NICHOLAS APPLEGATE CONVERTIBLE & INCOME FUND
Form N-2
April 01, 2003

As filed with the Securities and Exchange Commission on April 1, 2003

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1933 Act File No. 333-
1940 Act File No. 811-21284

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form N-2

[X] REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

[_] Pre-Effective Amendment No.

[_] Post-Effective Amendment No.
and

[X] REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940

[X] Amendment No. 4

Nicholas-Applegate Convertible & Income Fund
(Exact Name of Registrant as Specified in Declaration of Trust)

c/o PIMCO Advisors Fund Management LLC
1345 Avenue of the Americas
New York, New York 10105
(Address of Principal Executive Offices)
(Number, Street, City, State, Zip Code)

(212) 739-3369
(Registrant's Telephone Number, including Area Code)

Newton B. Schott, Jr.
c/o PIMCO Advisors Distributors LLC
2187 Atlantic Street
Stamford, Connecticut 06902
(Name and Address (Number, Street, City, State, Zip Code) of Agent for Service)

Copies of Communications to:

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Approximate Date of Proposed Public Offering:

As soon as practicable after the effective date of this Registration Statement

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If any of the securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. [_]

It is proposed that this filing will become effective (check appropriate box)

[X] when declared effective pursuant to section 8(c)

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount Being Registered	Proposed Maximum Offering Price Per Unit	Proposed Maxim Aggregate Offering Pric
Preferred Shares, par value $0.00001	10 Shares	$ 25,000.00	$ 250,000.

/1/ Estimated solely for the purpose of calculating the registration fee.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such dates as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this Prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities, and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION

PRELIMINARY PROSPECTUS 2003

Shares, Series A
Shares, Series B
Shares, Series C
Shares, Series D
Shares, Series E

[LOGO] PIMCO ADVISORS

Nicholas-Applegate Convertible & Income Fund

Auction Preferred Shares
Liquidation Preferred $25,000 Per Share

Investment Objective. The Fund is a recently organized, diversified, closed-end management investment company. The Fund's investment objective is to provide total return through a combination of capital appreciation and high current income.

Portfolio Contents. Under normal circumstances, the Fund will invest at least 80% of its total assets in a diversified portfolio of convertible securities and non-convertible income-producing securities. The Fund may invest up to 20% of its total assets in other types of securities. The portion of the Fund's assets invested in convertible securities, on the one hand, and non-convertible income-producing securities, on the other, will vary from time to time consistent with the Fund's investment objective, although the Fund will normally invest at least 50% of its total assets in convertible securities. In making allocation decisions, the Fund's portfolio manager will consider factors such as changes in equity prices, changes in interest rates and other economic and market factors. The Fund may invest without limit in securities that are below investment grade quality and expects that ordinarily the portfolio manager's strategies will result in the Fund investing primarily in these securities. Securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as "high yield" securities or "junk bonds." They involve greater risk of loss, are subject to greater price volatility and are less liquid, especially during periods of economic uncertainty or change, than higher rated securities. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative. There can be no assurance that the Fund will achieve its investment objective.

Certain capitalized terms used in this Prospectus are defined in the Glossary that appears at the end of this Prospectus.

Before buying any preferred shares you should read the discussion of the material risks of investing in the Fund in "Risks" beginning on page 29. Certain of these risks are summarized in "Prospectus summary--Special Risk Considerations" beginning on page 5.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Price to Public	Sales Load	Proceeds to Fund(1)
Per share	$25,000	$	$
Total	$	$	$

(1) Plus accumulated dividends if any, from the date the Auction Preferred Shares are issued, but before offering expenses payable by the Fund estimated to be $.

Auction Preferred Shares, Series A, Auction Preferred Shares, Series B, Auction Preferred Shares, Series C, Auction Preferred Shares, Series D, and Auction Preferred Shares, Series E (together, "APS") are being offered by the underwriters subject to certain conditions. The underwriters reserve the right to withdraw, cancel or modify the offering in whole or in part. It is expected that the APS will be delivered to the nominee of The Depository Trust Company on or about , 2003.

(continued from previous page)

Investors in APS will be entitled to receive cash dividends at an annual rate that may vary for the successive dividend periods for such shares. The dividend rate on the Series A APS for the initial period from and including the date of issue to, but excluding, , 2003 will be % per year. The dividend rate on the Series B APS for the initial period from and including the date of issue to, but excluding, , 2003 will be % per year. The dividend rate on the Series C APS for the initial period from and including the date of issue to, but excluding, , 2003 will be % per year. The dividend rate on the Series D APS for the initial period from and including the date of issue to, but excluding, , 2003 will be % per year. The dividend rate on the Series E APS for the initial period from and including the date of issue to, but excluding, , 2003 will be % per year. For each subsequent period, the Auction Agent will determine the dividend rate for a particular period by an auction conducted in accordance with the procedures described in this Prospectus and, in further detail, in Appendix A to the Statement of Additional Information (each, an "Auction").

The APS, which have no history of public trading, will not be listed on an exchange or automated quotation system. Broker-Dealers may maintain a secondary trading market in the APS outside of Auctions; however, they have no obligation to do so, and there can be no assurance that a secondary market for the APS will develop or, if it does develop, that it will provide holders with a liquid trading market (i.e., trading will depend on the presence of willing buyers and sellers and the trading price will be subject to variables to be determined at the time of the trade by such Broker-Dealers). A general increase in the level of interest rates may have an adverse effect on the secondary market price of the APS, and a selling shareholder that sells APS between Auctions may receive a price per share of less than $25,000. The Fund may redeem APS as described under "Description of APS--Redemption."

The APS will be senior in liquidation and distribution rights to the Fund's outstanding common shares. The Fund's common shares are traded on the New York Stock Exchange under the symbol "NCV." This offering is conditioned upon the APS receiving a rating of "Aaa" from Moody's Investors Service, Inc. ("Moody's").

You should read this Prospectus, which contains important information about the Fund, before deciding whether to invest, and retain it for future reference. A Statement of Additional Information, dated , 2003, containing additional information about the Fund, has been filed with the Securities and Exchange Commission and is incorporated by reference in its entirety into this Prospectus, which means that it is part of the Prospectus for legal purposes. You can review the table of contents of the Statement of Additional Information on page of this Prospectus. You may request a free copy of the Statement of Additional Information by calling (877) 819-2224 or by writing to the Fund, or obtain a copy (and other information regarding the Fund) from the Securities and Exchange Commission's web site (http://www.sec.gov).

The APS do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

You should rely only on the information contained or incorporated by reference in this Prospectus. The Fund has not, and the underwriters have not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The Fund is not, and the underwriters are not, making an offer of the APS in any state where the offer is not permitted. You should not assume that the information contained in this Prospectus is accurate as of any date other than the date on the front of this Prospectus. The Fund's business, financial condition, results of operations and prospects may have changed since that date.

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Prospectus summary

This is only a summary. This summary may not contain all of the information that you should consider before investing in the APS. You should review the more detailed information contained in this Prospectus and in the Statement of

Additional Information. Certain capitalized terms used in this Prospectus are defined in the Glossary that appears at the end of this Prospectus.

THE FUND

Nicholas-Applegate Convertible & Income Fund (the "Fund") is a recently organized, diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act"). See "The Fund." The Fund's common shares ("Common Shares") are traded on the New York Stock Exchange under the symbol "NCV." As of , 2003, the Fund had Common Shares outstanding and net assets of $.

THE OFFERING

The Fund is offering an aggregate of Series A APS, Series B APS, Series C APS, Series D APS and Series E APS, each at a purchase price of $25,000 per share plus accumulated dividends, if any, from the date of original issue. The APS are being offered through a group of underwriters led by (collectively, the "Underwriters"). See "Underwriting."

The APS will entitle their holders to receive cash dividends at an annual rate that may vary for successive Dividend Periods. In general, except as described under "Description of APS--Dividends," each Dividend Period will be seven days. The Auction Agent will determine the Applicable Rate for a particular period by an Auction conducted on the Business Day immediately prior to the start of that Dividend Period.

The APS are not listed on an exchange. Instead, investors may buy or sell APS at an Auction that normally is held weekly, by submitting orders to Broker-Dealers that have entered into an agreement with the Auction Agent and the Fund or to certain other Broker-Dealers. Deutsche Bank Trust Company Americas, the Auction Agent, reviews orders from Broker-Dealers on behalf of Existing Holders that wish to sell, or hold at the auction rate, or hold only at a specified Applicable Rate, and on behalf of Potential Holders that wish to buy, APS. The Auction Agent then determines the lowest Applicable Rate that will result in all of the outstanding APS continuing to be held. The first Auction Date for Series A APS will be , 2003, for Series B APS will be , 2003, for Series C APS will be , 2003, for Series D APS will be , 2003 and for Series E APS will be , 2003, each being the Business Day before the Initial Dividend Payment Date for the Initial Dividend Period for the relevant series of APS (, 2003, for Series A, , 2003 for Series B, , 2003 for Series C, 2003 for Series D and , 2003 for Series E). The Auction day for Series A APS generally will be Monday, for Series B APS generally will be Tuesday, for Series C APS generally will be Wednesday, for Series D APS generally will be Thursday and for Series E APS generally will be Friday, unless the then-current Dividend Period is a Special Dividend Period, or the day that normally would be the Auction Date or the first day of the subsequent Dividend Period is not a Business Day.

INVESTMENT OBJECTIVE AND STRATEGIES

Investment Objective

The Fund's investment objective is to provide total return through a combination of capital appreciation and high current income. The Fund attempts to achieve this objective by investing in a diversified portfolio of convertible securities and non-convertible income-producing securities described under

"Portfolio Contents" below. As described below, in seeking to achieve its investment objective, the Fund expects ordinarily to invest primarily in "high yield" securities or "junk bonds." The Fund cannot assure you that it will achieve its investment objective.

Portfolio Management Strategies

In selecting investments for the Fund, Nicholas-Applegate Capital Management LLC ("NACM"), the Fund's portfolio manager, attempts to identify issuers that successfully adapt to change. NACM uses traditional credit analysis combined with a disciplined, fundamental bottom-up research process that facilitates the early identification of issuers demonstrating an ability to improve their fundamental characteristics. See "Independent Credit Analysis" below. NACM attempts to identify potential investments that it expects will exceed minimum credit statistics and exhibit the highest visibility of future expected operating performance. NACM's sell discipline is clearly defined and designed to drive the Fund's portfolio continually toward strength, taking into account factors such as a change in credit fundamentals, a decline in attractiveness relative to other securities and a decline in industry fundamentals.

In selecting convertible securities for investment by the Fund, NACM evaluates each convertible security's investment characteristics as an income-producing security, using the techniques described above, as well as its potential for capital appreciation, using techniques that focus on the security's equity characteristics. NACM seeks to capture approximately 70-80% of any increase in the market price of the underlying equities (upside potential) and 50% or less of any decrease in the market price of the underlying equities (downside exposure). In analyzing specific companies for possible investment, NACM ordinarily looks for several of the following characteristics: above-average per share earnings growth; high return on invested capital; a healthy balance sheet; sound financial and accounting policies and overall financial strength; strong competitive advantages; effective research and product development and marketing; development of new technologies; efficient service; pricing flexibility; strong management; and general operating characteristics that will enable the companies to compete successfully in their respective markets. NACM will consider selling a particular convertible security when any of those factors materially changes.

Independent Credit Analysis

NACM relies heavily on its own analysis of the credit quality and risks associated with individual securities considered for the Fund, rather than relying exclusively on Rating Agencies or third-party research. The team managing the Fund utilizes this information in an attempt to minimize credit risk and identify issuers, industries or sectors that are undervalued or that offer attractive capital appreciation potential or high current income relative to NACM's assessment of their credit characteristics.

Portfolio Contents

Under normal circumstances, the Fund will invest at least 80% of its total assets in a diversified portfolio of convertible securities and non-convertible income-producing securities. The portion of the Fund's assets invested in convertible securities, on the one hand, and non-convertible income-producing securities, on the other, will vary from time to time consistent with the Fund's investment objective, although the Fund will normally invest at least 50% of its total assets in convertible securities. In making allocation decisions, NACM will consider factors such as changes in equity prices, changes in interest rates and other economic and market factors. The Fund may invest without limit in convertible securities and non-convertible income-producing securities that are below investment grade quality, and expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in these securities. The Fund invests in securities with a broad range of maturities. The weighted average maturity of the Fund will typically range from five to ten years, although the weighted average maturity of obligations held by the Fund may be shorter or longer at any time or from time to time depending on market

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conditions. The Fund may invest up to 20% of its total assets in other types of securities. The Fund may invest in securities of companies with smaller market capitalizations. The principal types of securities in which the Fund will invest are described below. For more detailed descriptions, see "The Fund's investment objective and strategies--Portfolio Contents and Other Information."

Convertible Securities

The Fund may invest without limit in convertible securities, and these securities will ordinarily constitute a principal component of the Fund's investment program. Under normal circumstances, the Fund will invest at least 50% of its total assets in convertible securities. Convertible securities are bonds, debentures, notes, preferred stocks or other securities that may be converted or exchanged (by the holder or by the issuer) into shares of the underlying common stock (or cash or securities of equivalent value) at a stated exchange ratio or predetermined price (the "conversion price"). A convertible security is designed to provide current income and also the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock. A convertible security may be called for redemption or conversion by the issuer after a particular date and under certain circumstances (including a specified price) established upon issue. Depending upon the relationship of the conversion price to the market value of the underlying security, a convertible security may trade more like an equity security than a debt instrument. See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--Convertible Securities."

Synthetic Convertible Securities

The Fund also may invest without limit in "synthetic" convertible securities, which combine separate securities that possess the two principal characteristics of a traditional convertible security, i.e., an income-producing security ("income-producing component") and the right to acquire an equity security ("convertible component"). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by investing in warrants or options to buy common stock at a certain exercise price, or options on a stock index. A simple example of a synthetic convertible security is the combination of a traditional corporate bond with a warrant to purchase equity securities of the issuer of the bond. The Fund may also purchase synthetic securities created by other parties, typically investment banks, including convertible structured notes. The income-producing and convertible components of a synthetic convertible security may be issued separately by different issuers and at different times. The Fund's holdings of synthetic convertible securities are considered convertible securities for purposes of the Fund's policy to invest at least 50% of its total assets in convertible securities and 80% of its total assets in a diversified portfolio of convertible securities and non-convertible income-producing securities. See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--Synthetic Convertible Securities."

Non-Convertible Income-Producing Securities

The Fund will also invest in non-convertible income-producing securities, including, but not limited to, corporate bonds, debentures, notes and other similar types of corporate debt instruments, as well as non-convertible preferred stocks, bank loans and loan participations, commercial paper, real estate investment trusts ("REITs") and commercial and other mortgage-related and asset-backed securities, payment-in-kind securities, credit-linked trust certificates and other securities issued by special purpose or structured vehicles, zero-coupon bonds, bank certificates of deposit, fixed time deposits, bankers' acceptances and U.S. Government securities. The Fund's investments in non-convertible income-producing securities may have fixed or variable principal payments and all types of interest rate and dividend payment and reset terms, including fixed rate, adjustable rate, zero-coupon, contingent, deferred, payment-in-kind and auction-rate features. See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--Non-Convertible Income-Producing Securities."

High Yield Securities

The Fund may invest without limit in convertible securities and non-convertible income-producing securities that are below investment grade quality, and expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in these securities. Below investment grade securities are securities rated, at the time of investment, below the four highest grades (i.e., rated Ba or lower by Moody's or BB or lower by Standard & Poor's ("S&P")) or securities that are unrated but judged to be of comparable quality by NACM. Below investment grade securities are sometimes referred to as "high yield" securities or "junk bonds." The Fund may invest in high yield securities of any rating, including securities given the lowest non-default rating (C by Moody's or S&P, as described in Appendix A) or unrated securities judged to be of comparable quality by NACM. Securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal. Securities in the lowest investment grade category (i.e., Baa by Moody's or BBB by S&P) also may be considered to possess some speculative characteristics. The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy. See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--High Yield Securities."

Foreign (Non-U.S.) Investments

The Fund may invest up to 20% of its total assets in U.S. dollar-denominated securities of foreign issuers based in developed countries. For this purpose, foreign securities include, but are not limited to, foreign convertible securities and non-convertible income-producing securities, foreign equity securities (including preferred securities of foreign issuers), foreign bank obligations, and obligations of foreign governments or their subdivisions, agencies and instrumentalities, international agencies and supranational entities. For this purpose, foreign securities do not include American Depository Receipts ("ADRs") or securities guaranteed by a United States person, but may include foreign securities in the form of Global Depository Receipts ("GDRs") or other securities representing underlying shares of foreign issuers See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--Foreign (Non-U.S.) Investments and Currencies."

Rule 144A Securities

The Fund may invest without limit in securities that have not been registered for public sale, but that are eligible for purchase and sale pursuant to Rule 144A under the Securities Act of 1933, as amended. Rule 144A permits certain qualified institutional buyers, such as the Fund, to trade in privately placed securities that have not been registered for sale under that Act. Rule 144A Securities may be deemed illiquid and thus subject to the Fund's limit on investments in illiquid securities, although the Fund may determine that certain Rule 144A Securities are liquid in accordance with procedures adopted by the Board of Trustees.

LEVERAGE

The Fund expects to utilize financial leverage on an ongoing basis for investment purposes. After completion of the offering of the APS, the Fund anticipates its total leverage from the issuance of APS will be approximately 35%. This amount may change, but total leverage will not exceed 50% of the Fund's total assets. Although the Fund may in the future offer other Preferred Shares, the Fund does not currently intend to offer Preferred Shares other than Series A APS, Series B APS, Series C APS, Series D APS and Series E APS. The Fund may also leverage the portfolio by borrowing money, issuing debt securities, and utilizing reverse repurchase agreements and other derivative instruments, although these forms of leverage will generally be used as a substitute for, rather than in addition to, the leverage obtained through the issuance of the APS.

The Fund generally will not utilize leverage if it anticipates that it would result in a lower return to Common Shareholders over time. Use of financial leverage creates an opportunity for increased income

for Common Shareholders but, at the same time, creates the possibility for greater loss (including the likelihood of greater volatility of net asset value and market price of the shares and of dividends), and there can be no assurance that a leveraging strategy will be successful during any period in which it is employed. Because the fees paid to the Manager and NACM will be calculated on the basis of the Fund's managed assets, the fees will be higher when leverage (including the APS) is utilized, giving the Manager and NACM an incentive to utilize leverage. See "Risks--Leverage Risk."

INVESTMENT MANAGER

PIMCO Advisors Fund Management LLC (the "Manager") serves as the investment manager of the Fund. Subject to the supervision of the Board of Trustees, the Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. The Manager will receive an annual fee, payable monthly, in an amount equal to 0.70% of the Fund's average daily total managed assets. "Total managed assets" means the total assets of the Fund (including any assets attributable to the APS or other forms of leverage that may be outstanding) minus accrued liabilities (other than liabilities representing leverage). The Manager is located at 1345 Avenue of the Americas, New York, New York 10105. Organized in 2000 as a subsidiary successor in the restructuring of a business originally organized in 1987, the Manager provides investment management and advisory services to several closed-end and open-end investment company clients. As of December 31, 2002, the Manager had approximately $16.6 billion in assets under management. Allianz Dresdner Asset Management of America L.P. is the direct parent company of PIMCO Advisors Retail Holdings LLC, of which the Manager is a wholly-owned subsidiary. As of December 31, 2002, Allianz Dresdner Asset Management of America L.P. and its subsidiary partnerships, including NACM, had approximately $357 billion in assets under management.

The Manager has retained its affiliate, NACM, as a sub-adviser to manage the Fund's portfolio investments. See "--Portfolio Manager" below.

PORTFOLIO MANAGER

NACM serves as the Fund's sub-adviser responsible for managing the Fund's portfolio investments, and is sometimes referred to herein as the "portfolio manager." Subject to the supervision of the Manager, NACM has full investment discretion and makes all determinations with respect to the investment of the Fund's assets.

NACM is located at 600 West Broadway, 30th Floor, San Diego, California 92101. Founded in 1984, NACM currently manages discretionary assets for numerous clients, including investment companies, employee benefit plans, corporations, public retirement systems and unions, university endowments, foundations, and other institutional investors and individuals. As of December 31, 2002, NACM had approximately $16.6 billion in assets under management.

The Manager (and not the Fund) will pay a portion of the fees it receives to NACM in return for NACM's services.

SPECIAL RISK CONSIDERATIONS

Risks of investing in APS include:

Auction Risk
You may not be able to sell your APS at an Auction if the Auction fails, that is, if there are more APS offered for sale than there are buyers for those shares. As a result, your investment in APS may be

illiquid. Neither the Broker-Dealers nor the Fund are obligated to purchase APS in an Auction or otherwise, nor is the Fund required to redeem APS in the event of a failed Auction.

Ratings and Asset Coverage Risk
A Rating Agency could downgrade the APS, which could affect their liquidity and value. In addition, the Fund may be forced to redeem your APS to meet regulatory or Rating Agency requirements. The Fund may also voluntarily redeem APS under certain circumstances.

Secondary Market Risk
You could receive less than the price you paid for your APS if you sell them outside of an Auction, especially when market interest rates are rising. Although the Broker-Dealers may maintain a secondary trading market in the APS outside of Auctions, they are not obligated to do so, and no secondary market may develop or exist at any time for the APS.

General risks of investing in the Fund include:

Limited Operating History
The Fund is a recently organized, diversified, closed-end management investment company which has been operational for less than   months.

Market Discount Risk
Shares of closed-end management investment companies like the Fund frequently trade at a discount from their net asset value.

Convertible Securities Risk
The Fund may invest without limit in convertible securities, and these securities will ordinarily constitute a principal component of the Fund's investment program. Under normal circumstances, the Fund will invest at least 50% of its total assets in convertible securities. Convertible securities

generally offer lower interest or dividend yields than non-convertible securities of similar quality. The market values of convertible securities tend to decline as interest rates increase and, conversely, to increase as interest rates decline. However, a convertible security's market value tends to reflect the market price of the common stock of the issuing company when that stock price is greater than the convertible security's "conversion price." The conversion price is defined as the predetermined price at which the convertible security could be exchanged for the associated stock. As the market price of the underlying common stock declines, the price of the convertible security tends to be influenced more by the yield of the convertible security. Thus, it may not decline in price to the same extent as the underlying common stock. In the event of a liquidation of the issuing company, holders of convertible securities would be paid before the company's common stockholders but after holders of any senior debt obligations of the company. Consequently, the issuer's convertible securities generally entail less risk than its common stock but more risk than its debt obligations. See "Risks--Convertible Securities Risk."

Synthetic Convertible Securities Risk
The Fund may invest without limit in synthetic convertible securities. The value of a synthetic convertible security will respond differently to market fluctuations than a traditional convertible security because a synthetic convertible is composed of two or more separate securities or instruments, each with its own market value. Because the convertible component is typically achieved by investing in warrants or options to buy common stock at a certain exercise price, or options on a stock index, synthetic convertible securities are subject to the risks associated with derivatives. See "Risks--Convertible Securities Risk" and "Risks--Derivatives Risk." In addition, if the value of the underlying common stock or the level of the index involved in the convertible component falls below the exercise price of the

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warrant or option, the warrant or option may lose all value. See "Risks--Synthetic Convertible Securities Risk."

Credit Risk/High Yield Risk
Credit risk is the risk that one or more securities in the Fund's portfolio will decline in price, or fail to pay interest or principal when due, because the issuer of the obligation or the issuer of a reference security experiences a decline in its financial status. Any default by an issuer of an debt obligation could have a negative impact on the Fund's ability to pay dividends on the APS and could result in the redemption of some or all of the APS. The Fund may invest without limit in securities that are below investment grade quality, and expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in these securities. Securities of below investment grade quality (commonly referred to as "high yield" securities or "junk bonds") are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal when due, and therefore involve a greater risk of default. The prices of these lower grade obligations are more sensitive to negative developments, such as a decline in the issuer's revenues or a general economic downturn, than are the prices of higher grade securities. The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy. Securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain Rating Agencies. See "The Fund's investment objective and strategies--Portfolio Contents and Other Information--High Yield Securities," "Risks--Credit Risk" and "Risks--High Yield Risk" for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

Interest Rate Risk
Generally, when market interest rates fall, the prices of convertible and non-convertible income-producing obligations rise, and vice versa. Interest rate risk is the risk that the securities in the Fund's portfolio will decline in value because of increases in market interest rates. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund's portfolio will decline in value. The prices of longer-term obligations generally fluctuate more than prices of shorter-term obligations as interest rates change. Because the weighted average maturity of the Fund's securities typically will range from five to ten years, the Fund's net asset value will tend to fluctuate more in response to changes in market interest rates than if the Fund invested mainly in short-term obligations. If interest rates rise, the value of the Fund's investment portfolio may decline reducing asset coverage on the APS. See "Risks--Interest Rate Risk" for additional information.

Issuer Risk
The value of securities in the Fund's portfolio may decline for a number of reasons which directly relate to the issuer, such as management performance, financial leverage and reduced demand for the issuer's goods and services.

Equity Securities Risk
The Fund will often have substantial exposure to equity securities by virtue of the equity component of the convertible securities in which the Fund invests. The Fund may also hold equity securities in its portfolio upon conversion of a convertible security or through direct investments in preferred stocks. The market price of equity securities may go up or down, sometimes rapidly or unpredictably. Equity securities may decline in value due to factors affecting equity securities markets generally, particular industries represented in those markets or the issuer itself, including the historical and prospective earnings of the issuer and the value of its assets. Equity securities generally have greater price volatility than debt and other income-producing securities.

Leverage Risk
The Fund utilizes financial leverage for investment purposes. Leverage risk includes the risk associated with the issuance of the APS to leverage the Fund's Common Shares. The Fund may also leverage the portfolio by borrowing money, issuing debt securities, and utilizing reverse repurchase agreements and other derivative instruments, although these forms of leverage will generally be used as a substitute for, rather than in addition to, the leverage obtained through the issuance of the APS. If the dividend rate on the APS and interest rates (if applicable) on other forms of leverage, as reset periodically, exceeds the net rate of return on the Fund's portfolio, the leverage will result in a lower net asset value than if the Fund were not leveraged, and the Fund's ability to pay dividends and to meet its asset coverage requirements on the APS would be reduced.

Because the fees received by the Manager and NACM are based on the total managed assets of the Fund, the fees will be higher when leverage (including the APS) is utilized, giving the Manager and NACM an incentive to utilize leverage.

Liquidity Risk
The Fund may invest up to 5% of its total assets in securities which are illiquid at the time of investment (determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, i.e., securities that cannot be disposed of within seven days in the ordinary

course of business at approximately the value at which the Fund has valued the securities). Illiquid securities may trade at a discount from comparable, more liquid investments, and may be subject to wide fluctuations in market value. Also, the Fund may not be able to dispose of illiquid securities when that would be beneficial at a favorable time or price.

Foreign (Non-U.S.) Investment Risk

The Fund's investments in U.S. dollar-denominated securities of foreign issuers involve special risks. For example, the value of these investments may decline in response to unfavorable political and legal developments, unreliable or untimely information, or economic and financial instability. Foreign settlement procedures also may involve additional risks.

Smaller Company Risk

The general risks associated with corporate income-producing and equity securities are particularly pronounced for securities issued by companies with smaller market capitalizations. These companies may have limited product lines, markets or financial resources, or they may depend on a few key employees. As a result, they may be subject to greater levels of credit, market and issuer risk. Securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. Companies with medium-sized market capitalizations may have risks similar to those of smaller companies.

Derivatives Risk

The Fund may utilize derivative instruments for investment purposes, as well as to leverage its portfolio, generally as a substitute for, rather than in addition to, the issuance of the APS. These may include derivatives used as a component of a synthetic convertible security or to gain exposure to high yield securities and other securities in which the Fund may invest (pending investment of the proceeds of this offering). Such derivative instruments include, but are not limited to, warrants, options on common stock or stock indexes and futures contracts. The Fund may also have exposure to derivatives, such as credit default swaps and interest rate swaps, through investments in credit-linked trust certificates or other securities issued by special purpose or structured vehicles. Derivatives are subject to a number of risks described elsewhere in this Prospectus, such as liquidity risk, equity securities risk, issuer risk, credit risk, interest rate risk, leveraging risk, management risk and, if applicable, smaller company risk. They also

involve the risk of mispricing or improper valuation, the risk of ambiguous documentation, and the risk that changes in the value of the derivative may not correlate perfectly with an underlying asset, interest rate or index. Suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions when that would be beneficial.

Counterparty Risk

The Fund will be subject to credit risk with respect to the counterparties to derivative contracts entered into directly by the fund or held by special purpose or structured vehicles in which the Fund invests. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract in a bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

REITs and Mortgage-Related Risk

Investing in REITs involves certain unique risks in addition to investing in the real estate industry in general. REITs are subject to interest rate risks (especially mortgage REITs) and the risk of default by lessees or borrowers. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by the ability of the issuers of its portfolio mortgages to repay their obligations. REITs whose underlying assets are concentrated in properties used by a particular industry are also subject to risks associated with such industry. REITs may have limited financial resources, may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities.

In addition to REITs, the Fund may invest in a variety of other mortgage-related securities, including commercial mortgage securities and other mortgage-backed instruments. Rising interest rates tend to extend the duration of mortgage-related securities, making them more sensitive to changes in interest rates, and may reduce the market value of the securities. In addition, mortgage-related securities are subject to prepayment risk--the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. The Fund's investments in other asset-backed securities are subject to risks similar to those associated with mortgage-backed securities, as well as additional risks associated with the nature of the assets and the servicing of those assets.

Reinvestment Risk

Income from the Fund's portfolio will decline if and when the Fund invests the proceeds from matured, traded or called obligations at market interest rates that are below the portfolio's current earnings rate. This could impact the Fund's net asset value and reduce asset coverage on the APS.

Inflation Risk

Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of payments at future dates. As inflation increases, the real value of the APS and distributions, as well as the value of the Fund's portfolio, could decline.

Management Risk

The Fund is subject to management risk because it is an actively managed portfolio. NACM and the portfolio management team will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these will produce the desired results.

Anti-Takeover Provisions

The Fund's Amended and Restated Agreement and Declaration of Trust (the "Declaration") and Amended Bylaws include provisions that could limit the ability of other entities or persons to acquire control of the Fund, convert the Fund to open-end status or to change the composition of the Board of Trustees. Preferred Shareholders will have voting rights in addition to and separate from the voting rights of the Common Shareholders in certain situations. See "Anti-takeover and other provisions in the Declaration of Trust." Preferred Shareholders, on the one hand, and Common Shareholders, on the other, may have interests that conflict in these situations.

Certain Affiliations

Because certain broker-dealers may be considered affiliated persons of the Fund, the Manager and/or NACM, the Fund's ability to utilize such broker-dealers is subject to restrictions and, in some cases, is prohibited.

This could limit the Fund's ability to engage in securities transactions and take advantage of market opportunities.

Market Disruption and Geopolitical Risk

The recent outbreak of war with Iraq is likely to have a substantial impact on the U.S. and world economies and securities markets. The nature, scope and duration of the war and such impact cannot be predicted with any certainty. Terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 closed some of the U.S. securities markets for a four-day period and similar events cannot be ruled out. The war, terrorism and related geopolitical risks have led, and may in the future lead, to increased short-term market volatility and may have adverse long-term effects on U.S. and world economies and markets generally. Those events could also have an acute effect on individual issuers or related groups of issuers. These risks could adversely affect interest rates, Auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Common Shares.

For additional information about the risks of investing in the APS and in the Fund, see "Risks."

DIVIDENDS ON APS

The APS will entitle their holders to receive cash dividends at a rate per annum that may vary for the successive Dividend Periods for such shares. In general, except as described below, each Dividend Period for each series of APS subsequent to the Initial Dividend Period will be seven days in length. The Applicable Rate for a particular Dividend Period will be determined by an Auction conducted on the Business Day next preceding the start of such Dividend Period.

Through their Broker-Dealers, Beneficial Owners and Potential Beneficial Owners of APS may participate in Auctions, although, except in the case of Special Dividend Periods of longer than 91 days, Beneficial Owners desiring to continue to hold all of their APS regardless of the Applicable Rate resulting from Auctions need not participate. For an explanation of Auctions and the method of determining the Applicable Rate, see "Description of APS--The Auction."

Except as described herein, investors in APS will not receive certificates representing ownership of their shares. Ownership of APS will be maintained in book-entry form by the Securities Depository or its nominee for the account of the investor's Agent Member. The investor's Agent Member, in turn, will maintain records of such investor's beneficial ownership of APS. Accordingly, references herein to an investor's investment in or purchase, sale or ownership of APS are to purchases, sales or ownership of those shares by Beneficial Owners.

After the Initial Dividend Period, each Subsequent Dividend Period for each series of APS will generally consist of seven days (a "7-Day Dividend Period"); provided, however, that prior to any Auction, the Fund may elect, subject to certain limitations described herein, upon giving notice to holders thereof, a

Special Dividend Period for any or all series. A "Special Dividend Period" is a Dividend Period consisting of a specified number of days, evenly divisible by seven and not fewer than 14 nor more than 364 (a "Short Term Dividend Period") or a Dividend Period consisting of a specified period of one whole year or more but not greater than five years (a "Long Term Dividend Period"). Dividends on the APS offered hereby are cumulative from the Date of Original Issue and are payable when, as and if declared by the Board of Trustees of the Fund, out of funds legally available therefor, commencing on the Initial Dividend Payment Date. In the case of Dividend Periods that are not Special Dividend Periods, dividends will be payable generally on each succeeding Tuesday for Series A APS, on each succeeding Wednesday for Series B APS, on each succeeding Thursday for Series C APS, on each succeeding Friday for Series D APS and on each succeeding Monday for Series E APS, subject to certain exceptions.

Dividends for the APS will be paid through the Securities Depository on each Dividend Payment Date. The Securities Depository's normal procedures provide for it to distribute dividends in same-day funds to Agent Members, who are in turn expected to distribute such dividends to the person for whom they are acting as agent in accordance with the instructions of such person. See "Description of APS--Dividends."

For each Subsequent Dividend Period, the cash dividend rate on each series of APS will be the Applicable Rate that the Auction Agent advises the Fund has resulted from an Auction. See "Description of APS--Dividends." The first Auction for each series of the APS is scheduled to be held on the ending date for the Initial Dividend Period as set forth above.

The Amended Bylaws provide that until the Fund gives a Request for Special Dividend Period and the related Notice of Special Dividend Period, only 7-Day Dividend Periods will be applicable to each series of APS. While the Fund does not currently intend to give a Request for Special Dividend Period with respect to any series of APS, it may so elect in the future subject to, and on, the conditions discussed under "Description of the APS--Dividends--Notification of Dividend Period."

A Special Dividend Period will not be effective for a series of APS unless Sufficient Clearing Bids exist at the Auction in respect of such Special Dividend Period. If Sufficient Clearing Bids do not exist at such Auction, the Dividend Period commencing on the Business Day succeeding such Auction will be a 7-Day Dividend Period, and the holders of the APS outstanding immediately prior to such Auction will be required to continue to hold some or all of such shares for such Dividend Period. In addition, the Fund may not give a Notice of Special Dividend Period with respect to the APS, or if the Fund has given a Notice of Special Dividend Period for the APS, the Fund will be required to give a Notice of Revocation in respect thereof, if (i) either the 1940 Act APS Asset Coverage is not satisfied or the Fund fails to maintain Moody's Eligible Assets with, an aggregate Discounted Value at least equal to the APS Basic Maintenance Amount, in each case on each of the two Valuation Dates immediately preceding the Business Day prior to-the related Auction Date for the APS, or (ii) sufficient funds for the payment of dividends payable on the immediately succeeding Dividend Payment Date have not been irrevocably deposited with the Auction Agent by the close of business on the third Business Day preceding the related Auction Date. In such event, the next succeeding Dividend Period will be a 7-Day Dividend Period.

DETERMINATION OF MAXIMUM APPLICABLE RATES

Except during a Non-Payment Period, the Applicable Rate for any Dividend Period for APS will not be more than the Maximum Applicable Rate applicable to such shares. The Maximum Applicable Rate for each series of APS will depend on the credit rating assigned to such series and on the duration of the Dividend Period. The Maximum Applicable Rate will be the Applicable Percentage of the Reference Rate. The Reference Rate is the applicable "AA" Financial Composite Commercial Paper Rate (for a dividend period of fewer than 184 days) or the applicable Treasury Index Rate (for a dividend period of 184 days or more). The Applicable Percentage is subject to upward but not downward adjustment in the discretion of the Board of Trustees after consultation with the Broker-Dealers. The Applicable Percentage is determined as follows:

Moody's Credit Rating	Applicable Percentage
Aa3 or higher	150%
A3 to A1	200%
Baa3 to Baa1	225%
Below Baa3	275%

There is no minimum Applicable Rate in respect of any Dividend Period. The Applicable Rate for any Dividend Period commencing during any Non-Payment Period, and the rate used to calculate the late charge described under "Description of APS--Dividends--Non-Payment Period; Late Charge," initially will be % of the Reference Rate.

AUCTION PROCEDURES

Separate Auctions will be conducted for each series of APS. Unless otherwise permitted by the Fund, Beneficial Owners and Potential Beneficial Owners of APS may only participate in Auctions through their Broker-Dealers. Broker-Dealers will submit the Orders of their respective customers who are Beneficial Owners and Potential Beneficial Owners to the Auction Agent, designating themselves as Existing Holders in respect of shares subject to Orders submitted or deemed submitted to them by Beneficial Owners and as Potential Holders in respect of shares subject to Orders submitted to them by Potential Beneficial Owners. On or prior to each Auction Date for the APS (the Business Day next preceding the first day of each Dividend Period), each Beneficial Owner may submit Orders to its Broker Dealer as follows:

.. Hold Order--indicating its desire to hold the APS without regard to the Applicable Rate for the next Dividend Period for such shares.

.. Bid--indicating its desire to hold the APS, provided that the Applicable Rate for the next Dividend Period for such shares is not less than the rate per annum specified in such Bid.

.. Sell Order--indicating its desire to sell the APS without regard to the Applicable Rate for the next Dividend Period for such shares.

A Beneficial Owner may submit different types of Orders to its Broker-Dealer with respect to the APS then held by such Beneficial Owner, provided that the total number of APS covered by such Orders does not exceed the number of APS held by such Beneficial Owner. If, however, a Beneficial Owner offers through its Broker-Dealer to purchase additional APS in such Auction, such Beneficial Owner, for purposes of such offer to purchase additional shares, will be treated as a Potential Beneficial Owner as described below. Bids by Beneficial Owners through their Broker-Dealers with rates per annum higher than the Maximum Applicable Rate will be treated as Sell Orders. A Hold Order (in the case of an Auction relating to a Dividend Period of 91 days or less) or a Sell Order (in the case of an Auction relating to a Special Dividend Period of longer than 91 days) shall be deemed to have been submitted on behalf of a Beneficial Owner if an Order with respect to the APS then held by such Beneficial Owner is not submitted on behalf of such Beneficial Owner for any reason, including the failure of a Broker-Dealer to submit such Beneficial Owner's Order to the Auction Agent.

Potential Beneficial Owners of APS may submit Bids through their Broker-Dealers in which they offer to purchase APS, provided that the Applicable Rate for the next Dividend Period for such shares is not less than the rate per annum specified in such Bid. A Bid by a Potential Beneficial Owner with a rate per annum higher than the Maximum Applicable Rate will not be considered.

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Neither the Fund nor the Auction Agent will be responsible for a Broker-Dealer's failure to act in accordance with the instructions of Beneficial Owners or Potential Beneficial Owners or failure to comply with any of the foregoing.

A Broker-Dealer also may hold APS for its own account as a Beneficial Owner. A Broker-Dealer thus may submit Orders to the Auction Agent as a Beneficial Owner or a Potential Beneficial Owner and therefore participate in an Auction as an Existing Holder or Potential Holder on behalf of both itself and its customers. Any Order placed with the Auction Agent by a Broker-Dealer as or on behalf of a Beneficial Owner or a Potential Beneficial Owner will be treated in the same manner as an Order placed with a Broker-Dealer by a Beneficial Owner or a Potential Beneficial Owner. Similarly, any failure by a Broker-Dealer to submit to the Auction Agent an Order in respect of any APS held by it or its customers who are Beneficial Owners will be treated in the same manner as a Beneficial Owner's failure to submit to its Broker-Dealer an Order in respect of APS held by it, as described above. Inasmuch as a Broker-Dealer participates in an Auction as an Existing Holder or a Potential Holder only to represent the interests of a Beneficial Owner or Potential Beneficial Owner, whether it be a customer or itself, all discussion herein relating to the consequences of an Auction for Existing Holders and Potential Holders also applies to the underlying beneficial ownership interests represented thereby.

If Sufficient Clearing Bids exist in an Auction for a series of APS (that is, in general, the number of APS subject to Bids by Potential Holders with rates equal to or lower than the Maximum Applicable Rate is at least equal to the number of APS subject to Sell Orders by Existing Holders), the Applicable Rate will be the lowest rate per annum specified in the Submitted Bids which, taking into account such rate per annum and all lower rates per annum bid by Existing Holders and Potential Holders, would result in Existing Holders and Potential Holders owning all of the APS available for purchase in the Auction. If Sufficient Clearing Bids do not exist, the Dividend Period next following the Auction automatically will be a 7-Day Dividend Period and the Applicable Rate will be the Maximum Applicable Rate, and in such event, Existing Holders that have submitted Sell Orders will not be able to sell in the Auction all, and may not be able to sell any, APS subject to such Sell Orders. Thus, in certain circumstances, Existing Holders and, thus, the Beneficial Owners they represent may not have liquidity of investment. If all Existing Holders submit (or are deemed to have submitted) Hold Orders in an Auction, the Dividend Period next following the Auction automatically shall be the same length as the immediately preceding Dividend Period, and the Applicable Rate will be 40% of the Reference Rate (as defined under "Determination of Maximum Applicable Rates" above) in effect on the date of the Auction. The Auction Procedures include a pro rata allocation of shares for purchase and sale, which may result in an Existing Holder selling or holding, or a Potential Holder purchasing, a number of APS that is less than the number of APS specified in its Order. To the extent the allocation has this result, a Broker-Dealer will be required to make appropriate pro rata allocations among its customers and itself.

A Sell Order by an Existing Holder will constitute an irrevocable offer to sell the APS subject thereto, and a Bid placed by an Existing Holder also will constitute an irrevocable offer to sell the APS subject thereto if the rate per annum specified in the Bid is higher than the Applicable Rate determined in the Auction, in each case at a price per share equal to $25,000. A Bid placed by a Potential Holder will constitute an irrevocable offer to purchase the APS subject thereto at a price per share equal to $25,000 if the rate per annum specified in such Bid is less than or equal to the Applicable Rate determined in the Auction. Settlement of purchases and sales will be made on the next Business Day (also a Dividend Payment Date) after the Auction Date through the Securities Depository. Purchasers will make payment through their Agent Members in same-day funds to the Securities Depository against delivery by book-entry to their Agent Members. The Securities Depository will make payment to the sellers' Agent Members in accordance with the Securities Depository's normal procedures, which now provide for payment in same-day funds. See "Description of APS--The Auction."

ASSET MAINTENANCE

Under the Amended Bylaws, the Fund must maintain (i) Moody's Eligible Assets having, in the aggregate, a Discounted Value at least equal to the APS Basic Maintenance Amount and (ii) 1940 Act APS Asset Coverage of at least 200%. See "Description of APS--Asset Maintenance."

In the event that the Fund does not maintain (or cure a failure to maintain) these coverage tests, some or all of the APS will be subject to mandatory redemption. See "Description of APS--Redemption--Mandatory Redemption."

The Fund estimates that, based on the composition of its portfolio at , 2003, 1940 Act APS Asset Coverage with respect to APS would be approximately % immediately after the issuance of the APS offered hereby in an amount representing approximately % of the Fund's capital (including the capital attributable to the APS). This asset coverage will change from time to time.

The Discount Factors and guidelines for calculating the Discounted Value of the Fund's portfolio for purposes of determining whether the APS Basic Maintenance Amount has been satisfied have been established by Moody's in connection with the Fund's expected receipt of a rating of "Aaa" on the APS on their Date of Original Issue. See "Rating agency guidelines."

MANDATORY REDEMPTION

If the APS Basic Maintenance Amount or the 1940 Act APS Asset Coverage is not maintained or restored as specified herein, the APS will be subject to mandatory redemption, out of funds legally available therefor, at the Mandatory Redemption Price of $25,000 per share plus an amount equal to, dividends thereon (whether or not earned or declared) accumulated but unpaid to the date fixed for redemption. Any such redemption will be limited to the minimum number of APS necessary to restore the APS Basic Maintenance Amount or the 1940 Act APS Asset Coverage, as the case may be. The Fund's ability to make such a mandatory redemption may be restricted by the provisions of the 1940 Act. See "Description of APS--Redemption--Mandatory Redemption."

OPTIONAL REDEMPTION

The APS are redeemable at the option of the Fund, as a whole or in part, on any Dividend Payment Date (except during the Initial Dividend Period or a Non-Call Period) at the Optional Redemption Price of $25,000 per share, plus an amount equal to dividends thereon (whether or not earned or declared) accumulated but unpaid to the date fixed for redemption plus the premium, if any, resulting from the designation of a Premium Call Period. See "Description of APS--Redemption--Optional Redemption."

LIQUIDATION PREFERENCE

The liquidation preference of the APS will be $25,000 per share, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared). See "Description of APS--Liquidation Rights."

RATING

It is a condition to their issuance that the APS be issued with a credit quality rating of "Aaa" from Moody's. The Fund may at some future time seek to have the APS rated by an additional or Substitute Rating Agency. See "Rating agency guidelines."

VOTING RIGHTS

The 1940 Act requires that the holders of APS and any other Preferred Shares, voting as a separate class, have the right to elect at least two Trustees at all times and to elect a majority of the Trustees at any time when two years' dividends on the APS or any other Preferred Shares are unpaid. The holders of APS and any other Preferred Shares will vote as a separate class on certain other matters as required under the Declaration and Amended Bylaws and under the 1940 Act. See "Description of APS--Voting Rights," "Description of capital structure" and "Anti-takeover and other provisions in the Declaration of Trust."

TAX CONSIDERATIONS

The distributions with respect to any series of APS (other than distributions in redemption of APS subject to Section 302(b) of the Internal Revenue Code of 1986, as amended (the "Code")) will constitute dividends to the extent of the Fund's current or accumulated earnings and profits, as calculated for federal income tax purposes. Such dividends generally will be taxable as ordinary income to holders. Distributions of net capital gains (i.e., the excess of net long-term capital gains over net short-term capital losses) that are designated by the Fund as capital gain dividends will be treated as long-term capital gains in the hands of holders receiving such distributions. The Internal Revenue Service (the "IRS") currently requires that a regulated investment company that has two or more classes of stock allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains) based upon the percentage of total dividends distributed to each class for the tax year. Accordingly, the Fund intends each year to allocate capital gain dividends as between and among its Common Shares and each series of the APS in proportion to the total dividends paid to each class during or with respect to such year. Ordinary income dividends and dividends qualifying for the dividends received deduction will similarly be allocated between and among classes. See "Tax matters."

Financial highlights (unaudited)

The financial highlights table set forth below is intended to help you understand the Fund's recent financial performance. Information contained in the table below under the headings "Per Share Operating Performance" and "Ratios/Supplemental Data" shows the unaudited operating performance of the Fund from the commencement of the Fund's investment operations on March 31, 2003 through , 2003. Because the Fund is recently organized and commenced investment operations on March 31, 2003, the table covers weeks of operations, during which a substantial portion of the Fund's portfolio was held in temporary investments pending investment in securities that meet the Fund's investment objective and policies. Accordingly, the information presented may not provide a meaningful picture of the Fund's operating performance.

		For the Period From March 31, 2003* through , 2003 (Unaudited)
Per Share Operating Performance		
Net Asset Value, Beginning of Period	$	**
Income from Investment Operations:		
Net Investment Income		
Net Realized and Unrealized Gain on Investments and Foreign Currency Transactions		
Net Increase in Net Assets from Investment Operations		
Common Stock Offering Expenses Charged to Paid-in-Capital in Excess of Par		
Net Asset Value, End of Period	$	
Market Price, End of Period	$	
Total Investment Return		%(1)
Ratios/Supplemental Data:		
Net Assets, End of Period (in thousands)	$	
Ratio of Expenses to Average Net Assets		%(2)
Ratio of Net Investment Income to Average Net Assets		%(2)
Portfolio Turnover		%

* Date of commencement of operations

** Initial public offering price of $ per share less underwriting discount of $ per share.

(1) Total Investment Return is calculated assuming a purchase of common stock at the current market price on the first day and a sale at the current market price on the last day of the period reported. Total Investment Return does not reflect brokerage commissions. Total Investment Return for a period less than one year is not annualized.

(2) Annualized

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The Fund

The Fund is a recently organized, diversified, closed-end management investment company registered under the 1940 Act. The Fund was organized as a Massachusetts business trust on January 17, 2003, pursuant to the Declaration, which is governed by the laws of The Commonwealth of Massachusetts. The Fund's principal office is located at 1345 Avenue of the Americas, New York, New York 10105, and its telephone number is (800) 331-1710.

The Fund commenced operations on March 31, 2003, upon the closing of an initial public offering of 60,000,000 of its Common Shares. The net proceeds of such offering were approximately $858,350,000 after the payment of organizational and offering expenses. In connection with the initial public offering of the Fund's Common Shares, the underwriters were granted an option to purchase up to an additional Common Shares to cover over-allotments. On , 2003, and , 2003, the underwriters purchased, at a price of $ per Common Share, an additional Common Shares of the Fund pursuant to the over-allotment option.

Use of proceeds

The net proceeds of the offering of APS will be approximately $ after payment of the estimated offering costs. The Fund will invest the net proceeds of the offering in accordance with the Fund's investment objective and policies as stated below. It is presently anticipated that the Fund will be able to invest substantially all of the net proceeds in convertible securities and non-convertible income-producing securities within three months after the completion of this offering. Pending such investment, it is anticipated that the proceeds will be invested in high grade, short-term securities, credit-linked trust certificates, and/or high yield securities index futures contracts or similar derivative instruments designed to give the Fund market exposure while NACM selects specific securities.

Capitalization

The following table sets forth the unaudited capitalization of the Fund as of , 2003, and as adjusted to give effect to the issuance of the APS offered hereby (including estimated offering expenses and sales load of $).

	Actual	As Adjusted
Auction Preferred Shares, par value $0.00001 per share (no shares issued; shares issued, as adjusted, at $25,000 per share liquidation preference)...	$0	$
Common Shares, par value $0.00001 per share, shares outstanding......	$	$
Undistributed net investment income..	$	$
Net realized gain/loss on investment transactions..........................	$	$
Net unrealized appreciation/(depreciation) on investments, swaps and foreign currency transactions...	$	$
Net assets applicable to Common Shares....................................	$	$

Portfolio composition

As of , 2003, approximately % of the market value of the Fund's portfolio was invested in long-term investments and approximately % of the market value of the Fund's portfolio was invested in short-term investments. The following table sets forth certain information with respect to the composition of the Fund's investment portfolio as of , 2003, based on the highest rating assigned.

S&P*	Moody's*	Number of Issues	Value (in Thousands)	Percent
AAA	Aaa		$	%
AA	Aa1, Aa			
A	A1			
BBB	Baa1			
BB	Ba1			
B	B1			
CCC	Caa			
CC	Ca			
C	C			
NR#	NR#			
Cash				
Total				100.0%

* Ratings: Using the higher of S&P's or Moody's ratings on the Fund's portfolio securities. S&P rating categories may be modified further by a plus (+) or minus (-) in AA, A, BBB, BB, B and C ratings. Moody's rating categories may be modified further by a 1, 2, or 3 in Aa, A, Baa, Ba and B ratings.

\# Refers to securities that have not been rated by Moody's or S&P but have been assessed by NACM as being of comparable credit quality to rated securities in which the Fund may invest. See "The Fund's investment objective and strategies."

The Fund's investment objective and strategies

INVESTMENT OBJECTIVE

The Fund's investment objective is to provide total return through a combination of capital appreciation and high current income. The Fund attempts to achieve its investment objective by investing in a diversified portfolio of convertible securities and non-convertible income-producing securities described under "--Portfolio Contents and Other Information" below. In seeking to achieve its investment objective, the Fund expects to invest primarily in "high yield" securities or "junk bonds." The Fund cannot assure you that it will achieve its investment objective.

PORTFOLIO MANAGEMENT STRATEGIES

In selecting investments for the Fund, NACM attempts to identify issuers that successfully adapt to change. NACM uses traditional credit analysis combined with a disciplined, fundamental bottom-up research process that facilitates the early identification of issuers demonstrating an ability to improve their fundamental characteristics. See "--Independent Credit Analysis" below. NACM attempts to identify potential investments that it expects will exceed minimum credit statistics and exhibit the highest visibility of future expected operating performance. NACM's sell discipline is clearly defined and designed to drive the Fund's portfolio continually toward strength. A series of sell alerts triggering

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further verification research, such as changes in credit fundamentals, declines in relative attractiveness to other issues and declines in industry fundamentals, are utilized, and NACM will consider selling a particular security if any of the original reasons for purchase materially changes.

In selecting convertible securities for investment by the Fund, NACM evaluates each convertible security's investment characteristics as an income-producing security, using the techniques described above, as well as its potential for capital appreciation, using techniques that focus on the security's equity characteristics. NACM seeks to capture approximately 70-80% of any increase in the market price of the underlying equities (upside potential) and 50% or less of any decrease in the market price of the underlying equities (downside exposure). In analyzing specific companies for possible investment, NACM ordinarily looks for several of the following characteristics: above-average per share earnings growth; high return on invested capital; a healthy balance sheet; sound financial and accounting policies and overall financial strength; strong competitive advantages; effective research and product development and marketing; development of new technologies; efficient service; pricing flexibility; strong management; and general operating characteristics that will enable the companies to compete successfully in their respective markets. NACM will consider selling a particular convertible security when any of those factors materially changes.

Credit Quality
The Fund may invest without limit in securities that are below investment grade quality, including unrated securities judged to be of comparable quality by NACM, and expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in these securities. The Fund may invest in issuers of any credit quality (including securities in the lowest ratings categories). The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy. As described under "Portfolio Contents and Other Information--High Yield Securities" below, securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as "high yield" securities or "junk bonds." Securities in the lowest investment grade category also may be considered to possess some speculative characteristics.

Independent Credit Analysis
NACM relies heavily on its own analysis of the credit quality and risks associated with individual securities considered for the Fund, rather than relying exclusively on rating agencies or third-party research. NACM has a devoted team of professionals that conducts fundamental credit research and analysis of individual issuers, industries and sectors and uses analytical tools to assess and monitor credit risk. The team managing the Fund utilizes this information in an attempt to minimize credit risk and identify issuers, industries or sectors that are undervalued or that offer attractive capital appreciation potential or current income relative to NACM's assessment of their

credit characteristics.

PORTFOLIO CONTENTS AND OTHER INFORMATION

Under normal circumstances, the Fund will invest at least 80% of its total assets in a diversified portfolio of convertible securities and non-convertible income-producing securities. The portion of the Fund's assets invested in convertible securities, on the one hand, and non-convertible income-producing securities, on the other, will vary from time to time consistent with the Fund's investment objective, although the Fund will normally invest at least 50% of its total assets in convertible securities. In making allocation decisions, NACM will consider factors such as changes in equity prices, changes in interest rates and other economic and market factors. The Fund invests in securities with a broad range of maturities. The weighted average maturity of the Fund will typically range from five to ten years,

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although the weighted average maturity of obligations held by the Fund may be shorter or longer at any time or from time to time depending on market conditions.

The Fund may invest up to 20% of its total assets in securities other than convertible securities and non-convertible income-producing securities. The Fund may invest up to 5% of its total assets in illiquid securities (which is determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, i.e., securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). The Fund may invest in securities of companies with smaller market capitalizations.

The Fund cannot change its investment objective without the approval of the holders of a "majority of the outstanding" Common Shares and any Preferred Shares (including the APS) voting together as a single class, and of the holders of a "majority of the outstanding" Preferred Shares (including the APS) voting as a separate class. A "majority of the outstanding" shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less. See "Description of APS--Voting Rights" for additional information with respect to the voting rights of holders of APS.

In addition to the issuance of the APS, the Fund may also leverage the portfolio by borrowing money, issuing debt securities, and utilizing reverse repurchase agreements and other derivative instruments, although these forms of leverage will generally be used as a substitute for, rather than in addition to, the leverage obtained through the issuance of the APS. See "Risks--Leverage."

Upon NACM's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, including during the period in which the net proceeds of this offering are being invested, the Fund may deviate from its investment objective and policies and invest some or all of its net assets in investments such as high grade, short-term debt securities. The Fund may not achieve its investment objective when it does so.

It is the policy of the Fund not to engage in trading for short-term profits although portfolio turnover rate is not considered a limiting factor in the execution of investment decisions for the Fund. Frequent changes in the Fund's investments (i.e., portfolio turnover), which are more likely in periods of volatile market movements, involve some expense to the Fund, including brokerage commissions or dealer mark-ups and other transaction costs, and may increase the amount of capital gains (and, in particular, short-term gains) realized by the Fund, on which shareholders may pay tax. Please see "Investment Objective and Policies--Portfolio Trading and Turnover Rate" in the Statement of Additional Information for more information regarding portfolio turnover.

The following provides additional information regarding the types of securities and other instruments in which the Fund will ordinarily invest. A more detailed discussion of these and other instruments and investment techniques that may be used by the Fund is provided under "Investment Objective and Policies" in the Statement of Additional Information. The ability of the Fund to use some of the strategies discussed below and in the Statement of Additional Information, such as derivatives, is limited by the Rating Agency guidelines. See "Rating agency guidelines" below.

Convertible Securities

The Fund may invest without limit in convertible securities, and these securities will ordinarily constitute a principal component of the Fund's investment program. Convertible securities are bonds, debentures, notes, preferred stocks or other securities that may be converted or exchanged (by the holder or by the

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issuer) into shares of the underlying common stock (or cash or securities of equivalent value) at a stated exchange ratio or predetermined price (the "conversion price"). A convertible security is designed to provide current income and also the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock. A convertible security may be called for redemption or conversion by the issuer after a particular date and under certain circumstances (including a specified price) established upon issue. If a convertible security held by the Fund is called for redemption or conversion, the Fund could be required to tender it for redemption, convert it into the underlying common stock or sell it to a third party. Convertible securities have general characteristics similar to both debt securities and equity securities. Although to a lesser extent than with debt obligations, the market value of convertible securities tends to decline as interest rates increase and, conversely, tends to increase as interest rates decline. In addition, because of the conversion feature, the market value of convertible securities tends to vary with fluctuations in the market value of the underlying common stocks and, therefore, it will also react to variations in the general market for equity securities. Depending upon the relationship of the conversion price to the market value of the underlying security, a convertible security may trade more like an equity security than a debt instrument.

Convertible securities are designed to provide for a stable stream of income with generally higher yields than common stocks. There can be no assurance of current income because the issuers of the convertible securities may default on their obligations. Convertible securities, however, generally offer lower interest or dividend yields than non-convertible securities of similar credit quality because of the potential for capital appreciation.

Synthetic Convertible Securities

The Fund also may invest without limit in "synthetic" convertible securities, which combine separate securities that possess the two principal characteristics of a traditional convertible security, i.e., an income-producing security ("income-producing component") and the right to acquire an equity security ("convertible component"). The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by investing in warrants or options to buy common stock at a certain exercise price, or options on a stock index. A simple example of a synthetic convertible security is the combination of a traditional corporate bond with a warrant to purchase equity securities of the issuer of the bond. The Fund may also purchase synthetic securities created by other parties, typically investment banks or other financial institutions, including convertible structured notes. The income-producing and convertible components of a synthetic convertible security may be issued separately by different issuers and at different times. Unlike a traditional convertible security, which is a single security having a unitary market value, a synthetic convertible comprises two or more separate securities, each with its own market value. Therefore, the market value of a synthetic convertible security is the sum of the values of its debt component and its convertibility component. For this reason, the values of a synthetic convertible and a traditional convertible security may respond differently to market fluctuations. The Fund's holdings of synthetic convertible securities are considered convertible securities for purposes of the Fund's policy to invest at least 50% of its total assets in convertible securities and 80% of its total assets in a diversified portfolio of convertible securities and non-convertible income-producing securities.

Non-Convertible Income-Producing Securities

The Fund will also invest in non-convertible income-producing securities, including, but not limited to, corporate bonds, debentures, notes and other similar types of corporate debt instruments, as well as non-convertible preferred stocks, bank loans and loan participations, commercial paper, REITs and

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commercial and other mortgage-related and asset-backed securities, payment-in-kind securities, credit-linked trust certificates and other securities issued by special purpose or structured vehicles, zero-coupon bonds, bank certificates of deposit, fixed time deposits, bankers' acceptances and U.S. Government securities. The Fund's investments in non-convertible income-producing securities may have fixed or variable principal payments and all types of interest rate and dividend payment and reset terms, including fixed rate, adjustable rate, zero-coupon, contingent, deferred, payment-in-kind and auction-rate features.

High Yield Securities

As noted above, the Fund may invest without limit in securities rated lower than Baa by Moody's or BBB by S&P (including securities in the lowest ratings categories (C by Moody's or S&P)), or in unrated securities judged to be of comparable quality by NACM, and expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in these securities. These securities are sometimes referred to as "high yield" securities or "junk bonds." Investing in high yield securities involves greater risks (in particular, greater risk of default) and special risks in addition to the risks associated with investments in investment grade obligations. While offering a greater potential opportunity for capital appreciation and higher yields, high yield securities typically entail greater potential price volatility and may be less liquid than higher-rated securities. High yield securities may be regarded as predominantly speculative with respect to the issuer's continuing ability to meet principal and interest payments. They also may be more susceptible to real or perceived adverse economic and competitive industry conditions than higher-rated securities. The Fund may purchase distressed securities that are in default or the issuers of which are in bankruptcy. Securities in the lowest investment grade category also may be considered to possess some speculative characteristics.

The market values of high yield securities tend to reflect individual developments of the issuer to a greater extent than do higher-quality securities, which tend to react mainly to fluctuations in the general level of interest rates. In addition, lower-quality securities tend to be more sensitive to economic conditions.

Credit Ratings and Unrated Securities

Rating agencies are private services that provide ratings of the credit quality of debt obligations, including convertible securities. Appendix A to this Prospectus describes the various ratings assigned to debt obligations by Moody's and S&P. Ratings assigned by a Rating Agency are not absolute standards of credit quality and do not evaluate market risks. Rating agencies may fail to make timely changes in credit ratings and an issuer's current financial condition may be better or worse than a rating indicates. The Fund will not necessarily sell a security when its rating is reduced below its rating at the time of purchase. As described above under "Portfolio Management Strategies--Independent Credit Analysis," NACM does not rely solely on credit ratings, and develops its own analysis of issuer credit quality. The ratings of a security may change over time. Moody's and S&P monitor and evaluate the ratings assigned to securities on an ongoing basis. As a result, instruments held by the Fund could receive a higher rating (which would tend to increase their value) or a lower rating (which would tend to decrease their value) during the period in which they are held.

The Fund may purchase unrated securities (which are not rated by a Rating Agency). Unrated securities may be less liquid than comparable rated securities and involve the risk that NACM may not accurately evaluate the security's comparative credit rating. Analysis of creditworthiness may be more complex for issuers of high yield securities than for issuers of higher-quality obligations. The Fund expects that ordinarily NACM's portfolio strategies will result in the Fund investing primarily in high yield and/or unrated securities. Therefore, the Fund's success in achieving its investment objective may depend more heavily on NACM's creditworthiness analysis than if the Fund invested exclusively in higher-quality and rated securities.

Foreign (Non-U.S.) Investments and Currencies
The Fund may invest up to 20% of its total assets in U.S. dollar-denominated securities of foreign issuers based in developed countries. For this purpose, foreign securities include, but are not limited to, foreign convertible securities and non-convertible income-producing securities, foreign equity securities (including preferred securities of foreign issuers), foreign bank obligations, and obligations of foreign governments or their subdivisions, agencies and instrumentalities, international agencies and supranational entities. For this purpose, foreign securities do not include ADRs or securities guaranteed by a United States person, but may include foreign securities in the form of GDRs or other securities representing underlying shares of foreign issuers. See "Risks--Foreign (Non-U.S.) Investment Risk."

The U.S. dollar-denominated foreign securities in which the Fund may invest include Eurodollar obligations and "Yankee Dollar" obligations. Eurodollar obligations are U.S. dollar-denominated certificates of deposit and time deposits issued outside the U.S. capital markets by foreign branches of U.S. banks and by foreign banks. Yankee Dollar obligations are U.S. dollar-denominated obligations issued in the U.S. capital markets by foreign banks. Eurodollar and Yankee Dollar obligations are generally subject to the same risks that apply to domestic debt issues, notably credit risk, market risk and liquidity risk. Additionally, Eurodollar (and to a limited extent, Yankee Dollar) obligations are subject to certain sovereign risks. One such risk is the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders. Other risks include adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of foreign withholding taxes; and the expropriation or nationalization of foreign issuers.

The Fund also may invest in sovereign debt issued by foreign governments, their agencies or instrumentalities, or other government-related entities. As a holder of sovereign debt, the Fund may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. In addition, there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. The Fund also may invest in Brady Bonds, which are securities created through the exchange of existing commercial bank loans to sovereign entities for new obligations in connection with a debt restructuring. Investments in Brady Bonds may be viewed as speculative. Brady Bonds acquired by the Fund may be subject to restructuring arrangements or to requests for new credit, which may cause the Fund to realize a loss of interest or principal on any of its portfolio holdings.

Please see "Investment Objective and Policies--Foreign (Non-U.S.) Securities" in the Statement of Additional Information for a more detailed description of the types of foreign investments in which the Fund may invest and their related risks.

Rule 144A Securities
The Fund may invest without limit in Rule 144A Securities. Rule 144A under the Securities Act of 1933, as amended, provides a non-exclusive safe harbor exemption from the registration requirements of the Act for the resale of certain "restricted" securities to certain qualified institutional buyers, such

as the Fund. Rule 144A Securities may be deemed illiquid and thus may be subject to the Fund's limit on investments in illiquid securities, although the Fund may determine that certain Rule 144A Securities are liquid in accordance with procedures adopted by the Board of Trustees.

Corporate Bonds
The Fund may invest in a wide variety of bonds of varying maturities issued by U.S. and foreign corporations and other business entities. Bonds are fixed or variable rate debt obligations, including bills,

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notes, debentures, money market instruments and similar instruments and securities. Bonds generally are used by corporations as well as governments and other issuers to borrow money from investors. The issuer pays the investor a fixed or variable rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are "perpetual" in that they have no maturity date.

Preferred Stocks
The Fund may invest in preferred stocks. The Fund's investments in preferred stocks typically will be convertible securities, although the Fund may also invest in non-convertible preferred stocks. Preferred stock represents an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from liquidation of the company. Some preferred stocks entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in the company. Some preferred stocks offer a fixed rate of return with no maturity date. Because they never mature, these preferred stocks act like long-term bonds and can be more volatile than other types of preferred stocks and may have heightened sensitivity to changes in interest rates. Other preferred stocks have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction process, involving bids submitted by holders and prospective purchasers of such stocks. Because preferred stocks represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt instruments to actual or perceived changes in a company's financial condition or prospects, or to fluctuations in the equity markets.

Investments in Equity Securities
Consistent with its investment objective, the Fund may hold or have exposure to equity securities. The Fund will often have substantial exposure to equity securities by virtue of the equity component of the convertible securities in which the Fund invests. The Fund may also hold equity securities in its portfolio upon conversion of a convertible security or through direct investments in preferred stocks. Equity securities, such as common stock, generally represent an ownership interest in a company. Although equity securities have historically generated higher average returns than debt securities, equity securities have also experienced significantly more volatility in those returns. An adverse event, such as an unfavorable earnings

report, may depress the value of a particular equity security held by the Fund. Also, the price of equity securities, particularly common stocks, are sensitive to general movements in the stock market. A drop in the stock market may depress the price of equity securities held by the Fund.

U.S. Government Securities
The Fund may invest in U.S. Government securities, which are obligations of, or guaranteed by, the U.S. Government, its agencies or government-sponsored enterprises. U.S. Government securities include a variety of securities that differ in their interest rates, maturities and dates of issue. Securities issued or guaranteed by agencies or instrumentalities of the U.S. Government may or may not be supported by the full faith and credit of the United States or by the right of the issuer to borrow from the U.S. Treasury.

Derivatives
The Fund may utilize derivative instruments for investment purposes, as well as to leverage its portfolio, generally as a substitute for, rather than in addition to, the APS. Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of any underlying asset, reference rate or index, and may relate to, among others, individual securities, interest rates and related indexes. The Fund may use derivatives as a component of a synthetic convertible security or to gain exposure to high yield securities and other securities in which the Fund may invest (pending investment of the proceeds of

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this offering). Such derivative instruments include, but are not limited to, warrants, options on common stock or stock indexes, futures contracts and swap agreements. In connection with its investments in synthetic convertible securities, the Fund may purchase warrants, call options on common stock and call options on stock indexes. A warrant is a certificate that gives the holder of the warrant the right to buy, at a specified time or specified times, from the issuer of the warrant, the common stock of the issuer at a specified price. A call option is a contract that gives the holder of the option, in return for a premium, the right to buy from the writer of the option the common stock underlying the option (or the cash value of the index) at a specified exercise price at any time during the term of the option. The Fund may also have exposure to derivatives, such as credit default swaps and interest rate swaps, through investments in credit-linked trust certificates and related instruments. The Fund's use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investment directly in securities and other more traditional investments. See "Risks--Derivatives Risk." Please see "Investment Objective and Policies--Derivative Instruments" in the Statement of Additional Information for additional information about these and other derivative instruments that the Fund may use and the risks associated with such instruments. There is no assurance that these derivative strategies will be available at any time or that NACM will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund is subject to certain restrictions on its use of derivative strategies imposed by guidelines of Moody's, which issues ratings for the APS.

Credit-Linked Trust Certificates

Among the income-producing securities in which the Fund may invest are credit-linked trust certificates, which are investments in a limited purpose trust or other vehicle formed under State law which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another fixed income market.

Subject to the investment limitations described in this Prospectus, the Fund may invest in credit-linked trust certificates during the period when the net proceeds of the Common Share offering and this offering are being invested, and during such period the high yield exposure will be broadly diversified. Thereafter, the Fund may invest up to 5% of its total assets in these instruments.

Like an investment in a bond, investments in these credit-linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust's receipt of payments from, and the trust's potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that the Fund would receive as an investor in the trust. Please see "Investment Objective and Policies--Derivative Instruments" in the Statement of Additional Information for additional information about credit default swaps. The Fund's investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, interest rate risk, leverage risk and management risk. It is expected that the trusts which issue credit-linked trust certificates will constitute "private" investment companies, exempt from registration under the 1940 Act. Therefore, the certificates will be subject to the risks described under "Other Investment Companies" below, and will not be subject to applicable investment limitations and other regulation imposed by the 1940 Act (although the Fund will remain subject to such limitations and regulation, including with respect to its investments in the

certificates). Although the trusts are typically private investment companies, they are generally not actively managed such as a "hedge fund" might be. It is also expected that the certificates will be exempt from registration under the Securities Act of 1933. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments. See "Risks--Liquidity Risk." If market quotations are not readily available for the certificates, they will be valued by the Fund at fair value as determined by the Board of Trustees or persons acting at its direction. See "Net asset value." The Fund may lose its entire investment in a credit-linked trust certificate. The Fund intends to invest in credit-linked trust certificates mainly as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income-producing securities are not available, including during the period when the net proceeds of the Common Share offering and this offering are being invested.

Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities

Zero-coupon bonds pay interest only at maturity rather than at intervals during the life of the security. Like zero-coupon bonds, "step up" bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security. Payment-in-kind securities ("PIKs") are debt obligations that pay "interest" in the form of other debt obligations, instead of in cash. Each of these instruments is normally issued and traded at a deep discount from face value. Zero-coupon bonds, step-ups and PIKs allow an issuer to avoid or delay the need to generate cash to meet current interest payments and, as a result, may involve greater credit risk than bonds that pay interest currently or in cash. The Fund would be required to distribute the income on these instruments as it accrues, even though the Fund will not receive the income on a current basis or in cash. Thus, the Fund may have to sell other investments, including when it may not be advisable to do so, to make income distributions to its shareholders.

Other Investment Companies

The Fund may invest in securities of other open- or closed-end investment companies to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act. The Fund may invest in other investment companies either during periods when it has large amounts of uninvested cash, such as the period shortly after the Fund receives the proceeds of the offering of its Common Shares or Preferred Shares, during periods when there is a shortage of attractive convertible securities and non-convertible income-producing securities available in the market, or when NACM believes share prices of other investment companies offer attractive values. The Fund may invest in investment companies that are advised by NACM or its affiliates to the extent permitted by applicable law and/or pursuant to exemptive relief from the Securities and Exchange Commission. As a stockholder in an investment company, the Fund will bear its ratable share of that investment company's expenses, and would remain subject to payment of the Fund's management fees and other expenses with respect to assets so invested. Common Shareholders would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. NACM will take expenses into account when evaluating the investment merits of an investment in an investment company relative to available investments in convertible securities and non-convertible income-producing securities. In addition, the securities of other investment companies may also be leveraged and will therefore be subject to the same leverage risks described herein. The net asset value and market value of leveraged shares will be more volatile and the yield to shareholders will tend to fluctuate more than the yield generated by unleveraged shares.

Commercial Paper

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The rate of return on commercial paper may be linked or indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

Bank Obligations
The Fund may invest in certain bank obligations, including certificates of deposit, bankers' acceptances and fixed time deposits. Certificates of deposit are negotiable certificates issued against funds deposited in a commercial bank for a definite period of time and earning a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are "accepted" by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties which vary depending upon market conditions and the remaining maturity of the obligation.

Loan Participations and Assignments
The Fund may invest in fixed- and floating-rate loans issued by banks and other corporations, which investments generally will be in the form of loan participations and assignments of portions of such loans. Participations and assignments involve credit risk, interest rate risk, liquidity risk and the risks of being a lender. If the Fund purchases a participation, it may only be able to enforce its rights through the lender, and may assume the credit risk of both the lender and the borrower. Given the current structure of the markets for loan participations and assignments, the Fund expects to treat these securities as illiquid.

REITs and Other Mortgage-Related and Asset-Backed Securities
The Fund may invest REITs, which primarily invest in income-producing real estate or real estate related loans or interests. REITs are generally classified as equity REITs, mortgage REITs or a combination of equity and mortgage REITs. Equity REITs invest the majority of their assets directly in real property and derive income primarily from the collection of rents. Equity REITs can also realize capital gains by selling properties that have appreciated in value. Mortgage REITs invest the majority of their assets in real estate mortgages and derive income from the collection of interest payments. REITs are not taxed on income distributed to shareholders provided they comply with the applicable requirements of the Code. The Fund will indirectly bear its proportionate share of any management and other expenses paid by REITs in which it invests in addition to the expenses paid by the Fund. Debt securities issued by REITs are, for the most part, general and unsecured obligations and are subject to risks associated with REITs.

Other mortgage-related securities include debt instruments which provide periodic payments consisting of interest and/or principal that are derived from or related to payments of interest and/or principal on underlying mortgages. Additional payments on mortgage-related securities may be made out of unscheduled prepayments of principal resulting from the sale of the underlying property, refinancing or foreclosure, net of fees or costs that may be incurred.

The Fund may invest in commercial mortgage-related securities issued by corporations. These are securities that represent an interest in, or are secured by, mortgage loans secured by commercial property, such as industrial and warehouse properties, office buildings, retail space and shopping malls, multifamily properties and cooperative apartments, hotels and motels, nursing homes, hospitals, and senior living centers. They may pay fixed or adjustable rates of interest. The commercial mortgage loans that underlie commercial mortgage-related securities have certain distinct risk characteristics. Commercial mortgage loans generally lack standardized terms, which may complicate their structure. Commercial properties themselves tend to be unique and difficult to value. Commercial mortgage loans tend to have shorter maturities than residential mortgage loans, and may not be fully amortizing, meaning that they may have a significant principal balance, or "balloon" payment, due on maturity. In addition, commercial properties, particularly industrial and warehouse properties, are subject to environmental risks and the burdens and costs of compliance with environmental laws and regulations.

Other mortgage-related securities in which the Fund may invest include mortgage pass-through securities, collateralized mortgage obligations ("CMOs"), mortgage dollar rolls, CMO residuals (other than residual interests in real estate mortgage investment conduits), stripped mortgage-backed securities ("SMBSs") and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property.

The Fund may invest in other types of asset-backed securities that are offered in the marketplace, including Enhanced Equipment Trust Certificates ("EETCs"). Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. EETCs tend to be less liquid than corporate bonds. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence of, or defalcation by, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that utilize the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

Please see "Investment Objective and Policies--REITs" and "Investment Objective and Policies--Mortgage-Related and Other Asset-Backed Securities" in the Statement of Additional Information, and "Risks--REITs and Mortgage-Related Risk" in this Prospectus for a more detailed description of the types of mortgage-related and other asset-backed securities in which the Fund may invest and their related risks.

Variable and Floating Rate Securities
Variable and floating rate securities provide for a periodic adjustment in the interest rate paid on the obligations. The Fund may invest in floating rate debt instruments ("floaters") and engage in credit spread trades. While floaters provide a certain degree of protection against rising interest rates, the Fund will participate in any decline in interest rates as well. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, where the value of the investment position is determined by changes in the difference between such prices or interest rates, as the case may be, of the respective securities.

When Issued, Delayed Delivery and Forward Commitment Transactions
The Fund may purchase securities which it is eligible to purchase on a when-issued basis, may purchase and sell such securities for delayed delivery

and may make contracts to purchase such securities for a fixed price at a future date beyond normal settlement time (forward commitments). When-issued transactions, delayed delivery purchases and forward commitments involve a risk of loss if the value of the securities declines prior to the settlement date. The risk is in addition to the risk that the Fund's other assets will decline in value. Therefore, these transactions may result in a form of leverage and increase the Fund's overall investment exposure. Typically, no income accrues on securities the Fund has committed to purchase prior to the time delivery of the securities is made, although the Fund may earn income on securities it has segregated to cover these positions.

Reverse Repurchase Agreements
The Fund may utilize reverse repurchase agreements to leverage its portfolio, generally as a substitute for, rather than in addition to, the leverage obtained through the issuance of the APS. In a reverse repurchase agreement, the Fund sells securities to a bank or broker-dealer and agrees to repurchase the securities at a mutually agreed date and price. Generally, the effect of such a transaction is that the Fund can recover

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and reinvest all or most of the cash invested in the portfolio securities involved during the term of the reverse repurchase agreement and still be entitled to the returns associated with those portfolio securities. Such transactions are advantageous if the interest cost to the Fund of the reverse repurchase transaction is less than the returns it obtains on investments purchased with the cash.

Unless the Fund covers its positions in reverse repurchase agreements (by segregating liquid assets at least equal in amount to the forward purchase commitment), its obligations under the agreements will be subject to the Fund's limitations on borrowings. Reverse repurchase agreements involve leverage risk and also the risk that the market value of the securities that the Fund is obligated to repurchase under the agreement may decline below the repurchase price. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Fund's use of the proceeds of the agreement may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

Lending of Portfolio Securities
For the purpose of achieving income, the Fund may lend its portfolio securities to brokers, dealers, and other financial institutions provided a number of conditions are satisfied, including that the loan is fully collatept" align=justify>

(A)

Business and Organization

Independence Holding Company, a Delaware corporation (NYSE: 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") and (ii) its marketing and administrative companies, including Insurers Administrative Corporation (IAC), managing general underwriter (MGU) affiliates, Health Plan Administrators (HPA), GroupLink Inc. (GroupLink) and Community America Insurance Services Inc. (CAIS , formerly CA Insurance Services LLC). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." The Company also owns a 48% equity interest in American Independence Corp. (NASDAQ:AMIC), which owns Independence American Insurance Company (Independence American) and several MGU s.

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 54% of IHC's outstanding common stock at September 30, 2006.

(B)

Basis of Presentation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 consolidated financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The consolidated results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

Reclassifications

Certain amounts in prior years' Consolidated Financial Statements and notes thereto have been reclassified to conform to the 2006 presentation.

(D)

Share-Based Compensation

Effective January 1, 2006, under the modified prospective method, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment" ("SFAS 123R"), which revises SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees and its related interpretations (APB 25). SFAS 123R applies to all awards granted after its effective date and to modifications, repurchases or cancellations of existing awards after that date. Results for prior periods have not been restated. Additionally, under the modified prospective method of adoption, the Company recognizes compensation expense for the portion of outstanding awards on the adoption date for which the requisite service period has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS 123 for purposes of pro forma disclosures.

For the three month and nine month periods ended September 30, 2006, total share-based compensation expense was $428,000 and $1,136,000, respectively, including $264,000 and $839,000, respectively, of incremental share-based compensation expense resulting from the adoption of SFAS 123R. This incremental expense resulted in decreases of $159,000 and $505,000, respectively, to net income, after income tax benefits of $105,000 and $334,000, respectively, for the three months and nine months ended September 30, 2006.

Prior to the adoption of SFAS 123R, the Company accounted for its share-based awards under APB 25. The following table details the effect on net income and earnings per share had compensation expense for employee share-based awards been recorded in the three month and nine month periods ended September 30, 2005 based on the fair value method under SFAS 123 (in thousands, except per share data):

		Three Months Ended September 30, 2005		**Nine Months Ended September 30, 2005**
Net income, as reported	$	4,788	$	16,406
Add stock-based employee compensation expense included				
in reported net income, net of related tax effects		-		-
Deduct total stock-based compensation expense determined				
under fair value based method for all awards, net of				
related tax effects	$	(155)	$	(495)
Proforma net income	$	4,633	$	15,911
Basic earnings per share:				
As reported	$	.34	$	1.17
Proforma	$	.33	$	1.14
Diluted earnings per share:				
As reported	$	.34	$	1.15
Proforma	$	.32	$	1.12

Under the terms of the Company s stock-based compensation plans, option exercise prices are 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. These shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period. There were 1,127,464 shares available for future option or restricted-stock grants under the shareholder-approved plans at September 30, 2006. Substantially all of these available shares relate to the Company s 2006 Stock Incentive Plan that was approved by shareholders in June 2006.

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The total intrinsic value of options exercised during the three month periods ended September 30, 2006 and 2005 was $536,000 and $464,000, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005 was $4,607,000 and $1,162,000, respectively. Cash proceeds received from options exercised for the three months ended September 30, 2006 and 2005 were $337,000 and $303,000, respectively. Cash proceeds received from options exercised for the nine months ended September 30, 2006 and 2005 were $2,119,000 and $653,000, respectively.

The Company s stock option activity for the nine months ended September 30, 2006 is as follows:

	Shares Under Option	Weighted-Average Exercise Price	
December 31, 2005	1,108,371	$	11.89
Granted	230,000		21.58
Exercised	(312,590)		6.78
Expired	(1,800)		20.89
September 30, 2006	1,023,981	$	15.61

The following table summarizes information regarding outstanding and exercisable options as of September 30, 2006:

		Outstanding		Exercisable
Number of options		1,023,981		681,781
Weighted average exercise price per share	$	15.61	$	12.86
Aggregate intrinsic value for all options	$	6,297,000	$	6,102,000
Weighted average contractual term remaining		2.4 years		1.6 years

The fair value of each 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, 2006 was $7.25. No stock options were granted during the nine months ended September 30, 2005. The Company issued 49,325 and 2,250 restricted stock awards during the nine month periods ended September 30, 2006 and 2005, respectively, with weighted-average grant-date fair values of $22.20 and $17.82 per share, respectively. The assumptions set forth in the table below were used to value the stock options granted during the nine month period ended September 30, 2006.

Weighted-average risk-free interest rate	4.9%

Annual dividend rate per share	$	.05
Weighted-average volatility factor of the Company's common stock		32.1%
Weighted-average expected term of options		4.5 years

As of September 30, 2006, there was $1,861,000 and $902,000 of total unrecognized compensation expense related to non-vested options and non-vested restricted stock awards, respectively, which will be recognized over the remaining requisite weighted-average service periods of 1.6 years and 2.4 years, respectively.

Prior to the adoption of SFAS 123R, the Company presented the tax benefit resulting from the exercise of stock options and restricted stock awards as operating cash flows in the Consolidated Statements of Cash Flows. SFAS 123R requires such benefits to be reported as a financing cash flow, rather than as an operating cash flow. In the nine month period ended September 30, 2006, excess tax benefits of $1,252,000 were classified as financing cash inflows. In the nine month period ended September 30, 2005, excess tax benefits of $407,000 were classified as operating cash inflows.

Note 2.

American Independence Corp.

AMIC is an insurance holding company engaged in the insurance and reinsurance business as a result of its acquisition of First Standard Holdings Corp. ("FSHC") from the Company in November 2002. AMIC does business with the Insurance Group, including reinsurance treaties under which, in 2005, Standard Security Life and Madison National Life ceded to Independence American an average of 22% of their medical stop-loss business, 10% of their fully-insured health business and 20% of their New York Statutory Disability business. IHC owned 48% of AMIC's outstanding common stock at September 30, 2006 and December 31, 2005, which was purchased in various transactions beginning in 2002. IHC accounts for its investment in AMIC under the equity method. At September 30, 2006 and December 31, 2005, IHC's investment in AMIC had a total carrying value of $44,009,000 and $43,637,000, respectively, including goodwill of $4,470,000 at both dates. At September 30, 2006 and December 31, 2005, based on the closing market price of AMIC's common stock, the fair value of the AMIC shares owned by IHC was approximately $46,262,000 and $46,668,000, respectively.

For the three months and nine months ended September 30, 2006, IHC recorded $47,000 and $406,000, respectively, of equity income from its investment in AMIC, representing IHC's proportionate share of income based on its ownership interests during those periods. IHC's equity income for the three months and nine months ended September 30, 2005 was $478,000 and $1,464,000, respectively. AMIC paid no dividends on its common stock in the three month and nine month periods ended September 30, 2006 and 2005.

IHC and its subsidiaries earned $138,000 and $136,000 for the three months ended September 30, 2006 and 2005, respectively, and $394,000 and $442,000 for the nine months ended September 30, 2006 and 2005, respectively, 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 also contracts for several types of insurance (e.g. directors and officers and professional liability) 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. The Company ceded premiums to AMIC of $14,279,000 and $14,450,000 for the three months ended September 30, 2006 and 2005, respectively, and $41,527,000 and $41,574,000 for the nine months ended September 30, 2006 and 2005, respectively.

Included in the Company s Consolidated Balance Sheets at September 30, 2006 and December 31, 2005, respectively, are the following balances arising from transactions in the normal course of business with AMIC and its subsidiaries: Due from reinsurers $13,764,000 and $14,122,000; Other assets $8,782,000 and $10,565,000; and Other liabilities $494,000 and $249,000.

Note 3.

Income Per Common Share

Included in the diluted income per share calculations are 207,000 and 267,000 shares for the three months ended September 30, 2006 and 2005, respectively, and 320,000 and 274,000 shares for the nine months ended September 30, 2006 and 2005, respectively, from the assumed exercise of options and vesting of restricted stock, using the treasury stock method. Net income does not change as a result of the assumed dilution.

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Note 4.

Acquisitions

The Company completed the following acquisitions in the first quarter of 2006. The results of operations of the acquired companies are included in IHC's Consolidated Financial Statements from the respective acquisition dates. None of the goodwill recognized in these acquisitions is deductible for income tax purposes. Pro forma results of operations for the nine months ended September 30, 2006 and for the three months and nine months ended September 30, 2005, as though these acquisitions had been completed at the beginning of those periods, have not been presented since the effect of the acquisitions was not material.

IAC Acquisition

In January 2006, the Company entered into a stock purchase agreement to purchase all of the voting and non-voting shares of the common stock of Insurers Administrative Corporation ("IAC") and Interlock Corporation for a total purchase price of $21,360,000 in cash and 446,663 shares of IHC common stock, which were issued at a value of $21.54 per share or $9,622,000. The Company recorded goodwill of $25,673,000 and other intangible assets consisting of $7,000,000 for the value of agent relationships and $1,800,000 for the value of computer software. The relationship intangible and the capitalized software are being amortized over periods of 13 years and 8.7 years, respectively (a weighted-average period of 12.1 years). Prior to entering into this agreement, IAC owned the minority interest in Strategic Health Associates (SHA) and administered IHC s block of fully-insured group health insurance. As a consequence of IHC s acquisition of the minority interest in SHA through the IAC purchase, IHC owns 100% of SHA and therefore recognized additional goodwill and other intangibles, and eliminated the minority interest previously reported.

IAC, which is based in Phoenix, Arizona, is a leading administrator, manager and distributor of Consumer Driven Health Plans (CDHPs). It currently administers approximately $270 million of individual and group health and life premiums and premium-equivalents. Of this business, approximately 40% is currently insured by Standard Security Life and Madison National Life. IAC, in combination with IHC s other fully-insured subsidiaries (HPA and GroupLink) administers, manages and distributes a full range of health products, including CDHPs, short-term medical, limited medical, dental and vision.

IHC issued a stock put on 194,443 of the IHC shares issued in the acquisition which vests on January 31, 2007 at a price of $17.00 per share and expires on January 31, 2008. The put was recorded at a fair value of $228,000 at the acquisition date. For the three months and nine months ended September 30, 2006, IHC recorded unrealized gains of $3,000 and $82,000, respectively, in the Consolidated Statements of Operations, representing the net change in fair value of the put.

CAIS Acquisition

On March 1, 2006, IHC acquired the remaining 55% membership interest in CA Insurance Services, LLC (CAIS) by merging CAIS into Community America Insurance Services, Inc., a newly created and wholly-owned direct subsidiary of IHC. The 55% interest was acquired for 46,250 shares of IHC common stock, which were issued at a value of $22.87 per share or $1,058,000. The Company recorded goodwill of $1,163,000 and other intangible assets of $370,000 for the value of agent relationships in connection with the acquisition. The other intangible assets are being amortized over a period of nine years.

On March 31, 2006, CAIS acquired a marketing organization, including key management and health insurance sales staff, which controls a block of approximately $50 million of fully-insured group major medical business (including CDHPs) for $750,000, which is recorded as an intangible asset. This acquired block of group major medical business began to be transitioned to Madison National Life effective August 1, 2006.

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Goodwill and Other Intangible Assets

At September 30, 2006 and December 31, 2005, the Company had goodwill of $46,425,000 and $16,110,000, respectively, and other intangible assets (included in Other assets in the Consolidated Balance Sheets) of $13,044,000 and $3,838,000, respectively. The change in the carrying amount of goodwill and other intangible assets for the first nine months of 2006 is as follows (in thousands):

		Goodwill		Other Intangible Assets
Balance at December 31, 2005	$	16,110	$	3,838
IAC acquisition		25,673		8,800
SHA minority interest		1,840		644
CAIS acquisition and other additions		2,802		1,120
Amortization expense		-		(1,358)
Balance at September 30, 2006	$	46,425	$	13,044

Note 5.

New Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections (SFAS 154), which replaces Accounting Principles Board Opinion No. 20, Accounting Changes (APB 20) and Statement of Financial Accounting Standards No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting and reporting a change in accounting principle. SFAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. APB 20 previously required that most voluntary changes in accounting principle be recognized as a cumulative effect adjustment in net income of the period of the change. SFAS 154 is effective for accounting changes made in annual periods beginning after December 15, 2005. The adoption of SFAS 154 had no impact on the Company s consolidated financial statements.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS 155), which amends Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). SFAS 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. SFAS 155 is effective for all financial instruments acquired, issued or subject to a re-measurement event occurring in fiscal years beginning after September 15, 2006. Adoption of SFAS 155 is not expected to have a material effect on the Company s consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 ("Interpretation 48"), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Interpretation 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation 48 is effective for fiscal years beginning after December 15, 2006. The Company has not yet determined the impact that FIN 48 will have on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Adoption of SFAS 157 is not expected to have a material effect on the Company s consolidated financial statements.

In September 2006, the staff of the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for years ending on or after November 15, 2006. Adoption of SAB 108 is not expected to have a material effect on the Company s consolidated financial statements.

In September 2005, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts" (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments". SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. A replacement contract that is substantially changed will be accounted for as an extinguishment of the replaced contract resulting in a release of the unamortized deferred acquisition costs, unearned revenue, and deferred sales inducements associated with the replaced contract. SOP 05-1 is effective for internal replacements occurring in fiscal years beginning after December 15, 2006, with earlier adoption encouraged. The Company has not yet determined the impact, if any, that SOP 05-1 may have on its consolidated financial statements.

Note 6.

Investments

The following tables summarize, for all securities in an unrealized loss position at September 30, 2006 and December 31, 2005, respectively, the aggregate fair value and gross unrealized loss by length of time those securities had continuously been in an unrealized loss position:

	Less than 12 Months		**12 Months or Longer**		**Total**	
September 30, 2006	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
			(In thousands)			
Corporate securities	$ 103,445	$ 3,319	$ 207,350	$ 11,490	$ 310,795	$ 14,809
CMOs and ABS (1)	39,169	489	73,994	2,254	113,163	2,743
U.S. Government and Agencies	-	-	60,781	2,233	60,781	2,233
Agency MBS (2)	-	-	20,244	538	20,244	538
GSE (3)	7,255	161	41,564	1,721	48,819	1,882
States and political subdivisions	9,387	141	11,123	143	20,510	284
Total fixed maturities	159,256	4,110	415,056	18,379	574,312	22,489
Common stock	3,402	276	-	-	3,402	276
Preferred stock	25,884	103	7,662	340	33,546	443
Total temporarily impaired securities	$ 188,542	$ 4,489	$ 422,718	$ 18,719	$ 611,260	$ 23,208

	Less than 12 Months		**12 Months or Longer**		**Total**	
December 31, 2005	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
			(In thousands)			

Corporate securities	$ 232,488	$ 8,085	$ 45,608	$ 3,159	$ 278,096	$ 11,244
CMOs and ABS (1)	50,118	984	38,495	1,358	88,613	2,342
U.S. Government and Agencies	40,250	842	21,266	798	61,516	1,640
Agency MBS (2)	16,534	239	7,761	117	24,295	356
GSE (3)	51,655	1,024	14,647	664	66,302	1,688
States and political Subdivisions	75,821	888	-	-	75,821	888
Total fixed Maturities	466,866	12,062	127,777	6,096	594,643	18,158
Common stock	1,137	76	96	58	1,233	134
Preferred stock	6,979	245	1,445	55	8,424	300
Total temporarily impaired securities	$ 474,982	$ 12,383	$ 129,318	$ 6,209	$ 604,300	$ 18,592

(1)

Collateralized mortgage obligations (CMOs) and asset-backed securities (ABS).

(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 Company reviews its investment securities regularly and determines whether other than temporary impairments have occurred. If a decline in fair value is judged by management to be other than temporary, a loss is recognized by a charge to the Consolidated Statements of Operations, establishing a new cost basis for the security. 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; whether the issuer of a debt security has remained current on principal and interest payments; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions; and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. For securities within the scope of Emerging Issues Task Force Issue 99-20, such as purchased interest-only securities, an impairment loss is recognized when there has been a decrease in expected cash flows combined with a decline in the security's fair value below cost. Based on management s consideration of these factors, the unrealized losses at September 30, 2006 and December 31, 2005 were deemed to be temporary impairments in value. For the nine months ended September 30, 2006, the Company recorded a realized loss of $247,000 for other-than-temporary impairments.

Substantially all of the unrealized losses at September 30, 2006 and December 31, 2005 relate to investment grade securities and are attributable to changes in market interest rates subsequent to purchase. There were no securities with unrealized losses that were individually significant dollar amounts at September 30, 2006 and December 31, 2005. At September 30, 2006 and December 31, 2005, a total of 65 and 121 securities, respectively, were in a continuous unrealized loss position for less than 12 months and 81 and 22 securities, respectively, had continuous unrealized losses for 12 months or longer. For fixed maturities, there are no securities past due or securities for which the Company currently believes it is not probable that it will collect all amounts due according to the contractual terms of the investment.

Note 7.

Debt

On August 22, 2006, a subsidiary of IHC amended its outstanding $12,500,000 credit agreement with a commercial bank. The terms of the amended agreement increase the principal amount outstanding to $15,000,000, with principal reductions of $2,500,000 due on August 22, 2007 and 2008 and the remaining principal balance due on August 22, 2009. Interest on the debt is at a variable rate equal to LIBOR plus 1.25%. The subsidiary simultaneously entered into an interest rate swap with the commercial bank lender, with a notional amount equal to the debt principal amount, under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate of 6.65%. The fair value of the swap, which is accounted for as a cash flow hedge, was insignificant at September 30, 2006.

Note 8.

Income Taxes

The provision for income taxes shown in the Consolidated Statements of Operations was computed based on the Company's estimate of the effective tax rate expected to be applicable for the current fiscal year.

The deferred income tax benefit for the nine months ended September 30, 2006 allocated to stockholders' equity (principally for net unrealized losses on investment securities) was $1,842,000, representing the increase in the related net deferred tax asset to $6,523,000 at September 30, 2006 from $4,681,000 at December 31, 2005.

Note 9.

Supplemental Disclosures of Cash Flow Information

Cash payments for income taxes were $4,220,000 and $2,526,000 for the nine months ended September 30, 2006 and 2005, respectively. Cash payments for interest were $2,638,000 and $2,544,000 for the nine months ended September 30, 2006 and 2005, respectively. Common stock issued in acquisitions (a non-cash financing activity) amounted to $10,679,000 during the nine months ended September 30, 2006. Non-cash assets acquired (other than intangibles) and liabilities assumed in these transactions were not significant.

Note 10.

Comprehensive Income (Loss)

The components of comprehensive income (loss) include (i) net income or loss reported in the Consolidated Statements of Operations, and (ii) certain amounts reported directly in stockholders equity, principally the after-tax net unrealized gains and losses on securities available for sale (net of deferred acquisition costs). The comprehensive income (loss) for the three months and nine months ended September 30, 2006 and 2005 is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
	(In thousands)			
Net income	$ 4,069	$ 4,788	$ 10,464	$ 16,406
Unrealized gains (losses) arising during the period, net of income taxes	11,580	(8,374)	(3,329)	(5,273)
Comprehensive income (loss)	$ 15,649	$ (3,586)	$ 7,135	$ 11,133

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Note 11.

Segment Reporting

The Insurance Group principally engages in the life and health insurance business. Certain allocations of items within segments have been reclassified in the 2005 information to reflect how management analyzes these segments currently. Information by business segment for the three months and nine months ended September 30, 2006 and 2005 is presented below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(In thousands)			
Revenues:				
Medical stop-loss	$ 42,165	$ 38,282	$ 121,292	$ 103,741
Fully-insured health	16,251	6,386	45,155	14,467
Group disability, life, annuities and DBL	13,203	12,971	39,521	37,173
Individual life, annuities and other	15,208	13,948	46,560	38,276
Credit life and disability	5,750	5,470	16,807	16,378
Corporate	264	384	1,348	977
	92,841	77,441	270,683	211,012
Net realized investment gains and losses	253	994	720	2,078
	$ 93,094	$ 78,435	$ 271,403	$ 213,090

	Three Months Ended September 30,		Nine Months Ended September 30,	
Income (loss) before income taxes:				
Medical stop-loss	$ 2,954	$ 3,637	$ 9,616	$ 19,643
Fully-insured health *	(134)	203	(7)	(833)
Group disability, life, annuities and DBL	2,819	1,049	4,525	3,431
Individual life, annuities and other	2,375	2,863	7,060	4,942
Credit life and disability	(139)	(236)	(489)	110
Corporate	(1,468)	(494)	(3,260)	(2,008)
	6,407	7,022	17,445	25,285
Net realized investment gains and losses	253	994	720	2,078
Interest expense	(990)	(883)	(2,821)	(2,593)
	$ 5,670	$ 7,133	$ 15,344	$ 24,770

(*) The Fully-insured health segment includes amortization of intangible assets recorded as a result of the recent acquisitions of IAC, HPA, GroupLink and CAIS. Total amortization expense was $435,000 and $187,000 for the three months ended September 30, 2006 and 2005, respectively, and $1,172,000 and $527,000 for the nine months ended September 30, 2006 and 2005, respectively. Amortization expense for the other segments is insignificant.

Note 12.

Subsequent Event

On October 5, 2006, IHC Health Solutions, Inc., a wholly-owned subsidiary of IHC, entered into an agreement to acquire 100% of the outstanding membership interests in CA Marketing and Management Services, LLC ("CAM") for a total purchase price payable at closing of $3,500,000, one third of which is payable in shares of IHC common stock. CAM is currently 100% owned by a senior officer of IHC. The Audit Committee of the Board of Directors of IHC unanimously approved the transaction, and upon recommendation by the audit committee, it was unanimously approved by the Board of Directors. The acquisition agreement includes customary representations and warranties for a transaction of this nature. The closing of the transaction is subject to such representations and warranties being correct, and IHC has a one-year indemnification period with respect to damages arising from a breach of this condition, with IHC's recovery capped at 100% of the total purchase price. The acquisition agreement will expire if the transaction has not closed by February 28, 2007. It is anticipated that the transaction will close during the first week of January 2007.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

This Form 10-Q contains forward-looking statements that involve risks and uncertainties. The future consolidated results of Independence Holding Company. (IHC) and Subsidiaries (collectively referred to as the "Company") could differ significantly from those set forth herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors " as set forth in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the Securities and Exchange Commission, as well as those discussed here in Item 2 and elsewhere in this quarterly report. Statements contained herein that are not historical facts are forward-looking statements that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Words such as "believes", "anticipates", "expects", "intends", estimates , "likelihood", unlikelihood , assessment , and foreseeable and other similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. A number of important factors could cause the Company's actual results for the year ending December 31, 2006, and beyond to differ materially from past results and those expressed or implied in any forward-looking statements made by the Company, or on its behalf. The Company undertakes no obligation to release publicly the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following discussion of the financial condition and results of operations of 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, 2005, as filed with the Securities and Exchange Commission, and our Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.

Overview

Independence Holding Company, a Delaware corporation (NYSE: IHC), is a holding company principally engaged in the life and health insurance business through: (i) its 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"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation (IAC), managing general underwriter (MGU) affiliates, Health Plan Administrators (HPA), GroupLink Inc. (GroupLink) and Community America Insurance Services Inc. (CAIS , formerly CA Insurance Services LLC). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." The Company also owns a 48% equity interest in American Independence Corp. (NASDAQ: AMIC), which owns Independence American Insurance Company (Independence American) and several MGU s.

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, major medical, STM, dental, vision, disability and DBL; mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. Management has always focused on managing costs of operations, and the Company believes that the acquisition of IAC in January 2006 affords it an opportunity to effect further cost efficiencies.

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

- Net income of $4.1 million and $10.5 million ($.27 and $.69 per share, diluted) for the three months and nine months ended September 30, 2006, respectively, as compared to $4.8 million and $16.4 million ($.34 and $1.15 per share, diluted), for the three months and nine months ended September 30, 2005;

- Consolidated investment yield of 5.3% for the three months and nine months ended September 30, 2006, as compared to 5.2% and 5.1%, respectively, in the comparable periods in 2005;

- Revenues of $93.1 million and $271.4 million for the three months and nine months ended September 30, 2006, respectively, representing increases of 18.7% and 27.4% over the respective three month and nine month periods of 2005; primarily due to an increase in revenues from the fully-insured health segment, an increase in net retention of the Company s direct medical stop-loss line to 51.5% in 2006 from 43.7% in 2005 (retention refers to net earned premiums after reinsurance) and the life and annuity acquisitions in 2005;

- Book value of $14.83 per common share; a 5.5% increase from December 31, 2005, reflecting net income, stock issuances and option exercises partially offset by net unrealized losses on securities;

- As of January 31, 2006, acquired IAC, a leading producer and administrator of group and individual major medical insurance (including Consumer Driven Health Plans (CDHPs)) and other life and health policies;

- As of March 1, 2006, acquired the remaining 55% of CAIS to further the marketing reach for CDHPs and other products; by March 31, 2006, CAIS acquired a block of $50 million of fully-insured group major medical business, which began to be transitioned to Madison National Life effective August 1, 2006;

- On October 5, 2006, announced the acquisition of CAM, expected to be effective January 1, 2007;

- Approved to write a variety of fully-insured medical products in a majority of states.

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

- Income before taxes from the Medical Stop-Loss segment decreased $.6 million for the three months ended September 30, 2006, and $10.0 million for the nine months ended September 30, 2006, compared to the same periods in 2005:

  ○ The Net Loss Ratio (defined as insurance benefits, claims and reserves divided by (premiums earned less underwriting expenses)) for the Medical Stop-Loss line of business for the three months and nine months ended September 30, 2006 was 94.6% and 94.9%, respectively, compared to 94.5% and 88.8% for the three months and nine months ended September 30, 2005, respectively;

  ○ Included in operating results for the Medical Stop-Loss segment for the first nine months of 2005 was $3.5 million of income from a commutation agreement and a loss cover that did not repeat in the first nine months of 2006;

- Fully-Insured segment reported a loss before taxes of $.1 million for the three months ended September 30, 2006 and break even for the nine months ended September 30, 2006, as compared to income of $.2 million and a loss of $.8 million for the three months and nine months ended September 30, 2005, respectively. Although revenues from this segment have increased, and losses have decreased, continuing losses on this line are due to increased expense from the amortization of intangible assets recorded as a result of the recent acquisitions of IAC, HPA, GroupLink, and CAIS, which will decline over the useful lives of the assets, and from higher selling, general, marketing and legal expenses related to the expansion of staff and product filings in anticipation of upcoming growth in this line. Total amortization expense was $1.2 million and $.5 million for the nine months ended September 30, 2006 and 2005, respectively;

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Income before taxes from the Group disability, life, annuities and DBL segment increased $1.8 million for the three months ended September 30, 2006, and $1.1 million for the nine months ended September 30, 2006, compared to a year earlier, primarily due to a decrease in LTD paid claims and net claims reserves during the current quarter;

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Income before taxes from the Individual life, annuities and other segment decreased $.5 million for the three months ended September 30, 2006, and increased $2.2 million for the nine months ended September 30, 2006, compared to a year earlier, primarily due to acquisitions of policy blocks of life and annuity business in 2005;

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Loss before taxes from the Credit life and disability segment decreased $.1 million for the three months ended September 30, 2006, and increased $.6 million for the nine months ended September 30, 2006, compared to a year earlier, primarily due to higher death and disability claims;

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Loss before taxes from the Corporate segment increased $1.0 million for the three months ended September 30, 2006, and $1.3 million for the nine months ended September 30, 2006, compared to a year earlier, primarily due to share-based compensation expense from the adoption of SFAS 123R on January 1, 2006; and

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Net realized investment gains and losses of $.3 million and $.7 million for the three month and nine month periods ended September 30, 2006, respectively, as compared to $1.0 million and $2.1 million for the three month and nine month periods ended September 30, 2005.

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Premiums for the three month and nine month periods ended September 30, 2006 and 2005 are as follows (in thousands):

Gross Direct and Assumed Earned Premiums:	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Medical stop-loss	$ 71,277	$ 68,891	$ 204,570	$ 203,442
Fully-insured health	20,129	12,573	56,190	28,503
Group disability, life, annuities and DBL	21,086	19,680	61,507	58,415
Individual, life, annuities and other	7,712	8,480	24,116	22,788
Credit life and disability	5,800	5,369	16,917	16,139
	$ 126,004	$ 114,993	$ 363,300	$ 329,287

	Three Months Ended September 30,		Nine Months Ended September 30,	
Net Premiums Earned:	**2006**	**2005**	**2006**	**2005**
Medical stop-loss	$ 40,304	$ 35,441	$ 115,654	$ 92,600
Fully-insured health	7,747	4,285	22,693	9,465
Group disability, life, annuities and DBL	10,848	10,776	32,523	30,560
Individual, life, annuities and other	7,072	7,037	22,067	19,731
Credit life and disability	5,580	5,152	16,192	15,544
	$ 71,551	$ 62,691	$ 209,129	$ 167,900

CRITICAL ACCOUNTING POLICIES

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2005. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Reserves, Deferred Acquisition Costs,* and *Investments* 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, 2005. During the nine months ended September 30, 2006, there were no additions to or changes in the critical accounting policies disclosed in the 2005 Form 10-K.

Results of Operations for the Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Net income was $4.1 million, or $.27 per share, diluted, for the three months ended September 30, 2006, a decrease of $.7 million compared to net income of $4.8 million, or $.34 per share, diluted, for the three months ended September 30, 2005. The Company's income before taxes decreased $1.4 million to $5.7 million for the three months ended September 30, 2006 from $7.1 million for the three months ended September 30, 2005. Information by business segment for the three months ended September 30, 2006 and 2005 is as follows:

September 30, 2006 (In thousands)	Premiums Earned	Net Investment Income	Equity Income From AMIC	Fee and Other Income	Benefits, Claims and Reserves	Amortization of Deferred Acquisition Costs	Selling, General And Administrative	Total
Medical stop-loss	$ 40,304	1,146	47	668	28,847	-	10,364	$ 2,954
Fully-Insured	7,747	58	-	8,446	4,365	13	12,007	(134)
Group disability, life, annuities and DBL	10,848	2,253	-	102	6,826	43	3,515	2,819
Individual life, annuities and other	7,072	7,977	-	159	9,716	1,035	2,082	2,375
Credit life and disability	5,580	157	-	13	2,612	1,261	2,016	(139)
Corporate	-	264	-	-	-	-	1,732	(1,468)
Sub total	$ 71,551	11,855	47	9,388	52,366	2,352	31,716	6,407
Net realized investment gains and losses								253
Interest expense								(990)
Income before income taxes								5,670
Income taxes								1,601
Net income								$ 4,069

	Net	Equity Income	Fee and	Benefits, Claims	Amortization	Selling, General

September 30, 2005	**Premiums Earned**	**Investment Income**	**From AMIC**	**Other Income**	**and Reserves**	**of Deferred Acquisition Costs**	**And Administrative**	**Total**
(In thousands)								
Medical stop-loss	$ 35,441	1,427	478	936	25,256	-	9,389	$ 3,637
Fully-Insured	4,285	(66)	-	2,167	2,633	149	3,401	203
Group disability, life, annuities and DBL	10,776	2,062	-	133	7,553	40	4,329	1,049
Individual life, annuities and other	7,037	6,825	-	86	7,954	1,056	2,075	2,863
Credit life and disability	5,152	296	-	22	2,599	1,197	1,910	(236)
Corporate	-	384	-	-	-	-	878	(494)
Sub total	$ 62,691	10,928	478	3,344	45,995	2,442	21,982	7,022
Net realized invest-ment gains and losses								994
Interest expense								(883)
Income before income taxes								7,133
Income taxes								2,345
Net income								$ 4,788

Premiums Earned

Total premiums earned grew $8.9 million to $71.6 million in the third quarter of 2006 from $62.7 million in the comparable period of 2005. The increase is primarily due to: (i) the Medical Stop-Loss segment which increased $4.9 million primarily due to increased retentions; and (ii) the Fully-Insured segment which had a $3.4 million increase in premiums from the third quarter of 2005 to the third quarter of 2006, comprised of a $.8 million increase in dental premiums, a $1.9 million increase in short-term medical and a $.7 million increase in group major medical primarily due to new business.

Net Realized Investment Gains and Losses

Net realized investment gains and losses decreased by $.7 million compared to the third quarter of 2005. 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.

Net Investment Income

Total net investment income increased $1.0 million primarily due to the maintenance of a higher level of invested assets due to the acquisitions of policy blocks in 2005, and a slight increase in the investment rate of return during the current year period. The annualized return on total investments was 5.3% in the third quarter of 2006 versus 5.2% in the third quarter of 2005.

Equity Income

Equity income from AMIC decreased $.4 million from the third quarter of 2005, as lower income earned by AMIC was slightly offset by an increase in IHC's ownership which was approximately 48% during the third quarter of 2006 compared to an average 44% in the third quarter of 2005. The reduction in income is primarily due to an increase in net loss ratios of AMIC's Medical Stop-Loss business.

Fee Income and Other Income

Fee income increased $5.9 million to $8.8 million from $2.9 million in the three months ended September 30, 2005, primarily due to fees of $7.4 million earned by IAC, which is a subsidiary that was not part of the Company during the third quarter of 2005, partially offset by $1.4 million earned by GroupLink that is eliminated in 2006 as a result of transferring business from outside insurance carriers to insurance subsidiaries of IHC.

Total other income increased $.2 million to $.6 million from $.4 million in the three months ended September 30, 2005.

Insurance Benefits, Claims and Reserves

Benefits, claims and reserves increased $6.4 million. The increase is due to: (i) an increase of $3.6 million in the Medical Stop-Loss segment primarily resulting from a 3% increase in retention and an increase in Net Loss Ratios to 94.6% as compared to 94.5% for the third quarter of 2005 (see Outlook for a discussion of factors affecting the recent underwriting profitability of the Medical Stop-Loss segment); (ii) an increase of $1.8 million in the Fully-Insured segment due to the increase in premiums; (iii) a $1.8 million increase in the Individual and Other segment due to higher losses, surrenders and interest credited on policies due to acquisitions made in 2005; and (iv) a decrease of $.8 million in the Group segment primarily due to a $1.9 million decrease in LTD paid claims and net claims reserves, partially offset by a $.5 million increase related to new business written for group A&H in point of service and a $.4 increase in DBL.

Amortization of Deferred Acquisition Costs

Amortization of deferred acquisition costs were relatively unchanged with a $.1 million decrease in Fully-Insured being offset by a $.1 million increase in Credit.

Interest Expense on Debt

Interest expense increased $.1 million, primarily due to an increase in the interest rate on $12.4 million of floating rate junior subordinated debt to 9.6% in the third quarter of 2006 as compared to 7.5% in the third quarter of 2005, in addition to a $2.5 million increase in outstanding debt during the third quarter of 2006.

Selling, General and Administrative Expenses

Total selling, general and administrative expenses increased $9.7 million in the third quarter of 2006 as compared to the third quarter of 2005. The increase is primarily due to (i) an $8.6 million increase in expenses associated with the operation of the Fully-Insured segment, primarily due to the acquisition of IAC, GroupLink, and higher commission expenses from the increase in Fully-Insured premiums; (ii) a $1.0 million increase in commissions and other general expenses in the Medical Stop-Loss segment due to a higher level of premiums earned, slightly offset by a decrease in profit commission expense due to the increase in net loss ratios; (iii) a $.8 million decrease in the Group segment primarily due to loss experience refunds which reduced commissions in the group A&H business as a result of higher loss ratios in 2006 compared to the prior year; and (iv) a $.9 million increase in other corporate expenses, including $.4 million of expenses related to share-based compensation due to the adoption of SFAS 123R in the first quarter of 2006.

Income Taxes

Income tax expense decreased $.7 million to $1.6 million for the quarter ended September 30, 2006 from $2.3 million for the third quarter of 2005 primarily due to the decrease in pre-tax income in 2006. The effective tax rates were 28.2% for the third quarter of 2006 and 32.9% for the third quarter of 2005.

Results of Operations for the Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Net income was $10.5 million, or $.69 per share, diluted, for the nine months ended September 30, 2006, a decrease of $5.9 million compared to net income of $16.4 million, or $1.15 per share, diluted, for the nine months ended September 30, 2005. The Company's income before taxes decreased $9.5 million to $15.3 million for the nine months ended September 30, 2006 from $24.8 million for the nine months ended September 30, 2005. Information by business segment for the nine months ended September 30, 2006 and 2005 is as follows:

September 30, 2006 (In thousands)	Premiums Earned	Net Investment Income	Equity Income From AMIC	Fee and Other Income	Benefits, Claims and Reserves	Amortization of Deferred Acquisition Costs	Selling, General and Administrative	Total
Medical stop-loss	$ 115,654	2,928	406	2,304	81,436	-	30,240	$ 9,616
Fully-Insured	22,693	123	-	22,339	13,103	89	31,970	(7)
Group disability, life, annuities and DBL	32,523	6,671	-	327	23,819	124	11,053	4,525
Individual life, annuities and other	22,067	23,558	-	935	29,214	3,671	6,615	7,060
Credit life and disability	16,192	560	-	55	7,595	3,657	6,044	(489)
Corporate	-	1,348	-	-	-	-	4,608	(3,260)
Sub total	$ 209,129	35,188	406	25,960	155,167	7,541	90,530	17,445
Net realized investment gains and losses								720
Interest expense								(2,821)
Income before income taxes								15,344
Income taxes								4,880
Net income								$ 10,464

September 30, 2005 (In thousands)	Premiums Earned	Net Investment Income	Equity Income From AMIC	Fee and Other Income	Benefits, Claims and Reserves	Amortization of Deferred Acquisition Costs	Selling, General and Administrative	Total
Medical stop-loss	$ 92,600	3,533	1,464	6,144	59,163	-	24,935	$ 19,643
Fully-Insured	9,465	(51)	-	5,053	6,136	450	8,714	(833)
Group disability, life, annuities and DBL	30,560	6,269	-	344	21,722	115	11,905	3,431
Individual life, annuities and other	19,731	18,092	-	453	24,178	3,717	5,439	4,942
Credit life and disability	15,544	744	-	90	7,244	3,484	5,540	110
Corporate	-	877	-	100	-	-	2,985	(2,008)
Sub total	$ 167,900	29,464	1,464	12,184	118,443	7,766	59,518	25,285
Net realized invest-ment gains and losses								2,078
Interest expense								(2,593)
Income before income taxes								24,770
Income taxes								8,364
Net income								$ 16,406

Premiums Earned

Total premiums earned grew $41.2 million to $209.1 million in the first nine months of 2006 from $167.9 million in the comparable period of 2005. The increase is due to: (i) the Medical Stop-Loss segment which increased $23.1 million primarily due to increased retentions; (ii) the Fully-Insured segment which had a $13.2 million increase in premiums, comprised of a $5.1 million increase in dental premiums, a $3.8 million increase in short-term medical and a $4.3 million increase in group major medical primarily due to new business that did not exist during the first nine months of 2005; (iii) the Individual and Other segment which increased $2.4 million, primarily from a $2.4 million increase in ordinary life due to higher premiums from policy blocks acquired at the end of the third quarter of 2005 and a $.3 million increase in blanket accident and sickness policy premiums, partially offset by decreases of $.3 million in all other lines; (iv) an increase of $1.9 million in the Group segment primarily due to a $2.2 million increase in point of service, a $.6 million increase in group term life, partially offset by a $.9 million decrease in DBL caused by a reduction in statutory rates; and (v) a $.6 million increase in the Credit Life and Disability segment due to new business.

Net Realized Investment Gains and Losses

Net realized investment gains and losses decreased by $1.4 million compared to the first nine months of 2005. 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.

Net Investment Income

Total net investment income increased $5.7 million primarily due to the maintenance of a higher level of invested assets due to the acquisitions of policy blocks in 2005, and a slight increase in the investment rate of return during the current year period. The annualized return on total investments was 5.3% in the first nine months of 2006 versus 5.1% in the first nine months of 2005.

Equity Income

Equity income from AMIC decreased $1.1 million from the first nine months of 2005, as lower income earned by AMIC was slightly offset by an increase in IHC's ownership which was approximately 48% during the first nine months of 2006 compared to an average 42% in the first nine months of 2005. The reduction in income is primarily due to an increase in net loss ratios of AMIC's Medical Stop-Loss business.

Fee Income and Other Income

Fee income increased $16.6 million to $23.9 million from $7.3 million in the nine months ended September 30, 2005, primarily due to fees of $18.8 million earned by IAC, which is a subsidiary that was not part of the Company during the first nine months of 2005, partially offset by $2.2 million earned by GroupLink that is eliminated in 2006 as a result of transferring business from outside insurance carriers to subsidiaries of IHC.

Total other income decreased $2.8 million to $2.1 million from $4.9 million in the nine months ended September 30, 2005. This was primarily due to the inclusion of $3.5 million of other income in the first nine months of 2005 from a commutation agreement and a loss ratio cover with a reinsurer that have no equivalent in the first nine months of 2006.

Insurance Benefits, Claims and Reserves

Benefits, claims and reserves increased $36.8 million. The increase is due to: (i) $22.3 million in the Medical Stop-Loss segment resulting primarily from an 8% increase in retention and an increase in Net Loss Ratios to 94.9% as compared to 88.8% for the first nine months of 2005 (see Outlook for a discussion of factors affecting the recent underwriting profitability of the Medical Stop-Loss segment); (ii) an increase of $7.0 million in the Fully-Insured segment due to an increase in premiums; (iii) a $5.0 million increase in the Individual and Other segment due to higher losses on assumed blocks of annuity and life business and surrenders and interest credited on policies due to acquisitions made in 2005; (iv) an increase of $2.1 million in the Group segment primarily due to a $2.3 million increase related to new business written for group A&H in point of service, a $.8 million increase in group term life losses, a $.5 million increase in interest credited in group annuities partially offset by a $1.5 million decrease in LTD paid claims and net claims reserves; and (v) a $.4 million increase in the Credit Life and Disability segment caused by higher loss ratios and new business.

Amortization of Deferred Acquisition Costs

Amortization of deferred acquisition costs decreased $.3 million, primarily due to costs associated with the purchase of a block of business in 2005 that is eliminated in 2006 as a result of certain acquisitions of subsidiaries in 2006.

Interest Expense on Debt

Interest expense increased $.2 million, primarily due to an increase in the interest rate on $12.4 million of floating rate junior subordinated debt to 9.0% in the first nine months of 2006 as compared to 7.1% in the first nine months of 2005, in addition to a $2.5 million increase in outstanding debt during the third quarter of 2006.

Selling, General and Administrative Expenses

Total selling, general and administrative expenses increased $31.0 million in the first nine months of 2006 as compared to the first nine months of 2005. The increase is primarily due to (i) a $23.3 million increase in expenses associated with the operation of the Fully-Insured segment, primarily due to the acquisition of IAC, GroupLink, and higher commission expense due to the increase in premiums; (ii) a $5.3 million increase in commissions and other general expenses in the Medical Stop-Loss segment due to a higher level of premiums earned; (iii) a $1.2 million increase in the Individual and Other segment due to the block acquisitions in 2005; (iv) a $.9 million decrease in the Group segment primarily due to loss experience refunds which reduced commissions in the group A&H business as a result of higher loss ratios in 2006 compared to the prior year; (v) a $.5 million increase in the Credit Life and Disability segment due to new business; and (vi) a $1.6 million increase in other corporate expenses, including $1.1 million of expenses related to share-based compensation due to the adoption of SFAS 123R in 2006.

Income Taxes

Income tax expense decreased $3.5 million to $4.9 million for the nine months ended September 30, 2006 from $8.4 million for the first nine months of 2005 primarily due to the decrease in pre-tax income in 2006. The effective tax rates were 31.8% for the first nine months of 2006 and 33.8% for the first nine months of 2005.

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.

Total Corporate liquidity (cash, cash equivalents, resale agreements, short-term investments, fixed maturities, equity securities, partnership interests and certain other assets, net of liabilities) amounted to $21.0 million at September 30, 2006.

BALANCE SHEET

Total investments and cash and cash equivalents decreased $8.0 million during the nine months ended September 30, 2006 largely due to $21.0 million in cash used for acquisitions and a $5.4 million increase in unrealized losses on available for sale securities, partially offset by a $16.0 million decrease in net amounts due from and to reinsurers and $2.5 million of debt proceeds.

Insurance reserves-life and annuity decreased $19.3 million primarily due to the recapture of an ordinary life block of business at Standard Life of $9.5 million, the runoff of acquired blocks of $8.0 million and $4.5 million due to the final settlement of several life and annuity acquisitions made in 2005. Reserves on block acquisitions are subject to change at final settlement. Deferred acquisition costs decreased $7.0 million of which $4.5 million is also due to the final settlement of the 2005 acquisitions.

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 (ii) 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.

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The Company's health reserves by segment at September 30, 2006 and December 31, 2005 are as follows (in thousands):

	Total Health Reserves	
	2006	2005
Medical Stop-Loss	$ 79,534	$ 72,860
Fully-Insured Health	7,114	4,000
Group Disability	63,806	65,256
Credit A&H	7,249	7,363
Individual A&H and Other	10,283	14,960
	$ 167,986	$ 164,439

The $24.2 million increase in total stockholders' equity in the first nine months of 2006 is primarily due to $10.5 million in net income and a $17.9 million net increase in common stock and paid-in capital mostly from issuances of common shares in acquisitions, partially offset by a $3.3 million increase in net unrealized losses on investments.

The Company had net receivables from reinsurers of $83.5 million at September 30, 2006. Substantially all of the business ceded to such reinsurers is of short duration. All of such receivables are either due from the Company's affiliate, Independence American, highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2006.

Asset Quality

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. Of the aggregate carrying value of the Insurance Group's investment assets, approximately 88.7% was invested in investment grade fixed maturities, resale agreements, policy loans and cash and cash equivalents at September 30, 2006. Also at such date, approximately 98.5% of the Insurance Group's fixed maturities were investment grade. These investments carry less risk and, therefore, lower interest rates than other types of fixed maturity investments. At September 30, 2006, approximately 1.5% of the carrying value of fixed maturities was invested in diversified non-investment grade fixed maturities (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any mortgage loans or non-performing fixed maturities at September 30, 2006.

The Company reviews its investments regularly and monitors its investments continually for impairments. For the nine months ended September 30, 2006, the Company recorded a realized loss of $247,000 for other-than-temporary impairments. For the three months and nine months ended September 30, 2005, the Company recorded an insignificant realized loss for other-than-temporary impairments.

The Company's gross unrealized losses on fixed maturities totaled $22.5 million at September 30, 2006. Substantially all of these securities were investment grade. The Company holds all fixed maturities as available-for-sale securities and, accordingly, marks all of its fixed maturities to market through accumulated other comprehensive income or loss. The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's policy and were determined to be temporary in nature at September 30, 2006.

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, 2006, is not materially different from that reported in the schedule of such obligations at December 31, 2005 which was included in Item 7 of the Company s Annual Report on Form 10-K.

In accordance with SFAS No. 115, the Company may carry its portfolio of fixed maturities either as held to maturity (carried at amortized cost), as trading securities (carried at fair market value) or as available-for-sale (carried at fair market value). The Company has chosen to carry all of its debt securities as available-for-sale. In the first nine months of 2006, the Company experienced an increase in net unrealized losses of $5.7 million which, net of deferred tax benefits of $1.8 million and net of deferred policy acquisition costs of $.6 million, decreased stockholders' equity by $3.3 million (reflecting net unrealized losses of $11.7 million at September 30, 2006 compared to net unrealized losses of $8.4 million at December 31, 2005). From time to time, as warranted, the Company employs investment strategies to mitigate interest rate and other market exposures.

OUTLOOK

IHC has historically been a life and health insurance holding company for two insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"), which relied on independent general agents, managing general underwriters (MGUs) and administrators to perform the majority of all marketing, underwriting, claims and administrative functions for its two primary product segments (M edical S top- L oss and G roup Disability, L ife, Annuities and DBL). The Company's operating results have been heavily dependent on the results of its Medical Stop-Loss line of business, particularly as IHC has increased its risk retention in recent years. For 2006, IHC s business plan has been to: (i) improve the profitability of its core lines of business, in particular Medical Stop-Loss, while expanding distribution, (ii) lay a solid foundation for substantial growth in the Fully-Insured health insurance sector, and thereby seek to reduce both the volatility of its portfolio and its exposure to market cycles , and (iii) seek opportunities to acquire blocks of life and annuity business , and blocks of fully-insured health and dental .. The following summarizes what IHC has accomplish ed and the outlook for the remainder of 2006 and 2007 by segment.

When an excess product, such as Medical Stop-Loss, experiences several consecutive years of underwriting profitability, it is not unusual for there to be more competitors entering that line, which can increase pressure on pricing and create a "softer" market. The Medical Stop-Loss market began to "soften" in 2003, and less favorable conditions continued through 2005. During 2005, the Company increased rates and made changes in its underwriting guidelines in response to the results of its underwriting audits. For the nine months ended September 30, 2006, the Medical Stop-Loss line was affected by further development on business incepting in 2005 and in 2004, which caused reduced underwriting profitability. The Company believes that the experience on business written in 2004 should now be nearly complete; and consequently, that business written in 2005 will be nearing completion during the third quarter of 2007. Based upon the Company s best estimate, due to the changes made in underwriting guidelines made during 2005, the experience on business incepting in 2005 is tracking better than business written in 2004, and business written in 2006 is tracking better than business incepting in 2005 at this point in time.

During the second half of 2005 and 2006, IHC has expanded into multiple new Fully-Insured Health product s, including short-term medical (ST M), group major medical (including Consumer Driven Health Plans (CDHPs)), limited medical, dental and vision (the Fully-Insured Health Products). IHC will further expand its F ully- I nsured H ealth P roducts in 2006 to include major medical for individuals and families including CDHPs and limited medical .. The Company believes that , on a gross annualized basis, by the end of 2007, its Fully-Insured Health premiums will exceed its Medical Stop-Loss premiums. The commercial F ully- I nsured H ealth market is a much larger market than the excess market, estimated at $500 billion compared to a Medical Stop-Loss market of approximately $4 billion. The Company's Fully-Insured Health net earned premiums increased 140% for the first nine months of 2006 compared to the same period in 2005 and will continue to increase for the year 2007. IHC has invested heavily in systems and personnel during 2006 in order to administer this increased business, which has contributed to the essentially break-even profitability of the Fully-Insured segment for the first nine months of 2006. As a result of its multiple product filings, distribution sources, and the sheer size of the market, the Company is optimistic that its F ully- I nsured Health business will grow rapidly and yield profitable results, which , if achieved, would help balance the more volatile and cyclical M edical S top- L oss business.

IHC will continue to look for financially viable life and annuity acquisitions during 2006 and 2007 .. Although the source and timing of new acquisitions is unpredictable, the Company believes that there exists an ample supply of acquisition prospects for 2007, but it may not close on any significant blocks during the remainder of 2006.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages interest rate risk by seeking to maintain a portfolio with a duration and average life that falls within the band of the duration and average life of the applicable liabilities. 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.

The expected change in fair value as a percentage of the Company's fixed income portfolio at September 30, 2006 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2005 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 issued by 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.

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 fiscal quarter ended September 30, 2006 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

The Company is involved in legal proceedings and claims which arise in the ordinary course of its businesses. The Company has established reserves that it believes are sufficient given information presently available related to its outstanding legal proceedings and claims. The Company believes the results of pending legal proceedings and claims are not expected to have a material adverse effect on its financial condition or cash flows, although there could be such an effect on its results of operations for a 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, 2005 in Item 1A to Part 1 of Form 10-K.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not Applicable

Share Repurchase Program

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. As of September 30, 2006, 76,705 shares were still authorized to be repurchased under the plan. Share repurchases during 2006 are summarized as follows:

Month of Repurchase	2006 Number of Shares Repurchased		Average Price of Repurchased Shares	Maximum Number of Shares Which Can be Repurchased
January	-	$	-	109,837
February	-		-	109,837
March	-		-	109,837
April	-		-	109,837
May	2,931		20.34	106,906
June	-		-	106,906
July	-		-	106,906
August	17,283		20.04	89,623
September	12,918		20.21	76,705

ITEM 3.

DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4.

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

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, 2006

Roy T.K. Thung

Chief Executive Officer and President

By:

/s/Teresa A. Herbert

Date:

November 9, 2006

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer

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