

INDEPENDENCE HOLDING CO  
Form 10-Q  
November 09, 2010

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

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**FORM 10-Q**

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

For the quarterly period ended **September 30, 2010**.

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

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

Commission File Number: **0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**

**58-1407235**

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(State or other jurisdiction of  
incorporation or organization)

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

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

**06902**

(Address of principal executive offices)

(Zip Code)

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

**NOT APPLICABLE**

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

**Class**

**Outstanding at November 9, 2010**

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

**15,232,865 Shares**

**INDEPENDENCE HOLDING COMPANY**

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

### Forward-Looking Statements

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

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

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

**PART I - FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

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

**September 30, 2010**

**December 31, 2009**

**(Unaudited)**

**ASSETS:**

Investments:

Short-term investments

\$

53

\$

52

Securities purchased  
under agreements to  
resell

34,060

42,708

Fixed maturities,  
available-for-sale

803,239

689,863

Equity securities,  
available-for-sale

53,858

60,815

Other investments

36,233

37,643

Total investments

927,443

831,081

Cash and cash  
equivalents

9,617

7,394

Due from securities  
brokers

17,629

5,579

Investment in American  
Independence Corp.  
("AMIC")

-

19,234

Deferred acquisition  
costs

38,647

44,244



Due and unpaid  
premiums

47,873

48,731

Due from reinsurers

166,360

184,583

Premium and claim  
funds

44,307

43,663

Notes and other  
receivables

18,092

13,528

Goodwill

51,713

48,859

Other assets

59,399

57,580

**TOTAL ASSETS**

\$

1,381,080

\$

1,304,476

**LIABILITIES AND  
EQUITY:**

**LIABILITIES:**

Insurance  
reserves-health

\$

184,374

\$

184,146

Insurance reserves-life  
and annuity

274,272

270,987

Funds on deposit

408,054

408,298

Unearned premiums

8,869

13,217

Policy claims-health

18,558

18,655

Policy claims-life

11,364

11,392

Other policyholders'  
funds

19,456

20,517

Due to securities  
brokers

30,679

8,187

Due to reinsurers

34,619

45,516

Accounts payable,  
accruals and other  
liabilities

73,210

71,362

Liabilities related to  
discontinued operations

910

1,546

Debt

7,500

9,000

Junior subordinated  
debt securities

38,146

38,146

**TOTAL  
LIABILITIES**

1,110,011



1,100,969

**EQUITY:**

**IHC  
STOCKHOLDERS'  
EQUITY:**

Preferred stock (none  
issued)

-

-

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

15,472,000 and  
15,459,720 shares  
issued;

15,232,865 and  
15,426,965 shares  
outstanding

15,472

15,460

Paid-in capital

100,901

100,447

Accumulated other  
comprehensive income  
(loss)

10,095

(7,104)

Treasury stock, at cost  
239,155 and 32,755  
shares

(1,917)

(326)

Retained earnings

116,234

94,490

**TOTAL IHC  
STOCKHOLDERS  
EQUITY**

240,785

202,967

**NONCONTROLLING  
INTERESTS IN  
SUBSIDIARIES**

30,284

540

**TOTAL EQUITY**

271,069

203,507

**TOTAL  
LIABILITIES AND  
EQUITY**

\$

1,381,080

\$

1,304,476

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



**INDEPENDENCE  
HOLDING  
COMPANY AND  
SUBSIDIARIES**

**CONDENSED  
CONSOLIDATED  
STATEMENTS OF  
OPERATIONS**

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

**Three Months  
Ended**

**Nine Months Ended**

**September 30,**

**September 30,**

**2010**

**2009**



**2010**

**2009**

**REVENUES:**

Premiums earned:

Health

\$

74,071

33

\$  
62,527  
\$  
211,735  
\$  
197,452

Life and annuity

9,188  
9,215  
27,022  
27,804

Net investment  
income

11,136  
11,303  
30,638

33,450

Fee income

8,102

6,614

25,343

22,943

Net realized  
investment gains

4,030

553

6,013

3,480

Other-than-temporary  
impairment losses

(132)

	-
	(2,797)
	(271)
Equity income from AMIC	
	-
	76
	280
	1,004
Gain on bargain purchase of AMIC	
	-
	-
	27,830

-

Other income

1,480

2,224

4,592

5,428

107,875

92,512

330,656

291,290

**EXPENSES:**

Insurance benefits,  
claims and reserves:

Health

48,494

45,636

145,309

137,876

Life and annuity

12,826

9,831

37,518

34,210

Selling, general and  
administrative  
expenses

37,182

33,250

105,007

104,719

Amortization of  
deferred acquisitions  
costs

1,678

1,001

4,716

3,351

Interest expense on  
debt

499

701

1,447

2,232

100,679

90,419

293,997

282,388

Income from  
continuing operations

40



before income taxes

7,196

2,093

36,659

8,902

Income taxes

2,145

212

41

12,913

1,709

**Income from  
continuing  
operations**

5,051

1,881

23,746

7,193

**Discontinued  
operations:**

Income (loss) from  
discontinued  
operations, net of tax

(21)

49

43

(203)

(305)

**Net income**

5,030

1,930

23,543

6,888

(Income) loss from  
noncontrolling  
interests in  
subsidiaries

(610)

(5)

(1,391)

15

**NET INCOME  
ATTRIBUTABLE  
TO IHC**

\$  
4,420  
\$  
1,925  
\$  
22,152  
\$  
6,903

**Basic income per  
common share:**

Income from  
continuing operations

\$

.29

\$

.12

\$

1.46

\$

.47

Loss from  
discontinued  
operations

-

-

47

(.01)

(.02)

Basic income per  
common share

\$

.29

\$

.12

\$

1.45

\$

.45

**WEIGHTED  
AVERAGE  
SHARES  
OUTSTANDING**



15,233

15,423

15,279

15,417

**Diluted income per  
common share:**

Income from  
continuing operations

\$

.29

\$

.12

\$

1.46

\$

.47

Loss from  
discontinued  
operations

-

-

(.01)

(.02)

Diluted income per  
common share

\$

50

.29

\$

.12

\$

1.45

\$

.45

**WEIGHTED  
AVERAGE  
DILUTED  
SHARES  
OUTSTANDING**

15,233

15,429

15,282

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

**INDEPENDENCE  
HOLDING  
COMPANY AND  
SUBSIDIARIES**

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

**NINE MONTHS  
ENDED  
SEPTEMBER 30,  
2010 (In thousands)**

**ACCUMULATED**

**NON-**

**OTHER**

**TREASURY**

**TOTAL IHC**

**CONTROLLING**

**COMMON**

**PAID-IN**

**COMPREHENSIVE**

**STOCK,**

**RETAINED**

**STOCKHOLDERS'**

**INTERESTS IN**

**TOTAL**

**STOCK**

**CAPITAL**

**INCOME (LOSS)**

**AT COST**



**EARNINGS**

**EQUITY**

**SUBSIDIARIES**

**EQUITY**

**BALANCE AT**

**DECEMBER 31,  
2009**

\$

15,460

\$

100,447

\$

(7,104)

\$

58

(326)

\$

94,490

\$

202,967

\$

540

\$

203,507

Net income

22,152

22,152

1,391

23,543

Net change in  
unrealized

gains (losses)

17,199

17,199

-

17,199

Total comprehensive

income

39,351

1,391

40,742

Repurchase of  
common stock

(1,591)

(1,591)

-

(1,591)

Acquisition of  
MedWatch



-

480

480

Acquisition of HBA

-

480

65

480

Acquisition of  
American

Independence Corp.

(4)

66

(4)

26,960

26,956

Common Stock  
dividend

(\$0.025 Per share)

(381)

(381)

-

(381)

Share-based  
compensation

expenses and related

tax benefits

12

417

429

-

429

Other capital  
transactions

70

41

(27)

14

433

447

**BALANCE AT**



**SEPTEMBER 30,  
2010**

\$  
15,472  
\$  
100,901  
\$  
10,095  
\$  
(1,917)  
\$  
116,234  
\$  
240,785  
\$  
30,284  
\$  
271,069



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



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

**(In thousands) (Unaudited)**

**Nine Months Ended  
September 30,**

**2010**

**2009**

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

Net income

\$

23,543

\$

6,888

Adjustments to  
reconcile net income  
to net change in cash  
from

operating activities:

Gain on bargain  
purchase of AMIC

(27,830)

Loss from  
discontinued  
operations

203

305

Amortization of  
deferred acquisition  
costs

4,716

3,351

Net realized  
investment gains

(6,013)

(3,480)

Other-than-temporary  
impairment losses

2,797

271

Equity income from  
AMIC and other  
equity method  
investments

(927)

(1,696)

Depreciation and  
amortization

3,609

4,028

Share-based  
compensation  
expenses



	574
	404
Deferred tax expense	
	14,730
	1,811
Other	
	1,408
	414
Changes in assets and liabilities:	

Net purchases of  
trading securities

(1,355)

-

Change in insurance  
liabilities

(27,244)

(18,879)

Additions to deferred  
acquisition costs, net

(4,952)

(1,368)

Change in net  
amounts due from  
and to reinsurers

15,934

(40,777)

Change in premium  
and claim funds

3,702

13,255

Change in income tax  
liability

(3,175)

(40)

Change in due and  
unpaid premiums

10,655

3,040

Change in other  
assets

79

3,504

Change in other  
liabilities

(9,732)

(955)

Net change in cash  
from operating  
activities of  
continuing operations

722

(29,924)

84

Net change in cash  
from operating  
activities of  
discontinued  
operations

(975)

(2,120)

Net change in cash  
from operating  
activities

(253)

(32,044)

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

Change in net  
amount due from and  
to securities brokers

10,093

16,601

Net sales of securities  
under resale and  
repurchase  
agreements

9,951

37,155

Sales of equity  
securities

49,295

13,672

Purchases of equity securities

(37,719)

-

Sales of fixed maturities

535,848

342,316

Maturities and other repayments of fixed maturities

96,178

87,641

Purchases of fixed  
maturities

(657,028)

(462,797)

Additional  
investments in other  
investments, net of  
distributions

2,070

(331)

Cash acquired in  
acquisition of AMIC,  
net of cash paid

4,562

-



Cash paid in  
acquisitions of  
companies, net of  
cash acquired

(3,469)

(775)

Cash paid in  
acquisition of policy  
blocks

(2,791)

-

Change in notes and  
other receivables

844

1,803

Other

(1,581)

(1,540)

Net change in cash  
from investing  
activities

6,253

33,745

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

Proceeds from  
issuance of common  
stock

-

1

Repayment of  
long-term debt

(1,500)

(1,000)

Repurchases of  
common stock

(1,591)

-

Excess tax expense  
from expired stock  
options and vesting

of restricted stock

(22)

(422)

Proceeds of  
investment-type  
insurance contracts

118

1,176

Dividends paid

(767)

(772)

Other capital  
transactions

(15)

92

-

Net change in cash  
from financing  
activities

(3,777)

(1,017)

Net change in cash  
and cash equivalents

2,223

684

Cash and cash  
equivalents,  
beginning of year

7,394

7,767

Cash and cash  
equivalents, end of  
period

\$

9,617

\$

8,451

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

**Significant Accounting Policies and Practices**

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); (ii) its majority owned insurance company, Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Administrative Services, Inc., managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ), and Actuarial Management Corporation ( AMC ). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a 50.1% interest in American Independence Corp. (AMIC).

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 54% of IHC's outstanding common stock at September 30, 2010.

**(B)**

**Basis of Presentation**

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

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

IHC acquired a controlling interest in AMIC on March 5, 2010. Prior to obtaining control, IHC recorded its investment in AMIC using the equity method. IHC recorded changes in its investment in AMIC in the Equity income from AMIC line in the Condensed Consolidated Statements of Operations. Upon achieving control, on March 5, 2010, AMIC's income and expense amounts became consolidated with IHC's results. The Condensed Consolidated Balance Sheet at September 30, 2010 includes the consolidated balance sheet of AMIC.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the results to be anticipated for the entire year.



(C)

## **Recent Accounting Pronouncements**

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

In January 2010, the Financial Accounting Standards Board ( FASB ) issued standards requiring new disclosures regarding (i) transfers in and out of Level 1 and Level 2 fair value measurements and (ii) activity in Level 3 fair value measurements. This guidance also clarifies existing disclosures regarding (i) the level of asset and liability disaggregation and (ii) fair value measurement inputs and valuation techniques. The guidance is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to provide Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010; early adoption is permitted. The adoption of this guidance, effective January 1, 2010, did not have a material effect on the Company's consolidated financial statements.

In September 2009, the FASB issued standards which among other things, amends former guidance on the consolidation of variable interest entities. The standards (i) require an entity to perform an analysis to determine whether an entity's variable interest or interests give it a controlling financial interest in a variable interest entity; (ii) require ongoing reassessments of whether an entity is the primary beneficiary of a variable interest entity and eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; (iii) amend previous guidance for determining whether an entity is a variable interest entity; and (iv) require enhanced disclosure that will provide users of financial statements with more transparent information about an entity's involvement in a variable interest entity. In December 2009, these standards were added to the Accounting Standards Codification ( Codification ). The adoption of this guidance, effective January 1, 2010, did not have a material effect on the Company's consolidated financial statements.

In September 2009, the FASB issued standards to revise previous authoritative guidance related to accounting for transfers of financial assets, and will require more disclosures about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. In December 2009, these standards were added to the Codification. Among other things, the guidance eliminates the concept of a "qualifying special-purpose entity", changes the requirements for derecognizing financial assets and enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and an entity's continuing involvement in transferred financial assets. The guidance was effective for the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter with earlier application prohibited. The recognition and measurement provisions shall be applied to transfers that occur on or after the effective date. The adoption of this guidance, effective January 1, 2010, did not have a material effect on the Company's consolidated financial statements.

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

In April 2010, the FASB issued guidance on the accounting effect, if any, that arises from the different signing dates between the Health Care and Education Reconciliation Act of 2010, which is a reconciliation bill that amends the Patient Protection and Affordable Care Act. This guidance is applicable for registrants with a period end that falls between the signing dates for which the timing difference could have an accounting impact. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

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

(D)

**Reclassifications**

Certain amounts in prior years' Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2010 presentation.

(E)

**Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company has evaluated all such events occurring subsequent to the balance sheet date herein of September 30, 2010. The effects of all subsequent events that provided additional evidence about conditions that existed at the date of the balance sheet, including estimates, if any, have been recognized in the accompanying Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Operations as of and for the three-month and nine-month periods ended September 30, 2010. The Company did not recognize subsequent events that provided evidence about conditions that arose after the balance sheet date.

**Note 2.**

**American Independence Corp.**

AMIC is an insurance holding company engaged in the insurance and reinsurance business. AMIC does business with the Insurance Group, including reinsurance treaties under which, in 2009, Standard Security Life and Madison National Life ceded to Independence American an average of 23% of their medical stop-loss business, 9% of a majority of their fully insured health business and 20% of their New York Statutory Disability business.

In March 2010, IHC acquired a controlling interest in AMIC as a result of the purchase of AMIC common stock in the open market. The principal reasons for acquiring control were: (i) the low market price of the AMIC stock; (ii) the improved financial presentation for IHC resulting from the consolidation of financial reporting; and (iii) a closer relationship that will create greater long-term value for both companies. The acquisition furthers IHC's goal of creating efficiencies by integrating the back office operations of our MGUs and marketing companies. Share purchases of 27,668 shares, or \$141,000, through March 5, 2010 (the "Acquisition Date"), totaling 0.33% of voting equity interest, brought the total of AMIC shares owned by the Company to more than 50% of AMIC's outstanding

common stock and as a result, IHC has included AMIC's consolidated assets and liabilities and results of operations subsequent to the Acquisition Date in its condensed consolidated financial results as of and for the period ended September 30, 2010. At December 31, 2009, 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. In the fourth quarter of 2009, under the equity method of accounting, due to the length of time, and the magnitude of the amount by which the quoted market price of AMIC had been below IHC's carrying value, the Company recorded an other-than-temporary impairment loss of \$29,198,000 on its investment in AMIC. At December 31, 2009, the carrying value of IHC's investment in AMIC was \$19,234,000.

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

than the fair value of the net assets of AMIC. This disparity is due to the low trading volume in AMIC shares, and a discount on the shares traded due to a lack of control by minority shareholders. The fair value of the noncontrolling interests in AMIC was based on the closing market price of AMIC's common stock on the Acquisition Date.

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

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

Investments

\$

58,418

Cash and cash  
equivalents

4,761

Identifiable  
intangible assets

12,200

Deferred tax  
assets, net

10,654

Other assets

31,127

Total  
identifiable  
assets

117,160

Insurance  
liabilities

27,671

Other liabilities

19,023

Total liabilities

46,694

Net identifiable  
assets acquired

70,466

Purchase  
consideration

(71)

Fair value of  
equity  
investment prior  
to the  
acquisition

(22,013)

Noncontrolling  
interests in  
AMIC

(22,065)

Elimination of  
the fair value  
adjustment  
related to  
AMIC s

investment in  
Majestic



(688)

Gain on bargain  
purchase

25,629

Gain on fair  
value of equity  
investment prior  
to the  
acquisition

2,201

Total gain on  
bargain  
purchase of  
AMIC, pretax

27,830

Deferred  
income taxes

11,097

Total gain on  
bargain  
purchase of  
AMIC, after tax

\$

16,733

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

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

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The unaudited pro forma revenues and operating results had the acquisition occurred as of the beginning of each period are presented below. The unaudited pro forma information presented is not indicative of the results of operations in future periods, nor does it necessarily reflect the results of operations that would have resulted had the acquisition been completed as of the beginning of the applicable periods presented.

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**2010**

**2009**

**2010**

**2009**

(in  
thousands)

Revenues

\$

107,875

\$

117,283

\$

316,426

\$

365,239

Net income

\$

5,030

\$

2,437

\$

7,323

\$

8,933

Pro forma adjustments to revenues principally reflect the elimination of intercompany fee income, the elimination of the Company's equity income related to AMIC and, in 2010, the elimination of the gain resulting from the bargain purchase. Pro forma adjustments to net income principally reflect the elimination of the Company's equity income related to AMIC and, in 2010, the elimination of the gain resulting from the bargain purchase.

Subsequent to the Acquisition Date, IHC purchased an additional 9,537 shares of AMIC common stock for a total consideration of \$58,000 through September 30, 2010.

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. During the three months and nine months ended September 30, 2009, IHC recorded \$76,000 and \$1,004,000, respectively, of equity income from its investments in AMIC. These amounts represent IHC's proportionate share of income based on its ownership interests during those periods. AMIC paid no dividends on its common stock during the Stub Period in 2010 or the three-month and nine-month periods ended September 30, 2009.

The following disclosures summarize the effects of certain transactions between IHC and its subsidiaries with AMIC during the Stub Period and other periods prior to the Acquisition Date. 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 and \$327,000 and \$833,000, respectively, for the three months and nine months ended September 30, 2009 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 and \$10,994,000 and \$34,728,000, respectively, for the three months and nine months ended September 30, 2009. Benefits to policyholders on business ceded to AMIC were \$3,020,000 during the Stub Period in 2010 and \$8,461,000 and \$23,115,000, respectively, for the three months and nine months ended September 30, 2009. 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 \$15,422,000 and \$48,271,000, respectively, for the three months and nine months ended September 30, 2009 and IHC recorded net commission expense of \$326,000 during the Stub Period in 2010 and \$624,000 and \$2,032,000, respectively, for the three months and nine months ended September 30, 2009 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.



Included in the Company's Condensed Consolidated Balance Sheet at December 31, 2009 are the following balances arising from transactions in the normal course of business with AMIC and its subsidiaries: Due from reinsurers \$15,453,000; Other assets \$2,632,000; and Other liabilities of \$480,000.

**Note 3.**

**Income Per Common Share**

Income per share calculations are based on income from continuing operations attributable to the common shareholders of IHC for the three months and nine months ended September 30, 2010 and 2009, as shown below (in thousands):

**Three Months  
Ended**

**Nine Months  
Ended**

**September 30,**

**September 30,**

**2010**

**2009**

**2010**

**2009**

Income from  
continuing  
operations

\$

5,051

\$

1,881

\$

23,746

\$

7,193

(Income) loss  
f r o m  
noncontrolling  
interests

in subsidiaries

(610)

(5)

(1,391)

Income from  
continuing  
operations

attributable to  
I H C  
shareholders,  
net of tax

4,441

1,876

22,355

7,208

Income (loss)  
f r o m  
discontinued  
operations, net  
of tax

(21)

49

(203)

(305)

117

Net income  
attributable to  
I H C  
shareholders

\$

4,420

\$

1,925

\$

22,152

\$

6,903

Included in the diluted income per share calculations for the three months and nine months ended September 30, 2010 are zero and 3,000 of incremental shares, respectively, from the assumed exercise of dilutive stock options and the assumed vesting of dilutive restricted stock computed using the treasury stock method. Included in the diluted income per share calculations for the three months and nine months ended September 30, 2009 are 6,000 and 3,000 of incremental shares from assumed exercise of options and vesting of restricted stock using the treasury stock method.

**Note 4.**

**Investments**

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

**September 30, 2010**

**GROSS**

**GROSS**

**AMORTIZED**

**UNREALIZED**

**UNREALIZED**



**FAIR**

**COST**

**GAINS**

**LOSSES**

**VALUE**

**(In thousands)**

**FIXED MATURITIES**

**AVAILABLE-FOR-SALE:**

Corporate securities

\$  
280,360  
\$  
8,093  
\$  
(587)  
\$  
287,866

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

69,936  
6,395  
(3,334)  
72,997  
122

CMOs - commercial

1,447

-

(625)

822

U.S. Government obligations

14,261

701

-

14,962

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

10,680

213

123

-

10,893

GSEs <sup>(3)</sup>

53,977

1,153

(175)

54,955

States and political  
subdivisions

355,818

6,920

(1,994)

360,744

124

Total fixed maturities

\$
786,479
\$
23,475
\$
(6,715)
\$
803,239

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks

\$

8,060

\$

126

398

\$

(103)

\$

8,355

Preferred stock - perpetuals

33,405

1,411

(454)

34,362

Preferred stock - with  
maturities

9,790

1,351

-

11,141

127

Total equity securities

\$
51,255
\$
3,160
\$
(557)
\$
53,858



**December 31, 2009**

**GROSS**

**GROSS**

**AMORTIZED**

**UNREALIZED**

**UNREALIZED**

**FAIR**

**COST**

**GAINS**

**LOSSES**

**VALUE**

**(In thousands)**

**FIXED MATURITIES**

**AVAILABLE-FOR-SALE:**

Corporate securities

\$  
207,554  
\$  
332  
\$  
(7,357)  
\$  
200,529

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

78,889  
3,620  
(8,582)  
73,927

CMOs - commercial

868  
-  
(402)  
131

466

U.S. Government obligations

6,319

44

-

6,363

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

40,156

182

-

40,338

GSEs <sup>(3)</sup>

15,398

132

-

(251)

15,147

States and political  
subdivisions

358,012

3,170

(8,089)

353,093

Total fixed maturities

\$  
707,196  
\$  
7,348  
\$  
(24,681)  
\$  
689,863

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks

\$

3,790

\$

151

\$

(69)

\$

3,872

Preferred stock - perpetuals

32,434

3,509

(215)

35,728

Preferred stock - with  
maturities

20,996

747

(528)

21,215



Total equity securities

\$  
57,220  
\$  
4,407  
\$  
(812)  
\$  
60,815

(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 cost basis of certain preferred stocks with maturities at September 30, 2010 and December 31, 2009 includes an adjustment of \$1,763,000 and \$2,394,000, respectively, related to other-than-temporary impairment losses recorded in accumulated other comprehensive income in prior periods.

Government-sponsored enterprise securities consist of Federal National Mortgage Association mortgage-backed securities and other fixed maturity securities issued by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

The amortized cost and fair value of fixed maturities at September 30, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

**% OF**

**AMORTIZED**

**FAIR**

**TOTAL FAIR**

**COST**

**VALUE**

**VALUE**

**(In thousands)**

Due after one  
year through  
five years

\$

167,842

\$

172,049

21.4%

Due after five  
years through  
ten years

139,925

143,659

17.9%

Due after ten  
years

343,986

349,271

43.5%

651,753

664,979

82.8%

CMO and MBS

15 year

97,607

100,818

12.5%

20 year

10,399

10,351

1.3%

30 year

26,720

27,091

3.4%

\$

786,479

\$

803,239

100.0%

The following tables summarize, for all securities in an unrealized loss position at September 30, 2010 and December 31, 2009, respectively, the aggregate fair value and gross unrealized loss by length of time those securities that have continuously been in an unrealized loss position:

**Less than 12  
Months**

**12 Months or  
Longer**

**Total**



**Fair**

**Unrealized**

**Fair**

**Unrealized**

**Fair**

**Unrealized**

**September 30,  
2010**

**Value**

**Losses**

**Value**

**Losses**

**Value**

**Losses**

**(In thousands)**

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

\$

16,887

\$

219

\$

10,511

\$

368

\$

27,398

\$

587

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

3,187

533

147

24,285

2,801

27,472

3,334

C M O ' s -  
commercial

329

250

493

375

822

148

625

GSEs

27,703

162

1,447

13

29,150

175

States and  
political

subdivisions

92,502

1,689

7,570

305

150

100,072

1,994

Total fixed  
maturities

140,608

2,853

44,306

3,862

184,914

6,715

Common stocks

2,148

103

-

-

2,148

103

Preferred  
stocks-perpetual

15,071

454

-

-

152



15,071

454

T o t a l  
temporarily

i m p a i r e d  
securities

\$

157,827

153

\$

3,410

\$

44,306

\$

3,862

\$

202,133

\$

7,272

**Less than 12  
Months**

**12 Months or  
Longer**

**Total**

**Fair**

**Unrealized**

**Fair**

**Unrealized**

**Fair**

**Unrealized  
December 31,  
2009**

**Value**

**Losses**

**Value**

**Losses**

**Value**

**Losses**

**(In thousands)**

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

\$

122,122

\$

2,287

\$

66,652

\$

5,070

158

	\$
	188,774
	\$
	7,357
C M O s - residential	
	7,937
	990
	35,757
	7,592
	43,694
	8,582
C M O s - commercial	
	-
	159

-

466

402

466

402

GSEs

9,901

186

5,246

65

160



15,147

251

States and  
political

subdivisions

132,180

4,459

52,196

3,630

184,376

8,089

**Total fixed  
maturities**

272,140

7,922

160,317

162

16,759

432,457

24,681

Common stocks

1,861

69

-

-

1,861

69

Preferred  
stocks-perpetual

163

416

8

8,060

207

8,476

215

Preferred stocks-  
with

maturities

-

-

8,692

528

8,692

528

165

T o t a l  
temporarily

i m p a i r e d  
securities

\$

274,417

\$

7,999

\$  
177,069

\$  
17,494

\$  
451,486

\$  
25,493

At September 30, 2010 and December 31, 2009, a total of 39 and 75 fixed maturities, respectively, and 12 and 13 equity securities, respectively, were in a continuous unrealized loss position for less than 12 months. At September 30, 2010 and December 31, 2009 a total of 24 and 56 fixed maturities, respectively, had continuous unrealized losses for 12 months or longer. At December 31, 2009, a total of 5 equity securities had continuous unrealized losses for 12 months or longer.

Substantially all of the unrealized losses on fixed maturities at September 30, 2010 and December 31, 2009 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. The unrealized loss on corporate securities and state and political subdivisions are due to wider spreads. Spreads have widened as investors shifted funds to US Treasuries in response to the current market turmoil. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2010.

At September 30, 2010, the Company had \$29,174,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 43.4% were in CMOs that originated in 2005 or earlier and 56.6% were in CMOs that originated in 2006. The unrealized losses on all other CMOs relate to prime rate CMOs and are primarily attributed to general disruptions in the credit market subsequent to purchase.

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

The Company reviews its investment securities regularly and determines whether other-than-temporary impairments have occurred. 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. For fixed maturities, if a decline in fair value is judged by management to be other-than-temporary, and the Company does not intend to sell the security and 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 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 Statements 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 Sheets. The factors considered by management in its regular review include, but are not limited to: the length of time and extent to which the fair value has been less than cost; 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, in the case of fixed maturities, the effect of changes in market interest rates); and the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis.

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 transactions where loan level data is not available, the model uses a proxy 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 similar characteristics referenced above for corporate debt securities.

To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost, a credit loss exists, and an other-than-temporary impairment is recognized through earnings. 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.

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 Statements of Operations. For the purpose of other-than-temporary impairment evaluations, 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 requires the use of the equity model in analyzing the security for other-than-temporary impairment.

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



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Based on management's review of the portfolio, which considered these factors, the Company recorded the following losses for other-than-temporary impairments in the Condensed Consolidated Statements of Operations for the three months and nine months ended September 30, 2010 and 2009 (in thousands):

**Three Months  
Ended**

**Nine Months Ended**

**September 30,**

**September 30,**

**2010**

**2009**

**2010**

**2009**

Other-than-temporary  
impairments:

Fixed maturities

\$

132

\$

-

\$

2,797

\$

-

Preferred stocks

-

-

-

271

\$

132

\$

-

\$

173

2,797

\$

271

Other-than-temporary impairments of \$132,000 and \$2,797,000, respectively, were recorded on fixed maturities during the three months and nine months ended September 30, 2010. Of these amounts, for the three months and nine months ended September 30, 2010, \$132,000 and \$2,065,000, respectively, are credit losses resulting from expected cash flows of debt securities less than the debt securities' amortized cost, and \$732,000 was the result of the Company's intent to sell certain municipal debt securities prior to the recovery of their amortized cost bases. No losses for other-than-temporary impairments were recognized in other comprehensive income for the three months or nine months ended September 30, 2010.

Cumulative credit losses for other-than-temporary impairments recorded on securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income were as follows (in thousands):

Balance at  
beginning of  
year

\$

2,394

Securities sold

(631)

Balance at  
September 30,  
2010

\$

1,763

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

**Note 5.**

**Net Realized Investment Gains**

Net realized investment gains for the three months and nine months ended September 30, 2010 and 2009 are as follows (in thousands):

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**2010**

**2009**

**2010**



2009

Net realized  
investment  
gains  
(losses):

Fixed  
maturities

\$

5,104

\$

553

\$

6,847

\$

3,492

Common  
stocks

(210)

-

(58)

-

Preferred  
stocks

490

-

516

(12)

5,384

553

7,305

3,480

Sales of  
trading  
securities

(1,355)

-

(1,355)

-

Other

1

-

63

-

Net realized  
investment  
gains

\$

4,030

180

\$  
553  
\$  
6,013  
\$  
3,480

For the three months and nine months ended September 30, 2010, the Company realized gross gains of \$6,220,000 and \$11,400,000, respectively, and realized gross losses of \$836,000 and \$4,095,000, respectively, on sales of available-for-sale securities. For the three months and nine months ended September 30, 2009, the Company realized gross gains of \$1,093,000 and \$5,922,000, respectively, and gross losses of \$540,000 and \$2,442,000, respectively, on sales of available-for-sale securities. As of September 30, 2010 and December 31, 2009, the Company did not hold any trading securities.

#### **Note 6.**

##### **Derivative Instruments**

In connection with its previously outstanding line of credit, a subsidiary of IHC entered into an interest rate swap with the commercial bank lender, for a notional amount equal to the debt principal amount, under which the Company received a variable rate equal to the rate on the debt and paid a fixed rate (6.65%) in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge and, in August 2009, the interest rate swap expired.

For the nine months ended September 30, 2009, the Company recorded \$156,000 of gains on the effective portion of the interest rate swap in accumulated other comprehensive loss on the accompanying Condensed Consolidated Balance Sheets, net of related taxes of \$104,000.

**Note 7.**

**Fair Value Disclosures of Financial Instruments**

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

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

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

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

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

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

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

The following tables present our financial assets and liabilities measured at fair value on a recurring basis, at September 30, 2010 and December 31, 2009, respectively (in thousands):

**September 30,  
2010**

**Level 1**

**Level 2**

**Level 3**

**Total**

**FINANCIAL  
ASSETS:**



Fixed maturities  
available-for-sale:

Corporate  
securities

\$

-

\$

287,866

\$

-

\$

287,866

CMOs -  
residential

-

30,235

42,762

72,997

CMOs -  
commercial

-

-

822

822

US Government  
obligations

-

14,962

-

14,962

Agency MBS -  
residential

-

10,893

-

10,893

GSEs

-

54,955

-

54,955

States and political  
subdivisions

-

360,744

-

360,744

Total fixed  
maturities

-

759,655

43,584

803,239

Equity securities  
available-for-sale:

Common stocks

8,355

-

-

8,355

Preferred stocks -  
perpetual

34,362

-

-

34,362

Preferred stocks -  
with maturities

11,141

-

-

11,141

Total equity  
securities

53,858

-

-

53,858

Total

\$

53,858

\$

759,655

\$

43,584

\$

857,097



**December 31,  
2009**

**Level 1**

**Level 2**

**Level 3**

**Total**

**FINANCIAL  
ASSETS:**

Fixed maturities  
available-for-sale:

Corporate securities

\$

-

\$

200,529

\$

-

\$

200,529

CMOs - residential

-

34,885

39,042

73,927

CMOs -  
commercial

-

-

466

466

US Government  
obligations

-

6,363

-

6,363

Agency MBS -  
residential

-

40,338

-

40,338

GSEs

-

15,147

-

15,147

States and political  
subdivisions

-

353,093

-

353,093

Total fixed  
maturities

-

650,355

39,508

689,863

Equity securities  
available-for-sale:

Common stocks

3,872

-

-

3,872

Preferred stocks -  
perpetual

35,728

-

-

35,728

Preferred stocks -  
with maturities

19,015

2,200

-

21,215

Total equity  
securities

58,615



2,200

-

60,815

Total

\$

58,615

\$

652,555

\$

39,508

\$

750,678

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 nine months ending September 30, 2010, 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 as a result of limited or inactive markets during the first nine months of 2010. All transfers into the Level 3 category during 2010 were the result of the AMIC acquisition. 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 sold or transferred out of the Level 3 category in 2010. For the nine months ending September 30, 2010, the Company did not include in earnings any realized investment gains or losses related to sales of securities categorized as Level 3 securities. The changes in the carrying value of Level 3 assets and liabilities for the nine months ended September 30, 2010 are summarized as follows (in thousands):

**September 30, 2010**

**CMOs**

**Residential**

**Commercial**

**Total**

Beginning balance

\$

39,042

\$

466

\$

39,508

Transfers into Level  
3:

Acquisition of AMIC

1,831

305

2,136

G a i n s ( l o s s e s )  
included in earnings:

Other-than-temporary  
impairments

(2,065)

-

(2,065)

Net unrealized gains  
(losses) included in

accumulated other  
comprehensive loss

7,500

50

7,550

Repayments and  
amortization of fixed  
maturities

(3,546)

1

(3,545)

Balance at end of  
period

\$

42,762

\$

822

\$

43,584

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

(A)

**Policy Loans**

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

(B)

**Funds on Deposit**

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

(C)

**Debt**

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

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



**September 30,  
2010**

**December 31,  
2009**

**Carrying**

**Fair**

**Carrying**

**Fair**

**Amount**

**Value**

**Amount**

**Value**

**(In thousands)**

**FINANCIAL  
ASSETS:**

Policy loans

\$

23,168

\$  
26,647  
\$  
23,833  
\$  
27,422

**FINANCIAL**

**LIABILITIES:**

Funds on  
deposit

\$

408,054

\$

405,626

\$

408,298

\$

410,485

Debt and junior

subordinated  
debt

securities

45,646

45,646

47,146

47,146

**Note 8.**

**Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill and other intangible assets (included in other assets in the Condensed Consolidated Balance Sheets) for the first nine months of 2010 is as follows (in thousands):

**Other  
Intangible  
Assets**

**Total**

**Other**

**Definitive**

**Indefinite**

**Intangible**

**Goodwill**

**Lives**

**Lives**

**Assets**



Balance at  
December 31,  
2009

\$

48,859

\$

7,785

\$

477

\$

8,262

Acquisitions:

AMIC

-

4,700

7,500

12,200

Alliance  
Underwriters

1,459

1,100

-

1,100

MedWatch

581

340

20

360

**HBA**

814

200

-

200

Capitalized  
software  
development

-

177

-

177

Amortization  
expense

-

(1,697)

-

(1,697)

Balance at  
September 30,

2010

\$

51,713

\$

12,605

\$

7,997

\$

20,602

In connection with the acquisition of a controlling interest in AMIC discussed in Note 2, 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, which is being amortized over a weighted average period of 7.6 years, \$1,000,000 represents the fair value of a domain name being amortized over a 10 year period, and \$2,000,000 represents the fair value of customer lists, which are being amortized over a period of 5.0 years. The remaining \$7,500,000 represents non-amortizable intangible assets consisting of the fair value of insurance licenses with indefinite lives. The AMIC acquisition was accounted for as a bargain purchase and accordingly, the Company did not record goodwill in connection with the transaction.

In January 2010, the Company acquired the assets of a managing general underwriter, Alliance Underwriters, LLC ( AU ) 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. AU is a managing general underwriter that controls approximately \$30 million of employer medical stop-loss business.

In January 2010, IHC Health Holdings Corp., a wholly owned subsidiary of the Company ( 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 11.6 years. MedWatch provides utilization review and medical management services to fully insured and self-funded health plans.

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 11.0 years.

**Note 9.**

**Discontinued Operations**

The Company sold its credit life and disability segment by entering into a 100% coinsurance agreement with an unaffiliated insurer effective December 31, 2007. Unearned premium reserves of this block and the corresponding amount in due from reinsurers of \$6,237,000 and \$8,847,000 are included in the Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009, respectively.

The Company recorded losses from discontinued operations representing expenses and changes in claims and reserves related to the insurance liabilities (currently in run-off status) for claims incurred prior to the sale on December 31, 2007 as follows (in thousands):

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**2010**

**2009**

**2010**

**2009**

Pretax loss  
from  
discontinued  
operations

\$

(32)

\$

76

\$

(312)

\$



(469)

Tax benefits  
allocated to  
discontinued  
operations

11

27

109

(164)

Loss from  
discontinued  
operations,  
net

\$

(21)

\$

49

\$

(203)

\$

(305)

Changes in the liabilities related to discontinued operations for the nine months ended September 30, 2010 were as follows (in thousands):

**Claims**

**Accrued**

**Termination**

**Liability**

**Expenses**

**Benefits**

**Total**

Balance at  
beginning of  
year

\$

1,522

\$

-

\$

24

\$

1,546

Loss from  
discontinued  
operations:

Changes in  
claims and  
reserves

related to  
block in  
run-off

283

-

-

229

Expenses  
incurred  
related to  
block in  
run-off

-

29

-

29

312

230

Payments of  
expenses  
accrued to  
administer

the business  
sold

-

(29)

(24)

(53)

231

Claim  
payments  
related to  
block in  
run-off

(895)

-

-

(895)



Balance at  
September  
30, 2010

\$

910

\$

-

\$

-

\$

910

The Company believes that the net liabilities of discontinued operations at September 30, 2010 adequately estimate the remaining costs associated with the credit life and disability discontinued operations.

**Note 10.**

**Share-Based Compensation**

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

A)

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

Total share-based compensation was \$208,000 and \$63,000 for the three months ended September 30, 2010 and 2009, respectively and \$530,000 and \$404,000 for the nine months ended September 30, 2010 and 2009, respectively.

Related tax benefits of \$83,000 and \$25,000 were recognized for the three months ended September 30, 2010 and 2009, respectively and \$211,000 and \$161,000 for the nine months ended September 30, 2010 and 2009, respectively.

Under the terms of IHC's stock-based compensation plans, option exercise prices are more than or equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three years for employee options. The Company may also grant shares of restricted stock, share appreciation rights ( SARs ) and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant and have a three year vesting period. Exercise prices of SARs are more than or equal to the quoted market price of IHC shares at the date of the grant and have three year vesting periods. At September 30, 2010, there were 726,589 shares available for future stock-based compensation grants under the IHC stock incentive plans.

### **Stock Options**

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

**Shares**

**Weighted-  
Average**

**Under Option**

**Exercise Price**

**December 31,  
2009**

312,170

\$

14.62

Granted

461,800

10.00

Expired

(6,490)

20.07

**September 30,  
2010**

767,480

11.79

The following table summarizes information regarding IHC s outstanding and exercisable options as of September 30, 2010:

**Outstanding**

**Exercisable**

Number of options

767,480

239,010

Weighted average  
exercise price per  
share

\$

11.79

\$

15.48

Aggregate intrinsic  
value for all  
options

\$

-

\$

-

Weighted average  
contractual term  
remaining

3.3 years

1.7 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. The weighted average grant-date fair-value of options granted during the nine months ended September 30, 2010 was \$1.57 per share. No options were granted during the nine months ended September 30, 2009. The assumptions set forth in the table below were used to value the stock options granted during the nine-month period ended September 30, 2010:

Weighted-average  
risk-free interest  
rate

2.3%

Annual dividend  
rate per share

\$

.05

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

45.0%

Weighted-average  
expected term of  
options

4.5 years

Compensation expense of \$120,000 and \$75,000 was recognized in the three months ended September 30, 2010 and 2009, respectively, and \$374,000 and \$281,000 in the nine months ended September 30, 2010 and 2009, respectively, for the portion of the grant-date fair value of stock options vesting during that period.

No options were exercised during the three months and nine months ended September 30, 2010 or 2009.

As of September 30, 2010, the total unrecognized compensation expense related to non-vested stock options was \$655,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.7 years.

### **Restricted Stock**

IHC issued 2,250 shares of restricted stock during both the nine months ended September 30, 2010 and 2009. The total fair value of IHC's restricted stock that vested during the first nine months of 2010 and 2009 was \$23,000 and \$70,000, respectively. Restricted stock expense was \$5,000 and \$12,000 for the three months ended September 30, 2010 and 2009, respectively, and was \$24,000 and \$92,000 for the nine months ended September 30, 2010 and 2009, respectively.

The following table summarizes restricted stock activity for the nine months ended September 30, 2010:

**No. of**

**Weighted-Average**

**Non-vested**

**Grant-Date**

**Shares**

**Fair Value**

December 31, 2009

5,380

\$

12.43

**Granted**

2,250

\$

7.01

**Vested**

(3,130)



\$  
15.19

September 30, 2010

4,500

\$  
7.80

As of September 30, 2010, the total unrecognized compensation expense related to IHC's non-vested restricted stock awards was \$29,000 which is expected to be recognized over the remaining requisite weighted-average service period of 2.0 years.

**SARs and Share-Based Performance Awards**

The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. No SARs were exercised in the nine months ended September 30, 2010 or 2009. Other liability-classified awards include share-based performance awards. Compensation costs for these plans are recognized and accrued as performance conditions are met, based on the current share price.

The intrinsic value of all of IHC's share-based liabilities paid in the nine months ended September 30, 2010 and 2009 was \$54,000 and \$35,000, respectively. Included in Other Liabilities on the Company's Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009 are liabilities of \$136,000 and \$58,000, respectively, pertaining to IHC's SARs and share-based performance awards.

**B)**

**AMIC Share-Based Compensation Plans**

Total AMIC share-based compensation expense was \$18,000 and \$44,000, respectively, for the three months ended September 30, 2010 and the period between the Acquisition Date and September 30, 2010. Related tax benefits of \$8,000 and \$18,000, respectively, were recognized for the three months ended September 30, 2010 and the period between the Acquisition Date and September 30, 2010.

Under the terms of the AMIC's stock-based compensation plan, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms are ten years; and vesting periods range from three to four years. AMIC may also grant shares of restricted stock, stock appreciation rights and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period. At September 30, 2010, there were 6,537,222 shares available for future stock-based compensation grants under the AMIC stock incentive plan.

### **Stock Options**

The following table summarizes information regarding AMIC's outstanding and exercisable options for the period between the Acquisition Date and September 30, 2010:

**Shares**

**Weighted-  
Average**

**Under Option**

**Exercise Price**

**March 5, 2010**

	355,900
	\$
	10.00
Granted	
	13,334
	4.60
Exercised	
	10,000
	4.50
<b>September 30, 2010</b>	
	359,234
	9.95

The following table summarizes information regarding AMIC s outstanding and exercisable options as of September 30, 2010:

**Outstanding**

**Exercisable**

Number of  
options

359,234

338,705

Weighted  
average exercise  
price per share

\$

9.95

\$

10.20

Aggregate  
intrinsic value  
for all options

\$

11,439

\$

10,639

Weighted  
average  
contractual term  
remaining

3.6 years

3.3 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 period between the Acquisition Date and September 30, 2010 was \$2.79 per share. The assumptions set forth in the table below were used to value the stock options granted during the period between the Acquisition Date and September 30, 2010:

Weighted-average  
risk-free interest  
rate

3.69%

Annual dividend  
rate per share

\$

-

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

45.0%

Weighted-average  
expected term of  
options

5 years

Compensation expense of \$14,000 and \$33,000 was recognized for the three months ended September 30, 2010 and the period between the Acquisition Date and September 30, 2010, respectively, for the portion of the grant-date fair value of AMIC's stock options vesting during those periods.

AMIC received cash proceeds of \$45,000 upon the exercise of 10,000 options with an intrinsic value of \$1,000 during the period between the Acquisition Date and September 30, 2010.

As of September 30, 2010, the total unrecognized compensation expense related to AMIC's non-vested options was \$64,000 which will be recognized over the remaining requisite service periods.

**Restricted Stock**

AMIC issued 12,000 restricted stock awards in the second quarter of 2008, with a weighted average grant-date fair value of \$6.92 per share. No restricted stock awards were issued in 2010. The total fair value of AMIC's restricted stock that vested during the period between the Acquisition Date and September 30, 2010 was \$13,000. Restricted stock expense was \$4,000 and \$11,000 for the three months ended September 30, 2010 and the period between the Acquisition Date and September 30, 2010, respectively.

The following table summarizes AMIC's restricted stock activity for the period between the Acquisition Date and September 30, 2010:

**No. of**

**Weighted-Average**

**Non-vested**

**Grant-Date**

**Shares**

**Fair Value**



March 5, 2010

6,333

\$

6.92

Vested

(2,500)

\$

6.92

Forfeited

(1,333)

\$

6.92

September 30, 2010

2,500

\$

6.92

As of September 30, 2010, there was approximately \$12,000 of total unrecognized compensation expense related to AMIC's non-vested restricted stock which will be recognized over the remaining requisite service periods.

**Note 11.**

**Debt**

On August 22, 2010, the Company made a \$1,500,000 principal debt repayment in accordance with the terms of its amortizing term note.

**Note 12.**

**Income Taxes**

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

separately for the life insurance company group and the non-life insurance company group.

The deferred income tax expense allocated to stockholders' equity (principally for net unrealized gains on investment securities) for the nine months ended September 30, 2010 was \$9,626,000, representing the decrease in the related net deferred tax liability to \$5,658,000 at September 30, 2010 from a tax asset of \$3,968,000 at December 31, 2009.

At September 30, 2010, AMIC, had net operating loss carryforwards of approximately \$273,400,000 for federal income tax purposes which expire between 2019 and 2029. The federal deferred tax asset relative to AMIC included in other assets on IHC's Condensed Consolidated Balance Sheet at September 30, 2010 was \$10,165,000, net of a valuation allowance of \$86,400,000. AMIC continues to file its own separate income tax return and is not included in the consolidated tax return of IHC.

**Note 13.**

**Supplemental Disclosures of Cash Flow Information**

Tax payments, net of tax refunds, were \$467,000 during the nine months ended September 30, 2010. Tax refunds, net of tax payments, were \$335,000 during the nine months ended September 30, 2009

Cash payments for interest were \$1,431,000 and \$2,380,000 during the nine months ended September 30, 2010 and 2009, respectively.

**Note 14.**

**Comprehensive Income**

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

Comprehensive income for the three months and nine months ended September 30, 2010 and 2009 is summarized as follows (in thousands):

**Three Months  
Ended**

**Nine Months  
Ended**

**September 30,**

**September 30,**

**2010**

**2009**

**2010**

**2009**

Net income

\$

5,030

\$

1,930

\$

23,543

\$

6,888

Unrealized  
gains arising

during the  
period, net of  
income taxes

8,268

23,907

17,199

52,223

Comprehensive  
income

13,298

25,837

40,742

59,111

Comprehensive  
(income) losses  
attributable to

noncontrolling  
interest

(610)

(5)

(1,391)

15

Comprehensive  
i n c o m e  
attributable to  
IHC

\$

12,688



\$  
25,832  
\$  
39,351  
\$  
59,126

Unrealized gains arising during the three months and nine months ended September 30, 2010 include the reclassification to earnings of \$410,000 of the non-credit related component of previously recorded other-than-temporary impairments on securities that were sold during the period, net of \$221,000 tax. No losses for other-than-temporary impairments of fixed maturities were recognized in other comprehensive income during the three months or nine months ended September 30, 2010.

**Note 15.**

**Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months and nine months ended September 30, 2010 and 2009 is presented below (in thousands):

**Three Months  
Ended**

**Nine Months Ended**

**September 30,**

**September 30,**

**2010**

**2009**

**2010**

**2009**

**Revenues:**

Medical Stop-Loss  
(A)

\$

34,187

\$

31,222

\$

99,533

\$

259

103,536
Fully Insured Health (B)
37,629
28,184
105,981
87,695
Group disability, life, annuities and DBL (C)
16,626
16,720
50,416
49,578
Individual life, annuities and other
15,858
15,379
260

44,027

46,164

Corporate

(323)

454

27,483

1,108

103,977

91,959

327,440

288,081

Net realized  
investment gains

4,030

261

553

6,013

3,480

Other-than-temporary  
impairment losses,  
net

(132)

-

(2,797)

(271)

\$

107,875

\$

92,512

\$

330,656

\$

291,290

**I n c o m e f r o m  
C o n t i n u i n g  
O p e r a t i o n s**

**Before Income Taxes:**

Medical Stop-Loss  
(A)

\$

955

\$

772

\$

3,407

\$

3,548

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

888

(3,016)

264



	1,967
	(3,766)
Group disability, life, annuities and DBL <sup>(C)</sup>	
	3,704
	1,701
	5,018
	5,082
Individual life, annuities and other	
	754
	3,248
	1,648
	5,049
Corporate	
	(2,504)
	265

	(464)
	22,850
	(1,988)
	3,797
	2,241
	34,890
	7,925
Net realized investment gains	
	4,030
	553
	6,013
	3,480
Other-than-temporary impairment losses,	
	266

net

(132)

-

(2,797)

(271)

Interest expense

(499)

(701)

(1,447)

(2,232)

\$

7,196

\$

2,093

\$

36,659

\$

8,902

**(A)**

The amount includes equity income from AMIC (prior to its acquisition) of \$40,000 for the three months ended September 30, 2009, and \$14,000 and \$693,000 for the nine months ended September 30, 2010 and 2009, respectively.

**(B)**

The amount includes equity income from AMIC (prior to its acquisition) of \$25,000 for the three months ended September 30, 2009 and \$244,000 and \$211,000 for nine months ended September 30, 2010 and 2009, respectively.

**(C)**

The amount includes equity income from AMIC (prior to its acquisition) of \$11,000 for the three months ended September 30, 2009, and \$22,000 and \$100,000 for nine months ended September 30, 2010 and 2009, respectively.

**(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 \$611,000 and \$619,000 for the three months ended September 30, 2010 and 2009, respectively, and \$1,771,000 and \$1,846,000 for the nine months ended September 30, 2010 and 2009, respectively. Amortization expense for the other segments is insignificant.



**ITEM 2.**

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

**CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2009, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

**Overview**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); (ii) its majority owned insurance company, Independence American Insurance Company ( Independence American ); and (iii) its marketing and administrative companies, including IHC Administrative Services, Inc., managing general underwriters ("MGUs") in which it owns a significant voting interest, IHC Health Solutions, Inc. ( IHC Health Solutions ), and Actuarial Management Corporation ( AMC ). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a 50.1% interest in American Independence Corp. ( AMIC ).

While management considers a wide range of factors in its strategic planning and decision-making, underwriting profit is consistently emphasized as the primary goal in all decisions as to whether or not to increase our retention in a core line, expand into new products, acquire an entity or a block of business, or otherwise change our business model. Management's assessment of trends in healthcare and morbidity, with respect to medical stop-loss, fully insured medical, disability and New York State short-term statutory disability benefit product ("DBL"); mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. IHC also seeks transactions that permit it to leverage its vertically integrated organizational structure by generating fee income from production and administrative operating companies as well as risk income for its carriers and profit commissions. Management has always focused on managing the costs of its operations and providing its insureds with the best cost containment tools available.



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

The results of operations for the three months and nine months ended September 30, 2010 and 2009 are summarized as follows (in thousands):

**Three Months  
Ended**

**Nine Months  
Ended**

**September 30,**

**September 30,**

**2010**

**2009**

**2010**

**2009**



Revenues

\$

107,875

\$

92,512

\$

330,656

\$

291,290

Expenses

100,679

90,419

293,997

282,388

Income from  
continuing  
operations

before income  
taxes

7,196

2,093

36,659

8,902

Income taxes

2,145

212

12,913

1,709

**Income from  
continuing  
operations**

5,051

1,881

23,746

7,193

**Discontinued  
operations:**

Income (loss)  
from  
discontinued  
operations

(21)

49

(203)

(305)

**Net income**

5,030

1,930

23,543

6,888

(Income) loss  
from  
noncontrolling  
interests

in subsidiaries

(610)

(5)

(1,391)

15

**Net income  
attributable to  
IHC**

\$

4,420

\$

1,925

\$

22,152

\$

6,903

Income from continuing operations increased \$3.2 million to \$5.1 million for the three months ended September 30, 2010 from \$1.9 million for the three months ended September 30, 2009. Income from continuing operations increased \$16.5 million to \$23.7 million for the nine months ended September 30, 2010 from \$7.2 million for the nine months ended September 30, 2009 primarily due to the \$16.8 million after-tax gain on the bargain purchase of AMIC (see Note 2 of Notes to Condensed Consolidated Financial Statements);

Consolidated investment yields (on an annualized basis) of 4.9% and 4.6%, respectively, for the three months and nine months ended September 30, 2010 compared to 5.4% and 5.2% for the respective periods in 2009;

Revenues of \$107.9 million and \$330.7 million for the three months and nine months ended September 30, 2010, respectively, representing increases of 16.6% and 13.5% over the respective three-month and nine-month periods in 2009; and

Book value of \$15.81 per common share, representing a 20.1% increase from December 31, 2009, primarily reflecting net income (including the gain on bargain purchase) and net unrealized gains on securities for the nine months ended September 30, 2010.





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

The Medical Stop-Loss segment reported income from continuing operations before taxes of \$1.0 million and \$.8 million for the three months ended September 30, 2010 and 2009, respectively, and reported income from continuing operations of \$3.4 million and \$3.5 million for the nine months ended September 30, 2010 and 2009, respectively. The increase in the quarterly results is primarily attributable to the consolidation of AMIC results in addition to business produced by a managing general underwriter acquired in 2010 for which there are no comparable amounts in 2009. For the nine months ended September 30, 2010, the aforementioned increases were offset by the cancellation of underperforming managing general underwriters and market conditions;

o

Premiums earned increased \$.9 million for three months ended September 30, 2010 and decreased \$8.6 million for the nine months ended September 30, 2010 when compared to the same periods in 2009. Excluding \$9.6 million and \$23.3 million of earned premiums related to the consolidation of AMIC's results for the three months and nine months ended September 30, 2010, respectively, premiums earned decreased \$8.7 million and \$31.9 million, respectively, due to reduced production volume for the reasons stated above;

o

Combined ratios for the three months and nine months ended September 30, 2010 include reported stop-loss combined ratios from AMIC of 98.3% and 100.4%, respectively, as adjusted for purchase accounting;

o

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

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**2010**

**2009**

**2010**

**2009**

Premiums  
Earned

\$

30,730

\$

29,832

\$

90,526

\$

99,121

Insurance  
Benefits,  
Claims &  
Reserves

22,081

22,321

65,355

71,684

Expenses

8,700

7,523

24,109

26,455

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

71.9%

74.8%

72.2%

72.3%

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

28.3%

25.2%

26.6%

26.7%

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

100.2%

100.0%

98.8%

99.0%

(A)

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

(B)

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

(C)

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

.

The Fully Insured Health segment reported \$.9 million of income from continuing operations before taxes for the three months ended September 30, 2010 compared to losses before taxes of \$3.0 million for the three months ended September 30, 2009. For the nine months ended September 30, 2010, the Fully Insured Health segment reported \$2.0 million of income from continuing operations before tax as compared to losses of \$3.8 million for the same period in 2009;

o

Fee and other income decreased \$.6 million and \$3.2 million for the three months and nine months ended September 30, 2010, respectively, as compared to the same periods in 2009.

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Excluding AMIC fee and other income of \$.3 million and \$1.0 million, respectively, fee and other income decreased by \$.9 million and \$4.2 million, respectively, primarily due to a decrease in non-IHC carrier business administered by IHC Administrative Services and reduced profit commissions from the comparable 2009 period. The Company also experienced a decrease in general expenses due to its lower volume of business;

o

Premiums earned increased \$9.8 million and \$21.0 million for the three months and nine months ended September 30, 2010, respectively, over the comparable periods in 2009. Excluding AMIC premiums of \$7.4 million and \$18.1 million during these respective periods, earned premiums increased \$2.4 million for the three months ended September 30, 2010 and increased \$2.9 million for the nine months ended September 30, 2010 compared to the prior year;

o

Underwriting experience for the Fully Insured segment, as indicated by its GAAP combined ratios, for the three months and nine months ended September 30, 2010 and 2009 is as follows (in thousands):

**Three  
Months  
Ended**

**Nine  
Months  
Ended**



**September  
30,**

**September  
30,**

**2010**

**2009**

**2010**

**2009**

Premiums  
Earned

\$

30,920

\$

21,109

\$

84,428

\$

63,362

Insurance  
Benefits,  
Claims &  
Reserves

21,004

16,225

57,371

44,802

Expenses

9,168

6,038

24,506

19,120

Loss Ratio

67.9%

76.9%

68.0%

70.7%

Expense  
Ratio

29.7%

28.6%

29.0%

30.2%

Combined  
Ratio

97.6%

105.5%

97.0%

100.9%

o

The underwriting expense ratio decreased primarily as a result of a decrease in profit commission and other general expenses in 2010;

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Income before taxes from the Group disability, life, annuities and DBL segment increased \$2.0 million for the three months ended September 30, 2010 and remained flat for the nine months ended September 30, 2010 compared to the same periods in 2009. The LTD line experienced higher profitability in both the three months and nine months ended September 30, 2010, which, on a year to date basis, was offset by higher death claims experienced by group term life lines in the first quarter of 2010.

Income before taxes from the Individual life, annuities and other segment decreased \$2.4 million and \$3.4 million for the three months and nine months ended September 30, 2010, respectively, compared to the same periods in 2009 primarily as a result of the commutation of reserves in the third quarter of 2009 and decreased investment income in 2010;

Income before taxes from the Corporate segment decreased \$2.0 million for the three months ended September 30, 2010 compared to 2009 due to lower partnership income in 2010 and higher expenses; and increased \$24.9 million for the nine months ended September 30, 2010 over 2009 primarily due to the inclusion of a \$27.8 million gain as a result of the March 2010 acquisition of a controlling interest in AMIC;

Net realized investment gains were \$4.0 million and \$6.0 million for the three months and nine months ended September 30, 2010, respectively, compared to \$.6 million and \$3.5 million for the comparable periods in 2009. Other-than-temporary impairment losses for the three months and nine months ended September 30, 2010 were \$.1 million and \$2.8 million, respectively, compared to \$.3 million for the nine months ended September 30, 2009. No other-than-temporary impairment losses were recorded in the three months ended September 30, 2009, and;

Premiums by principal product for the three months and nine months ended September 30, 2010 and 2009 are as follows (in thousands):

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**Gross  
Direct and  
Assumed**

**Earned  
Premiums:**

**2010**

**2009**

**2010**

**2009**

Medical  
Stop-Loss

\$

40,440

\$

295

47,920

\$

122,040

\$

156,367

Fully  
Insured  
Health

52,139

47,538

155,685

142,970

Group  
disability,  
life,  
annuities  
and DBL

25,744

26,845

78,588

78,328

Individual,  
life,  
annuities  
and other

8,655

7,403

296



24,395

22,960

\$

126,978

\$

129,706

\$

380,708

\$

400,625

**Three  
Months  
Ended**

**Nine  
Months  
Ended**

**September  
30,**

**September  
30,**

**Net  
Premiums  
Earned:**

**2010**

**2009**

**2010**

**2009**

Medical  
Stop-Loss

\$

30,730

\$

29,832

\$

90,526

\$

99,121

Fully  
Insured  
Health

30,920

21,109

84,428

63,362

Group  
disability,  
life,  
annuities  
and DBL

14,127

14,178

42,723

41,993

Individual,  
life,  
annuities  
and other

7,482

6,623

21,080

20,780

\$

83,259

\$

71,742

\$

238,757

\$

225,256

**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2009. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Reserves, Deferred Acquisition Costs, Investments, Goodwill and Other Intangible Assets, and Deferred Income Taxes* as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, *Critical Accounting Policies* in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2009. During the nine months ended September 30, 2010, there were no additions to or changes in the critical accounting policies disclosed in the 2009 Form 10-K except for the recently adopted accounting standards discussed in Note 1(C) of the Notes to Condensed Consolidated Financial Statements.

**Results of Operations for the Three Months Ended September 30, 2010 Compared to the Three Months Ended September 30, 2009**

Income from continuing operations was \$5.1 million for the three months ended September 30, 2010, an increase of \$3.2 million compared to \$1.9 million for the three months ended September 30, 2009. The Company's income from continuing operations before taxes increased \$5.1 million to \$7.2 million for the three months ended September 30, 2010 from \$2.1 million for the three months ended September 30, 2009. Information by business segment for the three months ended September 30, 2010 and 2009 is as follows:

**Equity**

**Benefits,**

**Amortization**

**Selling,**

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

**Premiums  
Investment  
From  
Other  
and  
Acquisition  
And**

**September 30, 2010**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

(In thousands)

Medical Stop-Loss
\$
30,730
1,407
-
2,050
22,081
-
304



11,151

\$

955

Fully Insured Health

30,920

384

-

6,325

21,004

7

15,730

888

Group disability,

life, annuities

and DBL

14,127

2,455

-

44

7,855

125

4,942

3,704

Individual life,

annuities and

other

7,482

7,213

-

1,163

10,380

1,546

3,178

754

Corporate

307

-

(323)

-

-

-

-

2,181

(2,504)

Sub total

\$

83,259

\$

11,136

\$

-

\$

9,582

\$

61,320

\$

1,678

\$

37,182

3,797

308

Net realized  
investment gains

4,030

Other-than-temporary  
impairment losses

(132)

Interest expense

(499)

Income from  
continuing operations  
before income taxes

7,196

Income taxes

2,145

Income from  
continuing operations

\$

310

**Equity**

**Benefits,**

**Amortization**

**Selling,**

**Net**

**Income**

**Fee and**

**Claims**

**of Deferred**

**General**

**Premiums**

**Investment**

**From**

**Other**

**and**

**Acquisition**

**And**

**September 30, 2009**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**



Medical Stop-Loss

\$

29,832

1,170

40

180

22,321

-

8,129

\$

772

Fully Insured Health

21,109

195

25

6,855

16,225

7

14,968

(3,016)

Group disability,

313

life, annuities

and DBL

14,178

2,442

11

89

314

10,184

169

4,666

1,701

Individual life,

annuities and

other

6,623

7,042

-

1,714

6,737

825

4,569

3,248

Corporate

-

454

-

-

-

-

918

(464)

Sub total

\$

71,742

\$

11,303

316

\$  
76  
\$  
8,838  
\$  
55,467  
\$  
1,001  
\$  
33,250  
  
2,241

Net realized  
investment gains

553

Other-than-temporary  
impairment losses

-

Interest expense

(701)

Income from  
continuing operations  
before income taxes

2,093

Income taxes

318

212

Income from  
continuing operations

\$

1,881

**Acquisition of AMIC**

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

Prior to obtaining control, IHC recorded its investment in AMIC using the equity method. IHC recorded changes in its investment in AMIC in the Equity income from AMIC line in the Condensed Consolidated Statements of Operations. Upon achieving control, on March 5, 2010, AMIC's income and expense amounts became consolidated with IHC's results. Accordingly, the individual line items on the Condensed Consolidated Statement of Operations for 2010 reflect approximately seven months of the operations of AMIC with no corresponding amounts for 2009.

**Premiums Earned**

Total premiums earned increased \$11.6 million to \$83.3 million in the third quarter of 2010 from \$71.7 million in the comparable period of 2009. Included in third quarter 2010 premiums are \$17.9 million of earned premiums related to AMIC with no comparable 2009 amounts. Excluding these amounts, earned premiums decreased \$6.3 million compared to the third quarter of 2009. The decrease is primarily due to: (i) the Medical Stop-Loss segment which decreased \$8.7 million, primarily due to the termination of certain non-owned managing general underwriters and market conditions; and (ii) the Group Disability Life, annuities and DBL segment which had a \$.9 million decrease in premiums in the third quarter of 2010 compared to the third quarter of 2009, due in part to lower production of group term life business; partially offset by (iii) a \$2.4 million increase in Fully Insured Health segment comprised primarily of increases in dental (\$1.1 million) and in limited medical and vision lines (\$.8 million) as a result of increased production in those lines, and an increase in small group business (\$1.0 million) due to increased retention, offset by a \$.5 decrease in the student accident line primarily as a result of the cancellation of a producer of this product; and (iv) a \$.9 million increase in the Individual life, annuities and other segment primarily as a result of an increase in production of individual annuity contracts.

**Net Investment Income**



Total net investment income decreased \$.2 million. The overall annualized investment yields were 4.9% and 5.4% (approximately 5.2% and 5.7%, on a tax advantaged basis) in the third quarter of 2010 and 2009, respectively. The annualized investment yields on bonds, equities and short-term investments were 4.8% and 5.0% in the third quarter of 2010 and 2009, respectively. The decrease in investment income is due to a decrease in yields and the shorter duration of our portfolio. IHC has approximately \$144.8 million in highly rated shorter duration securities earning on average 1.45%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in higher yielding longer-term securities in an increasing interest rate environment.

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

Net realized investment gains increased \$3.4 million to \$4.0 million in 2010 compared to \$.6 million in 2009. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period. For the three months ended September 30, 2010, the Company recorded \$.1 million of other-than-temporary impairment losses, pre-tax. This credit loss is a result of expected cash flows of debt securities that are less than the debt securities' amortized cost. For the three months ended September 30, 2009, the Company did not record any losses for other-than-temporary impairments.

**Fee Income and Other Income**

Fee income increased \$1.5 million to \$8.1 million in the three months ended September 30, 2010 from \$6.6 million in the three months ended September 30, 2009. Excluding AMIC related fee income of \$1.4 million, fee income for the third quarter of 2010 increased \$.1 million over the comparable period in 2009.

Total other income decreased \$.7 million in the three months ended September 30, 2010 to \$1.5 million from \$2.2 million in the three months ended September 30, 2009. Excluding AMIC related other income of \$.2 million, other income for the third quarter of 2010 decreased \$.9 million over the comparable 2009 period. The third quarter of 2009 includes income resulting from the commutation of a block of business.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves increased \$5.8 million for the three months ended September 30, 2010 compared to the same period in 2009. Included in the third quarter 2010 are \$11.8 million of claims and reserves related to AMIC with no comparable amounts in 2009. Excluding these amounts, benefits, claims and reserves decreased \$6.0 million in the third quarter of 2010 compared to 2009. The decrease is primarily attributable to: (i) a decrease of \$6.9 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; (ii) a decrease of \$2.8 million in the Group disability, life, annuities and DBL segment primarily related to a decrease in premiums earned from the group term life business and lower loss ratios in the LTD business; partially offset by (iii) a \$3.6 million increase in the Individual life, annuities and other segment primarily resulting from the commutation of reserves in the third quarter of 2009 in addition to an increase in the production of individual annuity contracts in 2010; and (iv) an increase of \$.1 million in the Fully Insured Health segment principally due to a \$.9 million increase in claims and reserves on dental, short term medical and vision lines of business, partially offset by a \$.8 million decrease primarily as a result of decreases in small group medical due to lower loss ratios in 2010 and a lower volume of student accident business in 2010.

**Amortization of Deferred Acquisition Costs**

Amortization of deferred acquisition costs increased \$.7 million.

-

**Interest Expense on Debt**

Interest expense decreased \$.2 million primarily as a result of principal repayments and lower interest rates.

**Selling, General and Administrative Expenses**

Total selling, general and administrative expenses increased \$3.9 million in the third quarter of 2010 compared to the third quarter of 2009. Excluding expenses related to AMIC, totaling \$6.9 million, total selling, general and administrative expenses decreased \$3.0 million. The decrease is primarily due to: (i) a \$1.1 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$1.4 million decrease in the Fully Insured Health segment largely due to a decrease in general expenses as a result of lower business volume and a reduction in work force; (iii) a \$1.4 million decrease in commission, other general and administrative expenses associated with the Individual life, annuities and other segment, partially related to the ceding of a block of life and annuity business in 2009; partially offset by (iv) a \$.9 million increase in corporate expenses.

**Income Taxes**

Income tax expense increased \$1.9 million to \$2.1 million for the third quarter ended September 30, 2010 from \$.2 million for the third quarter of 2009. The effective tax rate was 29.2% for the third quarter of 2010 compared to 9.5% for the third quarter of 2009. The increase in the effective tax rate is primarily attributable to higher jurisdictional tax rates on income from the non-life businesses.



**Results of Operations for the Nine Months Ended September 30, 2010 Compared to the Nine Months Ended September 30, 2009**

Income from continuing operations was \$23.7 million for the nine months ended September 30, 2010, an increase of \$16.5 million compared to \$7.2 million for the nine months ended September 30, 2009. The Company's income from continuing operations before taxes increased \$27.8 million to \$36.7 million for the nine months ended September 30, 2010 from \$8.9 million for the nine months ended September 30, 2009. Information by business segment for the nine months ended September 30, 2010 and 2009 is as follows:

**Gain on**

**Bargain**

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

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

**Premiums  
Investment  
From  
Other  
and  
Acquisition  
And**

**September 30, 2010**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**



Medical Stop-Loss

\$  
90,526  
3,132  
14  
5,861  
65,355  
-  
30,771  
\$  
3,407

Fully Insured Health

84,428  
965  
244  
20,344  
57,371  
21  
46,622  
1,967

Group disability,

life, annuities

and DBL

42,723

7,255

22

416

31,407

373

330

13,618

5,018

Individual life,

annuities and other

21,080

19,633

-

3,314

28,694

4,322

9,363

1,648

Corporate

-

331

(347)

-

27,830

-

-

4,633

22,850

Sub total

\$

238,757

\$

30,638

\$

280

\$

57,765

\$

182,827

\$

4,716

\$

105,007

34,890

Net realized  
investment gains

6,013

Other-than-temporary  
impairment losses

(2,797)

Interest expense

(1,447)

Income from  
continuing operations  
before income taxes

36,659

Income taxes

12,913

Income from  
continuing operations

\$

23,746

334

**Equity**

**Benefits,**

**Amortization**

**Selling,**

**Net**

**Income**

**Fee and**

**Claims**

**of Deferred**

**General**

**Premiums**

**Investment**

**From**

**Other**

**and**

**Acquisition**

**And**

**September 30, 2009**

**Earned**

**Income**

**AMIC**

**Income**

**Reserves**

**Costs**

**Administrative**

**Total**

**(In thousands)**



Medical Stop-Loss

\$  
99,121  
2,965  
693  
757  
71,684  
-  
28,304  
\$  
3,548

Fully Insured Health

63,362  
578  
211  
23,544  
44,802  
21  
46,638  
(3,766)

Group disability,

life, annuities

and DBL

41,993

7,216

100

269

30,114

273

338

14,109

5,082

Individual life,

annuities and other

20,780

21,583

-

3,801

25,486

3,057

12,572

5,049

Corporate

-

339

1,108

-

-

-

-

3,096

(1,988)

Sub total

\$

225,256

\$

33,450

\$

1,004

\$

28,371

\$

172,086

\$

3,351

\$

104,719

7,925

340

Net realized  
investment gains

3,480

Other-than-temporary  
impairment losses

(271)

Interest expense

(2,232)

Income from  
continuing operations  
before income taxes

8,902

Income taxes

1,709

Income from  
continuing operations

\$

7,193

342



**Premiums Earned**

Total premiums earned increased \$13.5 million to \$238.8 million in the first nine months of 2010 from \$225.3 million in the comparable period of 2009. Included in 2010 premiums earned are \$43.4 million of earned premiums related to AMIC with no comparable 2009 amounts. Excluding these amounts, earned premiums decreased \$29.9 million from the first nine months of 2009. The decrease is primarily due to: (i) the Medical Stop-Loss segment which decreased \$31.9 million, primarily due to reduced production from the termination of certain non-owned managing general underwriters and market conditions; and (ii) a \$1.2 million decrease in the Group disability, life, annuities and DBL segment primarily from a decrease of \$1.2 million in group term life business and a decrease of \$1.4 million in the point of service line and other lines, offset by an increase of 1.4 million from the LTD line due to new business written; partially offset by (iii) the Fully Insured Health segment which had a \$2.9 million increase in premiums in the first nine months of 2010 compared to the first nine months of 2009, comprised primarily of a \$2.8 million increase in dental premiums as a result of increased production and a \$2.0 million net increase in all other lines of this segment due to increased production principally in the vision and limited medical lines, offset a \$1.9 million decrease in student accident premiums as a result of the cancellation of a producer of this product; and (iv) an increase of \$.3 million in premiums earned in the Individual life, annuities and other segment.

**Net Investment Income**

Total net investment income decreased \$2.9 million. The overall annualized investment yields were 4.6% and 5.2% (approximately 4.8% and 5.5%, on a tax advantaged basis) in the first nine months of 2010 and 2009, respectively. The annualized investment yields on bonds, equities and short-term investments were 4.6% and 5.0% in the first nine months of 2010 and 2009, respectively. The decrease in investment income is due to a decrease in yields and the shorter duration of our portfolio. IHC has approximately \$144.8 million in highly rated shorter duration securities earning on average 1.45%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in higher yielding longer-term securities in an increasing interest rate environment.

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

Net realized investment gains increased \$2.5 million to \$6.0 million in 2010 compared to \$3.5 million in 2009. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period. For the nine months ended September 30, 2010 and 2009, the Company recorded \$2.8 million and \$.3 million, respectively, of other-than-temporary impairment losses, pre-tax. Of the amount recorded in 2010, \$2.0 million are credit losses resulting from expected cash flows of debt securities that are less than the debt securities amortized cost, and \$.8 million are the result of 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 increased \$2.4 million to \$25.3 million in the nine months ended September 30, 2010 from \$22.9 million in the nine months ended September 30, 2009. Excluding AMIC related fee income of \$4.1 million, fee income for the first nine months of 2010 decreased \$1.7 million over the comparable 2009 period. The decrease is primarily a result of decreased profit commissions and a decrease in other fully-insured business administered by IHC Administrative Services.

Total other income in the nine months ended September 30, 2010 was \$4.6 million compared to \$5.4 million in the nine months ended September 30, 2009. Excluding AMIC related other income of \$.2 million, other income for the nine months ended September 30, 2010 decreased \$1.0 million over the comparable 2009 period. Other income in 2009 includes income resulting from the commutation of a block

of business.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves increased \$10.7 million for the first nine months of 2010 compared to the first nine months of 2009. Included in the first nine months of 2010, are \$29.9 million of claims and reserves related to AMIC with no comparable amounts in 2009. Excluding these amounts, benefits, claims and reserves decreased \$19.2 million in the first nine months of 2010 compared to 2009. The decrease is primarily attributable to: (i) a decrease of \$23.5 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; partially offset by (ii) a \$3.2 million increase in the Individual life, annuity and other segment resulting from an increase in individual annuity contracts in 2010 and an increase in ordinary life and annuities over 2009 levels due to the commutation of reserves in 2009; (iii) an increase of \$.2 million in the Group disability, life, annuities and DBL segment largely as a result of higher claims on the LTD and group term life lines of business offset by a decrease in the point of service line; and (iv) an increase of \$.9 million in the Fully Insured Health segment, principally due to a \$4.0 million increase in claims and reserves on dental, short term medical, limited medical and vision lines of business partially offset by a \$2.0 million decrease in small group medical reserves due to lower loss ratios in 2010 and a \$1.1 million decrease in student accident reserves due to a lower volume of business.

**Amortization of Deferred Acquisition Costs**

Amortization of deferred acquisition costs increased \$1.3 million.

-

**Interest Expense on Debt**

Interest expense decreased \$.8 million primarily as a result of principal repayments and lower interest rates.

**Selling, General and Administrative Expenses**

Total selling, general and administrative expenses increased \$.3 million in the first nine months of 2010 as compared to the first nine months of 2009. Excluding \$16.4 million in AMIC related expenses included in the first nine months of 2010 with no comparable 2009 amount, total selling, general and administrative expenses decreased \$16.1 million. The decrease is primarily due to: (i) a \$6.9 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 \$5.5 million decrease in the Fully Insured Health segment largely due to a decrease in general expenses as a result of lower business volume and a reduction in work force, (iii) a \$1.0 million decrease in the Group disability, life, annuities and DBL segment

primarily due to decreased premiums; (iv) a \$3.2 million decrease in commission, other general and administrative expenses associated with the Individual life, annuities and other segment, partially related to the ceding of a block of life and annuity business in 2009; partially offset by (v) a \$.5 million increase in corporate general and administrative expenses.

**Income Taxes**

Income tax expense increased \$11.2 million to \$12.9 million for the nine months ended September 30, 2010 from \$1.7 million for the first nine months of 2009. The increase in tax expense is primarily related to the gain on the acquisition of the controlling interest in AMIC during the first quarter of 2010. The effective tax rate was 35.1% for the first nine months of 2010 compared to 19.1% in 2009. The increase in the effective tax rate is primarily attributable to higher jurisdictional tax rates on the gain related to the AMIC acquisition.

## **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.

### **Cash Flows**

As of September 30, 2010, the Company had \$9.6 million of cash and cash equivalents compared with \$7.4 million as of December 31, 2009.

Net cash provided by operating activities of continuing operations for the nine months ended September 30, 2010 was \$.7 million. Net cash used by operating activities of discontinued operations for the nine months ended September 30, 2010 was \$1.0 million.

Net cash provided by investing activities of continuing operations for the nine months ended September 30, 2010 was \$6.3 million primarily as a result of \$21.5 million in net proceeds on sales of equity securities and securities under resale and repurchase agreements, a \$10.1 million increase in net amounts due from brokers, \$1.1 million of net cash acquired in the acquisitions of AMIC and other companies, partially offset by \$25.0 million in net purchases of fixed maturities.

The Company has \$458.6 million of insurance reserves that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources

does not coincide with future cash flows. For the nine months ended September 30, 2010, cash received from the maturities and other repayments of fixed maturities was \$96.2 million.

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

### **BALANCE SHEET**

Total investments, net of amounts due from brokers, increased \$85.9 million to \$914.4 million during the nine months ended September 30, 2010 from \$828.5 million at December 31, 2009 largely due to \$57.3 million of investments acquired through the acquisition of AMIC and \$32.6 million in unrealized pre-tax gains on available-for-sale securities for the period.

The Company had net receivables from reinsurers of \$131.7 million at September 30, 2010. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2010.

Other assets increased \$1.8 million primarily due to intangible assets recorded during the first quarter of 2010 as a result of the acquisition of AMIC and other subsidiaries, partially offset by a decrease in tax assets.

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

**Total Health  
Reserves**

**September 30,**

**December 31,**

**2010**

**2009**

Medical Stop-Loss

\$

66,973

\$

71,504

Fully Insured  
Health

34,281

34,817

Group Disability

89,389

84,592

Individual A&H  
and Other

12,289

11,888

\$

202,932

\$

202,801

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

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

The \$37.8 million increase in IHC's stockholders' equity in the first nine months of 2010 is primarily due to a \$16.7 million after tax gain on the bargain purchase of AMIC and \$17.2 million in net unrealized gains on investments during the period.

### **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 \$6.7 million at September 30, 2010, approximately 96.3% of the Company's fixed maturities were investment grade and continue to be rated on average AA. The Company marks all of its available-for-sale securities to fair value through accumulated other comprehensive income or loss. These investments tend to carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At September 30, 2010, approximately 3.7% (or \$30.1 million) of the carrying value of fixed maturities was invested in non-investment grade fixed maturities (primarily mortgage securities) (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The increase in non-investment grade securities is primarily due to the downgrades in credit ratings of certain Alt-A mortgage securities. The Company does not have any non-performing fixed maturities at September 30, 2010.





The Company reviews its investments regularly and monitors its investments continually for impairments. For the nine months ended September 30, 2010, the Company recorded \$2.8 million of losses for other-than-temporary impairments. The unrealized losses on all remaining available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at September 30, 2010. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at September 30, 2010 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

**Greater  
than**

**Greater  
than**

**3 months,**

**6 months,**

**Less than**

**less than**

**less than**

**Greater  
than**

**3 months**

**6 months**

**12 months**

**12 months**

**Total**

Fixed  
maturities

\$

-

\$

498

\$

-

\$

1,791

\$

2,289

Equity  
securities

35

-

-

-

35

Total

\$

35

\$

498

\$

-

\$

1,791

\$

2,324

In 2010, the Company experienced an increase in net unrealized gains of \$32.6 million which, net of deferred taxes of \$9.6 million, and net of deferred policy acquisition costs of \$5.8 million, increased stockholders' equity by \$17.2 million (reflecting net unrealized gains of \$10.1 million at September 30, 2010 compared to net unrealized losses of \$7.1 million at December 31, 2009). From time to time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalances in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

### **CAPITAL RESOURCES**

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

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of September 30, 2010, is not materially different from that reported in the schedule of such obligations at December 31, 2009 which was included in Item 7 of the Company's Annual Report on Form 10-K.

### **OUTLOOK**

The Company remained highly liquid for the first nine months of the year, 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 \$144.8 million in highly rated shorter maturity securities earning on average 1.45%; 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.

In March 2010, IHC acquired control of AMIC through the purchase of additional shares of AMIC common stock in the open market; at September 30, 2010, IHC owned approximately 50.1% of the outstanding common stock of AMIC. The acquisition furthers our goal of creating efficiencies by integrating the back office operations of our MGUs and marketing companies. The Company will consider acquiring additional shares of AMIC stock in the market and/or in private transactions as opportunities arise.

For 2010, we will continue to emphasize:

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

•  
Seeking to acquire additional Medical Stop-Loss business to increase our premiums in a controlled underwriting environment. We have determined that the results of MGUs in which we have ownership generally outperform those of ones we do not own by a substantial margin, which is why we have reduced our block to focus primarily on business written by owned MGUs.

•  
Emphasizing cost containment strategies by integrating our new subsidiaries into our fully insured and medical stop-loss businesses.

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

We will continue to focus on our strategic objectives, including expanding our distribution network. However, the success of a portion of our Fully Insured Health business may be affected by the passage of the Patient Protection and Affordable Care and Education Reconciliation Act of 2010 signed by President Obama in March 2010. The National Association of Insurance Commissioners has now issued its proposed regulations. The regulations proposed to-date (including those mandating minimum loss ratios) seem to have validated our strategy of pursuing niche lines of business across many states utilizing multiple carriers and we believe they will have minimal impact in the near future. We have begun a comprehensive review of all the options for IHC and we are continuing a thorough evaluation of our options for those health insurance products that may be affected. Although the law will generally require insurers to operate with a lower expense structure for major medical plans in the small employer and individual



markets, the law may make exceptions for carriers, such as ours, that have a minimal presence in any one state. Non-essential lines of business are not impacted by health care reform.

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

**ITEM 3.**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at September 30, 2010 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2009 included in Item 7A of the Company's Annual Report on Form 10-K.

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

**ITEM 4.**

**CONTROLS AND PROCEDURES**

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

There has been no change in IHC's internal control over financial reporting during the nine months ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1.**

**LEGAL PROCEEDINGS**

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

**ITEM 1A.**

**RISK FACTORS**

There were no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 in Item 1A to Part 1 of Form 10-K.

**ITEM 2.**

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

**Share Repurchase Program**

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In January 2010, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC's common stock, inclusive of prior authorizations, under the 1991 plan. As of September 30, 2010, 293,600 shares were authorized to be repurchased under the plan. There were no share repurchases during the third quarter of 2010.

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**ITEM 4.**

**(REMOVED AND RESERVED)**

Not applicable

**ITEM 5.**

**OTHER INFORMATION**

Not applicable

**ITEM 6.**

**EXHIBITS**

31.1

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

31.2

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

32.1

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

32.2

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

**SIGNATURES**

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

**INDEPENDENCE HOLDING COMPANY**

(REGISTRANT)

By:

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

Date:

November 9, 2010

Roy T.K. Thung

Chief Executive Officer and President

By:

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

Date:

November 9, 2010

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer