

INDEPENDENCE HOLDING CO  
Form 10-Q  
May 09, 2014

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

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**FORM 10-Q**

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

For the quarterly period ended **March 31, 2014**.

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

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

Commission File Number: **0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**58-1407235**

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

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

**06902**

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(Address of principal executive offices)

(Zip Code)

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

**NOT APPLICABLE**

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

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

**Outstanding at May 1, 2014**  
**17,491,712 Shares**

**INDEPENDENCE HOLDING COMPANY**

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**PART I - FINANCIAL INFORMATION**

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

### Forward-Looking Statements

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

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

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

**PART I - FINANCIAL INFORMATION****Item 1.****Financial Statements**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

|  | March 31, 2014      | December 31,        |
|--|---------------------|---------------------|
|  | (Unaudited)         | 2013                |
| <b>ASSETS:</b>                                   |                     |                     |
| Investments:                                     |                     |                     |
| Short-term investments                           | \$ 50               | \$ 50               |
| Securities purchased under agreements to resell  | 34,971              | 22,594              |
| Trading securities                               | 10,594              | 7,125               |
| Fixed maturities, available-for-sale             | 535,094             | 542,287             |
| Equity securities, available-for-sale            | 11,995              | 11,803              |
| Other investments                                | 25,344              | 25,123              |
| Total investments                                | 618,048             | 608,982             |
| Cash and cash equivalents                        | 23,081              | 24,229              |
| Deferred acquisition costs                       | 29,857              | 29,777              |
| Due and unpaid premiums                          | 62,272              | 59,435              |
| Due from reinsurers                              | 380,002             | 380,229             |
| Premium and claim funds                          | 38,262              | 37,353              |
| Goodwill   | 50,318              | 50,318              |
| Other assets                                     | 86,178              | 78,712              |
| <b>TOTAL ASSETS</b>                              | <b>\$ 1,288,018</b> | <b>\$ 1,269,035</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>      |                     |                     |
| <b>LIABILITIES:</b>                              |                     |                     |
| Policy benefits and claims                       | \$ 236,656          | \$ 237,754          |
| Future policy benefits                           | 287,309             | 287,449             |
| Funds on deposit                                 | 274,090             | 274,826             |
| Unearned premiums                                | 13,833              | 12,423              |
| Other policyholders' funds                       | 25,014              | 25,129              |
| Due to reinsurers                                | 39,528              | 37,113              |
| Accounts payable, accruals and other liabilities | 80,867              | 71,889              |
| Debt   | 6,000               | 6,000               |
| Junior subordinated debt securities              | 38,146              | 38,146              |
| <b>TOTAL LIABILITIES</b>                         | <b>1,001,443</b>    | <b>990,729</b>      |

**STOCKHOLDERS' EQUITY:**

**IHC STOCKHOLDERS' EQUITY:**

|  |                     |                     |
|--|---------------------|---------------------|
| Preferred stock (none issued)  | --                  | -                   |
| Common stock \$1.00 par value, 23,000,000 shares authorized;           |                     |                     |
| 18,523,733 shares issued; 17,563,618 and 17,660,390 shares outstanding | 18,524              | 18,524              |
| Paid-in capital  | 126,335             | 126,239             |
| Accumulated other comprehensive loss                                   | (4,954)             | (10,472)            |
| Treasury stock, at cost; 960,115 and 863,343 shares                    | (9,432)             | (8,169)             |
| Retained earnings  | 146,357             | 142,669             |
| <b>TOTAL IHC STOCKHOLDERS' EQUITY</b>                                  | <b>276,830</b>      | <b>268,791</b>      |
| <b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>                        | <b>9,745</b>        | <b>9,515</b>        |
| <b>TOTAL EQUITY</b>  | <b>286,575</b>      | <b>278,306</b>      |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                    | <b>\$ 1,288,018</b> | <b>\$ 1,269,035</b> |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**  
(In thousands, except per share data)

|  | <b>Three Months Ended</b> |                 |
|--|---------------------------|-----------------|
|  | <b>March 31,</b>          |                 |
|  | <b>2014</b>               | <b>2013</b>     |
| <b>REVENUES:</b>   |                           |                 |
| Premiums earned  | \$ 123,270                | \$ 117,368      |
| Net investment income                                      | 5,801                     | 8,001           |
| Fee income   | 9,339                     | 6,542           |
| Other income   | 1,111                     | 1,352           |
| Net realized investment gains                              | 1,551                     | 4,619           |
|  | 141,072                   | 137,882         |
| <b>EXPENSES:</b>   |                           |                 |
| Insurance benefits, claims and reserves                    | 85,309                    | 85,460          |
| Selling, general and administrative expenses               | 48,135                    | 42,880          |
| Amortization of deferred acquisitions costs                | 1,282                     | 1,440           |
| Interest expense on debt                                   | 481                       | 487             |
|  | 135,207                   | 130,267         |
| Income before income taxes                                 | 5,865                     | 7,615           |
| Income taxes   | 1,860                     | 2,575           |
| <b>Net income</b>  | 4,005                     | 5,040           |
| Less: Income from noncontrolling interests in subsidiaries | (304)                     | (339)           |
| <b>NET INCOME ATTRIBUTABLE TO IHC</b>                      | <b>\$ 3,701</b>           | <b>\$ 4,701</b> |
| <b>Basic income per common share</b>                       | <b>\$ .21</b>             | <b>\$ .26</b>   |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>                 | <b>17,623</b>             | <b>17,919</b>   |
| <b>Diluted income per common share</b>                     | <b>\$ .21</b>             | <b>\$ .26</b>   |
| <b>WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING</b>         | <b>17,763</b>             | <b>18,040</b>   |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**  
**(In thousands)**

|  | <b>Three Months Ended</b> |                 |
|--|---------------------------|-----------------|
|  | <b>March 31,</b>          |                 |
|  | <b>2014</b>               | <b>2013</b>     |
| Net income   | \$ 4,005                  | \$ 5,040        |
| Other comprehensive income (loss):   |                           |                 |
| <b>Available-for-sale securities:</b>  |                           |                 |
| Unrealized gains (losses) on available-for-sale securities, pre-tax                      | 8,017                     | (2,107)         |
| Tax expense (benefit) on unrealized gains (losses) on available-for-sale securities      | 2,378                     | (580)           |
| Unrealized gains (losses) on available-for-sale securities, net of taxes                 | 5,639                     | (1,527)         |
| <b>Cash flow hedge:</b>  |                           |                 |
| Unrealized gains on cash flow hedge, pre-tax   | 17                        | 23              |
| Tax expense on unrealized gains on cash flow hedge                                       | 7                         | 9               |
| Unrealized gains on cash flow hedge, net of taxes  | 10                        | 14              |
| Other comprehensive income (loss), net of tax  | 5,649                     | (1,513)         |
| <b>COMPREHENSIVE INCOME, NET OF TAX</b>  | <b>9,654</b>              | <b>3,527</b>    |
| Comprehensive income, net of tax, attributable to noncontrolling interests:              |                           |                 |
| Income from noncontrolling interests in subsidiaries                                     | (304)                     | (339)           |
| Other comprehensive (income) loss, net of tax, attributable to noncontrolling interests: |                           |                 |
| Unrealized (income) loss on available-for-sale securities, net of tax                    | (131)                     | 91              |
| Other comprehensive (income) loss, net of tax, attributable to noncontrolling interests  | (131)                     | 91              |
| <b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO NONCONTROLLING INTERESTS</b>        | <b>(435)</b>              | <b>(248)</b>    |
| <b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO IHC</b>                             | <b>\$ 9,219</b>           | <b>\$ 3,279</b> |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Unaudited)**  
**THREE MONTHS ENDED MARCH 31, 2014 (In thousands)**

|  | COMMON<br>STOCK | PAID-IN<br>CAPITAL | ACCUMULATED<br>OTHER<br>COMPREHENSIVE<br>INCOME (LOSS) | TREASURY<br>STOCK,<br>AT COST | RETAINED<br>EARNINGS | TOTAL IHC<br>STOCKHOLDERS'<br>EQUITY | NON-<br>CONTROLLING<br>INTERESTS<br>SUBSIDIARIES |
|--|-----------------|--------------------|--|-------------------------------|----------------------|--------------------------------------|--|
| <b>BALANCE<br/>AT<br/>DECEMBER<br/>31, 2013</b>                              | 18,524\$        | 126,239\$          | (10,472)\$   | (8,169)\$                     | 142,669 \$           | 268,791 \$                           |  |
| Net<br>income  |                 |                    |  |                               | 3,701                | 3,701                                |  |
| Other<br>comprehensive<br>loss, net<br>of tax                                |                 |                    | 5,518  |                               |                      | 5,518                                |  |
| Repurchases<br>of<br>common<br>stock   |                 |                    |  | (1,263)                       |                      | (1,263)                              |  |
| Share-based<br>compensation<br>expenses<br>and<br>related<br>tax<br>benefits |                 | 85                 |  |                               |                      | 85                                   |  |
| Distributions<br>to<br>noncontrolling<br>interests                           |                 |                    |  |                               |                      |                                      | -  |
| Other<br>capital<br>transactions   |                 | 11                 |  |                               | (13)                 | (2)                                  |  |
| <b>BALANCE<br/>AT<br/>MARCH<br/>31, 2014</b>                                 | 18,524\$        | 126,335\$          | (4,954)\$  | (9,432)\$                     | 146,357 \$           | 276,830 \$                           |  |

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

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

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2014</b>                         | <b>2013</b> |
| <b>CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:</b>                        |                                     |             |
| Net income   | \$ 4,005                            | \$ 5,040    |
| Adjustments to reconcile net income to net change in cash from operating activities: |                                     |             |
| Amortization of deferred acquisition costs   | 1,282                               | 1,440       |
| Net realized investment gains  | (1,551)                             | (4,619)     |
| Equity income from equity method investments   | (433)                               | (906)       |
| Depreciation and amortization  | 1,005                               | 1,163       |
| Share-based compensation expenses  | 16                                  | 128         |
| Deferred tax expense   | 824                                 | 3,225       |
| Other  | 1,275                               | 1,906       |
| Changes in assets and liabilities:   |                                     |             |
| Net (purchases) sales of trading securities  | (2,889)                             | 764         |
| Change in insurance liabilities  | 2,552                               | 21,207      |
| Additions to deferred acquisition costs  | (1,383)                             | (1,387)     |
| Change in amounts due from reinsurers  | 227                                 | (5,676)     |
| Change in premium and claim funds  | (909)                               | (14,741)    |
| Change in current income tax liability   | 522                                 | 640         |
| Change in due and unpaid premiums  | (2,837)                             | (485)       |
| Change in other assets   | (1,777)                             | 5,006       |
| Change in other liabilities  | 4,125                               | (1,422)     |
| Net change in cash from operating activities   | 4,054                               | 11,283      |
| <b>CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:</b>                        |                                     |             |
| Net (purchases) sales of securities under resale and repurchase agreements           | (12,377)                            | 20,538      |
| Sales of equity securities   | 250                                 | 7,500       |
| Purchases of equity securities   | (250)                               | -           |
| Sales of fixed maturities  | 83,746                              | 88,859      |
| Maturities and other repayments of fixed maturities                                  | 17,344                              | 14,663      |
| Purchases of fixed maturities  | (94,159)                            | (149,871)   |
| Other investing activities   | 3,018                               | 5,246       |
| Net change in cash from investing activities   | (2,428)                             | (13,065)    |
| <b>CASH FLOWS PROVIDED BY (USED BY) FINANCING ACTIVITIES:</b>                        |                                     |             |

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|   |           |           |
|---|-----------|-----------|
| Repurchases of common stock                           | (1,120)   | (565)     |
| Cash paid in acquisitions of noncontrolling interests | -         | (1,199)   |
| Withdrawals of investment-type insurance contracts    | (816)     | (787)     |
| Dividends paid  | (620)     | -         |
| Other financing activities                            | (218)     | (583)     |
| Net change in cash from financing activities          | (2,774)   | (3,134)   |
| Net change in cash and cash equivalents               | (1,148)   | (4,916)   |
| Cash and cash equivalents, beginning of year          | 24,229    | 23,945    |
| Cash and cash equivalents, end of period              | \$ 23,081 | \$ 19,029 |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

**Organization, Consolidation, Basis of Presentation and Accounting Policies**

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC, IHC Health Solutions, Inc., IHC Specialty Benefits Inc. and IHC Carrier Solutions, Inc. IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss. Standard Security Life, Madison National Life and Independence American are sometimes collectively referred to as the Insurance Group . IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or IHC , or are implicit in the terms we , us and our .

Geneve Corporation, a diversified financial holding company, and its affiliated entities, held 52.1% of IHC's outstanding common stock at March 31, 2014.

**(B)**

**Consolidation**

**American Independence Corp.**

The Company owned 90.0% of the outstanding common stock of American Independence Corp. ("AMIC") at both March 31, 2014 and December 31, 2013. AMIC is an insurance holding company engaged in the insurance and reinsurance business.

(C)

**Basis of Presentation**

The Condensed Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The Condensed Consolidated Financial Statements include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements; and (ii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying Condensed Consolidated Financial Statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results to be anticipated for the entire year.

(D)

### **Reclassifications**

Certain amounts in prior year's Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2014 presentation.

(E)

### **Recent Accounting Pronouncements**

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

In July 2013, the Financial Accounting Standards Board ( FASB ), issued guidance for the presentation of unrecognized tax benefits to better reflect the manner in which an entity would settle, at the reporting date, any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The adoption of this guidance, effective January 1, 2014, did not have an effect on the Company's consolidated financial statements.

In July 2011, the FASB issued guidance specifying that the liability for the fees paid to the Federal Government by health insurers as a result of recent healthcare reform legislation should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. The amendments in this Update became effective January 1, 2014 and in accordance with the provisions, IHC recorded the estimated gross liability for the mandated fees payable to the Federal Government of \$1,500,000 and the corresponding deferred cost in the first quarter of 2014. The amounts were recorded in accounts payable, accruals and other liabilities and in other assets, respectively, on the Condensed Consolidated Balance Sheet. The deferred asset will be amortized ratably over the calendar year to selling, general and administrative expense in the Condensed Consolidated Statement of Income. This is an estimated amount and will be adjusted once the final assessment is received.

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

In April 2014, the FASB issued guidance: (i) improving the definition of discontinued operations by limiting the reporting of discontinued operations to disposals of components that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results; and (ii) requiring expanded disclosures for discontinued operations. Public entities are required to apply this guidance to: (i) all disposals (or classifications as held for sale) of

components of the entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years; and (ii) to all businesses that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in previously issued financial statements. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

**Note 2.**

**Income Per Common Share**

Included in the diluted earnings per share calculation for the three months ended March 31, 2014 and 2013 are 140,000 and 121,000 incremental common shares, respectively, primarily from the dilutive effect of share-based payment awards, computed using the treasury stock method.

**Note 3.****Investment Securities**

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

|   | <b>March 31, 2014</b>     |                                       |  |                       |
|---|---------------------------|---------------------------------------|--|-----------------------|
|   | <b>AMORTIZED<br/>COST</b> | <b>GROSS<br/>UNREALIZED<br/>GAINS</b> | <b>GROSS<br/>UNREALIZED<br/>LOSSES</b> | <b>FAIR<br/>VALUE</b> |
| <b>FIXED MATURITIES</b>                 |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |                                       |  |                       |
| Corporate securities                    | \$ 207,375                | \$ 1,301                              | \$ (4,986)                             | \$ 203,690            |
| CMOs - residential <sup>(1)</sup>       | 2,259                     | 8                                     | (11)                                   | 2,256                 |
| CMOs - commercial                       | 975                       | -                                     | (106)                                  | 869                   |
| U.S. Government obligations             | 15,592                    | 216                                   | (5)                                    | 15,803                |
| Agency MBS - residential <sup>(2)</sup> | 76                        | 4                                     | -                                      | 80                    |
| GSEs <sup>(3)</sup>                     | 19,200                    | 3                                     | (667)                                  | 18,536                |
| States and political subdivisions       | 256,226                   | 3,507                                 | (5,422)                                | 254,311               |
| Foreign government obligations          | 37,276                    | 127                                   | (1,768)                                | 35,635                |
| Redeemable preferred stocks             | 4,036                     | 82                                    | (204)                                  | 3,914                 |
| Total fixed maturities                  | \$ 543,015                | \$ 5,248                              | \$ (13,169)                            | \$ 535,094            |
| <b>EQUITY SECURITIES</b>                |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |                                       |  |                       |
| Common stocks                           | \$ 7,517                  | \$ 450                                | \$ (87)                                | \$ 7,880              |
| Nonredeemable preferred stocks          | 4,004                     | 111                                   | -                                      | 4,115                 |
| Total equity securities                 | \$ 11,521                 | \$ 561                                | \$ (87)                                | \$ 11,995             |
| <b>December 31, 2013</b>                |                           |                                       |  |                       |
|   | <b>AMORTIZED<br/>COST</b> | <b>GROSS<br/>UNREALIZED<br/>GAINS</b> | <b>GROSS<br/>UNREALIZED<br/>LOSSES</b> | <b>FAIR<br/>VALUE</b> |
| <b>FIXED MATURITIES</b>                 |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |                                       |  |                       |
| Corporate securities                    | \$ 215,412                | \$ 1,315                              | \$ (7,467)                             | \$ 209,260            |
| CMOs - residential <sup>(1)</sup>       | 2,457                     | 8                                     | (8)                                    | 2,457                 |
| CMOs - commercial                       | 975                       | -                                     | (382)                                  | 593                   |
| U.S. Government obligations             | 15,596                    | 271                                   | (6)                                    | 15,861                |
| Agency MBS - residential <sup>(2)</sup> | 79                        | 4                                     | -                                      | 83                    |

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|                                   |            |          |             |            |
|-----------------------------------|------------|----------|-------------|------------|
| GSEs <sup>(3)</sup>               | 28,484     | 4        | (340)       | 28,148     |
| States and political subdivisions | 256,645    | 2,435    | (9,377)     | 249,703    |
| Foreign government obligations    | 34,437     | 20       | (2,107)     | 32,350     |
| Redeemable preferred stocks       | 4,036      | 74       | (278)       | 3,832      |
| Total fixed maturities            | \$ 558,121 | \$ 4,131 | \$ (19,965) | \$ 542,287 |

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

|                                |           |        |          |           |
|--------------------------------|-----------|--------|----------|-----------|
| Common stocks                  | \$ 7,517  | \$ 328 | \$ (70)  | \$ 7,775  |
| Nonredeemable preferred stocks | 4,004     | 58     | (34)     | 4,028     |
| Total equity securities        | \$ 11,521 | \$ 386 | \$ (104) | \$ 11,803 |

(1)

Collateralized mortgage obligations ( CMOs ).

(2)

Mortgage-backed securities ( MBS ).

(3)

Government-sponsored enterprises ( GSEs ) are private enterprises established and chartered by the Federal Government

or its various insurance and lease programs which carry the full faith and credit obligation of the U.S. Government.

The amortized cost and fair value of fixed maturities available-for-sale at March 31, 2014, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. CMOs and MBSs are shown separately, as they are not due at a single maturity.

|  | <b>AMORTIZED<br/>COST</b> | <b>FAIR<br/>VALUE</b> |
|--|---------------------------|-----------------------|
| Due in one year or less                | \$ 28,453                 | \$ 28,451             |
| Due after one year through five years  | 43,264                    | 43,147                |
| Due after five years through ten years | 199,697                   | 196,073               |
| Due after ten years                    | 249,093                   | 245,682               |
| CMOs and MBSs                          | 22,508                    | 21,741                |
|  | \$ 543,015                | \$ 535,094            |

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

#### March 31, 2014

|                                   | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|-----------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                   | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities              | \$ 101,907          | \$ 2,689          | \$ 36,883           | \$ 2,297          | \$ 138,790 | \$ 4,986          |
| CMOs - residential                | 1,879               | 11                | -                   | -                 | 1,879      | 11                |
| CMOs - commercial                 | -                   | -                 | 869                 | 106               | 869        | 106               |
| U.S. Government obligations       | 494                 | 5                 | -                   | -                 | 494        | 5                 |
| GSEs                              | 13,199              | 469               | 5,288               | 198               | 18,487     | 667               |
| States and political subdivisions | 135,318             | 3,634             | 37,068              | 1,788             | 172,386    | 5,422             |
| Foreign governments               | 18,472              | 1,415             | 5,520               | 353               | 23,992     | 1,768             |
| Redeemable preferred stocks       | 3,558               | 204               | -                   | -                 | 3,558      | 204               |
|                                   | 274,827             | 8,427             | 85,628              | 4,742             | 360,455    | 13,169            |

**Total fixed maturities**

|                                |       |    |   |   |       |    |
|--------------------------------|-------|----|---|---|-------|----|
| Common stocks                  | 2,009 | 87 | - | - | 2,009 | 87 |
| <b>Total equity securities</b> | 2,009 | 87 | - | - | 2,009 | 87 |

**Total temporarily impaired securities**

|  |            |          |           |          |            |           |
|--|------------|----------|-----------|----------|------------|-----------|
|  | \$ 276,836 | \$ 8,514 | \$ 85,628 | \$ 4,742 | \$ 362,464 | \$ 13,256 |
|--|------------|----------|-----------|----------|------------|-----------|

**Number of securities in an unrealized loss position**

|  |     |  |    |  |     |  |
|--|-----|--|----|--|-----|--|
|  | 105 |  | 31 |  | 136 |  |
|--|-----|--|----|--|-----|--|

## December 31, 2013

|  | Less than 12 Months |                   | 12 Months or Longer |                   | Total             |                   |
|--|---------------------|-------------------|---------------------|-------------------|-------------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses |
| Corporate securities                                       | \$ 124,531          | \$ 5,340          | \$ 21,070           | \$ 2,127          | \$ 145,601        | \$ 7,467          |
| CMO s - residential  | 2,047               | 8                 | -                   | -                 | 2,047             | 8                 |
| CMOs - commercial  | -                   | -                 | 593                 | 382               | 593               | 382               |
| U.S. Government obligations                                | 493                 | 6                 | -                   | -                 | 493               | 6                 |
| GSEs   | 22,731              | 123               | 5,360               | 217               | 28,091            | 340               |
| States and political subdivisions                          | 149,704             | 7,312             | 32,983              | 2,065             | 182,687           | 9,377             |
| Foreign governments  | 27,587              | 1,766             | 3,523               | 341               | 31,110            | 2,107             |
| Redeemable preferred stocks                                | 3,485               | 278               | -                   | -                 | 3,485             | 278               |
| <b>Total fixed maturities</b>                              | <b>330,578</b>      | <b>14,833</b>     | <b>63,529</b>       | <b>5,132</b>      | <b>394,107</b>    | <b>19,965</b>     |
| Common stocks  | 2,589               | 70                | -                   | -                 | 2,589             | 70                |
| Nonredeemable preferred stocks                             | 2,625               | 34                | -                   | -                 | 2,625             | 34                |
| <b>Total equity securities</b>                             | <b>5,214</b>        | <b>104</b>        | <b>-</b>            | <b>-</b>          | <b>5,214</b>      | <b>104</b>        |
| <b>Total temporarily impaired securities</b>               | <b>\$ 335,792</b>   | <b>\$ 14,937</b>  | <b>\$ 63,529</b>    | <b>\$ 5,132</b>   | <b>\$ 399,321</b> | <b>\$ 20,069</b>  |
| <b>Number of securities in an unrealized loss position</b> | <b>126</b>          |                   | <b>27</b>           |                   | <b>153</b>        |                   |

Substantially all of the unrealized losses on fixed maturities available-for-sale at March 31, 2014 and December 31, 2012 relate to investment grade securities and are attributable to changes in market interest rates. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2014.

Net realized investment gains (losses) are as follows for periods indicated (in thousands):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2014</b>               | <b>2013</b> |
| Sales of available-for-sale securities:                   |                           |             |
| Fixed maturities  | \$ 2,186                  | \$ 4,451    |
| Preferred stocks  | -                         | 113         |
| Total sales of available-for-sale securities              | 2,186                     | 4,564       |
| Sales of trading securities                               | 5                         | 36          |
| Other gains (losses)                                      | (709)                     | (239)       |
| Total realized gains (losses)                             | 1,482                     | 4,361       |
| Unrealized gains (losses) on trading securities:          |                           |             |
| Change in unrealized gains (losses) on trading securities | 69                        | 258         |
| Total unrealized gains (losses) on trading securities     | 69                        | 258         |
| Net realized investment gains (losses)                    | \$ 1,551                  | \$ 4,619    |

For the three months ended March 31, 2014, proceeds from sales of available-for-sale securities were \$97,550,000 and the Company realized gross gains of \$2,605,000 and gross losses of \$419,000 as a result of those sales. For the three months ended March 31, 2013, proceeds from sales of available-for-sale

securities were \$96,359,000 and the Company realized gross gains of \$4,632,000 and gross losses of \$68,000 as a result of those sales.

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

We recognize an other-than-temporary impairment loss in earnings in the period that we determine: 1) we intend to sell the security; 2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis; or 3) the security has a credit loss. Any non-credit portion of the other-than-temporary impairment loss is recognized in other comprehensive income (loss). See Note 1G(vi) to the Consolidated Financial Statements in the 2013 Annual Report for further discussion of the factors considered by management in its regular review to identify and recognize other-than-temporary impairments on available-for-sale securities. The Company did not recognize any other-than-temporary impairments on available-for-sale securities in 2014 or 2013.

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

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2014</b>               | <b>2013</b> |
| Balance at beginning of year  | \$ 473                    | \$ 1,976    |
| Additional credit losses for which an other-than-temporary loss was previously recognized | -                         | -           |
| Securities sold   | -                         | -           |
| Balance at end of period  | \$ 473                    | \$ 1,976    |

The after-tax portion of other-than-temporary impairments included in accumulated other comprehensive income (loss) at both March 31, 2014 and December 31, 2013 consists of \$335,000 related to CMO securities.

#### **Note 4.**

##### **Cash Flow Hedge**

In connection with its outstanding amortizing term loan, a subsidiary of IHC entered into an interest rate swap on July 1, 2011 with the commercial bank lender, for a notional amount equal to the debt principal amount (\$6,000,000 at both March 31, 2014 and December 31, 2013), under which the Company receives a variable rate equal to the rate on

the debt and pays a fixed rate (1.60%) in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. As a result of the interest rate swap, interest payments on this debt are fixed at 4.95%. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge. At March 31, 2014 and December 31, 2013, the fair value of interest rate swap was \$186,000 and \$204,000, respectively, which is included in other liabilities on the accompanying Condensed Consolidated Balance Sheets. See Note 5 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap.

**Note 5.**

**Fair Value Disclosures**

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

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

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

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

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

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

Available-for-sale securities included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, collateralized mortgage obligations, municipals, GSEs and certain preferred stocks that were priced with observable market inputs. Level 3 securities consist primarily of CMO securities and municipal tax credit strips. For these securities, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management's assumptions and available market information. Significant unobservable inputs used in the fair value measurement of CMOs are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite change in the assumption used for prepayment rates. Further we retain independent pricing vendors to assist in valuing certain instruments.

**Trading securities:**

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

**Interest rate swap:**

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



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The following tables present our financial assets and liabilities measured at fair value on a recurring basis for the periods indicated (in thousands):

|                                       | <b>March 31, 2014</b> |                   |                 | <b>Total</b>      |
|---------------------------------------|-----------------------|-------------------|-----------------|-------------------|
|                                       | <b>Level 1</b>        | <b>Level 2</b>    | <b>Level 3</b>  |                   |
| <b>FINANCIAL ASSETS:</b>              |                       |                   |                 |                   |
| Fixed maturities available-for-sale:  |                       |                   |                 |                   |
| Corporate securities                  | \$ -                  | \$ 203,690        | \$ -            | \$ 203,690        |
| CMOs - residential                    | -                     | 2,256             | -               | 2,256             |
| CMOs - commercial                     | -                     | -                 | 869             | 869               |
| US Government obligations             | -                     | 15,803            | -               | 15,803            |
| Agency MBS - residential              | -                     | 80                | -               | 80                |
| GSEs                                  | -                     | 18,536            | -               | 18,536            |
| States and political subdivisions     | -                     | 251,901           | 2,410           | 254,311           |
| Foreign government obligations        | -                     | 35,635            | -               | 35,635            |
| Redeemable preferred stocks           | 3,914                 | -                 | -               | 3,914             |
| Total fixed maturities                | 3,914                 | 527,901           | 3,279           | 535,094           |
| Equity securities available-for-sale: |                       |                   |                 |                   |
| Common stocks                         | 7,880                 | -                 | -               | 7,880             |
| Nonredeemable preferred stocks        | 4,115                 | -                 | -               | 4,115             |
| Total equity securities               | 11,995                | -                 | -               | 11,995            |
| Trading securities - equities         | 10,594                | -                 | -               | 10,594            |
| Total trading securities              | 10,594                | -                 | -               | 10,594            |
| <b>Total Financial Assets</b>         | <b>\$ 26,503</b>      | <b>\$ 527,901</b> | <b>\$ 3,279</b> | <b>\$ 557,683</b> |
| <b>FINANCIAL LIABILITIES:</b>         |                       |                   |                 |                   |
| Interest rate swap                    | \$ -                  | \$ 186            | \$ -            | \$ 186            |

|                                      | <b>December 31, 2013</b> |                |                | <b>Total</b> |
|--------------------------------------|--------------------------|----------------|----------------|--------------|
|                                      | <b>Level 1</b>           | <b>Level 2</b> | <b>Level 3</b> |              |
| <b>FINANCIAL ASSETS:</b>             |                          |                |                |              |
| Fixed maturities available-for-sale: |                          |                |                |              |
| Corporate securities                 | \$ -                     | \$ 209,260     | \$ -           | \$ 209,260   |
| CMOs - residential                   | -                        | 2,457          | -              | 2,457        |
| CMOs - commercial                    | -                        | -              | 593            | 593          |
| US Government obligations            | -                        | 15,861         | -              | 15,861       |
| Agency MBS - residential             | -                        | 83             | -              | 83           |
| GSEs                                 | -                        | 28,148         | -              | 28,148       |
| States and political subdivisions    | -                        | 247,262        | 2,441          | 249,703      |
| Foreign government obligations       | -                        | 32,350         | -              | 32,350       |
| Redeemable preferred stocks          | 3,832                    | -              | -              | 3,832        |
| Total fixed maturities               | 3,832                    | 535,421        | 3,034          | 542,287      |

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|                                       |           |            |          |            |
|---------------------------------------|-----------|------------|----------|------------|
| Equity securities available-for-sale: |           |            |          |            |
| Common stocks                         | 7,775     | -          | -        | 7,775      |
| Nonredeemable preferred stocks        | 4,028     | -          | -        | 4,028      |
| Total equity securities               | 11,803    | -          | -        | 11,803     |
| Trading securities - equities         | 7,125     | -          | -        | 7,125      |
| Total trading securities              | 7,125     | -          | -        | 7,125      |
| <b>Total Financial Assets</b>         | \$ 22,760 | \$ 535,421 | \$ 3,034 | \$ 561,215 |
| <b>FINANCIAL LIABILITIES:</b>         |           |            |          |            |
| Interest rate swap                    | \$ -      | \$ 204     | \$ -     | \$ 204     |

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It is the Company's policy to recognize transfers of assets and liabilities between levels of the fair value hierarchy at the end of a reporting period. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow.

There were no securities transferred between Level 1, Level 2 or Level 3 in 2014 or 2013. The following table presents the changes in fair value of our Level 3 financial instruments for the periods indicated (in thousands):

|   | <b>Three Months Ended March 31, 2014</b> |  |  | <b>Total</b> |
|---|--|--|--|--------------|
|   | <b>CMOs<br/>Commercial</b>               | <b>States and<br/>Political<br/>Subdivisions</b> |  |              |
| Beginning balance   | \$ 593                                   | \$ 2,441   |  | \$ 3,034     |
| Gains (losses) included in other comprehensive income (loss): |  |  |  |              |
| Net unrealized gains (losses)                                 | 276                                      | (16)   |  | 260          |
| Repayments and amortization of fixed maturities               | -  | (15)   |  | (15)         |
| Balance at end of period                                      | \$ 869                                   | \$ 2,410   |  | \$ 3,279     |

|   | <b>Three Months Ended March 31, 2013</b> |                            |  | <b>Total</b> |
|---|--|----------------------------|--|--------------|
|   | <b>Residential</b>                       | <b>CMOs<br/>Commercial</b> | <b>States and<br/>Political<br/>Subdivisions</b> |              |
| Beginning balance   | \$ 14,053                                | \$ 570                     | \$ 2,558   | \$ 17,181    |
| Gains (losses) included in earnings:                          |  |                            |  |              |
| Net realized investment gains                                 | 1,490                                    | -                          | -  | 1,490        |
| Gains (losses) included in other comprehensive income (loss): |  |                            |  |              |
| Net unrealized gains (losses)                                 | (1,292)                                  | 6                          | (23)   | (1,309)      |
| Sales of securities   | (4,034)                                  | -                          | -  | (4,034)      |
| Repayments and amortization of fixed maturities               | (462)                                    | -                          | (6)  | (468)        |
| Balance at end of period                                      | \$ 9,755                                 | \$ 576                     | \$ 2,529   | \$ 12,860    |

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

|   | March 31, 2014           |                   | December 31, 2013        |                   |
|---|--------------------------|-------------------|--------------------------|-------------------|
|   | Level 2<br>Fair<br>Value | Carrying<br>Value | Level 2<br>Fair<br>Value | Carrying<br>Value |
| <b>FINANCIAL ASSETS:</b>                        |                          |                   |                          |                   |
| Policy loans                                    | \$ 13,914                | \$ 11,116         | \$ 14,177                | \$ 11,328         |
| <b>FINANCIAL LIABILITIES:</b>                   |                          |                   |                          |                   |
| Funds on deposit                                | \$ 274,038               | \$ 274,090        | \$ 274,773               | \$ 274,826        |
| Debt and junior subordinated<br>debt securities | \$ 44,146                | \$ 44,146         | \$ 44,146                | \$ 44,146         |

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

(A)

#### **Policy Loans**

The fair value of policy loans included in Level 2 of the fair value hierarchy is estimated by projecting aggregate loan cash flows to the end of the expected lifetime period of the life insurance business at the average policy loan rates, and discounting them at a current market interest rate.

(B)

#### **Funds on Deposit**

The Company has two types of funds on deposit. The first type is credited with a current market interest rate, resulting in a fair value which approximates the carrying amount. The second type carries fixed interest rates which are higher than current market interest rates. The fair value of these deposits was estimated by discounting the payments using current market interest rates. The Company's universal life policies are also credited with current market interest rates, resulting in a fair value which approximates the carrying amount. Both types of funds on deposit are included in Level 2 of the fair value hierarchy.

(C)

#### **Debt**

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

#### **Note 6.**

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

The carrying amount of goodwill was \$50,318,000 at March 31, 2014 and December 31, 2012.

The Company has net other intangible assets of \$14,088,000 and \$14,767,000 at March 31, 2014 and December 31, 2013, respectively, which are included in other assets in the Condensed Consolidated Balance Sheets. These intangible assets consist of: (i) finite-lived intangible assets, principally the fair value of acquired agent and broker relationships, which are subject to amortization; and (ii) indefinite-lived intangible assets which consist of the estimated fair value of insurance licenses that are not subject to amortization. The gross carrying amounts of these other intangible assets are as follows for the periods indicated (in thousands):

|  | <b>March 31, 2014</b>                |                                     | <b>December 31, 2013</b>             |                                     |
|--|--------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|
|  | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> |
| <b>Finite-lived Intangible Assets:</b>     |                                      |                                     |                                      |                                     |
| Agent and broker relationships             | \$ 22,725                            | \$ 16,614                           | \$ 22,725                            | \$ 15,935                           |
| <br>                                       |                                      |                                     |                                      |                                     |
|  |                                      |                                     | <b>March 31,<br/>2014</b>            | <b>December 31,<br/>2013</b>        |
| <b>Indefinite-lived Intangible Assets:</b> |                                      |                                     |                                      |                                     |
| Insurance licenses                         |                                      |                                     | \$ 7,977                             | \$ 7,977                            |

Amortization expense was \$679,000 and \$802,000 for the three months ended March 31, 2014 and 2013, respectively.

**Note 7.****Income Taxes**

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

At March 31, 2014, AMIC had net operating loss carryforwards of approximately \$265,229,000 for federal income tax purposes, expiring in varying amounts through the year 2028, with a significant portion expiring in 2020. The net deferred tax asset relative to AMIC included in other assets on IHC's Condensed Consolidated Balance Sheets was \$10,370,000 and \$10,689,000 at March 31, 2014 and December 31, 2013, respectively.

**Note 8.****Accumulated Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss) include (i) the after-tax net unrealized gains and losses on investment securities available-for-sale, including the subsequent increases and decreases in fair value of available-for-sale securities previously impaired and the non-credit related component of other-than-temporary impairments of fixed maturities and (ii) the after-tax unrealized gains and losses on a cash flow hedge.

Changes in the balances for each component of accumulated other comprehensive income (loss), shown net of taxes, for the periods indicated were as follows (in thousands):

|                   | <b>Three Months Ended March 31, 2014</b>  |                            |              |
|-------------------|---|----------------------------|--------------|
|                   | <b>Unrealized<br/>Gains (Losses)<br/>on<br/>Available-for<br/>Sale<br/>Securities</b> | <b>Cash Flow<br/>Hedge</b> | <b>Total</b> |
| Beginning balance | \$ (10,350)   | \$ (122)                   | \$ (10,472)  |

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|   |            |          |            |
|---|------------|----------|------------|
| Other comprehensive income (loss) before reclassifications                | 6,618      | 10       | 6,628      |
| Amounts reclassified from accumulated OCI                                 | (979)      | -        | (979)      |
| Net other comprehensive income (loss)                                     | 5,639      | 10       | 5,649      |
| Less: Other comprehensive income attributable to noncontrolling interests | (131)      | -        | (131)      |
| Ending balance  | \$ (4,842) | \$ (112) | \$ (4,954) |

## Three Months Ended March 31, 2013

|   | Unrealized<br>Gains (Losses)<br>on<br>Available-for-<br>Sale<br>Securities | Cash Flow<br>Hedge | Total     |
|---|--|--------------------|-----------|
| Beginning balance   | \$ 15,231  | \$ (218)           | \$ 15,013 |
| Other comprehensive income (loss) before reclassifications              | 1,448  | 14                 | 1,462     |
| Amounts reclassified from accumulated OCI                               | (2,975)  | -                  | (2,975)   |
| Net other comprehensive income (loss)                                   | (1,527)  | 14                 | (1,513)   |
| Less: Other comprehensive loss attributable to noncontrolling interests | 91   | -                  | 91        |
| Acquired from noncontrolling interests                                  | 36   | -                  | 36        |
| Ending balance  | \$ 13,831  | \$ (204)           | \$ 13,627 |

Presented below are the amounts reclassified out of accumulated other comprehensive income (loss) and recognized in earnings for each of the periods indicated (in thousands):

|   | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| Unrealized gains (losses) on available-for-sale securities reclassified during the period to the following income statement line items: |                                 |          |
| Net realized investment gains   | \$ 1,477                        | \$ 4,326 |
| Income before income tax  | 1,477                           | 4,326    |
| Tax effect  | 498                             | 1,351    |
| Net income  | \$ 979                          | \$ 2,975 |

**Note 9.****Share-Based Compensation**

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

**A) IHC Share-Based Compensation Plans**

Under the terms of IHC's stock-based compensation plans, option exercise prices are more than or equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are generally three years for employee options. The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. In addition to stock options, the Company has also granted restricted stock units, share appreciation rights (SARs) and share-based performance awards under the 2006 Plan. Restricted share units are valued at the quoted market price of the shares at the date of grant and have a three year vesting period. Compensation costs for options and restricted share units are recognized over the stated vesting periods on a straight-line basis. Exercise prices of SARs are more than or equal to the quoted market price of IHC shares at the date of the grant and have three year vesting periods. The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement.

At March 31, 2014, there were 384,139 shares available for future stock-based compensation grants under IHC's stock incentive plans. The following table summarizes share-based compensation expense, which is included in selling, general and administrative expenses on the Condensed Consolidated Statements of Income, applicable to the IHC plans by award type for each of the periods indicated (in thousands):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2014</b>               | <b>2013</b> |
| <b>IHC's Share-based Compensation Plan:</b> |                           |             |
| Stock options                               | \$ 66                     | \$ 13       |
| Restricted stock units                      | 19                        | 13          |
| SARs  | (81)                      | 99          |
| Performance awards                          | -                         | (5)         |
| Share-based compensation expense, pre-tax   | 4                         | 120         |
| Tax benefits                                | 1                         | 48          |
| Share-based compensation expense, net       | \$ 3                      | \$ 72       |

### Stock Options

At March 31, 2014 and December 31, 2013, there were 616,858 stock options outstanding with a weighted average exercise price of \$9.35 per share.

The following table summarizes information regarding outstanding and exercisable options:

|  | <b>March 31, 2014</b> |                    |
|--|-----------------------|--------------------|
|  | <b>Outstanding</b>    | <b>Exercisable</b> |
| Number of options  | 616,858               | 534,358            |
| Weighted average exercise price per share                | \$ 9.35               | \$ 9.25            |
| Aggregate intrinsic value for all options (in thousands) | \$ 2,513              | \$ 2,230           |
| Weighted average contractual term remaining              | 1.6 years             | 1.2 years          |

As of March 31, 2014, the total unrecognized compensation expense related to non-vested stock options was \$254,000, which is expected to be recognized over the remaining requisite weighted-average service period of 1.0 years.

**Restricted Stock**

At March 31, 2014 and December 31, 2013, there were 14,850 unvested restricted stock units outstanding with a weighted average grant-date fair value of \$10.60 per share.

As of March 31, 2014, the total unrecognized compensation expense related to non-vested restricted stock unit awards was \$98,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.6 years.

**SARs**

IHC had 251,800 SAR awards outstanding at March 31, 2014 and December 31, 2013. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at March 31, 2014 and December 31, 2013 are liabilities of \$1,226,000 and \$1,307,000, respectively, pertaining to SARs.

B)

**AMIC Share-Based Compensation Plans**

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

The following table summarizes share-based compensation expense, which is included in selling, general and administrative expenses on the Condensed Consolidated Statements of Income, applicable to the AMIC share-based compensation plans, by award type for each of the periods indicated (in thousands):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2014</b>               | <b>2013</b> |
| <b>AMIC's Share-based Compensation Plans:</b> |                           |             |
| Stock options                                 | \$ 12                     | \$ 8        |
| Share-based compensation expense, pre-tax     | 12                        | 8           |
| Tax benefits                                  | 4                         | 3           |
| Share-based compensation expense, net         | \$ 8                      | \$ 5        |

**Stock Options**

AMIC's stock option activity for the three months ended March 31, 2014 is as follows:

|                          | <b>Shares<br/>Under Option</b> | <b>Weighted- Average<br/>Exercise Price</b> |
|--------------------------|--------------------------------|---|
| <b>December 31, 2013</b> | 222,285                        | \$ 11.46                                    |
| Expired                  | (49,002)                       | 14.01                                       |
| <b>March 31, 2014</b>    | 173,283                        | \$ 10.74                                    |

The following table summarizes information regarding AMIC's outstanding and exercisable options as of March 31, 2014:

|  | <b>March 31, 2014</b> |                    |
|--|-----------------------|--------------------|
|  | <b>Outstanding</b>    | <b>Exercisable</b> |
| Number of options  | 173,283               | 158,838            |
| Weighted average exercise price per share                | \$ 10.74              | \$ 11.11           |
| Aggregate intrinsic value for all options (in thousands) | \$ 288                | \$ 228             |
| Weighted average contractual term remaining              | 3.29 years            | 2.80 years         |

As of March 31, 2014, the total unrecognized compensation expense related to AMIC's non-vested options was \$47,000 which will be recognized over the remaining requisite service periods.

**Note 10.****Supplemental Disclosures of Cash Flow Information**

Net cash payments (receipts) for income taxes were \$229,000 and \$(1,611,000) during the three months ended March 31, 2014 and 2013.

Cash payments for interest were \$464,000 and \$488,000 during the three months ended March 31, 2014 and 2013, respectively.

**Note 11.****Commitments and Contingencies**

On September 1, 2013, Madison National Life entered into an agreement with a former policyholder for a return of premium in connection with health insurance business written during 2007. The agreement was entered into in response to a potential lawsuit and, as a result, the Company accrued \$1,541,000 in return of premium reserves (net of recoveries). The Company terminated the MGU that produced this business in 2008. In April 2014, the amount was paid in full representing final refund of premium.

**Note 12.****Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment is presented below for the periods indicated (in thousands):

|   | <b>Three Months Ended<br/>March 31,</b> |                |
|---|---|----------------|
|   | <b>2014</b>                             | <b>2013</b>    |
| <b>Revenues:</b>                          |   |                |
| Medical Stop-Loss                         | \$ 47,588                               | \$ 42,122      |
| Fully Insured Health                      | 66,539                                  | 63,683         |
| Group disability, life, annuities and DBL | 16,427                                  | 14,474         |
| Individual life, annuities and other      | 8,938                                   | 12,947         |
| Corporate                                 | 29                                      | 37             |
|   | <b>139,521</b>                          | <b>133,263</b> |

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|   |    |         |    |         |
|---|----|---------|----|---------|
| Net realized investment gains             |    | 1,551   |    | 4,619   |
| <b>Total revenues</b>                     | \$ | 141,072 | \$ | 137,882 |
| <b>Income before income taxes:</b>        |    |         |    |         |
| Medical Stop-Loss                         | \$ | 4,738   | \$ | 3,016   |
| Fully Insured Health <sup>(A)</sup>       |    | 1,908   |    | (332)   |
| Group disability, life, annuities and DBL |    | 1,177   |    | 1,576   |
| Individual life, annuities and other      |    | (1,109) |    | 382     |
| Corporate                                 |    | (1,919) |    | (1,159) |
|   |    | 4,795   |    | 3,483   |
| Net realized investment gains             |    | 1,551   |    | 4,619   |
| Interest expense                          |    | (481)   |    | (487)   |
| <b>Income before income taxes</b>         | \$ | 5,865   | \$ | 7,615   |

(A)

The Fully Insured Health segment includes amortization of intangible assets. Total amortization expense was \$492,000 and \$602,000 for the three months ended March 31, 2014 and 2013, respectively. Amortization expense for the other segments is not material to their operating results.

**ITEM 2.**

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

**CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

**Overview**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc., IHC Specialty Benefits, Inc. and IHC Carrier Solutions, Inc. IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes Medical Stop-Loss. Standard Security Life, Madison National Life and Independence American are sometimes collectively referred to as the Insurance Group . IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or IHC , or are implicit in the terms we , us and our . At March 31, 2014, the Company also owned a 90.0% interest in American Independence Corp. ("AMIC").

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

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

The results of operations for the three months ended March 31, 2014 and 2013 are summarized as follows (in thousands):

|  | <b>Three Months Ended<br/>March 31,</b> |                 |
|--|---|-----------------|
|  | <b>2014</b>                             | <b>2013</b>     |
| Revenues   | \$ 141,072                              | \$ 137,882      |
| Expenses   | 135,207                                 | 130,267         |
| Income before income taxes                                 | 5,865                                   | 7,615           |
| Income taxes   | 1,860                                   | 2,575           |
| <b>Net income</b>  | <b>4,005</b>                            | <b>5,040</b>    |
| Less: Income from noncontrolling interests in subsidiaries | (304)                                   | (339)           |
| <b>Net income attributable to IHC</b>                      | <b>\$ 3,701</b>                         | <b>\$ 4,701</b> |

o

Net income of \$.21 per share, diluted, for the three months ended March 31, 2014 compared to \$.26 per share, diluted, for the same period in 2013.

o

Consolidated investment yields (on an annualized basis) of 3.5% for the three months ended March 31, 2014 compared to 3.9% for the comparable period in 2013 and \$1.6 million of net realized investment gains for the three months ended March 31, 2014 as compared to \$4.6 million for the comparable period in 2013;

o

Book value of \$15.76 per common share at March 31, 2014 compared to \$15.22 at December 31, 2013.

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

o

The Medical Stop-Loss segment reported income before taxes of \$4.7 million for the first quarter of 2014 compared to \$3.0 million in the same quarter in 2013. The increase is largely a result of lower loss ratios in 2014, primarily due to

adverse development in 2013 by independent MGU s that were cancelled at the end of 2013;

o

Premiums earned increased \$5.3 million for the three months ended March 31, 2014, respectively, when compared to the same period in 2013. The increase in premiums earned is primarily due to increased volume for business produced by IHC Risk Solutions.

o

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

|                                       | <b>Three Months Ended</b> |             |
|---------------------------------------|---------------------------|-------------|
|                                       | <b>March 31,</b>          |             |
|                                       | <b>2014</b>               | <b>2013</b> |
| Premiums Earned                       | \$ 45,586                 | \$ 40,255   |
| Insurance Benefits, Claims & Reserves | 31,825                    | 28,914      |
| Expenses                              | 10,281                    | 9,320       |
| Loss Ratio <sup>(A)</sup>             | 69.8%                     | 71.8%       |
| Expense Ratio <sup>(B)</sup>          | 22.6%                     | 23.2%       |
| Combined Ratio <sup>(C)</sup>         | 92.4%                     | 95.0%       |

(A)

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

(B)

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

(C)

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

o

The Company recorded a decrease in the loss ratio in the medical stop-loss line of business for the three months ended March 31, 2014 compared to the same period in 2013. Reserves in 2013 include unfavorable development related to business written with a certain producer. We ceased writing business with this producer in 2013.

.

The Fully Insured Health segment reported \$1.9 million of income before taxes for the three months ended March 31, 2014 as compared to \$0.3 million loss for the comparable period in 2013. The increase is primarily due to lower loss ratios in 2014;

o

Premiums earned increased \$0.4 million for the three months ended March 31, 2014 over the comparable period in 2013. Premiums increased in the ancillary, pet and occupational accident lines of business as a result of higher volume, but these were offset by a decrease of \$11.7 million in premiums as a result of the run-off of major medical health plans for individuals and families ( IMM ), which we exited in 2013, the run-off of the block of vision business in New York, and a decrease in small group major medical.

o

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

| <b>Three Months Ended</b> |             |
|---------------------------|-------------|
| <b>March 31,</b>          |             |
| <b>2014</b>               | <b>2013</b> |

|                                       |    |        |    |        |
|---------------------------------------|----|--------|----|--------|
| Premiums Earned                       | \$ | 57,309 | \$ | 56,899 |
| Insurance Benefits, Claims & Reserves |    | 37,421 |    | 39,678 |
| Expenses                              |    | 19,010 |    | 18,162 |
| Loss Ratio                            |    | 65.3%  |    | 69.7%  |
| Expense Ratio                         |    | 33.2%  |    | 31.9%  |
| Combined Ratio                        |    | 98.5%  |    | 101.6% |

o

The lower loss ratio in 2014 is primarily attributable to the effects of exiting the IMM markets in 2013. In 2013, the Company recorded an increase in claims experience on IMM and small group major medical produced by certain non-owned third party administrators, which we attribute, in large part, to changes brought on by health care reform, and to a reserve adjustment related to business written through an MGU that was previously terminated. As we adjust our mix of business from major medical to that of a specialty health insurance company, we anticipate improved loss ratios and a somewhat higher expense ratio concomitant with this type of product.

Income before taxes from the Group disability, life, annuities and DBL segment decreased \$0.4 million for the three months ended March 31, 2014 compared to the same period in 2013 primarily as a result of loss ratio fluctuations in the LTD business;

Income before taxes from the Individual life, annuities and other segment decreased \$1.5 million for the three-month period ended March 31, 2014 as compared to the same period in 2013 primarily

as a result of business ceded in connection with a coinsurance agreement during the second quarter of 2013;

Losses before tax from the Corporate segment in the first quarter of 2014 increased \$0.7 million in the three-month period ended March 31, 2014 over the same period of 2013, primarily due to an increase in employee-related expenses; and

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

| <b>Gross Direct and Assumed</b>           | <b>Earned Premiums:</b> | <b>Three Months Ended<br/>March 31,</b> |             |
|---|-------------------------|---|-------------|
|   |                         | <b>2014</b>                             | <b>2013</b> |
| Medical Stop-Loss                         | \$                      | 57,394                                  | \$ 48,095   |
| Fully Insured Health                      |                         | 63,670                                  | 65,481      |
| Group disability, life, annuities and DBL |                         | 26,351                                  | 24,375      |
| Individual, life, annuities and other     |                         | 7,018                                   | 7,553       |
|   | \$                      | 154,433                                 | \$ 145,504  |

| <b>Net Direct and Assumed</b>             | <b>Earned Premiums:</b> | <b>Three Months Ended<br/>March 31,</b> |             |
|---|-------------------------|---|-------------|
|   |                         | <b>2014</b>                             | <b>2013</b> |
| Medical Stop-Loss                         | \$                      | 45,586                                  | \$ 40,255   |
| Fully Insured Health                      |                         | 57,309                                  | 56,899      |
| Group disability, life, annuities and DBL |                         | 15,561                                  | 13,856      |
| Individual, life, annuities and other     |                         | 4,814                                   | 6,358       |
|   | \$                      | 123,270                                 | \$ 117,368  |

**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Condensed Consolidated Financial Statements in conformity with U.S. 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, 2013. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Liabilities, Deferred Acquisition Costs, Investments, Goodwill and Other Intangible Assets, and Deferred Income Taxes* as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, *Critical Accounting Policies* in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2013. During the three months ended March 31, 2014, there were no additions to or changes in the critical accounting policies disclosed in the 2013 Form 10-K except for the recently adopted accounting standards discussed in Note 1(D) of the Notes to Condensed Consolidated Financial Statements.

### Results of Operations for the Three Months Ended March 31, 2014 Compared to the Three Months Ended March 31, 2013

Information by business segment for the three months ended March 31, 2014 and 2013 is as follows:

| <u>March 31, 2014</u><br>(In thousands)   | <u>Premiums</u><br><u>Earned</u> | <u>Net</u><br><u>Investment</u><br><u>Income</u> | <u>Fee and</u><br><u>Other</u><br><u>Income</u> | <u>Benefits,</u><br><u>Claims</u><br><u>and</u><br><u>Reserves</u> | <u>Amortization</u><br><u>of Deferred</u><br><u>Acquisition</u><br><u>Costs</u> | <u>Selling,</u><br><u>General</u><br><u>and</u><br><u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|---|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health    | \$ 45,586                        | 1,215  | 787   | 31,825   | -   | 11,025   | \$ 4,738     |
| Group disability, life, annuities and DBL | 57,309                           | 646  | 8,584   | 37,421   | 212   | 26,998   | 1,908        |
| Individual life, annuities and other      | 15,561                           | 834  | 32  | 10,635   | -   | 4,615  | 1,177        |
| Corporate                                 | 4,814                            | 3,077  | 1,047   | 5,428  | 1,070   | 3,549  | (1,109)      |
| Sub total                                 | -                                | 29   | -   | -  | -   | 1,948  | (1,919)      |
|   | \$ 123,270                       | \$ 5,801   | \$ 10,450                                       | \$ 85,309  | \$ 1,282  | \$ 48,135  | 4,795        |
| Net realized investment gains             |                                  |  |   |  |   |  | 1,551        |
| Interest expense on debt                  |                                  |  |   |  |   |  | (481)        |
| Income before income taxes                |                                  |  |   |  |   |  | 5,865        |
| Income taxes                              |                                  |  |   |  |   |  | 1,860        |
| Net income                                |                                  |  |   |  |   |  | \$ 4,005     |

| <u>March 31, 2013</u><br>(In thousands)   | <u>Premiums</u><br><u>Earned</u> | <u>Net</u><br><u>Investment</u><br><u>Income</u> | <u>Fee and</u><br><u>Other</u><br><u>Income</u> | <u>Benefits,</u><br><u>Claims</u><br><u>and</u><br><u>Reserves</u> | <u>Amortization</u><br><u>of Deferred</u><br><u>Acquisition</u><br><u>Costs</u> | <u>Selling,</u><br><u>General</u><br><u>and</u><br><u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|---|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health    | \$ 40,255                        | 1,570  | 297   | 28,914   | -   | 10,192   | \$ 3,016     |
| Group disability, life, annuities and DBL | 56,899                           | 520  | 6,264   | 39,678   | 5   | 24,332   | (332)        |
| Individual life, annuities and other      | 13,856                           | 596  | 22  | 8,965  | -   | 3,933  | 1,576        |
| Corporate                                 | 6,358                            | 5,278  | 1,311   | 7,903  | 1,435   | 3,227  | 382          |
| Sub total                                 | -                                | 37   | -   | -  | -   | 1,196  | (1,159)      |
|   | \$ 117,368                       | \$ 8,001   | \$ 7,894  | \$ 85,460  | \$ 1,440  | \$ 42,880  | 3,483        |
| Net realized investment gains             |                                  |  |   |  |   |  | 4,619        |

|                            |          |
|----------------------------|----------|
| Interest expense on debt   | (487)    |
| Income before income taxes | 7,615    |
| Income taxes               | 2,575    |
| Net income                 | \$ 5,040 |

**Premiums Earned**

In the first quarter of 2014, premiums earned increased \$5.9 million over the comparable period of 2013. The increase is primarily due to: (i) a \$5.3 million increase in earned premiums from the Medical Stop-Loss segment as a result of higher volume; (ii) an overall increase of \$0.4 million in earned premiums from the Fully Insured Health segment (earned premiums increased in the ancillary lines (primarily short-term medical, fixed indemnity limited benefit and international), pet and occupational accident lines of business as a result of higher volume, but was negatively impacted by a decrease of \$11.7 million in premiums from exiting the IMM line and the New York vision block and from a decrease in the small group major medical line); (iii) a \$1.7 million increase in the Group disability, life, annuities and DBL segment primarily due to increased premiums from the DBL line; and (iv) partially offset by a decrease of \$1.5 million of earned premiums in the Individual life, annuities and other segment, primarily as a result of business ceded in connection with a coinsurance agreement during the second quarter of 2013.

**Net Investment Income**

Total net investment income decreased \$2.2 million. The overall annualized investment yields were 3.5% and 3.9% (approximately 3.7% and 4.0%, on a tax advantaged basis) in the first quarter of 2014 and 2013, respectively. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due to the transfer of \$215.1 million of invested assets in the second quarter of 2013 related to a coinsurance treaty. The annualized investment yields on bonds, equities and short-term investments were 3.4% and 3.5% in the first quarter of 2014 and 2013, respectively. IHC has approximately \$140.7 million in highly rated shorter duration securities earning on average 1.2%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

**Net Realized Investment Gains**

The Company had net realized investment gains of \$1.6 million in 2014 compared to \$4.6 million in 2013. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

**Fee Income and Other Income**

Fee income increased \$2.8 million for the three-month period ended March 31, 2014 compared to the three-month period ended March 31, 2013 as a result of increased volume in certain lines of the Fully Insured Health segment.

Other income decreased \$0.2 million in the first quarter of 2014 compared to the same period in 2013.

**Insurance Benefits, Claims and Reserves**

In the first quarter of 2014, insurance benefits, claims and reserves decreased \$0.2 million over the comparable period in 2013. The decrease is primarily attributable to: (i) a decrease of \$2.3 million in the Fully Insured Health segment, primarily due to a decrease of \$8.6 million in benefits, claims and reserves related to the run-off of the IMM and the New York vision block and from lower loss ratios in 2014; partially offset by increases in the volume of ancillary products, pet insurance and occupational accident business; (ii) a decrease of \$2.5 million in the Individual life, annuity and other segment, primarily as a result of business ceded in connection with a coinsurance agreement during the second quarter of 2013; partially offset by (iii) an increase of \$2.9 million in benefits, claims and reserves in the

Medical Stop-Loss segment as a result of an increase in premium volume offset by lower loss ratios; and (iv) an increase of \$1.7 million in the group disability, life, annuities and DBL segment primarily due to increases in the DBL line of \$0.8 million as a result of increased volume and \$0.8 million in the LTD line as a result of higher loss ratios in 2014.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased \$5.2 million. The increase is primarily due to: (i) an increase of \$2.7 million in the Fully Insured Health segment largely due to general expenses as a result of the higher volume of ancillary, pet and occupational accident business in 2014, which tends to have a higher expense structure than major medical; (ii) an increase of \$0.8 million in the Medical Stop-Loss segment as a result of increased premium volume; (iii) an increase of \$0.7 million in the group disability, life, annuities and DBL segment due to increased volume in the DBL line; (iv) an increase of \$0.3 million in Individual life, annuity and other segment; and (v) an increase of \$0.7 million in Corporate primarily due to employee-related expenses.

### **Income Taxes**

The effective tax rate for the three months ended March 31, 2014 and 2013 was 31.7% and 33.8%, respectively. The lower effective tax rate in 2014 was due to a higher benefit from tax-advantaged securities as a percentage of income in 2014.

### **LIQUIDITY**

#### **Insurance Group**

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

#### **Corporate**

Corporate derives its funds principally from: (i) dividends from the Insurance Group; (ii) management fees from its subsidiaries; and (iii) investment income from Corporate liquidity. Regulatory constraints historically have not affected the Company's consolidated liquidity, although state insurance laws have provisions relating to the ability of the parent company to use cash generated by the Insurance Group. No dividends were declared or paid by the Insurance Group during the three months ended March 31, 2014 or 2013.

#### **Cash Flows**

The Company had \$23.1 million and \$24.2 million of cash and cash equivalents as of March 31, 2014 and December 31, 2013, respectively.

For the three months ended March 31, 2014, operating activities of the Company provided \$4.1 million of cash, the settlement of investment activities utilized \$2.4 million and the settlement of financing activities utilized \$2.8 million of cash. Financing activities include \$1.1 million used for the settlement of treasury share purchases during the period and \$0.6 million for the payment of dividends.

The Company has \$523.4 million of future policy benefits and claims and claim adjustment expenses that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the three months ended March 31, 2014, cash received from the maturities and other repayments of fixed maturities was \$17.3 million.

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

### **BALANCE SHEET**

The Company had net receivables from reinsurers of \$340.5 million at March 31, 2014 compared to \$343.1 million at December 31, 2013. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at March 31, 2014.

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

|                          | <b>Total Health Reserves</b> |                              |
|--------------------------|------------------------------|------------------------------|
|                          | <b>March 31,<br/>2014</b>    | <b>December 31,<br/>2013</b> |
| Medical Stop-Loss        | \$ 74,685                    | \$ 72,307                    |
| Fully Insured Health     | 51,645                       | 56,848                       |
| Group Disability         | 103,376                      | 101,582                      |
| Individual A&H and Other | 6,950                        | 7,017                        |
|                          | <b>\$ 236,656</b>            | <b>\$ 237,754</b>            |

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

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

The \$8.0 million increase in IHC's stockholders' equity in the first three months of 2014 is primarily due to \$3.7 million of net income attributable to IHC and \$5.5 million of other comprehensive income attributable to IHC, partially offset by \$1.3 million of treasury stock purchases.

### **Asset Quality and Investment Impairments**

The nature and quality of insurance company investments must comply with all applicable statutes and regulations, which have been promulgated primarily for the protection of policyholders. Although the Company's gross unrealized losses on available-for-sale securities totaled \$13.3 million at March 31, 2014, approximately 99.8% of the Company's fixed maturities were investment grade and continue to be rated on average AA. The Company marks all of its available-for-sale securities to fair value through accumulated other comprehensive income or loss. These investments tend to carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At

March 31, 2014, approximately 0.2% (or \$0.9 million) of the carrying value of fixed maturities was invested in non-investment grade fixed maturities (primarily mortgage securities) (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any non-performing fixed maturities at March 31, 2014.

The Company reviews its investments regularly and monitors its investments continually for impairments. There were no securities with fair values less than 80% of their amortized cost at March 31, 2014 and the Company did not record any other-than-temporary impairment losses in the three months ended March 31, 2014 or 2013.

The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at March 31, 2014. In 2014, the Company recorded \$9.6 million of net unrealized gains on available-for sale securities, pre-tax, in other comprehensive income (loss) prior to DAC and reclassification adjustments. From time to time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalances in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

### **CAPITAL RESOURCES**

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

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of March 31, 2014, is not materially different from that reported in the schedule of such obligations at December 31, 2013 which was included in Item 7 of the Company's Annual Report on Form 10-K.

### **OUTLOOK**

For 2014, we anticipate:

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

Significant decrease in individual major medical premiums in 2014 as we have exited this line of business, however, we had negative underwriting results on this line of business in 2013 so less premium may improve our underwriting

margins although generate decreases in administrative revenues;

.

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

.

Continued growth in pet insurance;

.

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

.

Decline in small group major medical premiums, but an increase in small group stop-loss as more employers choose to self-fund;

.

Increasing sales of short-term, fixed indemnity limited benefit and supplemental health products, such as dental, hospital indemnity and critical illness and international products;

.

Significant growth in non-subscriber occupational accident insurance in Texas;

.

Increasing sales in our DBL line of business; and

.

Continued focus on administrative efficiencies.

The Company will remain highly liquid in 2014 as a result of the continuing shorter duration of the portfolio. As a result, the yields on our investment portfolio were, and continue to remain, lower than in prior years and investment income may continue to be depressed for 2014. IHC has approximately \$140.7 million in highly rated shorter maturity securities earning on average 1.2%; our portfolio as a whole is rated, on average, AA. The low duration of our portfolio enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income in the future. A low duration portfolio such as ours also mitigates the adverse impact of potential inflation. IHC will continue to monitor the financial markets and invest accordingly.

In 2014, we continued to achieve significant growth in our controlled direct written stop-loss business through Risk Solutions. This growth was achieved while maintaining underwriting profitability consistent with the prior year. Our overall results in 2013 were adversely impacted by business written through two non-owned MGUs, both of which have been terminated, although run-off will continue in 2014. This result reemphasizes the importance of our decision to focus our stop-loss business through our direct writing model. The favorable results of Risk Solutions are a direct result of their positioning to take advantage of market trends, including consolidation of relationships by producers and increased interest in stop-loss as a result of health care reform. We see these trends continuing and strengthening as we move into 2014 and beyond. Risk Solutions has established a reputation in the market for delivering innovative solutions for small to medium sized employer groups looking for self-funded alternatives. Risk Solutions has also established a reputation in the market for fair and responsible pricing and superior service levels. We foresee continued growth and favorable underwriting results as more of our stop-loss business comes through the Risk Solutions platform.

We will continue to focus on our strategic objectives, including expanding our distribution network. However, the success of a portion of our Fully Insured Health business has been affected by the passage of the Patient Protection and Affordable Care Act of 2010, as amended, and its subsequent interpretations by state and federal regulators. We are continuing our comprehensive review of all the options for IHC and we our evaluation of our portfolio of health insurance products. While the law has influenced our decision, and that of many other insurers, to exit or reduce their presence in major medical essential health benefit ( EHB ) plans in the small employer and individual markets, non-EHB lines of business and medical stop-loss have been impacted by health care reform minimally or not at all.

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

### **ITEM 3.**

#### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at March 31, 2014 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2013 included in Item 7A of the Company's Annual Report on Form 10-K.

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

#### **ITEM 4.**

#### **CONTROLS AND PROCEDURES**

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

There has been no change in IHC's internal control over financial reporting during the quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.



**PART II. OTHER INFORMATION**

**ITEM 1.**

**LEGAL PROCEEDINGS**

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

**ITEM 1A.**

**RISK FACTORS**

There were no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 in Item 1A to Part 1 of Form 10-K.

**ITEM 2.**

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

**Share Repurchase Program**

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In March 2013, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC's common stock, in addition to prior authorizations, under the 1991 plan. As of March 31, 2014, 168,221 shares were still authorized to be repurchased under the plan. Share repurchases during the first quarter of 2014 are summarized as follows:

|                            | <b>2014</b>               |  |  |  |
|----------------------------|---------------------------|--|--|--|
| <b>Month of Repurchase</b> | <b>Shares Repurchased</b> | <b>Average Price of Repurchased Shares</b> | <b>Maximum Number Of Shares Which Can be Repurchased</b> |  |
|                            |                           |  |  |  |

|          |        |    |       |         |
|----------|--------|----|-------|---------|
| January  | 20,512 | \$ | 12.40 | 244,481 |
| February | 31,329 | \$ | 12.47 | 213,152 |
| March    | 44,931 | \$ | 13.74 | 168,221 |

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4.**

**MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5.**

**OTHER INFORMATION**

On or as of May 7, 2014, each of the following events occurred:

1.

The Stock Agreement, dated as of July 30, 2002 among American Independence Corp. ( AMIC ) (f.k.a. SoftNet Systems, Inc.), Independence Holding Company ( IHC ) and Madison Investors Corporation was terminated by the parties and ceased to be of any further force or effect.

2.

The Quota Share Reinsurance Agreement between Madison National Life Insurance Company, Inc. and Independence American Insurance Company, as amended, was further amended to extend the termination date thereof from December 31, 2014 to December 31, 2019. This agreement, as



amended, is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q.

3.

The Quota Share Reinsurance Agreement between Standard Security Life Insurance Company of New York and Independence American Insurance Company, as amended, was further amended to extend the termination date thereof from December 31, 2014 to December 31, 2019. This agreement, as amended, is filed as Exhibit 10.2 to this Quarterly Report on Form 10-Q.

4.

The Board of Directors of AMIC granted approval for IHC and its subsidiaries, at any point in the future, to increase their aggregate ownership of AMIC's outstanding shares of common stock without restriction imposed under Article Twelve of AMIC's Second Amended and Restated Certificate of Incorporation or otherwise.

## **ITEM 6.**

### **EXHIBITS**

10.1

Quota Share Reinsurance Agreement between Madison National Life Insurance, Inc. and Independence American Insurance Company, as amended. \*\*

10.2

Quota Share Reinsurance Agreement between Standard Security Life Insurance Company of New York and Independence American Insurance Company, as amended. \*\*

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.

101.INS

XBRL Instance Document.

101.SCH

XBRL Taxonomy Extension Schema Document.

101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document.

101.LAB

XBRL Taxonomy Extension Label Linkbase Document.

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document.

101.DEF

XBRL Taxonomy Extension Definition Linkbase Document.

\*\* Filed herewith.

**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:

May 9, 2014

Roy T.K. Thung

Chief Executive Officer, President

and Chairman

By:

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

Date:

May 9, 2014

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer