,590
Debt and junior subordinated debt securities	46,146	48,146	45,646	47,146	48,146
IHC stockholders' equity	285,684	261,077	230,628	202,967	162,702
<b>Per Share Data:</b>					
Cash dividends declared per common share	.07	.045	.045	.045	.045
Basic income (loss) per common share					
from continuing operations	1.09	.74	1.31	(.44)	(1.45)
Diluted income (loss) per common					
share from continuing operations	1.09	.74	1.31	(.44)	(1.45)
Book value per common share	15.93	14.46	13.76	11.96	9.60

The Selected Financial Data should be read in conjunction with the accompanying Consolidated Financial Statements and Notes thereto included in Item 8 of this report.

**ITEM 7.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**OVERVIEW**

Independence Holding Company, a Delaware corporation (NYSE: IHC), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc., IHC Specialty Benefits, Inc. and Actuarial Management Corporation. 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." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life.

IHC s health insurance products serve niche sectors of the commercial market through multiple classes of business and varied distribution channels. Medical Stop-Loss is marketed to large employer groups that self-insure their medical risks; in 2012 the Company s average case size was 250 covered employee lives. This niche is expected to grow as result of federal health care reform. The small-group major medical product is purchased by employers with between two and 50 covered lives. With regard to those persons in the growing individual market, IHC s products offer major medical coverage for individuals and families and persons with short-term medical needs, and limited medical and scheduled

benefit plans through select distribution partners. Beginning in 2012, Independence American entered the pet insurance market through a national distributor with a long history in this niche. Standard Security Life's limited medical product is primarily purchased by hourly workers and others who are generally not eligible for coverage under their employer's group medical plan. Madison National Life and Independence American offer limited and scheduled benefit plans primarily to uninsured consumers. The dental and vision products are marketed to large and small groups as well as individuals. With respect to IHC's life and disability business, Madison National Life has historically sold almost all of this business through one distribution source specializing in serving school districts and municipalities.

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 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 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:*

The results of operations for the years ended December 31, 2012, 2011 and 2010, are summarized as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Revenues	\$ 428,061	\$ 417,996	\$ 435,368
Expenses	403,447	399,498	399,116
Income from continuing operations before income taxes	24,614	18,498	36,252
Income taxes	2,003	3,732	12,583
<b>Income from continuing operations</b>	<b>22,611</b>	<b>14,766</b>	<b>23,669</b>
<b>Discontinued operations:</b>			
Loss from discontinued operations	-	-	(256)
<b>Net income</b>	<b>22,611</b>	<b>14,766</b>	<b>23,413</b>
Less income from noncontrolling interests in subsidiaries	(2,950)	(1,763)	(1,676)
<b>Net income attributable to IHC</b>	<b>\$ 19,661</b>	<b>\$ 13,003</b>	<b>\$ 21,737</b>

.  
Declared a special 10% stock dividend to IHC shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. As a result, IHC issued 1.6 million shares of its common stock, net of treasury shares, with a fair value of \$15.8 million and paid cash in-lieu of fractional shares. All references to number of common shares and earnings per share amounts have been adjusted retroactively for all periods presented to reflect the change in capital structure;

.  
Income from continuing operations of \$1.09 per share, diluted, for the year ended December 31, 2012, compared to \$.74 per share, diluted, for the year ended December 31, 2011. Net income for 2010 includes a \$16.7 million after-tax gain on the bargain purchase of AMIC;

Consolidated investment yield (on an annualized basis) of 4.1% in 2012 compared to 4.3% in 2011;

Announced an increase to IHC's annual dividend from \$.045 to \$.07 per share

In the fourth quarter of 2011, Standard Security Life entered into a coinsurance agreement effective in January 2012 and transferred approximately \$143 million of group annuity reserves in the first quarter of 2012. For the year ended December 31, 2011, net realized investment gains were \$8.7 million of which a significant portion resulted from sales of invested assets in anticipation of the transfer of assets in accordance with the terms of such agreement in the first quarter of 2012. As a result of such agreement, the Company wrote-off \$4.6 million of deferred acquisition costs at December 31, 2011, which was more than offset by these net realized investment gains.

Book value of \$15.93 per common share, an increase of 10% from December 31, 2011.

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

The Medical Stop-Loss segment reported income from continuing operations before taxes of \$15.8 million and \$9.0 million for the years ended December 31, 2012 and 2011, respectively. The increase is primarily due to increased volume and improved loss ratios in 2012;

Premiums earned increased \$25.2 million for the year ended December 31, 2012 when compared to 2011. The increase in premiums earned is primarily due to increased volume and retention on business underwritten by Risk Solutions;



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

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

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Premiums Earned	\$ 139,724	\$ 114,478	\$ 121,156
Insurance Benefits, Claims & Reserves Expenses	90,406	75,490	89,968
	38,350	34,047	32,404
Loss Ratio <sup>(A)</sup>	64.7%	65.9%	74.3%
Expense Ratio <sup>(B)</sup>	27.4%	29.8%	26.7%
Combined Ratio <sup>(C)</sup>	92.1%	95.7%	101.0%

o

Loss ratios for the year ended December 31, 2012 decreased due to improved underwriting results in business produced by both Risk Solutions and by independent MGUs.

o

The expense ratio decreased for the year ended December 31, 2012 primarily due to a decrease in profit commission expense as a result of poor performance on certain business written through one program at AMIC.

(A)

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

(B)

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

(C)

The combined ratio is equal to the sum of the loss ratio and the expenses ratio.



The Fully Insured Health segment reported \$4.4 million of income from continuing operations before taxes for the year ended December 31, 2012 as compared to \$7.7 million for the year ended December 31, 2011;

o

Premiums earned increased \$0.2 million year ended December 31, 2012 over the comparable period in 2011. An increase in premiums during the year from the new pet insurance line of business at AMIC was offset by decreases in volume and retentions in certain other lines of the business;

o

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

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Premiums Earned	\$ 141,546	\$ 141,322	\$ 120,818
Insurance Benefits, Claims & Reserves Expenses	94,700	89,040	81,676
	43,639	44,535	35,192
Loss Ratio	66.9%	63.0%	67.6%
Expense Ratio	30.8%	31.5%	29.1%
Combined Ratio	97.7%	94.5%	96.7%

o

The increase in the loss ratio was primarily attributable to an increase in the claims experience on major medical business for groups and individuals not administered by Health Solutions and dental.

o

The underwriting expense ratio decreased primarily as a result of a decrease in general expenses.

Income before taxes from the Group disability, life, annuities and DBL segment increased \$6.9 million for the year ended December 31, 2012 compared to 2011 primarily as a result of the write-off of deferred acquisition costs in connection with the sale of group annuity contracts in 2011, in addition to better loss ratios in the group term life line;

Income before taxes from the Individual life, annuities and other segment increased \$0.5 million for the year ended December 31, 2012 compared to the prior year primarily due to new business written;

Income before taxes from the Corporate segment decreased \$1.9 million for the year ended December 31, 2012 compared to the prior year primarily due to an increase in corporate expenses and a decrease in investment income due to the redemption of a partnership interest;

Net realized investment gains were \$5.1 million for the year ended December 31, 2012 compared to \$8.7 million in 2011. A significant portion of the net realized investment gains in 2011 resulted from sales of invested assets in anticipation of a transfer of assets in the first quarter of 2012 in accordance with the terms of a coinsurance agreement.

Other-than-temporary impairment losses recognized in earnings for the years ended December 31, 2012 and 2011 were \$0.7 million and \$1.5 million, respectively; and

Premiums by principal product for the years indicated are as follows (in thousands):

**Gross Direct and Assumed**

<b>Earned Premiums:</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Medical Stop-Loss	\$ 168,596	\$ 146,209	\$ 161,530
Fully Insured Health	224,377	209,174	207,409
Group disability; life, annuities and DBL	90,935	94,688	102,986
Individual life, annuities and other	31,728	35,470	34,549
	\$ 515,636	\$ 485,541	\$ 506,474

**Net Premiums Earned:**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Medical Stop-Loss	\$ 139,724	\$ 114,478	\$ 121,156
Fully Insured Health	141,546	141,322	120,818
Group disability; life, annuities and DBL	49,315	50,698	55,828
Individual life, annuities and other	25,482	29,916	28,344
	\$ 356,067	\$ 336,414	\$ 326,146

Information pertaining to the Company's business segments is provided in Note 21 of Notes to Consolidated Financial Statements included in Item 8.

**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform to U.S. GAAP. The preparation of the 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 this report. Management has identified the accounting policies described below 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.

**Insurance Premium Revenue Recognition and Policy Charges**

***Health***

Premiums for short-duration medical insurance contracts are intended to cover expected claim costs resulting from insured events that occur during a fixed period of short duration. The Company has the ability to not renew the contract or to revise the premium rates at the end of each annual contract period to cover future insured events. Insurance premiums from annual health contracts are collected monthly and are recognized as revenue evenly as insurance protection is provided.

Premiums related to long-term and short-term disability contracts are recognized on a pro rata basis over the applicable contract term.

## *Life*

Traditional life insurance products consist principally of products with fixed and guaranteed premiums and benefits, primarily term and whole life insurance products. Premiums from these products are recognized as revenue when due.

Annuities and interest-sensitive life contracts, such as universal life and interest-sensitive whole life, are contracts whose terms are not fixed and guaranteed. Premiums from these policies are reported as funds on deposit. Policy charges consist of fees assessed against the policyholder for cost of insurance (mortality risk), policy administration and early surrender. These revenues are recognized when assessed against the policyholder account balance.

Policies that do not subject the Company to significant risk arising from mortality or morbidity are considered investment contracts. Deposits received from such contracts are reported as other policyholder funds. Policy charges for investment contracts consist of fees assessed against the policyholder account for maintenance, administration and surrender of the policy prior to contractually specified dates, and are recognized when assessed against the policyholder account balance.

## **Insurance Reserves**

The Company maintains loss reserves to cover its estimated liability for unpaid losses and loss adjustment expenses, where material, (including legal, other fees, and costs not associated with specific claims but related to the claims payment function) for reported and unreported claims incurred as of the end of each accounting period. These loss reserves are based on actuarial assumptions and are maintained at levels that are in accordance with U.S. generally accepted accounting principles. Many factors could affect these reserves, including economic and social conditions, frequency and severity of claims, medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, and changes in doctrines of legal liability and damage awards in litigation. Therefore, the Company's reserves are necessarily based on estimates, assumptions and analysis of historical experience. The Company's results depend upon the variation between actual claims experience and the assumptions used in determining reserves and pricing products. Reserve assumptions and estimates require significant judgment and, therefore, are inherently uncertain. The Company cannot determine with precision the ultimate amounts that will be paid for actual claims or the timing of those payments. The Company's estimate of loss represents management's best estimate of the Company's liability at the balance sheet date.

Loss reserves differ for short-duration and long-duration insurance policies, including annuities. Reserves are based on approved actuarial methods, but necessarily include assumptions about expenses, mortality, morbidity, lapse rates and future yield on related investments.

All of the Company's short-duration contracts are generated from its accident and health business, and are accounted for based on actuarial estimates of the amount of loss inherent in that period's claims, including losses incurred for which claims have not been reported. Short-duration contract loss estimates rely on actuarial observations of ultimate loss experience for similar historical events.

Management believes that the Company's methods of estimating the liabilities for insurance reserves provided appropriate levels of reserves at December 31, 2012. Changes in the Company's reserve estimates are recorded through a charge or credit to its earnings.

### *Health*

The Company believes that its recorded insurance reserves are reasonable and adequate to satisfy its ultimate liability. The Company primarily uses its own loss development experience, but will also supplement that with data from its outside actuaries, reinsurers and industry loss experience as warranted.



To illustrate the impact that Loss Ratios have on the Company's loss reserves and related expenses, each hypothetical 1% change in the Loss Ratio for the health business (i.e., the ratio of insurance benefits, claims and settlement expenses to earned health premiums) for the year ended December 31, 2012, would increase reserves (in the case of a higher ratio) or decrease reserves (in the case of a lower ratio) by approximately \$3.2 million with a corresponding increase or decrease in the pre-tax expense for insurance benefits, claims and reserves in the Consolidated Statement of Operations. Depending on the circumstances surrounding a change in the Loss Ratio, other pre-tax amounts reported in the Consolidated Statement of Operations could also be affected, such as amortization of deferred acquisition costs and commission expense.

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

	<b>Claim Reserves</b>	<b>December 31, 2012 Policy Claims</b>	<b>Total Health Reserves</b>
Medical Stop-Loss	\$ 59,029	\$ -	\$ 59,029
Fully Insured Health	40,747	-	40,747
Group Disability	76,109	11,062	87,171
Individual Accident and Health and Other	7,278	255	7,533
	<b>\$ 183,163</b>	<b>\$ 11,317</b>	<b>\$ 194,480</b>

	<b>Claim Reserves</b>	<b>December 31, 2011 Policy Claims</b>	<b>Total Health Reserves</b>
Medical Stop-Loss	\$ 58,741	\$ -	\$ 58,741
Fully Insured Health	32,508	-	32,508
Group Disability	79,571	13,707	93,278
Individual Accident and Health and Other	8,222	238	8,460
	<b>\$ 179,042</b>	<b>\$ 13,945</b>	<b>\$ 192,987</b>

### Medical Stop-Loss

All of the Company's Medical Stop-Loss policies are short-duration and are accounted for based on actuarial estimates of the amount of loss inherent in that period's claims or open claims from prior periods, including losses incurred for claims that have not been reported (IBNR). Short-duration contract loss estimates rely on actuarial observations of ultimate loss experience for similar historical events.

The two primary assumptions underlying the calculation of loss reserves for Medical Stop-Loss business are (i) projected Net Loss Ratio, and (ii) claim development patterns. The projected Net Loss Ratio is set at expected levels consistent with the underlying assumptions ( Projected Net Loss Ratio ). Claim development patterns are set quarterly as reserve estimates are developed and are based on recent claim development history ( Claim Development Patterns ). The Company uses the Projected Net Loss Ratio to establish reserves until developing losses provide a better indication of ultimate results and it is feasible to set reserves based on Claim Development Patterns. The Company has concluded that a reasonably likely change in the Projected Net Loss Ratio assumption could have a material effect on the

Company's financial condition, results of operations, or liquidity ( Material Effect ) but a reasonably likely change in the Claim Development Pattern would not have a Material Effect.

### ***Projected Net Loss Ratio***

Generally, during the first twelve months of an underwriting year, reserves for Medical Stop-Loss are first set at the Projected Net Loss Ratio, which is set using assumptions developed using completed prior experience trended forward. The Projected Net Loss Ratio is the Company's best estimate of future performance until such time as developing losses provide a better indication of ultimate results.

While the Company establishes a best estimate of the Projected Net Loss Ratio, actual experience may deviate from this estimate. This was the case with the 2009, 2010 and 2011 underwriting years which deviated by 1.5, (1.3) and 0.8 Net Loss Ratio points, respectively. After the recorded reserve estimate, it is reasonably likely that the actual experience will fall within a range up to five Net Loss Ratio points above or below the expected Projected Net Loss Ratio for the 2012 underwriting year at December 31, 2012. The impact of these reasonably likely changes at December 31, 2012, would be an increase in net reserves (in the case of a higher ratio) or a decrease in net reserves (in the case of a lower ratio) of up to approximately \$3.3 million with a corresponding increase or decrease in the pre-tax expense for insurance benefits, claims and reserves in the 2012 Consolidated Statement of Operations.

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 as discussed above.

### ***Claim Development Patterns***

Subsequent to the first twelve months of an underwriting year, the Company's developing losses provide a better indication of ultimate losses. At this point, claims have developed to a level where Claim Development Patterns can be applied to generate reasonably reliable estimates of ultimate claim levels. Development factors based on historical patterns are applied to paid and reported claims to estimate fully developed claims. Claim Development Patterns are reviewed quarterly as reserve estimates are developed and are based on recent claim development history. The Company must determine whether changes in development represent true indications of emerging experience or are simply due to random claim fluctuations.

The Company also establishes its best estimates of claim development factors to be applied to more developed treaty year experience. While these factors are based on historical Claim Development Patterns, actual claim development may vary from these estimates. The Company does not believe that reasonably likely changes in its actual claim development patterns would have a Material Effect.

Predicting ultimate claims and estimating reserves in Medical Stop-Loss is more complex than fully insured medical and disability business due to the excess of loss nature of these products with very high deductibles applying to specific claims on any individual claimant and in the aggregate for a given group. The level of these deductibles makes it more difficult to predict the amount and payment pattern of such claims. Fluctuations in results for specific coverage are primarily due to the severity and frequency of individual claims, whereas fluctuations in aggregate coverage are largely attributable to frequency of underlying claims rather than severity. Liabilities for first dollar medical reserves and disability coverages are computed using completion factors and expected Net Loss Ratios derived from actual historical premium and claim data.

Due to the short-term nature of Medical Stop-Loss, redundancies or deficiencies will typically emerge during the course of the following year rather than over a number of years. For Employer Stop-Loss, as noted above, the Company maintains its reserves based on underlying assumptions until it determines that an adjustment is appropriate based on emerging experience from all of its MGUs for prior underwriting years.

### **Fully Insured Health**

Reserves for fully insured medical and dental business are established using historical claim development patterns. Claim development by number of months elapsed from the incurred month is studied each month and development factors are calculated. These claim development factors are then applied to the amount of claims paid to date for each incurred month to estimate fully complete claims. The difference between fully complete claims and the claims paid to date is the estimated reserve. Total reserves are the sum of the reserves for all incurred months.

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.

### **Group Disability**

The Company's Group Disability segment is comprised of Long Term Disability ( LTD ) and Disability Benefits Law ( DBL ). The two primary assumptions on which Group Disability reserves are based are: (i) morbidity levels; and (ii) recovery rates. If morbidity levels increase, for example due to an epidemic or a recessionary environment, the Company would increase reserves because there would be more new claims than expected. In regard to the assumed recovery rate, if disabled lives recover more quickly than anticipated then the existing claims reserves would be reduced; if less quickly, the existing claims reserves would be increased. Advancements in medical treatments could affect future recovery, termination, and mortality rates. With respect to LTD only, other assumptions are: (i) changes in market interest rates; (ii) changes in offsets; (iii) advancements in medical treatments; and (iv) cost of living. Changes in market interest rates could change reserve assumptions since the payout period could be as long as 40 years. Changes in offsets such as Social Security benefits, retirement plans and state disability plans also impact reserving. As a result of the forgoing assumptions, it is possible that the historical trend may not be an accurate predictor of the future development of the block. As with most long term insurance reserves that require judgment, the reserving process is subject to uncertainty and volatility and fluctuations may not be indicative of the claim development overall.

While the Company believes that larger variations are possible, the Company does not believe that reasonably likely changes in its primary assumptions would have a Material Effect.

**Individual Accident and Health and Other**

This segment is a combination of closed lines of business as well as certain small existing lines. While the assumptions used in setting reserves vary between these different lines of business, the assumptions would generally relate to the following: (i) the rate of disability; (ii) the morbidity rates on specific diseases; and (iii) accident rates. The reported reserves are based on management's best estimate for each line within this segment. General uncertainties that surround all insurance reserving methodologies would apply. However, since the Company has so few policies of this type, volatility may occur due to the small number of claims.

### *Life*

For traditional life insurance products, the Company computes insurance reserves primarily using the net premium method based on anticipated investment yield, mortality, and withdrawals. These methods are widely used in the life insurance industry to estimate the liabilities for insurance reserves. Inherent in these calculations are management and actuarial judgments and estimates that could significantly impact the ending reserve liabilities and, consequently, operating results. Actual results may differ, and these estimates are subject to interpretation and change.

Policyholder funds represent interest-bearing liabilities arising from the sale of products, such as universal life, interest-sensitive life and annuities. Policyholder funds are comprised primarily of deposits received and interest credited to the benefit of the policyholder less surrenders and withdrawals, mortality charges and administrative expenses.

### *Interest Credited*

Interest credited to policyholder funds represents interest accrued or paid on interest-sensitive life policies and investment policies. Amounts charged to operations (including interest credited and benefit claims incurred in excess of related policyholder account balances) are reported as insurance benefits, claims and reserves-life and annuity. Credit rates for certain annuities and interest-sensitive life policies are adjusted periodically by the Company to reflect current market conditions, subject to contractually guaranteed minimum rates.

### **Deferred Acquisition Costs**

Costs that vary with and are primarily related to acquiring insurance policies and investment type contracts are deferred and recorded as deferred policy acquisition costs ("DAC"). These costs are principally broker fees, agent commissions, and the purchase prices of the acquired blocks of insurance policies and investment type policies. DAC is amortized to expense and reported separately in the Consolidated Statements of Operations. All DAC within a particular product type is amortized on the same basis using the following methods:

For traditional life insurance and other premium paying policies, amortization of DAC is charged to expense over the related premium revenue recognition period. Assumptions used in the amortization of DAC are determined based upon the conditions as of the date of policy issue or assumption and are not generally revised during the life of the policy.

For long duration type contracts, such as annuities and universal life business, amortization of DAC is charged to expense over the life of the underlying contracts based on the present value of the estimated gross profits ("EGPs") expected to be realized over the life of the book of contracts. EGPs consist of margins based on expected mortality rates, persistency rates, interest rate spreads, and other revenues and expenses. The Company regularly evaluates its EGPs to determine if actual experience or other evidence suggests that earlier estimates should be revised. If the Company determines that the current assumptions underlying the EGPs are no longer the best estimate for the future due to changes in actual versus expected mortality rates, persistency rates, interest rate spreads, or other revenues and expenses, the future EGPs are updated using the new assumptions and prospective unlocking occurs. These updated EGPs are utilized for future amortization calculations. The total amortization recorded to date is adjusted through a current charge or credit to the Consolidated Statements of Operations.

Internal replacements of insurance and investment contracts determined to result in a replacement contract that is substantially changed from the original contract will be accounted for as an extinguishment of the original contract, resulting in a release of the unamortized deferred acquisition costs, unearned revenue, and deferral of sales inducements associated with the replaced contract.



## **Investments**

The Company has classified all of its investments as either available-for-sale or trading securities. These investments are carried at fair value with unrealized gains and losses reported through other comprehensive income for available-for-sale securities or as unrealized gains or losses in the Consolidated Statements of Operations for trading securities. Fixed maturities and equity securities available-for-sale totaled \$735.2 million and \$880.4 million at December 31, 2012 and 2011, respectively. Premiums and discounts on debt securities purchased at other than par value are amortized and accreted, respectively, to interest income in the Consolidated Statements of Operations, using the constant yield method over the period to maturity. Net realized gains and losses on investments are computed using the specific identification method and are reported in the Consolidated Statements of Operations.

Fair value is determined using quoted market prices when available. In some cases, we use quoted market prices for similar instruments in active markets and/or model-derived valuations where inputs are observable in active markets. When there are limited or inactive trading markets, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management assumptions and available current market information. Further, we retain independent pricing vendors to assist in valuing certain instruments. Most of the securities in our portfolio are classified in either Level 1 or Level 2 of the Fair Value Hierarchy.

The Company periodically reviews and assesses the vendor's qualifications and the design and appropriateness of its pricing methodologies. Management will on occasion challenge pricing information on certain individual securities and, through communications with the vendor, obtain information about the assumptions, inputs and methodologies used in pricing those securities, and corroborate it against documented pricing methodologies. Validation procedures are in place to determine completeness and accuracy of pricing information, including, but not limited to: (i) review of exception reports that (a) identify any zero or un-priced securities; (b) identify securities with no price change; and (c) identify securities with significant price changes; (ii) performance of trend analyses; (iii) periodic comparison of pricing to alternative pricing sources; and (iv) comparison of pricing changes to expectations based on rating changes, benchmarks or control groups. In certain circumstances, pricing is unavailable from the vendor and broker pricing information is used to determine fair value. In these instances, management will assess the quality of the data sources, the underlying assumptions and the reasonableness of the broker quotes based on the current market information available. To determine if an exception represents an error, management will often have to exercise judgment. Procedures to resolve an exception vary depending on the significance of the security and its related class, the frequency of the exception, the risk of material misstatement, and the availability of information for the security. These procedures include, but are not limited to; (i) a price challenge process with the vendor; (ii) pricing from a different vendor; (iii) a reasonableness review; (iv) a change in price based on better information, such as an actual market trade, among other things. Management considers all facts and relevant information obtained during the above procedures to determine the proper classification of each security in the Fair Value Hierarchy.

Declines in value of securities available-for-sale that are judged to be other-than-temporary are determined based on the specific identification method. 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 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 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 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 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.

### **Goodwill and Other Intangible Assets**

Goodwill carrying amounts are evaluated for impairment, at least annually, at the reporting unit level which is equivalent to an operating segment. If the fair value of a reporting unit is less than its carrying amount, further evaluation is required to determine if a write-down of goodwill is required. In determining the fair value of each reporting unit, we used an income approach, applying a discounted cash flow method which included a residual value.

Based on historical experience, we make assumptions as to: (i) expected future performance and future economic conditions, (ii) projected operating earnings, (iii) projected new and renewal business as well as profit margins on such business, and (iv) a discount

rate that incorporated an appropriate risk level for the reporting unit. Any impairment of goodwill would be charged to expense. No impairment charge for goodwill was required in 2012, 2011 or 2010.

Other intangible assets are amortized to expense over their estimated useful lives and are subject to impairment testing. Any impairment write-down of other intangible assets would be charged to expense. No impairment charges for intangible assets were required in 2012, 2011 or 2010.

At December 31, 2012, the Company's market capitalization was less than its book value indicating a potential impairment of goodwill. As a result, the Company assessed the factors contributing to the performance of IHC stock in 2012. The Company does not believe that an impairment of goodwill exists at this time.

If we experience a sustained decline in our results of operations and cash flows, or other indicators of impairment exist, we may incur a material non-cash charge to earnings relating to impairment of our goodwill, which could have a material adverse effect on our results.

### **Deferred Income Taxes**

The provision for deferred income taxes is based on the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized by applying enacted statutory tax rates to temporary differences between amounts reported in the Consolidated Financial Statements and the tax bases of existing assets and liabilities. A valuation allowance is recognized for the portion of deferred tax assets that, in management's judgment, is not likely to be realized. The effect on deferred income taxes of a change in tax rates or laws is recognized in income tax expense in the period that includes the enactment date. The Company has certain tax-planning strategies that were used in determining that a valuation allowance was not necessary on its deferred taxes.

**RESULTS OF OPERATIONS****Results of Operations for the Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011**

Information by business segment for the year ended December 31, 2012 and 2011 is as follows:

<b><u>December 31,</u></b>		<b>Net</b>	<b>Fee and</b>	<b>Benefits, Claims</b>	<b>Amortization of</b>	<b>Selling, General</b>	
<b><u>2012</u></b>	<b>Premiums</b>	<b>Investment</b>	<b>Other</b>	<b>and</b>	<b>Deferred</b>	<b>and</b>	
<b>(In thousands)</b>	<b><u>Earned</u></b>	<b><u>Income</u></b>	<b><u>Income</u></b>	<b><u>Reserves</u></b>	<b><u>Costs</u></b>	<b><u>Administrative</u></b>	<b><u>Total</u></b>
Medical stop-loss Fully Insured	\$ 139,724	4,990	1,664	90,406	-	40,154	\$ 15,818
Group disability, life, annuities and DBL	141,546	1,733	28,213	94,700	17	72,415	4,360
Individual life, annuities and other	49,315	2,618	116	27,663	-	15,779	8,607
Corporate	25,482	23,475	4,250	32,022	6,549	13,731	905
Sub total	-	540	-	-	-	7,920	(7,380)
	\$ 356,067	\$ 33,356	\$ 34,243	\$ 244,791	\$ 6,566	\$ 149,999	22,310
Net realized investment gains							5,099
Other-than-temporary impairment losses							(704)
Interest expense							(2,091)
Income from continuing operations before income taxes							24,614
Income taxes							2,003
Income from continuing operations							\$ 22,611

<b><u>December 31,</u></b>		<b>Net</b>	<b>Fee and</b>	<b>Benefits, Claims</b>	<b>Amortization of</b>	<b>Selling, General</b>	
<b><u>2011</u></b>	<b>Premiums</b>	<b>Investment</b>	<b>Other</b>	<b>and</b>	<b>Deferred</b>	<b>and</b>	
<b>(In thousands)</b>	<b><u>Earned</u></b>	<b><u>Income</u></b>	<b><u>Income</u></b>	<b><u>Reserves</u></b>	<b><u>Costs</u></b>	<b><u>Administrative</u></b>	<b><u>Total</u></b>
Medical stop-loss Fully Insured	\$ 114,478	4,399	4,620	75,490	-	39,024	\$ 8,983
Group disability, life, annuities and DBL	141,322	1,429	25,149	89,040	21	71,147	7,692
Individual life,	50,698	9,495	183	37,946	5,099	15,598	1,733

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

annuities and other	29,916	23,492	4,695	36,386	6,449	14,879	389
Corporate	-	973	-	-	-	6,454	(5,481)
Sub total	\$ 336,414	\$ 39,788	\$ 34,647	\$ 238,862	\$ 11,569	\$ 147,102	13,316
Net realized investment gains							8,670
Other-than-temporary impairment losses							(1,523)
Interest expense							(1,965)
Income from continuing operations before income taxes							18,498
Income taxes							3,732
Income from continuing operations							\$ 14,766

**Premiums Earned**

In 2012, premiums earned increased \$19.7 million over the comparable period of 2011. The increase is primarily due to: (i) an \$25.2 million increase in the Medical Stop-Loss segment due to increased volume and retention of business in 2012; and (ii) a \$0.2 million increase in the Fully Insured Health segment primarily as a result of premiums from the new pet and international lines of business, partially offset by decreased retentions and premium volume in the short term medical business, major medical business for groups and individuals, limited medical and dental lines of business; partially offset by (iii) a decrease of \$4.4 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the transfer of certain annuity contracts in the fourth quarter of 2011 and decreased premium volume from other lines in run-off; and (iv) a \$1.4 million decrease in the Group disability, life, annuities and DBL segment primarily due to decreased premiums from the group term life and LTD lines

due in part to reduced production sources, partially offset by premiums generated by a new line of international LTD and life business.

### **Net Investment Income**

Total net investment income decreased \$6.4 million. The overall annualized investment yields were 4.1% and 4.3% (approximately 4.2% and 4.4%, on a tax advantaged basis) for 2012 and 2011, respectively. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due to the transfer of \$143.5 million of assets in the first quarter of 2012 related to a coinsurance treaty. The annualized investment yields on bonds, equities and short-term investments were 3.8% and 4.1% in 2012 and 2011, respectively. IHC has approximately \$197.5 million in highly rated shorter duration securities earning on average 1.6%. 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 \$5.1 million in 2012 compared to \$8.7 million in 2011. 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. A significant portion of the net realized investment gains in 2011 resulted from sales of invested assets in anticipation of a transfer of assets in the first quarter of 2012 in accordance with the terms of a coinsurance agreement.

For the year ended December 31, 2012 and 2011, the Company recorded \$0.7 million and \$1.5 million, respectively, of other-than-temporary impairment losses in earnings. The other-than-temporary impairment losses in 2012 consist of credit losses resulting from expected cash flows of debt securities that are less than their amortized cost. In 2011, other-than-temporary impairment losses recognized in earnings consist of \$1.3 million of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost and \$0.2 million of losses resulting from the Company's intent to sell certain corporate debt securities prior to the recovery of their amortized cost bases.

### **Fee Income and Other Income**

Fee income increased \$0.7 million for the year ended December 31, 2012 compared to the year ended December 31, 2011 primarily as a result of the increased volume of gross business in certain lines of the Fully Insured Health segment offset by decreased fee income from the Medical Stop-Loss segment due to increased retentions.



Total other income decreased \$1.0 million in the year ended December 31, 2012 to \$5.0 million from \$6.0 million in the year ended December 31, 2011 primarily due to business in run-off.

**Insurance Benefits, Claims and Reserves**

In 2012, insurance, benefits, claims and reserves increased \$5.9 million over the comparable period in 2011. The decrease is primarily attributable to: (i) an increase of \$14.9 million in the Medical Stop-Loss segment as a result of an increase in premium volume by Risk Solutions, offset by improved loss ratios; and (ii) an increase of \$5.7 million in the Fully Insured Health segment, principally due to increases arising from the new pet and international lines of business offset by volume decreases in the short term medical and dental lines of business; partially offset by (iii) a \$10.3 million decrease in the Group disability, life, annuities and DBL segment as a result of lower production coupled with lower loss ratios in the LTD line and the transfer of certain annuity contracts in the fourth quarter of 2011; (iv) a \$4.4 million decrease in the Individual life, annuity and other segment primarily resulting from the

transfer of certain group annuity contracts in the fourth quarter of 2011 and decreased premium volume from other lines in run-off.

#### **Amortization of Deferred Acquisition Costs**

Amortization of deferred acquisition costs in 2011 includes the write-off of \$4.6 million of deferred acquisition costs that were recorded in connection with a coinsurance agreement. Excluding this write-off in 2011, amortization of deferred acquisition costs decreased \$0.3 million.

-

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

Selling, general and administrative expenses increased \$2.9 million. The increase is primarily due to: (i) a \$1.2 million increase in commissions and other general expenses in the Medical Stop-Loss segment as a result of increased production; (ii) a \$1.3 million increase in the Fully Insured Health segment largely due to commissions and other general expenses related to the new pet and international lines of business partially offset by decreases in expenses resulting from the decreased retentions and premium volume in the short term medical business, major medical business for groups and individuals, limited medical and dental lines of business; and (iii) an increase of \$1.5 million in corporate overhead expenses due to employee, option, SAR and benefit related expenses; partially offset by (iv) a \$1.1 million decrease in the individual life, annuities and other segment primarily a result of decreases in volume from the transfer of certain group annuity contracts in the fourth quarter of 2011 and decreased volume from other lines in run-off.

#### **Income Taxes**

In 2012, the Company recorded a \$5.9 million credit to federal income taxes as a result of the reduction in AMIC's valuation allowance related to its deferred tax asset at December 31, 2012. Excluding this transaction, the effective tax rate for the year ended December 31, 2012 was 32.1%. 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. Excluding this transaction, the effective tax rate for the year ended December 31, 2011 was 32.4%. The lower effective tax rate in 2012 was due to a higher benefit from tax advantaged securities as a percentage of income in 2012.

### **Results of Operations for the Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010**

#### **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 re-measuring 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 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 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 Consolidated Statement of Operations for 2010 reflect approximately ten months of the operations of AMIC.

Information by business segment for the year ended December 31, 2011 and 2010 is as follows:

<b>December 31,</b> <b>2011</b> <b>(In thousands)</b>	<b>Premiums</b> <b>Earned</b>	<b>Net</b> <b>Investment</b> <b>Income</b>	<b>Equity</b> <b>Income</b> <b>From</b> <b>AMIC</b>	<b>Fee and</b> <b>Other</b> <b>Income</b>	<b>Benefits, Amortization</b> <b>Claims of Deferred</b> <b>and Acquisition</b> <b>Reserves Costs</b>	<b>Selling,</b> <b>General</b> <b>and</b> <b>Administrative</b>	<b>Total</b>
Medical stop-loss	\$ 114,478	4,399	-	4,620	75,490	-	\$ 8,983
Fully Insured Group disability, life, annuities and DBL	141,322	1,429	-	25,149	89,040	21	7,692
Individual life, annuities and other	50,698	9,495	-	183	37,946	5,099	1,733
Corporate	29,916	23,492	-	4,695	36,386	6,449	389
Sub total	\$ 336,414	\$ 39,788	\$ -	\$ 34,647	\$38,862	\$ 11,569	\$ 147,102
Net realized investment gains							8,670
Other-than-temporary impairment losses							(1,523)
Interest expense							(1,965)
Income from continuing operations before income taxes							18,498
Income taxes							3,732
Income from continuing operations							\$ 14,766

<b>December 31,</b> <b>2010</b> <b>(In thousands)</b>	<b>Premiums</b> <b>Earned</b>	<b>Net</b> <b>Investment</b> <b>Income</b>	<b>Equity</b> <b>Income</b> <b>From</b> <b>AMIC</b>	<b>Fee and</b> <b>Other</b> <b>Income</b>	<b>Benefits, Amortization</b> <b>Claims of Deferred</b> <b>and Acquisition</b> <b>Reserves Costs</b>	<b>Selling,</b> <b>General</b> <b>and</b> <b>Administrative</b>	<b>Total</b>
Medical stop-loss	\$ 121,156	4,080	14	5,404	89,968	-	\$ 1,878

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Fully Insured G r o u p disability, l i f e , annuities and DBL	120,818	1,454	244	28,168	81,676	28	65,854	3,126
Individual life, annuities and other	55,828	9,668	22	454	41,440	497	17,389	6,646
Corporate	28,344	25,839	-	4,458	38,234	5,718	12,472	2,217
Sub total	-	760	-	27,830	-	-	5,120	23,470
	\$ 326,146	\$ 41,801	\$ 280	\$ 66,314	\$ 51,318	\$ 6,243	\$ 139,643	37,337

Net realized investment losses	4,646
Other-than-temporary impairment losses	(3,819)
Interest expense	(1,912)
Income from continuing operations before income taxes	36,252
Income taxes	12,583
Income from continuing operations	\$ 23,669

**Premiums Earned**

Premiums in 2011 include twelve months of earned premiums from AMIC of \$72.4 million compared to ten months of earned premiums from AMIC of \$61.6 million in 2010. Excluding these amounts, earned premiums decreased \$.5 million. The decrease is primarily due to: (i) a \$15.6 million net increase of premiums earned in the Fully Insured Health segment in 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 \$1.6 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; more than offset by (iii) a \$12.3 million decrease in the Medical Stop-Loss segment primarily due to the cancellation of non-owned managing general underwriters in 2010; and (iv) a \$5.4 million decrease in the Group disability, life, annuities and DBL segment primarily due to lower production and reduced rates in the DBL line and the discontinuance of the point of service line.

### **Net Investment Income**

Total net investment income decreased \$2.0 million. The overall annualized investment yields were 4.3% and 4.6% (approximately 4.4% and 4.8%, on a tax advantaged basis) for 2011 and 2010, respectively. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due to lower yields and the shorter duration of our portfolio. IHC has approximately \$273.3 million in highly rated shorter duration securities earning on average 1.5%. 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 \$8.7 million in 2011 compared to \$4.6 million 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. A significant portion of the net realized investment gains in 2011 resulted from sales of invested assets in anticipation of a transfer of assets in the first quarter of 2012 in accordance with the terms of a coinsurance agreement at December 31, 2011. Net realized investment gains in 2010 were reduced by an additional loss of \$3.3 million resulting from discussions in the fourth quarter of 2010 with the trustee in bankruptcy pertaining to the resolution of claims related to the non-affiliate broker-dealer that managed the trading accounts of the Company in 2008. The \$3.3 million pre-tax loss consisted of: (i) the reversal of \$0.5 million of anticipated SIPC recoveries initially recorded by a subsidiary of IHC; (ii) the reversal of \$0.5 million of anticipated SIPC recoveries initially recorded by AMIC; and (iii) an additional \$2.3 million of withdrawals by IHC and AMIC deemed subject to return. See Note 8 in the Notes to Consolidated Financial Statements included in the Item 8 of this report for more information about net realized investment gains and losses.

For the year ended December 31, 2011 and 2010, the Company recorded \$1.5 million and \$3.8 million, respectively, of other-than-temporary impairment losses in earnings, pre-tax. In 2011, other-than-temporary impairment losses recognized in earnings consist of \$1.3 million of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost and \$0.2 million of losses resulting from the Company's intent to sell certain corporate debt securities prior to the recovery of their amortized cost bases. In 2010, other-than-temporary

impairment losses recognized in earnings consist of \$3.1 million of credit losses resulting from expected cash flows of debt securities that are less than the debt securities' amortized cost and \$0.7 million resulting from the Company's intent to sell certain municipal debt securities prior to the recovery of their amortized cost bases.

**Fee Income and Other Income**

Fee income decreased \$4.1 million primarily 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 2011 remained comparable to other income for 2010.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves in 2011 includes twelve months of benefits, claims and reserves from AMIC of \$47.8 million compared to ten months of benefits, claims and reserves from AMIC of \$42.0 million in 2010. Excluding these amounts, benefits, claims and reserves decreased \$18.2 million. The decrease is primarily attributable to: (i) a decrease of \$16.4 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned and improved loss ratios; (ii) a \$3.7 million decrease in the Group disability, life, annuities and DBL segment largely as a result of lower loss ratios on the GTL line of business and a decrease in the point of service line which has been discontinued; and (iii) a \$1.8 million decrease in the Individual life, annuity and other segment primarily resulting from a decrease in individual annuity contracts in 2011; partially offset by (iv) an increase of \$3.7 million in the Fully Insured Health segment, principally due to the increase in premiums on the major medical business for groups and individuals and the limited medical line of business, partially offset by a decrease in short term medical business due to improved experience and a decrease in the student accident line resulting from a lower volume of business due to the cancellation of a producer of this product.

**Amortization of Deferred Acquisition Costs**

On December 31, 2011, the Company wrote-off \$4.6 million of deferred acquisition costs in connection with a coinsurance agreement that is effective in the first quarter of 2012. Excluding this write-off, amortization of deferred acquisition costs increased \$0.8 million.

-

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses in 2011 include twelve months of expenses from AMIC of \$28.0 million compared to ten months of expenses from AMIC of \$23.1 million in 2010. Excluding these amounts, selling, general and administrative expenses increased \$2.6 million. The increase is primarily due to: (i) a \$3.2 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$1.9 million decrease in the Group disability, life, annuities and DBL segment; more than offset by (iii) a \$4.5 million increase in the Fully Insured Health segment largely due to an increase in commissions as a result of increased retentions in the major medical business for groups and individuals, short term medical and limited medical lines of business in 2011 combined with administrative expenses resulting from the increased volume of major medical business for groups and individuals and limited medical business; (iv) a \$2.4 million increase in the Individual life, annuity and other segment related to the increase in premium volume of the ordinary life and annuity business; and (v) a net increase of \$.8 million in corporate selling, general and administrative expenses.

**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 year ended December 31, 2011 was 32.4% compared to 34.8% 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. In the fourth quarter of 2011, the Insurance Group was reorganized such that Madison National Life and Standard Security Life became sister companies under a common Corporate parent company, whereas prior Standard Security Life was a wholly owned subsidiary of Madison National Life. The Insurance Group declared and paid \$11,430,000, \$2,000,000 and \$3,450,000 of cash dividends to Corporate in 2012, 2011 and 2010, respectively.

In July 2012, the Company made a \$2.0 million principal debt repayment in accordance with the terms of its amortizing term loan.

Corporate utilizes cash primarily for the payment of general overhead expenses, common stock dividends, common stock repurchases and debt repayment.

### **Cash Flows**

As of December 31, 2012, the Company had \$23.9 million of cash and cash equivalents compared with \$18.2 million as of December 31, 2011.

The decrease in cash from operating activities of \$115.4 million is primarily the result of \$143.5 million cash that Standard Security Life transferred to an unaffiliated reinsurer in connection with a coinsurance agreement in February

2012, partially offset by net income of \$22.6 million. Cash provided by investing activities of \$122.9 million consists primarily of proceeds from the net sales of investments in preparation for such transfer of funds by Standard Security Life.

The Company has \$460.7 million of insurance reserves that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the year ended December 31, 2012, cash received from the maturities and other repayments of fixed maturities was \$74.4 million.

Financing activities for the year ended December 31, 2012 used \$1.8 million, primarily consisting of dividends paid, the repayment of debt and repurchases of common stock, net of proceeds from investment-type insurance contracts.

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**

Total investments decreased \$121.6 million during the year ended December 31, 2012 largely due to net sales of investments in the first quarter of 2012 in connection with the transfer of \$143.5 cash in connection with a coinsurance agreement, partially offset by \$13.8 million in pre-tax unrealized gains on available-for-sale securities.

The Company had net receivables from reinsurers of \$118.7 million at December 31, 2012. All of such reinsurance receivables are either due from highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at December 31, 2012.

The Company made a \$2.0 million principal debt repayment in July 2012 in accordance the terms of its amortizing term loan.

The \$24.6 million increase in IHC's stockholders' equity in 2012 is primarily due to \$19.7 million of net income attributable to IHC and \$7.2 million of other comprehensive income, partially offset by \$1.3 million of treasury share purchases and \$1.3 million of cash declared.

### **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 \$2.5 million at December 31, 2012, approximately 98.1% 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 December 31, 2012, approximately 1.9% (or \$13.5 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 Company does not have any non-performing fixed maturity investments at December 31, 2012.

Approximately 1.2% of fixed maturities, primarily municipal obligations, in our investment portfolio are insured by financial guaranty insurance companies. The purpose of this insurance is to increase the credit quality of the fixed maturities and their credit ratings. If the obligations of these financial guarantors ceased to be valuable, either through a credit rating downgrade or default, these debt securities would likely receive lower credit ratings by the rating agencies that would reflect the creditworthiness of the various obligors as if the fixed maturities were uninsured. The following table summarizes the credit quality of our fixed maturity portfolio as rated, and as rated if the fixed maturities were uninsured, at December 31, 2012:



<b><u>Bond Ratings</u></b>	<b><u>As Rated</u></b>	<b><u>As Rated If Uninsured</u></b>
AAA	20.2%	20.2%
AA	47.0%	46.6%
A	30.1%	29.6%
BBB	0.8%	1.7%
<b>Total Investment Grade</b>	<b>98.1%</b>	<b>98.1%</b>
BB or lower	1.9%	1.9%
<b>Total Fixed Maturities</b>	<b>100.0%</b>	<b>100.0%</b>

Changes in interest rates, credit spreads, and investment quality ratings may cause the market value of the Company's investments to fluctuate. The Company does not have the intent to sell nor is it more likely than not that the Company will have to sell debt securities in unrealized loss positions that are not other-than-temporarily impaired before recovery. In the event that the Company's liquidity needs require the sale of fixed maturity securities in unfavorable interest rate, liquidity or credit spread environments, the Company may realize investment losses.

The Company reviews its investments regularly and monitors its investments continually for impairments, as discussed in Note 1(E) (vi) of the Notes to Consolidated Financial Statements in Item 8 of this report. For the years ended December 31, 2012 and 2011 the Company recorded losses of \$1.0 million and \$2.5 million, respectively, for other-than-temporary impairments on available-for-sale securities. Of those impairment losses, credit losses of \$0.7 million and \$1.5 million, respectively, were recognized in earnings for the years ended December 31, 2012 and 2011, and the remaining non-credit losses were recognized in other comprehensive income. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at December 31, 2012 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	\$ -	\$ -	\$ -	\$ 409	\$ 409
Equity securities	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ 409	\$ 409

The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at December 31, 2012. In 2012, the Company recorded \$10.8 million of net unrealized gains on available-for-sale securities in other comprehensive income, pre-tax. Related deferred tax benefits were \$3.6 million. 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.

## **Goodwill**

Goodwill represents the excess of the amount we paid to acquire subsidiaries and other businesses over the fair value of their net assets at the date of acquisition. The Company tests goodwill for impairment at least annually and between annual tests if an event or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Goodwill is considered impaired when the carrying amount of goodwill exceeds its implied fair value.

All goodwill carrying amounts are evaluated for impairment at the reporting unit level which is equivalent to an operating segment. Goodwill was allocated to each reporting unit or operating segment at the time of acquisition. At December 31, 2012, total goodwill was \$50.3 million, of which \$44.6 million was attributable to the Fully Insured Health segment and \$5.7 million to the Medical Stop Loss segment.

Based upon the goodwill impairment testing performed at December 31, 2012, the fair value of each reporting unit exceeded its carrying value and no impairment charge was required. Fair value exceeded carrying value by 10% or more in both the Fully Insured Health and the Medical Stop Loss segments.

In determining the fair value of each reporting unit, we used an income approach, applying a discounted cash flow method which included a residual value. Based on historical experience, we made assumptions as to: (i) expected future performance and future economic conditions, (ii) projected operating earnings, (iii) projected new and renewal business as well as profit margins on such business, and (iv) a discount rate that incorporated an appropriate risk level for the reporting unit.

Management uses a significant amount of judgment in estimating the fair value of the Company's reporting units. The key assumptions underlying the fair value process are subject to uncertainty and change. The following represent some of the potential risks that could impact these assumptions and the related expected future cash flows: (i) increased competition; (ii) an adverse change in the insurance industry and overall business climate; (iii) changes in state and federal regulations; (iv) rating agency downgrades of our insurance companies; and (v) a sustained and significant decrease in our share price and market capitalization. As a result of the global economic crisis that began in 2008, we experienced a significant decline in our stock price. Due to this significant decline, our market capitalization as of December 31, 2012 was significantly below the sum of our reporting units' fair values. As a result, the Company assessed the factors contributing to the performance of IHC stock in 2012, and concluded that the market capitalization does not represent the fair value of the Company. The Company noted several factors that have led to a difference between the market capitalization and the fair value of the Company, including (i) the Company's stock is thinly traded and a sale of even a small number of shares can have a large percentage impact on the price of the stock, (ii) Geneve Corporation and insiders own approximately 56% of the outstanding shares, which has had a significant adverse impact on the number of shares available for sale and therefore the trading potential of IHC stock, and (iii) lack of analyst coverage of the Company. If we experience a sustained decline in our results of operations and cash flows, or other indicators of impairment exist, we may incur a material non-cash charge to earnings relating to impairment of our goodwill, which could have a material adverse effect on our results.





**Health Reserves**

The following table summarizes the prior year net favorable amount incurred in 2012 according to the year to which it relates, together with the opening reserve balance (net of reinsurance recoverable) to which it relates (in thousands):

	<b>Reserves at January 1, 2012</b>		<b>Prior Year Amount Incurred in 2012</b>	
<b>Total Reserves</b>				
2011	\$	74,356	\$	(2,888)
2010		11,730		(3,668)
2009		5,352		(800)
2008 and Prior		18,411		(1,552)
Total	\$	109,849	\$	(8,908)

The following sections describe, for each segment, the unfavorable (favorable) development experienced in 2012, together with the key assumptions and changes therein affecting the reserve estimates.

**Medical Stop-Loss**

The Company experienced net favorable development of \$3.0 million in the Medical Stop-Loss segment. The favorable development was the result of on-going analysis of recent loss development trends primarily attributable to improvements on the direct written business in the 2010 year.

**Fully Insured Health**

The Fully Insured Health segment had a favorable development of \$0.4 million. The Company experienced a \$0.8 million favorable variance related to 2010 reserves primarily on the vision line of business offset by additional expense incurred related to 2011 reserves primarily due to group major medical business.

**Group Disability**

The Group Disability segment had a favorable development of \$4.5 million. This amount consists of favorable developments of \$2.7 million and \$1.3 million on the 2011 and 2010 reserves, respectively, primarily due to LTD

business from those years and, in part, to DBL business from the 2011 year.

Due to the long-term nature of LTD, in establishing loss reserves the Company must make estimates for case reserves, IBNR, and reserves for Loss Adjustment Expenses ( LAE ). Case reserves generally equal the actuarial present value of the liability for future benefits to be paid on claims incurred as of the balance sheet date. The IBNR reserve is established based upon historical trends of existing incurred claims that were reported after the balance sheet date. The LAE reserve is calculated based on an actuarial expense study. Since the LTD block of policies is relatively small, with the potential for very large claims on individual policies, results can vary from year to year. If a small number of claimants with large claim reserves were to recover or several very large claims were incurred, the results could distort the Company's reserve estimates from year to year. High termination rates and offsets caused favorable development in LTD prior year reserves. With respect to DBL, reserves for the most recent quarter of earned premium are established using a Net Loss Ratio methodology. The Net Loss Ratio is determined by applying the completed prior four quarters of historical Net Loss Ratios to the last quarter of earned premium. Reserves associated with the premium earned prior to the last quarter are established using a completion factor methodology. The completion factors are developed using the historical payment patterns for DBL. The favorable development in the DBL line is due to lower than expected claims.

There were normal fluctuations to the Company's experience factor. The IBNR factors were updated to reflect the current experience. The reserving process used by management was consistent from 2011 to 2012.

### Individual Life, Annuities and Other

All other lines, primarily due to the blanket and other individual health products, experienced a favorable development of \$1.0 million.

### 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. In November 2004, December 2003 and March 2003, the Company borrowed \$15.0 million, \$12.0 million and \$10.0 million, respectively, through pooled trust preferred issuances by unconsolidated subsidiary trusts. In August 2009, the outstanding line of credit was cancelled and converted into an amortizing term loan. In 2011 the term loan was amended and increased from \$7.5 million to \$10.0 million. See Note 13 of the Notes to Consolidated Financial Statements in Item 8 of this report.

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 chart below reflects the maturity distribution of IHC's contractual obligations at December 31, 2012 (in thousands):

	Debt	Junior Subordinated Debt	Interest On Debt	Leases	Insurance Reserves	Funds on Deposit	Total
2013	\$ 2,000	\$ -	\$ 1,900	\$ 2,981	\$ 147,537	\$ 28,864	\$ 183,282
2014	2,000	-	1,800	2,696	43,279	26,896	76,671
2015	2,000	-	1,701	2,576	34,876	24,863	66,016
2016	2,000	-	1,602	2,070	30,574	23,133	59,379
2017	-	-	1,553	784	28,529	21,638	52,504

2018 and Thereafter	-	38,146	25,102	462	175,890		152,690	392,290
Totals	\$ 8,000	\$ 38,146	\$ 33,658	\$ 11,569	\$ 460,685	\$	\$ 278,084	\$ 830,142

**OUTLOOK**

For 2013, we will emphasize:

Continued growth in our medical stop-loss segment as the demand for this product continues to grow and Risk Solutions continues to build its reputation as a direct writer and provider of captive solutions;

·  
Adapting to health care reform by continuing to proactively adjust our distribution strategies and mix of Fully Insured Health products to take advantage of changing market demands;

·  
Continued growth in pet insurance;

·  
Increasing emphasis on direct-to-consumer distribution initiatives as we believe this will be a growing means for selling health insurance in the coming years;

·  
Growth in small group major medical premiums in 2013, but a decline in this line of business in 2014 as we cease writing new business in certain states and as employers may choose to drop group health coverage or self-fund;

·  
Increasing sales of short-term, limited medical and supplemental health products, such as dental, hospital indemnity and critical illness and international products to offset the reduction in major medical premiums in 2014;

·  
Selling non-subscriber occupational accident insurance in Texas;

·  
Increasing sales in our DBL line of business; and

·  
Continued focus on administrative efficiencies.

The Company remained highly liquid in 2012 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 \$197.5 million in highly rated shorter maturity securities earning on average 1.6%; 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 December 31, 2012, IHC owned 78.6% of AMIC's outstanding common stock. In January 2013, as a result of AMIC's share repurchases, IHC's ownership interest increased to 80.6%.

We had a significant increase in the profitability and growth of our stop-loss business in 2012, our largest core business, which we attribute to the more efficient and controlled model of writing the majority of our medical stop-loss on a direct basis. At present, all indicators point to a continuation of this growth and higher level of profitability. There are a number of market forces that support this expectation. We have observed a trend on the part of our producers of stop-loss to consolidate their business with a smaller number of stop-loss carriers. The direct writing model employed by Risk Solutions is well suited to take advantage of this trend. There is an increased interest in self-funded options to address concerns about cost and regulatory burdens and we have developed targeted programs to address these needs. Finally there appears to be a market recognition that stop loss buying decisions need to be more about price. Service and fair claims payment practices are also important considerations and the partnership model under which Risk Solutions operates is increasingly recognized as addressing those issues.

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 Act of 2010, as amended, signed by President Obama in March 2010 and its subsequent interpretations by state and federal regulators. The appropriate regulatory agencies have now issued their 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 essential health benefit ( EHB ) 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-EHB lines of business and Medical Stop-Loss have been impacted by health care reform minimally or not at all.

Our results depend on the adequacy of our product pricing, our underwriting, the accuracy of our reserving methodology, returns on our invested assets, and our ability to manage expenses. We will also need to be diligent with the increased rate review scrutiny to effect timely rate changes and will need to stay focused on the management of medical cost drivers as medical trend levels have reversed direction in 2012 causing some margin pressures. Therefore, factors affecting these items, as well as unemployment and global financial markets, may have a material adverse effect on our results of operations and financial condition.

**ITEM 7A.**

**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 following summarizes the estimated pre-tax change in fair value (based upon hypothetical parallel shifts in the U.S. Treasury yield curve) of the fixed income portfolio (excluding redeemable preferred stocks) assuming immediate changes in interest rates at specified levels at December 31, 2012:

	<b>Change in Interest Rates</b>				
	<b>200 basis point rise</b>	<b>100 basis point rise</b>	<b>Base scenario</b>	<b>100 basis point decline</b>	<b>200 basis point decline</b>
Corporate securities	\$ 316,424	\$ 334,185	\$ 353,823	\$ 373,990	\$ 388,143
CMO s	19,261	19,939	20,664	21,336	21,447
U.S. Government obligations	18,165	18,512	18,866	19,012	19,012
Agency MBSs	405	416	428	433	434
GSEs	42,388	45,756	49,606	54,025	59,115
State & Political Subdivisions	230,808	248,994	268,225	284,078	293,144



Total estimated fair value	\$ 627,451	\$ 667,802	\$ 711,612	\$ 752,874	\$ 781,295
Estimated change in value	\$ (84,161)	\$ (43,810)		\$ 41,262	\$ 69,683

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.

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 8.**

**FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

See Index to Consolidated Financial Statements and Schedules on page 58.

**ITEM 9.**

**CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON  
ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A.**

**CONTROLS AND PROCEDURES**

**Evaluation of Disclosure 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 (the Securities Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC'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.

### **Management Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(b) and 15d-15(f) promulgated under the Securities Exchange Act as a process designed by, or under the supervision of IHC's principal executive and principal financial officers and effected by IHC's board, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP and includes those policies and procedures that:

.

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

.

provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP and that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the Company; and

.

provide reasonable assurance regarding prevention or timely detection of unauthorized

acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of human error and the circumvention or overriding of controls, material misstatements may not be prevented or detected on a timely basis. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes and conditions or that the degree of compliance with policies or procedures may deteriorate. Accordingly, even internal controls determined to be effective can provide only reasonable assurance that information required to be disclosed in and reports filed under the Securities Exchange Act is recorded, processed, summarized and represented within the time periods required.

### **Changes in Internal Control Over Financial Reporting**

There has been no change in IHC's internal control over financial reporting during the year ended December 31, 2012 that materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

The Report of Management on Internal Control Over Financial Reporting is included in Item 8 of this Form 10-K.

### **ITEM 9B.**

#### **OTHER INFORMATION**

None.

## **PART III**

### **ITEM 10.**

#### **DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE**

#### **GOVERNANCE**

The information required by this Item is hereby incorporated by reference from our definitive proxy statement relating to the annual meeting of IHC's stockholders to be held in June 2013, which definitive proxy statement will be filed with the Securities and Exchange Commission ( SEC ).

Our written Code of Business Ethics and Corporate Code of Conduct may be found on our website, [www.ihcgroup.com](http://www.ihcgroup.com), under the Corporate Information / Corporate Governance tabs. Both Codes apply to all of our directors, officers and employees, including our principal executive officer and our senior financial officers. Any amendment to or waiver from either of the Codes will be posted to the same location on our website, to the extent such disclosure is legally required.

**ITEM 11.**

**EXECUTIVE COMPENSATION**

The information required by this Item is hereby incorporated by reference from our definitive proxy statement relating to the annual meeting of IHC's stockholders to be held in June 2013, which definitive proxy statement will be filed with the SEC.

**ITEM 12.**

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item is hereby incorporated by reference from our definitive proxy statement relating to the annual meeting of IHC's stockholders to be held in June 2013, which definitive proxy statement will be filed with the SEC.

**ITEM 13.**

**CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information required by this Item is hereby incorporated by reference from our definitive proxy statement relating to the annual meeting of IHC's stockholders to be held in June 2013, which definitive proxy statement will be filed with the SEC.

**ITEM 14.**

**PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item is hereby incorporated by reference from our definitive proxy statement relating to the annual meeting of IHC's stockholders to be held in June 2013, which definitive proxy statement will be filed with the SEC.

**PART IV**

**ITEM 15.**

**EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) (1) and (2)**

See Index to Consolidated Financial Statements and Schedules on page 58.

**(a) (3) EXHIBITS**

See Exhibit Index on page 121.

**SIGNATURES**

Pursuant to the requirements of Section 13 or Section 15(d) 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, on March 15, 2013.

**INDEPENDENCE HOLDING COMPANY**

**REGISTRANT**

By:

/s/ Roy T. K. Thung

Roy T.K. Thung

President and

Chief Executive Officer

(Principal Executive Officer)

By:

/s/ Teresa A. Herbert

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated as of the 15<sup>th</sup> day of March, 2013.



/s/ Larry R. Graber

Larry R. Graber

Director and Senior Vice President

/s/ Steven B. Lapin

Steven B. Lapin

Director and Vice Chairman

/s/ Allan C. Kirkman

Allan C. Kirkman

Director

/s/ James G. Tatum

James G. Tatum

Director

/s/ David T. Kettig

David T. Kettig

Director, Chief Operating Officer and  
Senior Vice President

/s/ Roy T.K. Thung

Roy T.K. Thung

Chief Executive Officer, President and Chairman  
(Principal Executive Officer)

/s/ John L. Lahey

John L. Lahey

Director

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**

	<b>PAGE</b>
<b>Report of Management on Internal Control Over Financial Reporting</b>	59
<b>Reports of Independent Registered Public Accounting Firm</b>	60
<b><u>CONSOLIDATED FINANCIAL STATEMENTS:</u></b>	
<b>Report of Independent Registered Public Accounting Firm</b>	62
Consolidated Balance Sheets	63
Consolidated Statements of Operations	64
Consolidated Statements of Comprehensive Income	65
Consolidated Statements of Changes in Stockholders' Equity	66
Consolidated Statements of Cash Flows	67
Notes to Consolidated Financial Statements	68
<b><u>SCHEDULES:*</u></b>	
Summary of Investments - Other Than Investments in Related Parties (Schedule I)	116
Condensed Financial Information of Parent Company (Schedule II)	117
Supplementary Insurance Information (Schedule III)	120

\*All other schedules have been omitted as they are not applicable or not required, or the information is included in the Consolidated Financial Statements or Notes thereto.



**Report of Management on Internal Control Over Financial Reporting**

**The Board of Directors and Stockholders**

**Independence Holding Company:**

The management of Independence Holding Company ("IHC") is responsible for establishing and maintaining adequate internal control over financial reporting. IHC's internal control system is a process designed to provide reasonable assurance to the Company's management and board of directors regarding the reliability of financial reporting and fair presentation of published financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of IHC's internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*. Based on our assessment we concluded that, as of December 31, 2012, IHC's internal control over financial reporting is effective.

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Independence Holding Company:

We have audited Independence Holding Company's internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Independence Holding Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Independence Holding Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework*

issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Independence Holding Company and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2012, and our report dated March 15, 2013 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

New York, New York

March 15, 2013

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Independence Holding Company:

We have audited the accompanying consolidated balance sheets of Independence Holding Company and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012. In connection with our audits of the consolidated financial statements, we have also audited financial statement schedules I to III. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Independence Holding Company and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Independence Holding Company's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 15, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

New York, New York



March 15, 2013

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31,**

	<b>2012</b>	<b>2011</b>
	<b>(In thousands, except share data)</b>	
<b>ASSETS:</b>		
Investments:		
Short-term investments	\$ 50	\$ 50
Securities purchased under agreements to resell	33,956	17,258
Trading Securities	7,016	-
Fixed maturities, available-for-sale	719,602	851,977
Equity securities, available-for-sale	15,598	28,437
Other investments	35,134	35,223
Total investments	811,356	932,945
Cash and cash equivalents	23,945	18,227
Due from securities brokers	15,609	12,106
Deferred acquisition costs	33,401	37,101
Due and unpaid premiums	49,430	37,341
Due from reinsurers	166,880	159,729
Premium and claim funds	40,596	43,604
Notes and other receivables	20,207	15,500
Goodwill	50,318	50,318
Other assets	50,566	51,988
<b>TOTAL ASSETS</b>	<b>\$ 1,262,308</b>	<b>\$ 1,358,859</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
<b>LIABILITIES:</b>		
Insurance reserves-health	\$ 183,163	\$ 179,042
Insurance reserves-life and annuity	277,522	279,636
Funds on deposit	278,084	417,310
Unearned premiums	8,453	4,319
Policy claims-health	11,317	13,945
Policy claims-life	12,716	11,948
Other policyholders' funds	22,373	21,546
Due to securities brokers	356	383
Due to reinsurers	48,192	40,030
Accounts payable, accruals and other liabilities	71,139	66,410
Debt	8,000	10,000
Junior subordinated debt securities	38,146	38,146
<b>TOTAL LIABILITIES</b>	<b>959,461</b>	<b>1,082,715</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock (none issued)	-	-
Common stock \$1.00 par value, 23,000,000 and 20,000,000 shares authorized; 18,461,992 and 18,450,917 shares issued,		

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

	17,932,954 and 18,052,660 shares outstanding	18,462	18,451
Paid-in capital		126,589	126,298
Accumulated other comprehensive income		15,013	7,853
Treasury stock, at cost; 529,038 and 398,257 shares		(4,533)	(3,277)
Retained earnings		130,153	111,752
<b>TOTAL IHC STOCKHOLDERS EQUITY</b>		<b>285,684</b>	<b>261,077</b>
<b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>		<b>17,163</b>	<b>15,067</b>
<b>TOTAL EQUITY</b>		<b>302,847</b>	<b>276,144</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>\$ 1,262,308</b>	<b>\$ 1,358,859</b>

See accompanying notes to consolidated financial statements.

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
YEARS ENDED DECEMBER 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>(In thousands, except per share data)</b>		
<b>REVENUES:</b>			
Premiums earned:			
Health	\$ 319,655	\$ 298,546	\$ 289,586
Life and annuity	36,412	37,868	36,560
Net investment income	33,356	39,788	41,801
Fee income	29,290	28,632	32,741
Other income	4,953	6,015	5,743
Net realized investment gains	5,099	8,670	4,646
Other-than-temporary impairment losses:			
Total other-than-temporary impairment losses	(992)	(2,471)	(3,819)
Portion of losses recognized in other comprehensive income	288	948	-
Net impairment losses recognized in earnings	(704)	(1,523)	(3,819)
Equity income from AMIC	-	-	280
Gain on bargain purchase of AMIC	-	-	27,830
	428,061	417,996	435,368
<b>EXPENSES:</b>			
Insurance benefits, claims and reserves:			
Health	204,910	190,213	201,136
Life and annuity	39,881	48,649	50,182
Selling, general and administrative expenses	149,999	147,102	139,643
Amortization of deferred acquisition costs	6,566	11,569	6,243
Interest expense on debt	2,091	1,965	1,912
	403,447	399,498	399,116
Income from continuing operations before income taxes	24,614	18,498	36,252
Income taxes	2,003	3,732	12,583
<b>Income from continuing operations</b>	<b>22,611</b>	<b>14,766</b>	<b>23,669</b>
<b>Discontinued operations:</b>			
Loss from discontinued operations	-	-	(256)
<b>Net income</b>	<b>22,611</b>	<b>14,766</b>	<b>23,413</b>
Less income from noncontrolling interests in subsidiaries	(2,950)	(1,763)	(1,676)
<b>NET INCOME ATTRIBUTABLE TO IHC</b>	<b>\$ 19,661</b>	<b>13,003</b>	<b>21,737</b>
<b>Basic income (loss) per common share:</b>			
Income from continuing operations	\$ 1.09	.74	\$ 1.31

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Loss from discontinued operations	-	-	(.02)
Basic income per common share	\$ 1.09	.74	1.29
<b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>	17,979	17,577	16,795
<b>Diluted income (loss) per common share:</b>			
Income from continuing operations	\$ 1.09	.74	\$ 1.31
Loss from discontinued operations	-	-	(.02)
Diluted income per common share	\$ 1.09	\$ .74	1.29
<b>WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING</b>	18,088	17,584	16,797

See accompanying notes to consolidated financial statements.

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
YEARS ENDED DECEMBER 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>		
Net income	\$ 22,611	\$ 14,766	\$ 23,413
Other comprehensive income:			
Unrealized gains on available-for-sale securities, net of taxes	7,196	7,740	7,981
Unrealized gains (losses) on derivative instruments, net of taxes	79	(297)	-
Other comprehensive income, net of tax	7,275	7,443	7,981
<b>COMPREHENSIVE INCOME, NET OF TAX</b>	<b>29,886</b>	<b>22,209</b>	<b>31,394</b>
Comprehensive income, net of tax, attributable to noncontrolling interests:			
Income from noncontrolling interests in subsidiaries	(2,950)	(1,763)	(1,676)
Other comprehensive income, net of tax, attributable to noncontrolling interests:			
Unrealized gains on available-for-sale securities, net of tax	(118)	(343)	(244)
Other comprehensive income, net of tax, attributable to noncontrolling interests	(118)	(343)	(244)

<b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE NONCONTROLLING INTERESTS</b>	(3,068)	(2,106)	(1,920)
<b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO IHC</b>	\$ 26,818	\$ 20,103	\$ 29,474

**See accompanying notes to consolidated financial statements.**

**INDEPENDENCE HOLDING  
COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS  
OF CHANGES IN  
STOCKHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31,  
2010, 2011 AND 2012** (In thousands,  
except share data)

	COMMON STOCK		PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE	TREASURY STOCK, AT COST		RETAINED EARNINGS	TOTAL STOCK EQUITY
	SHARES	AMOUNT		INCOME (LOSS)	SHARES	AMOUNT		
<b>BALANCE DECEMBER 31, 2009</b>	17,004,615	\$ 17,005	\$ 115,062	(7,104)	(36,030)	\$ (358)	\$ 78,362	
Net income							21,737	
Other comprehensive income, net of tax				7,737				
Repurchase of common stock					(227,040)	(1,789)	198	
Acquisition of MedWatch								
Acquisition of HBA								
Acquisition of AMIC			(4)					
Common stock dividend (\$.045 per share)							(762)	
Share-based compensation expense and related tax benefits	13,530	13	513					
Contributions from noncontrolling interests								
Distributions to noncontrolling interests								
Other capital transactions			46				(28)	

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

<b>BALANCE</b>	17,018,145\$	17,018\$	115,617\$	633	(263,070)\$	(2,147)\$	99,507 \$
<b>DECEMBER</b>							
<b>31, 2010</b>							
Net income							13,003
Other comprehensive income, net of tax				7,100			
Repurchase of common stock					(135,187)	(1,130)	119
Purchases of noncontrolling interests in AMIC			143	5			
Non-cash purchases of noncontrolling interests in AMIC	1,422,791	1,423	9,856	115			
Purchases of noncontrolling interests in WUA			391				
Sales of certain majority owned subsidiaries							
Common stock dividend (\$.045 per share)							(807)
Share-based compensation expense and related tax benefits	9,981	10	200				
Distributions to noncontrolling interests							
Other capital transactions			91				(70)
<b>BALANCE</b>	18,450,917\$	18,451\$	126,298\$	7,853	(398,257)\$	(3,277)\$	111,752 \$
<b>AT</b>							
<b>DECEMBER</b>							
<b>31, 2011</b>							
Net income							19,661
Other comprehensive income, net of tax				7,157			
Repurchase of common stock					(130,781)	(1,256)	



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Purchases of noncontrolling interests in AMIC			29		3		
Common stock dividend (\$.07 per share)							(1,271)
Share-based compensation expense and related tax benefits	11,075	11	233				
Distributions to noncontrolling interests							
Other capital transactions			29				11
<b>BALANCE</b>	18,461,992\$	18,462\$	126,589\$		15,013	(529,038)\$	(4,533)\$
<b>AT DECEMBER 31, 2012</b>							130,153\$

See accompanying notes to consolidated financial statements.

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
		<b>(In thousands)</b>	
<b>Cash Flows Provided By (Used By) Operating Activities:</b>			
Net income	\$ 22,611	\$ 14,766	\$ 23,413
Adjustments to reconcile net loss to net change in cash from			
operating activities:			
Gain on bargain purchase of AMIC	-	-	(27,830)
Loss from discontinued operations	-	-	256
Amortization of deferred acquisition costs	6,566	11,569	6,243
Net realized investment gains	(5,099)	(8,670)	(4,646)
Net impairment losses recognized in earnings	704	1,523	3,819
Equity income from equity method investments	(1,435)	(1,591)	(974)
Depreciation and amortization	4,228	4,153	4,650
Share-based compensation expenses	832	616	734
Deferred tax expense (benefits)	(1,200)	(1,188)	15,100
Other	7,010	4,951	2,329
Changes in assets and liabilities:			
Net purchases of trading securities	(1,289)	-	(1,619)
Change in insurance liabilities	(137,440)	963	(34,787)
Additions to deferred acquisition costs	(5,795)	(7,659)	(8,343)
Change in net amounts due from and to reinsurers	1,011	2,990	24,985
Change in premium and claim funds	3,008	(5,958)	10,363
Change in current income tax liability	1,673	7,612	(4,320)
Change in due and unpaid premiums	(12,089)	11,245	9,946
Change in other assets	(1,807)	(2,595)	1,379
Change in other liabilities	3,117	(4,842)	(15,007)
Net change in cash from operating activities of continuing operations	(115,394)	27,885	5,691
Net change in cash from operating activities of discontinued operations	-	-	(1,196)
Net change in cash from operating activities	(115,394)	27,885	4,495
<b>Cash Flows Provided By (Used By) Investing Activities:</b>			
Change in net amount due from and to securities brokers	(3,529)	(29,171)	14,490
Net sales of securities under resale and repurchase agreements	(16,698)	23,823	2,930
Sales of equity securities	14,689	71,183	123,178
Purchases of equity securities	(7,354)	(61,743)	(105,637)
Sales of fixed maturities	483,092	596,651	614,588
Maturities and other repayments of fixed maturities	74,416	158,650	129,876
Purchases of fixed maturities	(412,753)	(786,560)	(778,153)

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Distributions from other investments, net of additional investments	1,080	3,231	1,719
Cash acquired in acquisition of AMIC, net of cash paid	-	-	4,562
Cash paid in acquisitions of companies, net of cash acquired	(243)	-	(3,469)
Cash received in acquisitions of policy blocks	-	-	1,192
Change in notes and other receivables	(4,674)	969	1,170
Other investing activities	(5,159)	(1,259)	(1,869)
Net change in cash from investing activities	122,867	(24,226)	4,577
<b>Cash Flows Provided By (Used By) Financing Activities:</b>			
Repurchases of common stock	(1,244)	(1,011)	(1,591)
Excess tax expense from expired stock options and vesting of restricted stock	(94)	(164)	(51)
Cash paid in acquisitions of noncontrolling interests	(58)	(1,587)	-
Proceeds (withdrawals) of investment-type insurance contracts	3,320	5,433	(1,117)
Proceeds of debt	-	2,500	-
Repayment of debt	(2,000)	-	(1,500)
Dividends paid	(1,681)	(777)	(767)
Other capital transactions	2	(1,252)	(14)
Net change in cash from financing activities	(1,755)	3,142	(5,040)
Net change in cash and cash equivalents	5,718	6,801	4,032
Cash and cash equivalents, beginning of year	18,227	11,426	7,394
Cash and cash equivalents, end of year	\$ 23,945	\$ 18,227	\$ 11,426

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Risk Solutions, LLC, IHC Health Solutions, Inc., IHC Specialty Benefits Inc. and Actuarial Management Corporation. 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." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life. At December 31, 2012, the Company also owned a 78.6% interest in American Independence Corp. ("AMIC"). In January 2013, as a result of share repurchases by AMIC, IHC 's ownership interest increased to 80.6%.

Geneve Corporation, a diversified financial holding company, and its affiliated entities, held 51.0% of IHC's outstanding common stock at December 31, 2012.

##### (B)

#### Basis of Presentation

The Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles ( GAAP ) and 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.

In February 2012, IHC declared a special 10% stock dividend to shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. All references to number of common shares and earnings per share amounts have been adjusted retroactively for all periods presented to reflect the change in capital structure.

(C)

#### **Cash Equivalents and Short-Term Investments**

Cash equivalents are carried at cost which approximates fair value and include principally interest-bearing deposits at brokers, money market instruments and U.S. Treasury securities with original maturities of less than 91 days. Investments with original maturities of 91 days to one year are considered short-term investments and are carried at cost which approximates fair value.

**(D)**

**Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase**

Securities purchased under agreements to resell ("resale agreements") and securities sold under agreements to repurchase ("repurchase agreements") are carried at the amounts at which the securities will be subsequently resold or repurchased as specified in the agreements.

**(E)**

**Investment Securities**

**(i)** Investments in fixed maturities, redeemable preferred securities, equity securities and derivatives (options and options on futures contracts) are accounted for as follows:

**(a)** Securities which are held for trading purposes are carried at estimated fair value ("fair value"). Changes in fair value are credited or charged, as appropriate, to net realized investment gains (losses) in the Consolidated Statements of Operations.

**(b)** Securities not held for trading purposes which may or may not be held to maturity ("available-for-sale securities") are carried at fair value. Unrealized gains and losses deemed temporary, net of deferred income taxes and adjustments to deferred policy acquisition costs, are credited or charged, as appropriate, directly to accumulated other comprehensive income or loss (a component of stockholders' equity). Premiums and discounts on debt securities purchased at other than par value are amortized and accreted, respectively, to interest income in the Consolidated Statements of Operations, using the constant yield method over the period to maturity. Net realized gains and losses on sales of available-for-sale securities are credited or charged to net realized investment gains (losses) in the Consolidated Statements of Operations.

**(ii)** Financial instruments sold, but not yet purchased, represent obligations to replace borrowed securities that have been sold. Such transactions occur in anticipation of declines in the fair value of the securities. The Company's risk is an increase in the fair value of the securities sold in excess of the consideration received, but that risk is mitigated as a result of relationships to certain securities owned. Unrealized gains or losses on open transactions are credited or charged, as appropriate, to net realized investments gains in the Consolidated Statements of Operations. While the transaction is open, the Company will also incur an expense for any accrued dividends or interest payable to the lender of the securities. When the transaction is closed, the Company realizes a gain or loss in an amount equal to the difference between the price at which the securities were sold and the cost of replacing the borrowed securities. There were no such transactions outstanding at December 31, 2012 and 2011.

**(iii)** Gains or losses on sales of securities are determined on the basis of specific identification.

(iv) The Company enters into derivative transactions, such as put and call option contracts and options on interest rate futures contracts, to minimize losses on portions of the Company's fixed income portfolio in a rapidly changing interest rate environment. Equity index options are entered into to offset price fluctuations in the equity markets. These derivative financial instruments are all readily marketable and are carried on the Consolidated Balance Sheets at their current fair value with changes in fair value (unrealized gains and losses), credited or charged, as appropriate, to net realized investment gains (losses) in the Consolidated Statements of Operations (hedge accounting is not applied to these derivatives). There were no such derivative transactions outstanding at December 31, 2012 and 2011.

(v) Fair value is determined using quoted market prices when available. In some cases, we use quoted market prices for similar instruments in active markets and/or model-derived valuations where inputs are observable in active markets. When there are limited or inactive trading markets, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management assumptions and available current market information. Further, we retain independent pricing vendors to assist in valuing certain instruments. Most of the securities in our portfolio are classified in either Level 1 or Level 2 of the Fair Value Hierarchy.

The Company periodically reviews and assesses the vendor's qualifications and the design and appropriateness of its pricing methodologies. Management will on occasion challenge pricing information on certain individual securities and, through communications with the vendor, obtain information about the assumptions, inputs and methodologies used in pricing those securities, and corroborate it against documented pricing methodologies. Validation procedures are in place to determine completeness and accuracy of pricing information, including, but not limited to: (i) review of exception reports that (a) identify any zero or un-priced securities; (b) identify securities with no price change; and (c) identify securities with significant price changes; (ii) performance of trend analyses; (iii) periodic comparison of pricing to alternative pricing sources; and (iv) comparison of pricing changes to expectations based on rating changes, benchmarks or control groups. In certain circumstances, pricing is unavailable from the vendor and broker pricing information is used to determine fair value. In these instances, management will assess the quality of the data sources, the underlying assumptions and the reasonableness of the broker quotes based on the current market information available. To determine if an exception represents an error, management will often have to exercise judgment. Procedures to resolve an exception vary depending on the significance of the security and its related class, the frequency of the exception, the risk of material misstatement, and the availability of information for the security. These procedures include, but are not limited to; (i) a price challenge process with the vendor; (ii) pricing from a different vendor; (iii) a reasonableness review; (iv) a change in price based on better information, such as an actual market trade, among other things. Management considers all facts and relevant information obtained during the above procedures to determine the proper classification of each security in the Fair Value Hierarchy.

(vi) 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 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 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 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 Consolidated Statement of Operations. For the purpose of other-than-temporary impairment evaluations, redeemable preferred stocks 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 are evaluated using the equity model in consideration of 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 Consolidated Balance Sheet.

(F)

#### **Other Investments**

Investment partnership interests relate to limited investment partnerships that have relatively "market neutral" arbitrage strategies, or strategies that are relatively insensitive to interest rates. All securities held by these partnerships are carried at fair value with changes in fair value credited or charged, as appropriate, to the Consolidated Statements of Operations. The Company's investment partnership interests are carried at a value which approximates the Company's equity in the underlying net assets of the partnerships or the equivalent of the net asset value per share. Operating partnership interests relate to insurance related limited operating partnerships. The Company's operating partnership interests are carried on the equity method which approximates the Company's equity in the underlying net assets of the partnership. Equity income or loss on partnership interests are credited or charged, as appropriate, to the Consolidated Statements of Operations.

Policy loans are stated at their aggregate unpaid balances.

(G)

**Deferred Acquisition Costs ("DAC")**

Costs that vary with and are primarily related to acquiring insurance policies and investment type contracts are deferred and recorded as deferred policy acquisition costs ("DAC"). These costs are principally broker fees, agent commissions, and the purchase prices of the acquired blocks of insurance policies and investment type policies. DAC is amortized to expense and reported separately in the Consolidated Statements of Operations. All DAC within a particular product type is amortized on the same basis using the following methods:

For traditional life insurance and other premium paying policies, amortization of DAC is charged to expense over the related premium revenue recognition period. Assumptions used in the amortization of

DAC are determined based upon the conditions as of the date of policy issue or assumption and are not generally revised during the life of the policy.

For long duration type contracts, such as annuities and universal life business, amortization of DAC is charged to expense over the life of the underlying contracts based on the present value of the estimated gross profits ("EGPs") expected to be realized over the life of the book of contracts. EGPs consist of margins based on expected mortality rates, persistency rates, interest rate spreads, and other revenues and expenses. The Company regularly evaluates its EGPs to determine if actual experience or other evidence suggests that earlier estimates should be revised. If the Company determines that the current assumptions underlying the EGPs are no longer the best estimate for the future due to changes in actual versus expected mortality rates, persistency rates, interest rate spreads, or other revenues and expenses, the future EGPs are updated using the new assumptions and prospective unlocking occurs. These updated EGPs are utilized for future amortization calculations. The total amortization recorded to date is adjusted through a current charge or credit to the Consolidated Statements of Operations.

Internal replacements of insurance and investment contracts determined to result in a replacement contract that is substantially changed from the original contract will be accounted for as an extinguishment of the original contract, resulting in a release of the unamortized deferred acquisition costs, unearned revenue, and deferral of sales inducements associated with the replaced contract.

Deferred acquisition costs have been decreased by \$2,930,000, \$2,453,000 and \$3,042,000 in 2012, 2011 and 2010 respectively, representing the portion of unrealized gains on investment securities available-for-sale that have been allocated to deferred acquisition costs on interest sensitive products, with the corresponding decrease recorded in other comprehensive income or loss.

**(H)**

### **Property and Equipment**

Property and equipment of \$3,731,000 and \$3,231,000 are included in other assets at December 31, 2012 and 2011, respectively, net of accumulated depreciation and amortization of \$13,967,000 and \$12,971,000, respectively. Improvements are capitalized while repair and maintenance costs are charged to operations as incurred. Depreciation of property and equipment has been provided on the straight-line method over the estimated useful lives of the respective assets. Amortization of leasehold improvements has been provided on the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

(I)

### **Insurance Reserves**

The Company maintains loss reserves to cover its estimated liability for unpaid losses and loss adjustment expenses, where material, including legal, other fees, and costs not associated with specific claims but related to the claims payment function), for reported and unreported claims incurred as of the end of each accounting period. These loss reserves are based on actuarial assumptions and are maintained at levels that are in accordance with U.S. generally accepted accounting principles. Many factors could affect these reserves, including economic and social conditions, frequency and severity of claims, medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, and changes in doctrines of legal liability and damage awards in litigation. Therefore, the Company's reserves are necessarily based on estimates, assumptions and analysis of historical experience. The Company's results depend upon the variation between actual claims experience and the assumptions used in determining reserves and pricing products. Reserve assumptions and estimates require significant judgment and, therefore, are inherently uncertain. The Company cannot determine with

precision the ultimate amounts that will be paid for actual claims or the timing of those payments. The Company's estimate of loss represents management's best estimate of the Company's liability at the balance sheet date.

Loss reserves differ for short-duration and long-duration insurance policies, including annuities. Reserves are based on approved actuarial methods, but necessarily include assumptions about expenses, mortality, morbidity, lapse rates and future yield on related investments.

All of the Company's short-duration contracts are generated from its accident and health business, and are accounted for based on actuarial estimates of the amount of loss inherent in that period's claims, including losses incurred for which claims have not been reported. Short-duration contract loss estimates rely on actuarial observations of ultimate loss experience for similar historical events.

## *Health*

### **Medical Stop-Loss**

Liabilities for insurance reserves on medical stop-loss coverage are computed using completion factors and expected Net Loss Ratios derived from actual historical premium and claim data. Reserves for medical stop-loss insurance are more volatile in nature than those for fully insured medical insurance. This is primarily due to the excess nature of medical stop-loss, with very high deductibles applying to specific claims on any individual claimant and in the aggregate for a given group. The level of these deductibles makes it more difficult to predict the amount and payment pattern of such claims. Furthermore, these excess claims are highly sensitive to changes in factors such as medical trend, provider contracts and medical treatment protocols, adding to the difficulty in predicting claim values and estimating reserves. Also, because medical stop-loss is in excess of an underlying benefit plan, there is an additional layer of claim reporting and processing that can affect claim payment patterns. Finally, changes in the distribution of business by effective month can affect reserve estimates due to the timing of claim occurrences and the time required to accumulate claims against the stop-loss deductible.

The two primary or key assumptions underlying the calculation of loss reserves for Medical Stop-Loss business are (i) projected Net Loss Ratio, and (ii) claim development patterns. The projected Net Loss Ratio is set at expected levels consistent with the underlying assumptions ( *Projected Net Loss Ratio* ). Claim development patterns are set quarterly as reserve estimates are developed and are based on recent claim development history ( *Claim Development Patterns* ). The Company uses the Projected Net Loss Ratio to establish reserves until developing losses provide a better indication of ultimate results and it is feasible to set reserves based on Claim Development Patterns. The Company has concluded that a reasonably likely change in the Projected Net Loss Ratio assumption could have a material effect on the Company's financial condition, results of operations, or liquidity ( *Material Effect* ) but a reasonably likely change in the Claim Development Pattern would not have a Material Effect.

#### *Projected Net Loss Ratio*

Generally, during the first twelve months of an underwriting year, reserves for Medical Stop-Loss are first set at the Projected Net Loss Ratio, which is set using assumptions developed using completed prior experience trended forward. The Projected Net Loss Ratio is the Company's best estimate of future performance until such time as developing losses provide a better indication of ultimate results.

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.

*Claim Development Patterns*

Subsequent to the first twelve months of an underwriting year, the Company's developing losses provide a better indication of ultimate losses. At this point, claims have developed to a level where Claim Development Patterns can be applied to generate reasonably reliable estimates of ultimate claim levels. Development factors based on historical patterns are applied to paid and reported claims to estimate fully developed claims. Claim Development Patterns are reviewed quarterly as reserve estimates are developed and are based on recent claim development history. The Company must determine whether changes in development represent true indications of emerging experience or are simply due to random claim fluctuations.



The Company also establishes its best estimates of claim development factors to be applied to more developed treaty year experience. While these factors are based on historical Claim Development Patterns, actual claim development may vary from these estimates.

Predicting ultimate claims and estimating reserves in Medical Stop-Loss is more complex than fully insured medical and disability business due to the excess of loss nature of these products with very high deductibles applying to specific claims on any individual claimant and in the aggregate for a given group. The level of these deductibles makes it more difficult to predict the amount and payment pattern of such claims. Fluctuations in results for specific coverage are primarily due to the severity and frequency of individual claims, whereas fluctuations in aggregate coverage are largely attributable to frequency of underlying claims rather than severity. Liabilities for first dollar medical reserves and disability coverages are computed using completion factors and expected Net Loss Ratios derived from actual historical premium and claim data.

Due to the short-term nature of Medical Stop-Loss, redundancies or deficiencies will typically emerge during the course of the following year rather than over a number of years. For Employer Stop-Loss, as noted above, the Company maintains its reserves based on underlying assumptions until it determines that an adjustment is appropriate based on emerging experience from all of its MGUs for prior underwriting years.

### **Fully Insured Health**

Reserves for Fully Insured Health business are established to provide for the liability for incurred but not paid claims. Reserves are calculated using standard actuarial methods and practices. The primary assumption in the determination of Fully Insured Health reserves is that historical Claim Development Patterns are representative of future Claim Development Patterns. Factors which may affect this assumption include changes in claim payment processing times and procedures, changes in time delay in submission of claims, and the incidence of unusually large claims. Liabilities for fully insured medical reserves and disability coverage are computed using completion factors and expected Net Loss Ratios derived from actual historical premium and claim data. 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 not material. The delay in submission of claims tends to be stable over time and not subject to significant volatility.

While these calculations are based on standard methodologies, they are estimates based on historical patterns. To the extent that actual claim payment patterns differ from historical patterns, such estimated reserves may be redundant or inadequate. The effects of such deviations are evaluated by considering claim backlog statistics and reviewing the reasonableness of projected claim ratios. Other factors which may affect the accuracy of reserve estimates include the proportion of large claims which may take longer to adjudicate, changes in billing patterns by providers and changes in claim management practices such as hospital bill audits.

### **Long Term Disability**

The Company's long term disability reserves are developed using actuarial principles and assumptions that consider, among other things, future offsets and recoveries, elimination periods, interest rates, probability of rehabilitation or mortality, incidence and termination rates based on the Company's experience. The loss reserve is made up of case reserves, incurred but not reported reserves, reopen reserves, and loss adjustment expense. Incurred but not reported and reopen reserves are calculated by a hind-sight study, which takes historical experience and develops the reserve as a percentage of premiums from prior years.

The two primary assumptions on which long term disability reserves are based are: (i) morbidity levels; and (ii) recovery rates. If morbidity levels increase, for example due to an epidemic or a recessionary environment, the Company would increase reserves because there would be more new claims than expected. In regard to the assumed recovery rate, if disabled lives recover more quickly than anticipated then the existing claims reserves would be reduced; if less quickly, the existing claims reserves would be increased.

## **Life**

For traditional life insurance products, the Company computes insurance reserves primarily using the net premium method based on anticipated investment yield, mortality, and withdrawals. These methods are widely used in the life insurance industry to estimate the liabilities for insurance reserves. Inherent in these calculations are management and actuarial judgments and estimates that could significantly impact the ending reserve liabilities and, consequently, operating results. Actual results may differ, and these estimates are subject to interpretation and change.

Policyholder funds represent interest-bearing liabilities arising from the sale of products, such as universal life, interest-sensitive life and annuities. Policyholder funds are primarily comprised of deposits received and interest credited to the benefit of the policyholder less surrenders and withdrawals, mortality charges and administrative expenses.

### ***Interest Credited***

Interest credited to policyholder funds represents interest accrued or paid on interest-sensitive life policies and investment policies. These amounts are reported as insurance benefits, claims and reserves-life and annuity on the Consolidated Statements of Operations. Credit rates for certain annuities and interest-sensitive life policies are adjusted periodically by the Company to reflect current market conditions, subject to contractually guaranteed minimum rates.

Management believes that the Company's methods of estimating the liabilities for insurance reserves provided appropriate levels of reserves at December 31, 2012 and 2011. Changes in the Company's reserve estimates are recorded through a charge or credit to its earnings.

**(J)**

## **Funds on Deposit**

Funds received (net of mortality and expense charges) for certain long-duration contracts (principally deferred annuities and universal life policies) are credited directly to a policyholder liability account, funds on deposit. Withdrawals are recorded directly as a reduction of respective policyholders' funds on deposit. Amounts on deposit were credited at annual rates ranging from 2.7% to 8.0% in 2012, and 2.7% to 5.8% in 2011 and 2.9% to 6.5% in 2010. The average credited rate was 4.1% in 2012, 4.1% in 2011, and 4.1% in 2010.

**(K)**

## **Insurance Premium Revenue Recognition and Policy Charges**

### ***Health***

Premiums from short-duration medical insurance contracts are intended to cover expected claim costs resulting from insured events that occur during a fixed period of short duration. The Company has the ability to not renew the contract or to revise the premium rates at the end of each annual contract

period to cover future insured events. Insurance premiums from annual health contracts are collected monthly and are recognized as revenue evenly as insurance protection is provided.

Premiums related to long-term and short-term disability contracts are recognized on a pro rata basis over the applicable contract term.

### *Life*

Traditional life insurance products consist principally of products with fixed and guaranteed premiums and benefits, primarily term and whole life insurance products. Revenue from these products are recognized as premium when due.

Annuities and interest-sensitive life contracts, such as universal life and interest sensitive whole life, are contracts whose terms are not fixed and guaranteed. Premiums from these policies are reported as funds on deposit. Policy charges consist of fees assessed against the policyholder for cost of insurance (mortality risk), policy administration and early surrender. These revenues are recognized when assessed against the policyholder account balance.

Policies that do not subject the Company to significant risk arising from mortality or morbidity are considered investment contracts. Deposits received for such contracts are reported as other policyholder funds. Policy charges for investment contracts consist of fees assessed against the policyholder account for maintenance, administration and surrender of the policy prior to contractually specified dates, and are recognized when assessed against the policyholder account balance.

(L)

### **Participating Policies**

Participating policies represent 11.4%, 11.3% and 11.4% of the individual life insurance in-force and 7.8%, 9.3% and 11.3% of the net life and annuity premiums earned, as of and for the years ended December 31, 2012, 2011 and 2010, respectively, and provide for the payment of dividends. Dividends to policyholders are determined annually and are payable only upon declaration by the Board of Directors of the insurance companies.

(M)

### **Deferred Income Taxes**

The provision for deferred income taxes is based on the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized by applying enacted statutory tax rates to temporary differences between amounts reported in the Consolidated Financial Statements and the tax bases of existing assets and liabilities. A valuation allowance is recognized for the portion of deferred tax assets that, in management's judgment, is not likely to be realized. The effect on deferred income taxes of a change in tax rates or laws is recognized in income tax expense in the period that includes the enactment date.

Interest and penalties are classified as other interest expense and are included in selling, general and administrative expenses in the Consolidated Statements of Operations.

(N)

### **Income Per Common Share**

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Included in the diluted earnings per share calculation for 2012, 2011 and 2010 are 109,000, 7,000 and 2,000 incremental common shares, respectively, primarily from the assumed exercise of dilutive stock options and from the assumed vesting of dilutive restricted stock, computed using the treasury stock method.

(O)

### **Reinsurance**

Amounts paid for or recoverable under reinsurance contracts are included in total assets or total liabilities as due from reinsurers or due to reinsurers. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies using assumptions consistent with those used to account for the underlying policies.

(P)

### **Share-Based Compensation**

Compensation costs for equity awards, such as stock options and non-vested stock, are measured based on grant-date fair value and are recognized in the Consolidated Statements of Operations over the requisite service period (which is usually the vesting period). For such awards with only service conditions, the Company recognizes the compensation cost on a straight-line basis over the requisite service period for the entire award.

Compensation costs for liability-classified awards, such as share appreciation rights ( SARs ) and share-based performance awards, are measured and accrued each reporting period in the Consolidated Statements of Operations as the requisite service or performance conditions are met.

(Q)

### **Goodwill and Other Intangible Assets**

Goodwill carrying amounts are evaluated for impairment at the reporting unit level, which is equivalent to an operating segment, at least annually. If the fair value of a reporting unit is less than its carrying amount, further evaluation is required to determine if a write-down of goodwill is required. In determining the fair value of each



reporting unit, we used an income approach, applying a discounted cash flow method which included a residual value. Based on historical experience, we make assumptions as to: (i) expected future performance and future economic conditions, (ii) projected operating earnings, (iii) projected new and renewal business as well as profit margins on such business, and (iv) a discount rate that incorporated an appropriate risk level for the reporting unit. Any impairment write-down of goodwill would be charged to expense.

Other intangible assets are amortized to expense over their estimated useful lives and are subject to impairment testing. Any impairment write-down of other intangible assets would be charged to expense.

**(R)**

### **Derivative Instruments**

All derivatives, whether designated in hedging relationships or not, are required to be recorded in the balance sheet as assets or liabilities at fair value. Hedge accounting is permitted only if certain criteria are met, including a requirement that a highly effective relationship exist between the derivative instrument and the hedged item, both at inception of the hedge and on an ongoing basis. Results of effective hedges are recognized in other comprehensive income for cash flow hedges and in current earnings for fair value hedges. The ineffective portions of hedge results are recognized in current earnings.

At December 31, 2012, the Company had an interest rate swap agreement that converts an

outstanding term loan from a variable rate to a fixed rate. This agreement is designated and effective as a cash flow hedge. The objective of the swap is to reduce the variability in cash flows associated with the re-pricing of interest rates on certain variable rate debt. Changes in fair value of the swap were recorded through other comprehensive income or loss.

(S)

## **Recent Accounting Pronouncements**

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

In September 2011, the Financial Accounting Standards Board ( 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 was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company's consolidated financial statements.

In June and December 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 were effective for fiscal years and interim periods within those years, beginning after December 15, 2011. This standard only affected the Company's presentation of comprehensive income and did not affect 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 ( IFRS ). 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 was effective during interim and annual periods beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not 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 was effective for the first interim or annual period beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not 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 was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance, which was applied prospectively starting January 1, 2012, had a negligible impact on the Company's consolidated financial statements.



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

In February 2013, the FASB issued guidance requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. For other amounts, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This guidance is effective prospectively for fiscal years beginning after December 15, 2012, with early adoption permitted. The adoption of this guidance will only affect the Company's presentation of information pertaining to other comprehensive income and is not expected to have a material effect on the Company's consolidated financial statements.

In July 2012, the FASB issued guidance to revise the subsequent measurement requirements for indefinite-lived intangible assets. In accordance with the amendments in this Update, an entity will have the option to first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In December 2011, the FASB issued guidance to amend the disclosure requirements on offsetting financial instruments and related derivatives. Entities are required to provide both net and gross information for these assets and liabilities in order to enhance comparability between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. The amendments in this Update are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. 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. Management has not yet determined the impact that the adoption of this guidance will have on the Company's consolidated financial statements.

**Note 2.**

**American Independence Corp.**

AMIC is an insurance holding company engaged in the insurance and reinsurance business. As of December 31, 2012, the Company owned 78.6% of AMIC's outstanding common stock. In January 2013, as a result of share repurchases by AMIC, IHC's ownership interest increased to 80.6%.



(A)

*Acquisitions of Noncontrolling Interests*

i.

In 2012, IHC acquired an aggregate 12,624 shares of AMIC common stock from noncontrolling interests for an aggregate of \$58,000 cash consideration. As a result of these transactions, the Company: (i) recorded a \$29,000 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 78.6%.

ii.

In 2011, IHC acquired shares of AMIC common stock from noncontrolling interests in the following transactions:

In the fourth quarter of 2011, AMIC purchased 251,370 shares of its own common stock and IHC purchased an additional 15,981 shares of AMIC common stock in the open market thereby increasing IHC's ownership interest in AMIC to 78.4% as of December 31, 2011.

On July 15, 2011, IHC commenced an offer to exchange 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 762,551 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 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 660,240 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%.

**iii.**

In 2011, AMIC acquired an additional ownership interest in its subsidiary, IPA Family, LLC ( IPA ) from noncontrolling interests for an aggregate cash consideration of \$525,000, thereby increasing its ownership in IPA to 89.6%. As a result of this transaction, and giving effect to noncontrolling interests in AMIC, the Company (i) reduced noncontrolling interests by \$1,568,000; and (ii) recorded a \$1,043,000 credit to paid-in capital representing the difference between the fair value of the consideration paid and the carrying value of the noncontrolling interests.

**iv.**

In 2010, subsequent the acquisition of AMIC, IHC purchased an additional 9,537 shares of AMIC common stock for a total consideration of \$58,000 through December 31, 2010.

**(B)**

**Acquisition of AMIC**

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 consolidated financial results as of and for the periods ended December 31, 2010, 2011 and 2012.

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 re-measuring 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 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-K

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 period from the Acquisition Date to December 31, 2010, the Company's Consolidated Statement of Operations includes revenues and net income of \$74,187,000 and \$2,711,000, respectively, from AMIC.

Had the acquisition date been January 1 of the previous year, the Company's consolidated revenues and net income for the year ended December 31, 2010 would have been \$421,139,000 and \$7,193,000, respectively. This pro forma information 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 prior period presented. For the purpose of the pro forma disclosures above, the gain resulting from the bargain purchase transaction

has been excluded from the revenues and net income for 2010 and instead included in the revenues and net income for the prior year. Other pro forma adjustments principally reflect the elimination of the Company's equity income related to AMIC, the elimination of intercompany fee income and the corresponding administrative expenses.

(C)

**Equity Investment in AMIC**

Prior to the acquisition in March 2010, IHC owned 49.7% of AMIC's outstanding common stock which was purchased in various transactions from 2002 through 2008 and accounted for its investment in AMIC under the equity method.

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 interests during that period. AMIC paid no dividends on its common stock during the Stub Period in 2010.

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 during the Stub Period in 2010 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 during the Stub Period in 2010. Benefits to policyholders on business ceded to AMIC were \$3,020,000 during the Stub Period in 2010. 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 during the Stub Period in 2010 and IHC recorded net commission expense of \$326,000 during the Stub Period in 2010 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.**

**Securities Purchased Under Agreements to Resell**

Securities purchased under agreements to resell are utilized to invest excess funds on a short-term basis. At December 31, 2012, the Company had \$33,956,000 invested in resale agreements, all of which settled on January 2, 2013 and were subsequently reinvested. The Company maintains control of securities purchased under resale agreements, values the collateral on a daily basis and obtains additional collateral, if necessary, to protect the Company in the

event of default by the counterparties.



**Note 4.****Investment Securities**

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 (in thousands):

	<b>December 31, 2012</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Corporate securities	\$ 343,529	\$ 11,247	\$ (953)	\$ 353,823
CMOs - residential <sup>(1)</sup>	12,993	7,166	(65)	20,094
CMOs - commercial	975	-	(405)	570
U.S. Government obligations	18,376	492	(2)	18,866
Agency MBS - residential <sup>(2)</sup>	397	31	-	428
GSEs <sup>(3)</sup>	48,598	1,075	(67)	49,606
States and political subdivisions	260,086	9,134	(995)	268,225
Redeemable preferred stocks	6,323	1,667	-	7,990
Total fixed maturities	\$ 691,277	\$ 30,812	\$ (2,487)	\$ 719,602
<b>EQUITY SECURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Nonredeemable preferred stocks	\$ 15,355	\$ 253	\$ (10)	\$ 15,598
Total equity securities	\$ 15,355	\$ 253	\$ (10)	\$ 15,598
	<b>December 31, 2011</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Corporate securities	\$ 319,343	\$ 5,873	\$ (2,076)	\$ 323,140
CMOs - residential <sup>(1)</sup>	33,119	5,200	(1,544)	36,775
CMOs - commercial	1,448	-	(910)	538

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

U.S. Government obligations	164,807	1,775	-	166,582
Agency MBS - residential <sup>(2)</sup>	539	46	-	585
GSEs <sup>(3)</sup>	59,633	379	(161)	59,851
States and political subdivisions	250,361	5,692	(651)	255,402
Redeemable preferred stocks	8,051	1,136	(83)	9,104
Total fixed maturities	\$ 837,301	\$ 20,101	\$ (5,425)	\$ 851,977

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks	\$ 6,537	\$ 311	\$ (149)	\$ 6,699
Nonredeemable preferred stocks	21,767	422	(451)	21,738
Total equity securities	\$ 28,304	\$ 733	\$ (600)	\$ 28,437

(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.

The amortized cost and fair value of fixed maturities available-for-sale at December 31, 2012, by contractual maturity, are shown below (in thousands). 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>December 31, 2012</b>		
	<b>AMORTIZED COST</b>	<b>FAIR VALUE</b>	<b>% OF TOTAL FAIR VALUE</b>
Due in one year or less	\$ 3,816	\$ 3,881	0.5%
Due after one year through five years	110,163	112,516	15.6%
Due after five years through ten years	232,024	238,756	33.2%
Due after ten years	282,311	293,752	40.8%
	628,314	648,905	90.1%
<b>CMO and MBS:</b>			
15 year	24,634	31,481	4.4%
20 year	475	490	0.1%
30 year	37,854	38,726	5.4%
<b>Total fixed maturities</b>	<b>\$ 691,277</b>	<b>\$ 719,602</b>	<b>100.0%</b>



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

The following tables summarize, for all available-for-sale securities in an unrealized loss position at December 31, 2012 and December 31, 2011, respectively, the aggregate fair value and gross unrealized loss by length of time those securities that have continuously been in an unrealized loss position (in thousands):

**December 31, 2012**

	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Corporate securities	\$ 61,386	\$ 953	\$ -	\$ -	\$ 61,386	\$ 953
CMOs - residential	2,416	21	1,138	44	3,554	65
CMOs - commercial	-	-	570	405	570	405
U.S. Government obligations	5,667	2	-	-	5,667	2
GSEs	6,162	40	2,784	27	8,946	67
States and political subdivisions	53,036	657	17,707	338	70,743	995
Redeemable preferred stocks	-	-	-	-	-	-
<b>Total fixed maturities</b>	128,667	1,673	22,199	814	150,866	2,487
Nonredeemable preferred stocks	1,378	10	-	-	1,378	10
<b>Total temporarily impaired securities</b>	\$ 130,045	\$ 1,683	\$ 22,199	\$ 814	\$ 152,244	\$ 2,497
<b>Number of securities in an unrealized loss position</b>	45		23		68	

**December 31, 2011**

	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Corporate securities	\$ 128,820	\$ 1,989	\$ 9,451	\$ 87	\$ 138,271	\$ 2,076
CMOs - residential	1,396	176	14,597	1,368	15,993	1,544
CMOs - commercial	-	-	538	910	538	910

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

GSEs	15,134	131	2,367	30	17,501	161
States and political subdivisions	43,978	291	20,929	360	64,907	651
Redeemable preferred stocks	1,644	83	-	-	1,644	83
<b>Total fixed maturities</b>	190,972	2,670	47,882	2,755	238,854	5,425
Common stocks	1,724	149	-	-	1,724	149
Nonredeemable preferred stocks	-	-	4,968	451	4,968	451
<b>Total temporarily impaired securities</b>	\$ 192,696	\$ 2,819	\$ 52,850	\$ 3,206	\$ 245,546	\$ 6,025
<b>Number of securities in an unrealized loss position</b>	58		30		88	

Substantially all of the unrealized losses on fixed maturities available-for-sale at December 31, 2012 and December 31, 2011 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

***Other-Than-Temporary-Impairments***

For other-than-temporary impairment losses, we recognize an other-than-temporary impairment loss in earnings in the period that we determine: 1) we intend to sell the security; 2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis; or 3) the security has a credit loss. Any non-credit portion of the other-than-temporary impairment loss is recognized in other comprehensive income. Our other-than-temporary impairment losses were as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Total other-than-temporary impairment losses	\$ 992	\$ 2,471	\$ 3,819
Portion of losses recognized in other comprehensive income	(288)	(948)	-
Net impairment losses recognized in earnings	\$ 704	\$ 1,523	\$ 3,819

Credit losses were recognized on certain fixed maturities for which each security also had an impairment loss recognized in other comprehensive income. The rollforward of these credit losses were as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Balance at beginning of year	\$ 2,555	\$ 1,763	\$ 2,394
Credit losses during the period for which an other-than-temporary loss was not previously recognized	473	878	-
Additional credit losses for which an other-than-temporary loss was previously recognized	148	-	-
Securities sold	(1,200)	(86)	(631)
Balance at end of period	\$ 1,976	\$ 2,555	\$ 1,763

The after-tax portion of other-than-temporary impairments included in accumulated other comprehensive income at December 31, 2012 and 2011 consists of \$389,000 and \$618,000, respectively, related to CMO securities; and \$684,000 and \$1,077,000, respectively, related to redeemable preferred stock.

**Note 5.**

**Derivative Instruments**

In connection with its outstanding 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 (\$8,000,000 and \$10,000,000 December 31, 2012 and December 31, 2011, respectively), under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate (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 are fixed at 4.95%. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge. At December 31, 2012 and 2011, the fair value of interest rate swap was \$363,000 and \$494,000, respectively, which is included in other liabilities on the accompanying Consolidated Balance Sheets. See Note 6 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap. For the years ended December 31, 2012 and 2011, the Company recorded \$79,000 and



\$(297,000), respectively, of gains (losses) representing the change in fair value of the interest rate swap, in accumulated other comprehensive income on the accompanying Consolidated Balance Sheets, net of related tax expense (benefit) of \$52,000 and \$(197,000), respectively.

**Note 6.**

**Fair Value Disclosures**

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 and liabilities 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 primarily of CMO securities backed by Alt-A mortgages and municipal tax credit strips. 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. Significant unobservable inputs used in the fair value measurement of CMOs are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite change in the assumption used for prepayment rates. Further we retain independent pricing vendors to assist in valuing certain instruments.

**Trading securities:**

Trading securities included in Level 1 are equity securities with quoted market prices.

**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.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

The following tables present our financial assets and liabilities measured at fair value on a recurring basis, at December 31, 2012 and December 31, 2011, respectively (in thousands):

	<b>December 31, 2012</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>FINANCIAL ASSETS:</b>				
Fixed maturities available-for-sale:				
Corporate securities	\$ -	\$ 353,823	\$ -	\$ 353,823
CMOs - residential	-	6,041	14,053	20,094
CMOs - commercial	-	-	570	570
US Government obligations	-	18,866	-	18,866
Agency MBS - residential	-	428	-	428
GSEs	-	49,606	-	49,606
States and political subdivisions	-	265,667	2,558	268,225
Redeemable preferred stocks	7,990	-	-	7,990
Total fixed maturities	7,990	694,431	17,181	719,602
Equity securities available-for-sale:				
Nonredeemable preferred stocks	15,598	-	-	15,598
Total equity securities	15,598	-	-	15,598
Trading securities - equities	7,016	-	-	7,016
Total trading securities	7,016	-	-	7,016
<b>Total Financial Assets</b>	<b>\$ 30,604</b>	<b>\$ 694,431</b>	<b>\$ 17,181</b>	<b>\$ 742,216</b>
<b>FINANCIAL LIABILITIES:</b>				
Interest rate swap	\$ -	\$ 363	\$ -	\$ 363

	<b>December 31, 2011</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>FINANCIAL ASSETS:</b>				
Fixed maturities available-for-sale:				
Corporate securities	\$ -	\$ 323,140	\$ -	\$ 323,140
CMOs - residential	-	14,648	22,127	36,775
CMOs - commercial	-	-	538	538
US Government obligations	-	166,582	-	166,582
Agency MBS - residential	-	585	-	585
GSEs	-	59,851	-	59,851
States and political subdivisions	-	255,402	-	255,402
Redeemable preferred stocks	9,104	-	-	9,104
Total fixed maturities	9,104	820,208	22,665	851,977
Equity securities available-for-sale:				

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Common stocks	6,699	-	-	6,699
Nonredeemable preferred stocks	21,738	-	-	21,738
Total equity securities	28,437	-	-	28,437
<b>Total Financial Assets</b>	<b>\$ 37,541</b>	<b>\$ 820,208</b>	<b>\$ 22,665</b>	<b>\$ 880,414</b>
<b>FINANCIAL LIABILITIES:</b>				
Interest rate swap	\$ -	\$ 494	\$ -	\$ 494

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. For the year ended December 31, 2012, 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 for the year ended December 31, 2012. 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 2012. The changes in the carrying value of Level 3 assets and liabilities for the years ended December 31, 2011 and 2012 are summarized as follows (in thousands):

	CMOs		States and Political	Total
	Residential	Commercial	Subdivisions	
<b>Balance at December 31, 2010</b>	\$ 37,457	\$ 808	\$ -	\$ 38,265
Gains(losses) included in earnings:				
Net realized investment losses	(32)	-	-	(32)
Other-than-temporary impairments	(1,346)	-	-	(1,346)
Gains (losses) included in other comprehensive income:				
Net unrealized gains (losses)	466	(271)	-	195
Non-credit portion of other-than-temporary impairments	(948)	-	-	(948)
Sales of securities	(9,556)	-	-	(9,556)
Repayments and amortization of fixed maturities	(3,914)	1	-	(3,913)
<b>Balance at December 31, 2011</b>	<b>22,127</b>	<b>538</b>	<b>-</b>	<b>22,665</b>
Purchases of securities	-	-	2,135	2,135
Gains(losses) included in earnings:				
Net realized investment losses	(1,212)	-	-	(1,212)
Other-than-temporary impairments	(231)	(473)	-	(704)

Gains(losses) included in other comprehensive income:

Net unrealized gains (losses)	3,327	929	397	4,653
Non-credit portion of other-than-temporary impairments	136	(424)	-	(288)
Sales of securities	(7,087)	-	-	(7,087)
Repayments and amortization of fixed maturities	(3,007)	-	26	(2,981)
<b>Balance at December 31, 2012</b>	<b>\$ 14,053</b>	<b>\$ 570</b>	<b>\$ 2,558</b>	<b>\$ 17,181</b>

The following table provides carrying values, fair values and classification in the fair value hierarchy of the Company's financial instruments that are not carried at fair value but are subject to fair value disclosure requirements at December 31, 2012 and 2011 (in thousands):

	December 31, 2012		December 31, 2011	
	Level 2 Fair Value	Carrying Value	Level 2 Fair Value	Carrying Value
<b>FINANCIAL ASSETS:</b>				
Policy loans	\$ 28,748	\$ 22,165	\$ 29,511	\$ 23,109
<b>FINANCIAL LIABILITIES:</b>				
Funds on deposit	\$ 279,125	\$ 278,084	\$ 418,823	\$ 417,310
Debt and junior subordinated debt securities	\$ 46,146	\$ 46,146	\$ 48,146	\$ 48,146

The following methods and assumptions were used to estimate the fair value of the financial instruments that are not carried at fair value in the Consolidated Financial Statements:

**(A)**

**Policy Loans**

The fair value of policy loans included in Level 2 of the fair value hierarchy 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. Both types of funds on deposit are included in Level 2 of the fair value hierarchy.

(C)

**Debt**

The fair value of debt with variable interest rates approximates its carrying amount and is included in Level 2 of the fair value hierarchy.

**Note 7.****Net Investment Income**

Major categories of net investment income for the years ended December 31, 2012, 2011 and 2010 are summarized as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Fixed maturities	\$ 27,785	\$ 33,161	\$ 34,022
Equity securities	1,967	2,749	4,661
Short-term investments	194	63	311
Policy loans	1,542	1,587	1,598
Partnership income:			
Investment partnerships	592	677	684
Operating partnerships	1,435	1,591	694
Other	5	175	160
Investment expenses	(164)	(215)	(329)
Net investment income	\$ 33,356	\$ 39,788	\$ 41,801

**Note 8.****Net Realized Investment Gains and Losses**

Net realized investment gains (losses) for the years ended December 31, 2012, 2011 and 2010 are as follows (in thousands):



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

	2012	2011	2010
Sales of available-for-sale securities:			
Fixed maturities	\$ 6,837	\$ 9,086	\$ 8,407
Common stocks	419	(874)	654
Preferred stocks	(495)	749	413
Total sales of available-for-sale securities	6,761	8,961	9,474
Sales of trading securities	79	-	(1,619)
Other trading losses, net	-	-	(3,272)
Other gains (losses)	(1,409)	-	63
Total realized gains (losses) on securities	5,431	8,961	4,646
Unrealized gains (losses) on trading securities:			
Available-for-sale securities transferred to trading category	138	-	-
Change in unrealized gains (losses) on trading securities	(26)	-	-
Total unrealized gains (losses) on trading securities	112	-	-
Loss on other investment	(444)	(291)	-
Net realized investment gains (losses)	\$ 5,099	\$ 8,670	\$ 4,646

For the years ended December 31, 2012, 2011 and 2010, the company realized gross gains of \$10,629,000, \$18,661,000 and \$14,848,000, respectively, and gross losses of \$3,868,000, \$9,700,000 and \$5,374,000, respectively, on sales of available-for-sale securities.

On January 1, 2012, the Company transferred equity securities previously classified as available-for-sale into the trading category and, as a result, recognized \$287,000 of gross gains and \$149,000 of gross losses in net realized investment gains on the accompanying Consolidated Statement of Operations. These gains and losses were previously included in accumulated other comprehensive income on the accompanying Consolidated Balance Sheet at December 31, 2011.

In the fourth quarter of 2008, the Company became aware of certain activities engaged in by the non-affiliate broker-dealer that managed the trading accounts of the Company. The broker-dealer went into bankruptcy. The Company filed a claim to recover the maximum amount available from the Securities Investor Protection Corporation. Based on discussions with the trustee in bankruptcy in the fourth quarter of 2010 pertaining to the resolution of these claims, the Company recorded an additional \$3,272,000 of pre-tax losses. A settlement agreement was entered into with the trustee in the first quarter of 2011 and payment was made by the Company in July 2011.

**Note 9.****Other Investments**

Other investments consist of the following at December 31, 2012 and 2011 (in thousands):

	<b>2012</b>	<b>2011</b>
Policy loans	\$ 22,165	\$ 23,109
Investment partnership interests	3,647	4,139
Operating partnership interests	7,676	6,829
Investment in trust subsidiaries	1,146	1,146
Other	500	-
	\$ 35,134	\$ 35,223

The Company had invested a total of \$3,152,000 at December 31, 2011 in a domestic feeder fund of Dolphin Limited Partnership III, L.P. ("Dolphin III"). In the fourth quarter of 2011, the Company withdrew \$2,901,000 of its investment in Dolphin III, and in the first quarter of 2012, withdrew the remaining \$3,585,000. The Company's net investment income from Dolphin III for the years ended December 31, 2012, 2011 and 2010 was \$433,000, \$876,000 and \$659,000, respectively. An unsettled balance of \$359,000, due upon completion of the audit of Dolphin III, is included in other receivables on the Consolidated Balance Sheet at December 31, 2012.

**Note 10.****Acquisitions**

The Company completed the following acquisitions in 2012, 2011 and 2010. The results of operations of the acquired companies are included in IHC's Consolidated Financial Statements from the



respective acquisition dates. None of the goodwill recognized in these acquisitions is deductible for income tax purposes. With the exception of AMIC, the effect of the following acquisitions were not material, therefore pro forma results of operations have not been presented.

(A)

**CPR Risk Management, Inc.**

In February 2012, the Company acquired the net assets of CPR Risk Management, Inc. ( CPR ) for an aggregate purchase price of \$275,000. The Company recorded other intangible assets of \$327,000 representing customer relationships, which is being amortized over a weighted average period of 5.0 years.

**(B)**

**Wisconsin Underwriting Associates, Inc.**

In January 2011, the Company acquired the remaining 49% noncontrolling interest of Wisconsin Underwriting Associates, LLC ("WUA"). The difference between the fair value of the consideration paid and the amount of the non-controlling interest resulted in a credit of \$391,000 to additional paid-in capital attributable to IHC Health Holdings Corp., a wholly owned subsidiary of the Company ( IHC Health Holdings ).

**(C)**

**American Independence Corp.**

Refer to Note 2 for the discussion pertaining to the acquisition of a controlling interest in AMIC in March 2010 and subsequent acquisitions of non-controlling interests.

**(D)**

**Alliance Underwriters, LLC**

In January 2010, the Company acquired the assets of a managing general underwriter, Alliance Underwriters, LLC for a \$2,500,000 purchase price. The Company recorded goodwill of \$1,459,000 and other intangible assets of \$1,100,000, for the fair value of customer relationships, which is being amortized over a weighted average period of 8.0 years.

**(E)**

**MedWatch, LLC**

In January 2010, IHC Health Holdings acquired a 51% interest in the stock of MedWatch, LLC ( MedWatch ) for a \$500,000 purchase price. The Company recorded goodwill of \$581,000 and other intangible assets of \$360,000, primarily for the fair value of customer relationships, which is being amortized over a weighted average period of 7.5 years. MedWatch provides utilization review and medical management services to fully insured and self-funded health plans. In the fourth quarter of 2011, the Company realized a loss of \$9,000 on the Consolidated Statement of Operations resulting from the sale of its interest in MedWatch.

(F)

**Hospital Bill Analysis, LLC**

In January 2010, IHC Health Holdings acquired a 51% interest in the stock of Hospital Bill Analysis, LLC ( HBA ), a hospital bill review company, for a \$500,000 purchase price. The Company recorded goodwill of \$814,000 and other intangible assets of \$200,000, primarily for the fair value of customer relationships, which is being amortized over a weighted average period of 7.0 years. In the fourth quarter of 2011, the Company realized a loss of \$284,000 on the Consolidated Statement of Operations resulting from the sale of its interest in HBA.

**Note 11.****Goodwill and Other Intangible Assets**

The changes in the carrying amount of goodwill by business segment are as follows for the years ended December 31, 2012 and 2011 (in thousands):

	<b>2012</b>	<b>2011</b>
Balance at beginning of year	\$ 50,318	\$ 51,713
<b>Fully Insured:</b>		
Sale of MedWatch	-	(581)
Sale of HBA	-	(814)
Balance at end of year	\$ 50,318	\$ 50,318

See Note 21 for goodwill carrying amounts by segment as of December 31, 2012 and 2011.

At December 31, 2012, the Company's market capitalization was less than its book value indicating a potential impairment of goodwill. As a result, the Company assessed the factors contributing to the performance of IHC stock in 2012, and concluded that the market capitalization does not represent the fair value of the Company. The Company noted several factors that have led to a difference between the market capitalization and the fair value of the Company, including (i) the Company's stock is thinly traded and a sale of even a small number of shares can have a large percentage impact on the price of the stock, (ii) Geneve Corporation and insiders own approximately 56% of the outstanding shares, which has had a significant adverse impact on the number of shares available for sale and therefore the trading potential of IHC stock, and (iii) lack of analyst coverage of the Company. If we experience a sustained decline in our results of operations and cash flows, or other indicators of impairment exist, we may incur a material non-cash charge to earnings relating to impairment of our goodwill, which could have a material adverse effect on our results.

At December 31, 2012 and 2011, the Company had other intangible assets of \$18,271,000 and \$17,715,000, respectively, net of accumulated amortization of \$13,163,000 and \$10,324,000, respectively, which are included in other assets in the Consolidated Balance Sheets. These intangible assets principally represent the estimated fair value of acquired agent and broker relationships. At December 31, 2012 and 2011, other intangible assets include \$7,977,000 of intangible assets, primarily the estimated fair value of insurance licenses with indefinite lives, which are not subject to amortization.





The changes in the carrying amount of intangible assets by business segment are as follows for the years ended December 31, 2012 and 2011 (in thousands):

	<b>Other Intangible Assets</b>		<b>Total Other Intangible Assets</b>
	<b>Definitive Lives</b>	<b>Indefinite Lives</b>	
<b>Balance at December 31, 2010</b>	\$ 12,101	\$ 7,977	\$ 20,078
<b>Fully insured:</b>			
Sale of MedWatch	(218)	-	(218)
Sale of HBA	(117)	-	(117)
Capitalized software development	233	-	233
Amortization expense	(2,261)	-	(2,261)
<b>Balance at December 31, 2011</b>	9,738	7,977	17,715
<b>Medical Stop-Loss:</b>			
Acquired broker relationships	2,925	-	2,925
<b>Fully insured:</b>			
Acquired CPR	327	-	327
Capitalized software development	144	-	144
Amortization expense	(2,840)	-	(2,840)
<b>Balance at December 31, 2012</b>	\$ 10,294	\$ 7,977	\$ 18,271

In July 2012, AMIC acquired the assets and renewal contract rights of Medical Stop-Loss business from an unaffiliated MGU for an aggregate purchase price of \$1,825,000. The purchase price consists of \$1,300,000 in cash and \$525,000 in contingent consideration expected to be paid in early 2013 based on expected growth in the acquired block of business. AMIC recorded other intangible assets representing broker relationships, which will be amortized over a weighted average period of 7.0 years.

In November 2012, AMIC entered into a consulting agreement to continue writing certain medical stop-loss business for an aggregate fee of \$1,100,000. The fee consists of \$500,000 in cash and \$600,000 in contingent consideration expected to be paid in 2013 and 2014 based on the expected growth in the acquired block of business. AMIC recorded other intangible assets representing broker relationships, which will be amortized over a weighted average period of 7.0 years.

Estimated amortization expense for each of the next five years is as follows (in thousands):

<b>Year</b>		<b>Amortization Expense</b>
2013	\$	3,288
2014		2,717
2015		1,618
2016		1,168
2017		765

**Note 12.****Insurance Policy Claims and Reserves**

The liabilities for unpaid claims and claim adjustment expenses and insurance reserves-health represent amounts necessary to provide for the estimated cost of settling claims relating to insured events that have been incurred prior to the balance sheet date which have not yet been settled.

Changes in the liability for reserves, unpaid claims and claim adjustment expenses for the Insurance Group's health and disability coverages for the years ended December 31, 2012, 2011 and 2010 are summarized below (in thousands).

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Balance at beginning of year	\$ 192,987	\$ 197,968	\$ 202,801
Less: reinsurance recoverable	83,137	82,724	100,711
Net balance at beginning of year	109,850	115,244	102,090
Gross reserves of AMIC acquired	-	-	27,373
Less: reinsurance recoverable	-	-	10,296
Net reserves of AMIC acquired	-	-	17,077
Amount incurred:			
Current year	213,818	197,705	203,602
Prior years	(8,908)	(7,492)	(2,466)
Total	204,910	190,213	201,136
Amount paid, related to:			
Current year	130,386	123,702	137,953
Prior years	68,523	71,905	67,106
Total	198,909	195,607	205,059
Net balance at end of year	115,851	109,850	115,244
Plus: reinsurance recoverable	78,629	83,137	82,724
Balance at end of year	\$ 194,480	\$ 192,987	\$ 197,968

The preceding schedule reflects: (i) the due and unpaid; (ii) claims in the course of settlement; (iii) estimated incurred but not reported reserves; and (iv) the present value of amounts not yet due on claims. The incurred and paid data

above reflects all activity for the year. The net favorable development in 2012 for prior years of \$8,908,000 is primarily the result of \$2,968,000 of net favorable developments in Medical Stop-Loss reserves, \$375,000 in the Fully Insured reserves, \$4,508,000 in the group disability reserves and \$1,057,000 in all other reserves. The net favorable development in 2011 for prior years of \$7,492,000 is primarily the result of \$2,622,000 of net favorable developments in Medical Stop-Loss reserves, \$2,276,000 in the Fully Insured reserves, \$2,397,000 in the group disability reserves and \$197,000 in all other reserves. The net favorable development in 2010 for prior years of \$2,466,000 is primarily the result of favorable development of \$4,299,000 in the group disability reserves offset by \$1,258,000 incurred in Medical Stop-Loss reserves and \$575,000 incurred on all other reserves.

These changes in reserve estimates are generally the result of on-going analysis of recent loss development trends. Medical stop-loss business is excess coverage with a short duration. Predicting

ultimate claims and estimating reserves in medical stop-loss is especially complicated due to the excess of loss nature of these products with very high deductibles applying to specific claims on any individual claimant and in the aggregate for a given group. Fluctuations in results for specific coverage are primarily due to the severity and frequency of individual claims. Due to the short-term nature of medical stop-loss, redundancies and deficiencies will typically emerge during the following year rather than over a number of years.

**Note 13.**

**Debt and Junior Subordinated Debt Securities**

**(A)**

**Debt**

In July 2011, a subsidiary of IHC amended its amortizing term loan with a commercial bank and increased its outstanding debt 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 principal payments in the amount of \$2,000,000 annually, commencing on July 1, 2012 through maturity. The Company simultaneously entered into an interest rate swap with the commercial bank lender effectively fixing the rate at 4.95%. See Note 5 for further discussion pertaining to the interest rate swap. As to such subsidiary, the line of credit (i) contains restrictions with respect to, among other things, the creation of additional indebtedness, the consolidation or merger with or into certain corporations, the payment of dividends and the retirement of capital stock; (ii) requires the maintenance of minimum amounts of net worth, as defined, certain financial ratios, and certain investment restrictions; and (iii) is secured by the stock of Madison National Life, Standard Security Life and the assets of such subsidiary of IHC. At December 31, 2012 and 2011, there was \$8,000,000 and \$10,000,000, respectively, of outstanding debt under this amortizing term loan.

**(B)**

**Junior Subordinated Debt Issued to Trust Preferred Subsidiaries**

Junior subordinated debt consisted of the following at both December 31, 2012 and 2011 (in thousands):

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Independence Preferred Trust I - Trust Preferred	\$	10,000
Independence Preferred Trust I - Common Stock		310
Junior subordinated debt security -Trust I		10,310
Independence Preferred Trust II -Trust Preferred		12,000
Independence Preferred Trust II - Common Stock		372
Junior subordinated debt security - Trust II		12,372
Independence Preferred Trust III Trust Preferred		15,000
Independence Preferred Trust III Common Stock		464
Junior subordinated debt security Trust III		15,464
Total junior subordinated debt securities	\$	38,146

The Company has three statutory business trusts that were formed for the purpose of issuing trust preferred securities, totaling \$37,000,000, to institutional investors in pooled issuances. Although the Company owns all of the trusts' common securities, it is not the primary beneficiary and, therefore, the

trusts are unconsolidated subsidiaries for financial reporting purposes. As a result, the Company recognized liabilities of \$38,146,000 for junior subordinated debt and assets of \$1,146,000 for the investments in trust subsidiaries at both December 31, 2012 and 2011. The Company's subordinated debt securities, which are the sole assets of the subsidiary trusts, are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has provided a full and unconditional guarantee of amounts due on the trust preferred securities. The terms of the junior subordinated debt securities, including interest rates and maturities, are the same as the related trust preferred securities.

The distributions payable on the capital securities are cumulative and payable quarterly in arrears. The Company has the right, subject to events of default, to defer payments of interest for a period not to exceed 20 consecutive quarters, provided that no extension period may extend beyond the maturity dates which range from April 2033 to December 2034. The Company has no current intention to exercise its right to defer interest payments. The rates on the capital securities are as follows: Independence Preferred Trust I, 400 basis points over the three-month LIBOR, (4.34% at December 31, 2012); Independence Preferred Trust II, 390 basis points over the three-month LIBOR, (4.24% at December 31, 2012); and Independence Preferred Trust III, 350 basis points over the three-month LIBOR (3.81% at December 31, 2012).

The capital securities are mandatorily redeemable upon maturity. The Company has the right to redeem the capital securities, in whole or in part without penalties with respect to Independence Preferred Trust I, Independence Preferred Trust II and Independence Preferred Trust III. The redemption price would be 100% (without penalty) of the principal amount plus accrued and unpaid interest.

Cash payments for interest on debt and junior subordinated debt securities were \$2,107,000 \$1,943,000 and \$1,908,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

#### **Note 14.**

##### **Preferred Stock**

IHC has 100,000 authorized shares of preferred stock, par value \$1.00 per share, none of which was issued as of December 31, 2012 and 2011.

**Note 15.**

**Common Stock**

IHC issued 1,638,849 shares of common stock, net of treasury shares, in connection with a special 10% stock dividend payable to shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. Accordingly, IHC charged retained earnings \$15,799,000, representing the fair value of such shares on the distribution date, and recorded a credit to common stock for the par value of such shares and a credit to paid-in capital for the remaining difference. Fractional shares were paid in cash in-lieu of stock. All references to number of common shares and earnings per share amounts have been adjusted retroactively for all periods presented to reflect the change in capital structure.

In June 2012, the stockholders of the Company approved an amendment to the Company's restated certificate of incorporation to increase the number of authorized shares of common stock from 20,000,000 shares to 23,000,000 shares.

In 2011, IHC issued of an aggregate 660,240 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, in



connection with the acquisition of an aggregate 900,325 shares of AMIC's common stock. See Note 2 regarding AMIC share acquisitions. 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.

In August 2011, pursuant to the Exchange Offer discussed in Note 2, IHC issued 762,551 shares of its common stock, plus a de minimis amount of cash paid in-lieu, in exchange for 1,109,225 shares of AMIC's common stock.

In 1991, IHC initiated a program of repurchasing shares of its common stock. In January 2010, the Board of Directors authorized the repurchase of up to 550,000 shares of IHC's common stock, inclusive of prior authorizations, under the 1991 plan. Through December 31, 2012, the Company has repurchased 6,438,025 common shares at a cumulative cost of \$41,771,000. This total includes repurchases of 100,246, 123,417 and 227,040 shares in 2012, 2011 and 2010, respectively. All of the repurchased shares have been either retired, reissued, or have become treasury shares. At December 31, 2012, there were 99,297 shares still authorized to be repurchased under the plan authorized by the Board of Directors.

## **Note 16.**

### **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 activity subsequent to the Acquisition Date.

#### **A)**

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

In June 2003, the stockholders approved the Independence Holding Company 2003 Stock Incentive Plan (the "2003 Plan") under which, 693,000 shares of common stock were reserved for options and other common stock awards. The final option grants under the 2003 Plan were made during 2006.

In June 2006, the stockholders approved the Independence Holding Company 2006 Stock Incentive Plan (the "2006 Plan") under which, 1,430,000 shares of common stock were reserved for options and other common stock awards.

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 December 31, 2012, there were 357,118 shares available for future stock-based compensation grants under IHC's stock incentive plans.

Total share-based compensation expense recorded for the years ended December 31, 2012, 2011 and 2010 was \$799,000, \$573,000 and \$672,000, respectively, and the related tax benefits recognized for the years ended December 31, 2012, 2011 and 2010 were \$319,000, \$228,000 and \$268,000, respectively.

### **Stock Options**

The Company's stock option activity for the year ended December 31, 2012 was as follows:

	<b>Shares Under Option</b>	<b>Weighted- Average Exercise Price</b>
<b>December 31, 2011</b>	758,714	\$ 9.71
Forfeited	(3,667)	9.09
Expired	(61,211)	13.73
<b>December 31, 2012</b>	693,836	\$ 9.36

The following table summarizes information regarding outstanding and exercisable options:

	<b>December 31, 2012</b>	
	<b>Outstanding</b>	<b>Exercisable</b>
Number of options	693,836	528,176
Weighted average exercise price per share	\$ 9.36	\$ 9.45
Aggregate intrinsic value for all options	\$ 84	\$ 84
Weighted average contractual term remaining	1.5 years	1.3 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 year ended December 31, 2010 was \$1.43 per share. No options were granted in 2012 or 2011. The assumptions set forth in the table below were used to value these grants:

	<b>2010</b>
Weighted-average risk-free interest rate	2.3%
Annual dividend rate per share	0.5%
Weighted-average volatility factor of the Company's common stock	45.0%
Weighted-average expected term of options	4.5 years

Compensation expense of \$237,000, \$292,000 and \$494,000 was recognized in the years ended December 31, 2012, 2011 and 2010, respectively, for the portion of the grant-date fair value of stock options vested during that period.

As of December 31, 2012, compensation costs related to non-vested stock options have been substantially recognized as those shares will fully vest in the first week in January 2013.

### **Restricted Stock**

IHC issued 7,425 restricted stock awards during years ended December 31, 2012 and 2011, and issued 2,475 restricted stock awards in the year ended December 31, 2010 with weighted-average grant-date fair values of \$9.39, \$9.84 and \$6.37 per share, respectively. The total fair value of restricted stock that vested in 2012, 2011 and 2010 was \$40,000, \$23,000 and \$23,000, respectively. Restricted stock expense was \$45,000, \$27,000 and \$28,000 in 2012, 2011 and 2010, respectively.

The following table summarizes IHC's restricted stock activity for the year ended December 31, 2012:

	<b>No. of Non-vested Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
<b>December 31, 2011</b>	9,900	\$ 8.95
Granted	7,425	9.39
Vested	(4,125)	8.40
<b>December 31, 2012</b>	13,200	\$ 9.37

At December 31, 2012, the total unrecognized compensation cost related to non-vested restricted stock awards was \$96,000 which is expected to be recognized as compensation expense over a weighted average period of 2.0 years.

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

IHC had 269,950 and 230,450 SAR awards outstanding at December 31, 2012 and 2011, respectively. During the year ended 2012 and 2011, the Company granted 56,000 SAR awards and 120,450 SAR awards, respectively. 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 years ended December 31, 2012, 2011 and 2010, IHC recorded \$428,000, \$209,000 and \$79,000, respectively, of compensation costs for these awards. In 2012, 13,750 SARs were exercised with an aggregate intrinsic value of \$33,000, and 2,750 SARs were forfeited. No SARs were exercised or forfeited during the years ended December 31, 2011 or 2010. Included in Other Liabilities in the Company's Consolidated Balance Sheets at December 31, 2012 and December 31, 2011 are liabilities of \$683,000 and \$288,000, 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 years ended December 31, 2012, 2011 and 2010, IHC recorded \$89,000, \$45,000 and \$74,000, respectively, of compensation costs for these awards. The intrinsic value of share-based performance awards paid during the years ended December 31, 2012, 2011 and 2010 was \$57,000, \$55,000 and \$54,000, respectively. Included in the other liabilities on the Company's Consolidated Balance Sheets at December 31, 2012 and 2011 are liabilities of \$97,000 and \$65,000, respectively, pertaining to share-based performance awards.

**B)**

**AMIC Share-Based Compensation Plans**

Total AMIC share-based compensation expense was \$33,000 and \$43,000 for the years ended December 31, 2012 and 2011, respectively, and was \$62,000 for the period between the Acquisition Date and December 31, 2010. Related tax benefits of \$11,000 and \$15,000 were recognized for the years ended December 31, 2012 and 2011, respectively, and \$21,000 was recognized for the period between the Acquisition Date and December 31, 2010.

Effective July 1, 2009, AMIC implemented the 2009 Stock Incentive Plan ( AMIC 2009 Plan ), which the AMIC stockholders approved on June 19, 2009. The AMIC 2009 Plan provided for the grants of non-statutory and incentive stock options, stock appreciation rights, restricted stock awards, performance shares, and other awards to officers, employee and other individuals. Under the terms of the AMIC 2009 Plan, stock options have a maximum term of ten years from the date of grant, and have various vesting criteria depending on the grant with most grants vesting ratably over four years. AMIC s 1998 Plan, which expired by its terms on October 7, 2008, had reserved for issuance a total of 7,154,198 common stock shares. At December 31, 2012, stock options for 227,285 common stock shares were outstanding, stock options for 215,062 common stock shares were vested, and 6,517,221 common stock shares that had not been issued remained available for future stock options grants and other awards. Awards made under AMIC s 1998 Plan prior to its expiration are still in effect.

**Stock Options**

The following table summarizes information regarding AMIC s outstanding and exercisable options for the year ended December 31, 2012:

	<b>Shares Under Option</b>	<b>Weighted- Average Exercise Price</b>
<b>December 31, 2011</b>	333,956	\$ 10.43
Expired	(90,003)	7.87
Forfeited	(16,668)	11.10
<b>December 31, 2012</b>	227,285	\$ 11.40

The following table summarizes information regarding AMIC s outstanding and exercisable options as of December 31, 2012:

	<b>December 31, 2012</b>	
	<b>Outstanding</b>	<b>Exercisable</b>
Number of options	227,285	215,062
Weighted average exercise price per share	\$ 11.40	\$ 11.74
Aggregate intrinsic value for all options (in thousands)	\$ 5	\$ 4
Weighted average contractual term remaining	3.08 years	2.79 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. No options were granted during the year ended December 31, 2012. The weighted average grant-date fair-value of options granted during the year ended December 31, 2011 and during the period between the Acquisition Date and December 31, 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>2011</b>	<b>2010</b>
-------------	-------------



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

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%	45.0%
Weighted-average expected term of options	5 years	5 years

Compensation expense of \$33,000, \$36,000 and \$47,000 was recognized for the years ended December 31, 2012, 2011, and for the period between the Acquisition Date and December 31, 2010, respectively, representing the portion of the grant-date fair value of AMIC's stock options vesting during those periods.

No options were exercised during the year ended December 31, 2012. AMIC received cash proceeds of \$57,000 upon the exercise of 13,611 options with an intrinsic value of \$11,000 during the year ended December 31, 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 December 31, 2010.

As of December 31, 2012, the total unrecognized compensation expense related to AMIC s non-vested options was \$48,000 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 since then. AMIC had no unvested restricted stock awards outstanding at December 31, 2012 and 2011. The total fair value of AMIC's restricted stock that vested during the year ended December 31, 2011 and during the period between the Acquisition Date and December 31, 2010 was \$12,000 and \$13,000, respectively. Restricted stock expense was \$7,000 and \$15,000 for the year ended December 31, 2011 and for the period between the Acquisition Date and December 31, 2010, respectively.

**Note 17.****Income Taxes**

As of December 31, 2012, IHC and its subsidiaries, excluding AMIC, filed a consolidated Federal income tax return on a June 30 fiscal year and AMIC continued to file its own separate income tax return on a September 30 fiscal year. Effective January 15, 2013, AMIC will be included in the consolidated Federal income tax returns of IHC on a June 30 fiscal year as a result of the increase in IHC's ownership interest in AMIC to over 80%. The provision for income tax expense (benefit) attributable to income from continuing operations as shown in the Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010 is as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>CURRENT:</b>			
U.S. Federal	\$ 2,555	\$ 4,397	\$ (2,973)
State and Local	648	523	456
	3,203	4,920	(2,517)
<b>DEFERRED:</b>			
U.S. Federal	(1,188)	(912)	12,698
State and Local	(12)	(276)	2,402
	(1,200)	(1,188)	15,100
	\$ 2,003	\$ 3,732	\$ 12,583

In 2011, the Company recorded 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 future periods for any earnings or stockholders' equity adjustments relating to IHC's investment in AMIC.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Taxes computed at the Federal statutory rate of 35% in 2012, 2011 and 2010, attributable to pretax income from continuing operations, are reconciled to the Company's actual income tax expense on income from continuing operations as follows (in thousands):

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Tax computed at the statutory rate	\$ 8,615	\$ 6,474	\$ 12,688
Dividends received deduction and tax exempt interest	(1,336)	(600)	(1,816)
State and local income taxes, net of Federal effect	414	444	1,858
AMIC deferred income tax reversal	-	(2,319)	-
AMIC valuation allowance adjustment	(5,900)	-	-
Other, net	210	(267)	(147)
Income tax expense	\$ 2,003	\$ 3,732	\$ 12,583

Deferred income tax expense for the year ended December 31, 2012 allocated to stockholders' equity (principally for net unrealized gains on investment securities) was \$3,683,000, representing the increase in the related net deferred tax liability to \$7,451,000 at December 31, 2012 from \$3,768,000 at December 31, 2011.

Temporary differences between the Consolidated Financial Statement carrying amounts and tax bases of assets and liabilities that give rise to the deferred tax assets and liabilities at December 31, 2012 and 2011 are summarized below (in thousands). The net deferred tax asset or liability is included in Other Assets or Other Liabilities, as appropriate, in the Consolidated Balance Sheets. IHC and its subsidiaries, excluding AMIC, have certain tax-planning strategies that were used in determining that a valuation allowance was not necessary on its deferred tax assets at December 31, 2012 or 2011. The net deferred tax asset relative to AMIC included in other assets on IHC's Consolidated Balance Sheets at December 31, 2012 and 2011 was \$12,173,000 and \$8,030,000, respectively.

	2012		2011
<b>DEFERRED TAX ASSETS:</b>			
Deferred insurance policy acquisition costs	\$ 970	\$	1,996
Unrealized losses on investment securities	146		197
Investment write-downs	1,932		5,189
Loss carryforwards	116,913		114,876
Insurance reserves	1,135		1,269
Other	4,820		4,407
Total gross deferred tax assets	125,916		127,934
Less AMIC valuation allowance	(78,572)		(84,665)
Net deferred tax assets	47,344		43,269
<b>DEFERRED TAX LIABILITIES:</b>			
Deferred insurance policy acquisition costs	(8,984)		(9,942)
Insurance reserves	(7,129)		(6,101)
Unrealized gains on investment securities	(8,134)		(4,336)
Other	(10,668)		(7,892)
Total gross deferred tax liabilities	(34,915)		(28,271)
Net deferred tax asset	\$ 12,429	\$	14,998

As of December 31, 2012, IHC and its subsidiaries, excluding AMIC, had NOL carryforwards arising from limitations on offsetting non-life insurance company losses against life insurance company income. The non-life insurance company NOL carryforwards amount to approximately \$43,000,000 at December 31, 2012, which expire in varying amounts between 2025 and 2033. In addition, as of December 31, 2012, IHC and its subsidiaries, excluding AMIC, had capital tax loss carryforwards of approximately \$13,400,000 expiring in 2014, 2015 and 2018 arising from excess capital losses realized by the life insurance company group.

At December 31, 2012, AMIC had federal NOL carryforwards of approximately \$271,770,000 which expire in varying amounts between the years 2019 and 2031, a significant portion of which expires in the year 2021. At December 31, 2012, AMIC also had NOL carryforwards of approximately \$25,814,000 for state income tax purposes in the State of California. Management believes that it is more likely than not that the state tax benefit of these NOL carryforwards will not be realized and has provided a valuation allowance against the full amount.

IHC's or AMIC's ability to utilize its loss carryforwards would be substantially reduced if IHC or AMIC were to undergo an "ownership change" within the meaning of Section 382(g)(1) of the Internal Revenue Code. IHC or AMIC

will be treated as having had an "ownership change" if there is more than a 50% increase in stock ownership during a three year "testing period" by "5% stockholders."

As the loss carryforwards are utilized by IHC and AMIC, the amount of loss carryforwards could be reduced upon audit by the IRS for those tax years open for assessment under the statute of limitations.

During the year ended December 31, 2012 and 2011, AMIC decreased its valuation allowance by \$6,093,000 and \$1,394,000, respectively. The December 31, 2012 valuation allowance decrease included

\$5,900,000 for the projected utilization of federal net operating losses allocated to operations. The valuation allowance at December 31, 2012 and 2011 was primarily related to net operating loss carryforwards that, in the judgment of management, were not considered realizable.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Management believes that it is more likely than not that IHC and its subsidiaries, and AMIC, will realize the benefits of these net deferred tax assets recorded at December 31, 2012. As of December 31, 2012, IHC and its subsidiaries, and AMIC, believe there were no material uncertain tax positions that would require disclosure under U.S. GAAP.

Interest expense and penalties for the years ended December 31, 2012, 2011 and 2010 are insignificant.

Net cash payments (receipts) for income taxes were \$550,000, \$(3,626,000) and \$637,000 in 2012, 2011 and 2010, respectively.

#### **Note 18.**

##### **Commitments and Concentration of Credit Risk**

Certain subsidiaries of the Company are obligated under non-cancelable operating lease agreements for office space. Total rental expense for the years 2012, 2011 and 2010 for operating leases was \$3,750,000, \$4,016,000 and \$4,942,000, respectively.

The approximate minimum annual rental payments under operating leases that have remaining non-cancelable lease terms in excess of one year at December 31, 2012 are as follows (in thousands):

2013	\$	2,981
2014		2,696



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

2015		2,576
2016		2,070
2017		784
2018 and thereafter		462
Total	\$	11,569

At December 31, 2012, the Company had no investment securities of any one issuer or in any one industry which exceeded 10% of stockholders' equity, except for investments in obligations of the U.S. Government and its agencies and mortgage-backed securities issued by GSEs, as summarized in Note 4.

Fixed maturities with a carrying value of \$12,468,000 and \$11,406,000 were on deposit with various state insurance departments at December 31, 2012 and 2011, respectively.

At December 31, 2012, the Company had net receivables of \$44,045,000 and \$34,236,000 from two different reinsurers, Alterra Bermuda, Inc. and RGA Reinsurance Company, respectively, which are rated A and A+, respectively, by A.M. Best. These are the only reinsurers with net receivables that

individually exceed 10% of the stockholders' equity of the Company. The Company believes that these receivables are fully collectible.

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 relating 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.

On January 2, 2013, Madison National Life was named one of several defendants in a lawsuit related to certain provisions of a particular health insurance plan whereby Madison National Life was the insurance carrier during one of the years in question. Because legal discovery has not commenced and many aspects of the lawsuit are as yet unknown, it is not possible to provide a meaningful estimate of the lawsuit's ultimate financial effect, if any, on the Company.

#### **Note 19.**

##### **Acquisitions of Policy Blocks**

In addition to its core life and health lines of business, IHC has acquired blocks of life insurance and annuity policies from other insurance companies, guaranty associations and liquidators. The deferred acquisition costs that arise from the acquisition of these policy blocks are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance contracts. As these were acquisitions of blocks of existing policies, the deferral reflects the purchase price of the policies and the associated finder's fees. Both of these were variable and directly related to obtaining the policy block.

The Company did not record any significant policy block acquisitions in 2012 or 2011. During 2010, Madison National Life acquired a block of life insurance policies with approximately \$1,603,000 of reserves.

#### **Note 20.**

## **Reinsurance**

Standard Security Life, Madison National Life and Independence American reinsure portions of certain business in order to limit the assumption of disproportionate risks. Standard Security Life, Madison National Life and Independence American retain varying amounts of individual life or group life insurance. Amounts not retained are ceded to other companies on an automatic or facultative basis. In addition, Standard Security Life, Madison National Life and Independence American participate in various coinsurance treaties on a quota share or excess basis. Standard Security Life, Madison National Life and Independence American are contingently liable with respect to reinsurance in the unlikely event that the assuming reinsurers are unable to meet their obligations. The ceding of reinsurance does not discharge the primary liability of the original insurer to the insured.

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

The effect of reinsurance on life insurance in-force, benefits to policyholders and premiums earned is as follows (in thousands):

	<b>GROSS AMOUNT</b>	<b>ASSUMED FROM OTHER COMPANIES</b>	<b>CEDED TO OTHER COMPANIES</b>	<b>NET AMOUNT</b>	<b>PERCENTAGE OF AMOUNT ASSUMED TO NET</b>
<b>Life Insurance In-Force:</b>					
December 31, 2012	\$ 11,293,128	\$ 213,041	\$ 6,004,459	\$ 5,501,710	3.9%
December 31, 2011	\$ 11,322,537	\$ 236,650	\$ 6,207,385	\$ 5,351,802	4.4%
December 31, 2010	\$ 11,253,298	\$ 291,467	\$ 5,797,444	\$ 5,747,321	5.1%
 <b>B e n e f i t s t o Policyholders:</b>					
December 31, 2012	\$ 286,859	\$ 53,966	\$ 111,937	\$ 228,888	23.6%
December 31, 2011	\$ 272,128	\$ 53,929	\$ 101,994	\$ 224,063	24.1%
December 31, 2010	\$ 307,988	\$ 65,624	\$ 132,936	\$ 240,676	27.3%
 <b>Premiums Earned:</b>					
December 31, 2012					
Health	\$ 400,076	\$ 60,232	\$ 140,653	\$ 319,655	18.8%
Life and annuity	47,790	7,538	18,916	36,412	20.7%
	\$ 447,866	\$ 67,770	\$ 159,569	\$ 356,067	19.0%
December 31, 2011					
Health	\$ 377,294	\$ 51,703	\$ 130,451	\$ 298,546	17.3%
Life and annuity	48,881	7,663	18,676	37,868	20.2%
	\$ 426,175	\$ 59,366	\$ 149,127	\$ 336,414	17.6%
December 31, 2010					
Health	\$ 394,446	\$ 55,036	\$ 159,896	\$ 289,586	19.0%
Life and annuity	48,280	8,712	20,432	36,560	23.8%
	\$ 442,726	\$ 63,748	\$ 180,328	\$ 326,146	19.5%

Included in Gross Amount in 2010 are \$8,452,000 of premiums written through AMIC subsidiaries prior to its consolidation in 2010. Included in Ceded to Other Companies in 2010 are \$5,867,000 of Premiums Earned and \$3,020,000 of Benefits to Policyholders for business ceded to Independence American, a subsidiary of AMIC prior to its consolidation in 2010.

Effective January 26, 2012, Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer to cede group annuity reserves. In accordance with the agreement, Standard Security Life transferred \$143,537,000 of cash in the first quarter of 2012 and recorded a corresponding amount as due from reinsurers. The Company received final approval from the New York State Insurance Department to convert the transfer from a coinsurance to an assumption agreement which contractually relieves Standard Security Life of liability with regards to the policies. During the third quarter of 2012, a significant portion of the reserves were assumed. In anticipation of such agreement, the Company wrote-off \$4,568,000 of deferred acquisition costs on December 31, 2011.

**Note 21.****Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Interest expense, taxes, and general expenses associated with parent company activities are included in Corporate. Identifiable assets by segment are those assets that are utilized in each segment and are allocated based upon the mean reserves and liabilities of each such segment. Corporate assets are composed principally of cash equivalents, resale agreements, fixed maturities, equity securities, partnership interests and certain other investments. Information by business segment for the years ended December 31, 2012, 2011 and 2010 is presented below (in thousands).

	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Revenues:</b>			
Medical Stop-Loss <sup>(A)</sup>	\$ 146,378	\$ 123,497	\$ 130,654
Fully Insured Health <sup>(B)</sup>	171,492	167,900	150,684
Group disability; life, annuities and DBL <sup>(C)</sup>	52,049	60,376	65,972
Individual life, annuities and other	53,207	58,103	58,641
Corporate	540	973	28,590
	423,666	410,849	434,541
Net realized investment gains	5,099	8,670	4,646
Other-than-temporary impairment losses	(704)	(1,523)	(3,819)
Total revenues	\$ 428,061	\$ 417,996	\$ 435,368
<b>Income (loss) from continuing operations</b>			
<b>before income taxes:</b>			
Medical Stop-Loss <sup>(A)</sup>	\$ 15,818	\$ 8,983	\$ 1,878
Fully Insured Health <sup>(B)</sup>	4,360	7,692	3,126
Group disability; life, annuities and DBL <sup>(C) (D)</sup>	8,607	1,733	6,646
Individual life, annuities and other	905	389	2,217
Corporate	(7,380)	(5,481)	23,470
	22,310	13,316	37,337
Interest expense	(2,091)	(1,965)	(1,912)
Net realized investment gains	5,099	8,670	4,646
Other-than-temporary impairment losses	(704)	(1,523)	(3,819)
Income (loss) from continuing operations before income taxes	\$ 24,614	\$ 18,498	\$ 36,252

(A)

The amount includes equity income from AMIC (prior to its acquisition) of \$14,000 for the year 2010.

(B)

The amount includes equity income from AMIC (prior to its acquisition) of \$244,000 for the year ended December 31, 2010.

(C)

The amount includes equity income from AMIC (prior to its acquisition) of \$22,000 for the year ended December 31, 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 \$2,453,000, \$2,374,000 and \$2,382,000 for the years ended December 31, 2012, 2011 and 2010, respectively. Amortization expense for the other segments is insignificant.

	<b>2012</b>		<b>2011</b>
<b>IDENTIFIABLE ASSETS AT YEAR END</b>			
Medical Stop-Loss <sup>(A)</sup>	\$ 184,125	\$	164,593
Fully Insured Health <sup>(B)</sup>	184,796		159,404
Group disability; life, annuities and DBL	156,556		311,422
Individual life, annuities and other	703,211		689,522
Corporate	33,620		33,918
	\$ 1,262,308	\$	1,358,859

(A)

The Medical Stop-Loss segment includes allocated goodwill of \$5,664,000 at both December 31, 2012 and 2011.

(B)

The Fully Insured Health segment includes allocated goodwill of \$44,654,000 at both December 31, 2012 and 2011.

**Note 22.****Dividend Restrictions and Statutory Information**

Dividends from Madison National Life are subject to the prior notification to the Commissioner of Insurance of the State of Wisconsin if such dividend distribution exceeds 115% of the distribution for the corresponding period of the previous year. In addition, if such dividends, together with the fair market value of other dividends paid or credited and distributions made within the preceding twelve months, exceed the lesser of (i) total net income for the preceding calendar year minus realized capital gains for that calendar year and (ii) 10% of surplus with regard to policyholders as of December 31 of the preceding year, such dividends may be paid so long as such dividends have not been disapproved by the Wisconsin Insurance Commissioner within 30 days of its receipt of notice thereof. In the fourth quarter of 2011, upon approval by the Wisconsin Insurance Commissioner, Madison National Life transferred to its parent, a subsidiary of IHC, all of the outstanding common stock of its wholly owned subsidiary, Standard Security



Life, representing an extraordinary dividend with a statutory value of \$106,314,000. In addition, Madison National Life declared and paid cash dividends of \$3,450,000, \$2,000,000 and \$3,450,000, in 2012, 2011 and 2010, respectively. Madison National Life's statutory capital and surplus was \$72,304,000 and \$70,266,000 as of December 31, 2012 and 2011, respectively. For the years ended December 31, 2012, 2011 and 2010, Madison National Life's statutory net income was \$11,903,000, \$15,080,000 and \$12,820,000, respectively.

The payment of dividends by Standard Security Life to its parent, a subsidiary of IHC, is subject to the prior notification to the New York State Insurance Department if such dividends, together with other dividends in such calendar year exceed the lesser of (i) 10% of surplus as regards policyholders as of the immediately preceding calendar year and (ii) net gain from operations for the immediately preceding calendar year, not including realized capital gains. Such dividends may be paid so long as they have not been disapproved by the New York State Department of Insurance within 30 days of its receipt of notice thereof. Standard Security Life declared and paid dividends to its parent of \$7,980,000, \$4,950,000 and \$8,500,000 in 2012, 2011 and 2010, respectively. Standard Security Life's statutory capital and surplus was \$116,282,000 and \$106,481,000 as of December 31, 2012 and 2011, respectively.

For the years ended December 31, 2012, 2011 and 2010, Standard Security Life's statutory net income was \$15,805,000, \$7,709,000 and \$3,267,000, respectively.

Dividends from Independence American to its parent, a subsidiary of AMIC, are subject to the prior notification to the Delaware Insurance Commissioner, if such dividends, together with the fair market value of other dividends or distributions made within the preceding twelve months, exceed the greater of (i) 10% of surplus as regards policyholders as of the preceding December 31 or (ii) net income, not including realized capital gains, for the twelve-month period ending the December 31 next preceding. Such dividends may be paid as long as they have not been disapproved by the Delaware Insurance Commissioner within 30 days of its receipt of notice thereof. Independence American paid dividends of \$2,000,000, \$1,000,000 and \$1,500,000 in 2012, 2011 and 2010, respectively. Independence American's statutory surplus was \$54,427,000 and \$51,407,000 as of December 31, 2012 and 2011, respectively, and statutory net income was \$3,271,000, \$4,542,000 and \$2,697,000 for 2012, 2011 and 2010, respectively.

The insurance subsidiaries are required to maintain certain minimum amounts of statutory surplus to satisfy their various state insurance departments of domicile. Risk-based capital ( RBC ) requirements are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholders. At December 31, 2012 and 2011, the statutory capital of our insurance subsidiaries is significantly in excess of regulatory RBC requirements.

Under Delaware law, IHC is permitted to pay dividends from surplus or net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. Dividends to shareholders are paid from funds available at the corporate holding company level. In 2012, IHC increased its annual dividend from \$.045 to \$.07 per share. In February 2012, IHC announced a special 10% stock dividend payable to shareholders. See Note 15 for more information regarding the stock dividend. IHC declared cash dividends of \$1,271,000 in 2012, \$807,000 in 2011 and \$762,000 in 2010.

**Note 23.**

**Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss) include (i) 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 the non-credit related component of other-than-temporary impairments of fixed maturities and (ii) the after-tax unrealized gains and losses on certain derivative instruments.



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Changes in the balances for each component of accumulated other comprehensive income, shown net of taxes, for the years ended December 31, 2012, 2011 and 2010 were as follows (in thousands):

	2012	2011	2010
<b>Unrealized Gains and Losses Available-for Sale:</b>			
Beginning balance	\$ 8,150	\$ 633	\$ (7,104)
Unrealized gains (losses) on investments	13,519	15,737	14,608
Other-than-temporary impairments recognized in other comprehensive income	(247)	(618)	-
Adjustments to DAC (Refer to Note 1G)	(2,930)	(2,453)	(3,042)
Unrealized gains (losses) on investments arising during the year before reclassifications	10,342	12,666	11,566
Amounts reclassified from accumulated other comprehensive income	(3,146)	(4,926)	(3,585)
Other comprehensive income	7,196	7,740	7,981
Less: Other comprehensive income attributable to noncontrolling interests	(118)	(343)	(244)
Purchases of noncontrolling interests	3	120	-
Ending balance	\$ 15,231	\$ 8,150	\$ 633
<b>Derivative instruments:</b>			
Beginning balance	\$ (297)	\$ -	\$ -
Other comprehensive income before reclassifications	79	(297)	-
Amounts reclassified from accumulated other comprehensive income	-	-	-
Other comprehensive income	79	(297)	-
Ending balance	\$ (218)	\$ (297)	\$ -
<b>Total accumulated other comprehensive income</b>	<b>\$ 15,013</b>	<b>\$ 7,853</b>	<b>\$ 633</b>



Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Amounts reclassified from other comprehensive income to earnings for the years ended December 31, 2012, 2011 and 2010, and the related tax effects, were as follows (in thousands):

	<b>Before Tax</b>	<b>Tax Effect</b>	<b>Net of Tax</b>
<b><u>2012:</u></b>			
Unrealized gains on available-for-sale securities arising during the year	\$ 15,475	\$ (5,133)	\$ 10,342
Reclassification adjustments to income statement line items:			
Net realized investment gains	(5,352)	1,684	(3,668)
Net impairment losses recognized in earnings	704	(182)	522
Net unrealized gains on available-for-sale securities	10,827	(3,631)	7,196
Net unrealized gains (losses) on derivative instruments	131	(52)	79
Other comprehensive income	\$ 10,958	\$ (3,683)	\$ 7,275
<b><u>2011:</u></b>			
Unrealized gains on available-for-sale securities arising during the year	\$ 18,783	\$ (6,117)	\$ 12,666
Reclassification adjustments to income statement line items:			
Net realized investment gains	(8,961)	3,026	(5,935)
Net impairment losses recognized in earnings	1,523	(514)	1,009
Net unrealized gains on available-for-sale securities	11,345	(3,605)	7,740
Net unrealized gains (losses) on derivative instruments	(494)	197	(297)
Other comprehensive income	\$ 10,851	\$ (3,408)	\$ 7,443
<b><u>2010:</u></b>			
Unrealized gains on available-for-sale securities arising during the year	\$ 17,964	\$ (6,398)	\$ 11,566
Reclassification adjustments to income statement line items:			
Net realized investment gains	(9,474)	3,433	(6,041)
Net impairment losses recognized in earnings	3,819	(1,363)	2,456
Net unrealized gains on available-for-sale securities	12,309	(4,328)	7,981
Net unrealized gains (losses) on derivative instruments	-	-	-
Other comprehensive income	\$ 12,309	\$ (4,328)	\$ 7,981



**Note 24.****Quarterly Data (Unaudited)**

The quarterly results of operations for the years ended December 31, 2012 and 2011 are summarized below (in thousands, except per share data):

	<b>FIRST QUARTER</b>	<b>SECOND QUARTER</b>	<b>THIRD QUARTER</b>	<b>FOURTH QUARTER</b>
<b><u>2012</u></b>				
<b>Total revenues</b>	\$ 102,156	\$ 101,443	\$ 111,502	\$ 112,960
Net income	\$ 4,330	\$ 3,830	\$ 4,390	\$ 10,061
Less income from noncontrolling interests in subsidiaries	(408)	(299)	(472)	(1,771)
Net income attributable to IHC	\$ 3,922	\$ 3,531	\$ 3,918	\$ 8,290
<b>Basic income per common share</b>	\$ .22	\$ .20	\$ .22	\$ .46
<b>Diluted income per share</b>	\$ .22	\$ .20	\$ .22	\$ .46
	<b>FIRST QUARTER</b>	<b>SECOND QUARTER</b>	<b>THIRD QUARTER</b>	<b>FOURTH QUARTER</b>
<b><u>2011</u></b>				
<b>Total revenues</b>	\$ 104,319	\$ 105,525	\$ 103,659	\$ 104,493
Net income	\$ 3,800	\$ 3,464	\$ 4,011	\$ 3,491
Less income from noncontrolling interests in subsidiaries	(616)	(424)	(457)	(266)
Net income attributable to IHC	\$ 3,184	\$ 3,040	\$ 3,554	\$ 3,225
<b>Basic income per common share</b>	\$ .19	\$ .17	\$ .20	\$ .18



<b>Diluted income per share</b>	\$	.19	\$	.17	\$	.20	\$	.18
---------------------------------	----	-----	----	-----	----	-----	----	-----

## SCHEDULE I

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**SUMMARY OF INVESTMENTS OTHER THAN INVESTMENTS IN RELATED PARTIES**  
**DECEMBER 31, 2012**  
(In thousands)

TYPE OF INVESTMENT	COST	VALUE	AMOUNT SHOWN IN BALANCE SHEET
<b>FIXED MATURITIES , AVAILABLE-FOR-SALE:</b>			
Bonds:			
United States Government and Government agencies and authorities	\$ 67,371	\$ 68,900	\$ 68,900
States, municipalities and political subdivisions	260,086	268,225	268,225
Foreign governments	21,888	21,968	21,968
Public utilities	51,244	51,668	51,668
All other corporate bonds	284,365	300,851	300,851
Redeemable preferred stock	6,323	7,990	7,990
<b>TOTAL FIXED MATURITIES</b>	<b>691,277</b>	<b>719,602</b>	<b>719,602</b>
<b>EQUITY SECURITIES , AVAILABLE-FOR-SALE AND TRADING:</b>			
Common stocks:			
Public utilities	722	715	715
Banks, trust and insurance companies	215	216	216
Industrial, miscellaneous and all other	5,967	6,085	6,085
Non-redeemable preferred stocks	15,355	15,598	15,598
<b>TOTAL EQUITY SECURITIES</b>	<b>22,259</b>	<b>22,614</b>	<b>22,614</b>
Policy loans	22,165	22,165	22,165
Short-term investments and resale agreements	34,006	34,006	34,006
Other long-term investments	12,969	12,969	12,969
<b>TOTAL INVESTMENTS</b>	<b>\$ 782,676</b>	<b>\$ 811,356</b>	<b>\$ 811,356</b>



## SCHEDULE II

**INDEPENDENCE HOLDING COMPANY**  
**CONDENSED BALANCE SHEETS (In thousands, except share data)**  
**(PARENT COMPANY ONLY)**

	DECEMBER 31,	
	2012	2011
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 589	\$ 3,098
Fixed maturities, available-for-sale	5,667	-
Other investments	1,146	4,298
Investments in consolidated subsidiaries	365,235	331,784
Taxes receivable	17,356	16,233
Goodwill	228	228
Other assets	426	56
<b>TOTAL ASSETS</b>	<b>\$ 390,647</b>	<b>\$ 355,697</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Accounts payable and other liabilities	\$ 6,692	\$ 4,586
Amounts due to consolidated subsidiaries, net	36,155	28,813
Income taxes payable	6,807	7,597
Junior subordinated debt securities	38,146	38,146
Dividends payable	-	411
<b>TOTAL LIABILITIES</b>	<b>87,800</b>	<b>79,553</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock (none issued)	-	-
Common stock <sup>(A)</sup>	18,462	18,451
Paid-in capital	126,589	126,298
Accumulated other comprehensive income	15,013	7,853
Treasury stock, at cost <sup>(B)</sup>	(4,533)	(3,277)
Retained earnings	130,153	111,752
<b>TOTAL IHC S STOCKHOLDERS' EQUITY</b>	<b>285,684</b>	<b>261,077</b>
<b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>	<b>17,163</b>	<b>15,067</b>
<b>TOTAL EQUITY</b>	<b>302,847</b>	<b>276,144</b>

<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	\$ 390,647	\$ 355,697
---	------------	------------

(A)

Common stock \$1 par value, 23,000,000 and 20,000,000 shares authorized, respectively; 18,461,992 and 18,450,917 shares issued, respectively, 17,932,954 and 18,052,660 shares outstanding, respectively.

(B)

Treasury stock, at cost; 529,038 and 398,257 shares, respectively, outstanding.

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes.

**SCHEDULE II**  
**(Continued)**

**INDEPENDENCE HOLDING COMPANY**  
**CONDENSED STATEMENTS OF OPERATIONS (In thousands)**  
**(PARENT COMPANY ONLY)**

	2012	2011	2010
<b>REVENUES:</b>			
Net investment income	\$ 491	\$ 929	\$ 746
Net realized investment gains	2	23	62
Other income	2,251	3,138	3,142
	2,744	4,090	3,950
<b>EXPENSES:</b>			
Interest expense on debt	1,638	1,575	1,589
General and administrative expenses	5,125	4,088	3,805
	6,763	5,663	5,394
Loss before tax benefit	(4,019)	(1,573)	(1,444)
Income tax benefit	(1,528)	(563)	(559)
Loss before equity in net income of subsidiaries	(2,491)	(1,010)	(885)
Equity in net income of subsidiaries	25,102	15,776	24,554
<b>Income from continuing operations</b>	<b>22,611</b>	<b>14,766</b>	<b>23,669</b>
<b>Discontinued operations:</b>			
Loss from discontinued operations	-	-	(256)
<b>Net income</b>	<b>22,611</b>	<b>14,766</b>	<b>23,413</b>
Less income from noncontrolling interests in subsidiaries	(2,950)	(1,763)	(1,676)
Net income attributable to IHC	\$ 19,661	\$ 13,003	\$ 21,737

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes thereto.





**SCHEDULE II**  
**(Continued)**

**INDEPENDENCE HOLDING COMPANY**  
**CONDENSED STATEMENTS OF CASH FLOWS (In thousands)**  
**(PARENT COMPANY ONLY)**

	2012	2011	2010
<b>CASH FLOWS PROVIDED BY (USED BY)</b>			
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 22,611	\$ 14,766	\$ 23,413
Adjustments to net income:			
Equity in net income of subsidiaries	(25,102)	(15,776)	(24,554)
Loss from discontinued operations	-	-	256
Other	604	(1,470)	(640)
Changes in other assets and liabilities	(439)	1,828	368
Net change in cash from operating activities	(2,326)	(652)	(1,157)
<b>CASH FLOWS PROVIDED BY (USED BY)</b>			
<b>INVESTING ACTIVITIES:</b>			
Decrease in investments in and advances to consolidated subsidiaries	5,109	2,264	1,762
Purchases of fixed maturities	(11,781)	(497)	(2,567)
Sales of fixed maturities	6,109	1,271	5,377
Net distributions from (additions to) other investments	3,152	2,025	(659)
Other investing activities	-	-	(199)
Net change in cash from investing activities	2,589	5,063	3,714
<b>CASH FLOWS PROVIDED BY (USED BY)</b>			
<b>FINANCING ACTIVITIES:</b>			
Repurchases of common stock	(941)	(911)	(1,591)
Cash paid in acquisitions of noncontrolling interests	(58)	(62)	-
Excess tax benefits from exercises of common stock options and vesting of restricted stock	(94)	(164)	(51)
Dividends paid	(1,681)	(777)	(767)
Other financing activities	2	-	-

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Net change in cash from financing activities	(2,772)	(1,914)	(2,409)
Net change in cash and cash equivalents	(2,509)	2,497	148
Cash and cash equivalents, beginning of year	3,098	601	453
Cash and cash equivalents, end of year	\$ 589	\$ 3,098	\$ 601

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

**INDEPENDENCE HOLDING COMPANY**  
**SUPPLEMENTARY INSURANCE INFORMATION**  
(in thousands)

	<b>DEFERRED ACQUISITION COSTS</b>	<b>FUTURE POLICY BENEFITS, UNEARNED LOSSES &amp; CLAIMS</b>	<b>NET PREMIUMS (3)</b>	<b>NET PREMIUMS EARNED</b>	<b>NET INVESTMENT INCOME (1)</b>	<b>INSURANCE BENEFITS, CLAIMS &amp; RESERVES</b>	<b>AMORTIZATION OF DEFERRED ACQUISITION COSTS</b>	<b>AT</b>
<b>December 31, 2012</b>								
Medical Stop-Loss Fully Insured Health Group disability; life, annuities and DBL Individual life, annuities and other Corporate	\$ - 48 - 33,353 -	59,029 41,034 - 535,899 -	- 6,897 1,347 209 -	139,724 141,546 49,315 25,482 -	4,990 1,733 2,618 23,475 540	90,406 94,700 27,663 32,022 -	-	-
	\$ 33,401	762,802	8,453	356,067	33,356	244,791	6,549	6,566
<b>December 31, 2011</b>								
Medical Stop-Loss Fully Insured Health Group disability; life, annuities and DBL Individual life, annuities	\$ - 65 -	58,741 32,508 265,595	- 1,471 2,565	114,478 141,322 50,698	4,399 1,429 9,495	75,490 89,040 37,946	-	21
							5,099	

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

and other Corporate	37,036	545,037	283	29,916	23,492	36,386	6,449
	-	-	-	-	973	-	-
\$	37,101	901,881	4,319	336,414	39,788	238,862	11,569
<b>December 31, 2010</b>							
Medical \$	-	64,339	-	121,156	4,080	89,968	-
Stop-Loss Fully Insured Health Group disability; life, annuities and DBL Individual life, annuities and other Corporate	87	34,540	1,452	120,818	1,454	81,676	28
	4,015	249,937	2,336	55,828	9,668	41,440	497
	39,363	547,527	255	28,344	25,839	38,234	5,718
	-	-	-	-	760	-	-
\$	43,465	896,343	4,043	326,146	41,801	251,318	6,243

(1)

Net investment income is allocated between product lines based on the mean reserve method.

(2)

Where possible, direct operating expenses are specifically identified and charged to product lines. Indirect expenses are allocated based on time studies; however, other acceptable methods of allocation might produce different results.

**EXHIBIT INDEX**

**Exhibit Number**

3.1

Restated Certificate of Incorporation of Independence Holding Company (Filed as Exhibit 3(i) to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1996 and incorporated herein by reference).

3.2

Certificate of Amendment of Restated Certificate of Incorporation of Independence Holding Company (Filed as Exhibit 3.1 to our Current Report on Form 8-K filed with the SEC on July 29, 2004 and incorporated herein by reference).

3.3

By-Laws of Independence Holding Company (Filed as Exhibit 3.3 to our Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference).

10.3

Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, Standard Security Life Insurance Company of New York and Mr. David T. Kettig (Filed as Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).

10.4

Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, Madison National Life Insurance Company, Inc. and Mr. Larry R. Graber (Filed as Exhibit 10.2 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).

10.5

Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, IHC Health Solutions, Inc. and Mr. Jeffrey C. Smedsrud made as of April 18, 2011 (Filed as Exhibit 10.3 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).

10.6

Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, Actuarial Management Corporation and Mr. Bernon R. Erickson, Jr. (Filed as Exhibit 10.4 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).

10.7

Edgar Filing: INDEPENDENCE HOLDING CO - Form 10-K

Officer Employment Agreement, made as of April 18, 2011, by and between Independence Holding Company and Ms. Teresa A. Herbert (Filed as Exhibit 10.5 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).

10.8

Officer Employment Agreement, made as of May 11, 2011, by and between Independence Holding Company and Mr. Roy T.K. Thung (Filed as Exhibit 10.1 to our Quarterly Report on Form 10-Q for the period ended March 31, 2011 that was filed with the SEC on May 12, 2011, and incorporated herein by reference).

10.9

Amended and Restated Officer Employment Agreement, by and among Independence Holding Company, IHC Specialty Benefits, Inc. and Mr. Jeffrey C. Smedsrud, dated as of May 22, 2012 (Filed as Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on May 29, 2012, and incorporated herein by reference).

10.10

Amended and Restated Officer Employment Agreement, by and among Independence Holding Company, Actuarial Management Corporation and Mr. Bernon R. Erickson, Jr., dated as of May 22, 2012 (Filed as Exhibit 10.2 to our Current Report on Form 8-K filed with the SEC on May 29, 2012, and incorporated herein by reference).

10.11 Officer Employment Agreement, by and among Independence Holding Company, IHC Risk Solutions, LLC and Mr. Michael A. Kemp, dated as of May 22, 2012 (Filed as Exhibit 10.3 to our Current Report on Form 8-K filed with the SEC on May 29, 2012, and incorporated herein by reference).

21

Subsidiaries of Independence Holding Company, as of December 31, 2012.\*

23

Consent of Independent Registered Public Accounting Firm.\*

31.1

Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

31.2

Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

32.1

Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

32.2

Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002.\*

101.INS

XBRL Instance Document.

101.SCH

XBRL Taxonomy Extension Schema Document.



101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document.

101.LAB

XBRL Taxonomy Extension Label Linkbase Document.

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document.

101.DEF

XBRL Taxonomy Extension Definition Linkbase Document.

\*Filed herewith.