

INDEPENDENCE HOLDING CO  
Form 10-Q  
August 10, 2009

**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 **June 30, 2009**

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 August 7, 2009**  
**15,423,175 Shares**



**INDEPENDENCE HOLDING COMPANY**

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

### Forward-Looking Statements

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

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

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

**PART I - FINANCIAL INFORMATION****Item 1.****Financial Statements****INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)**

|  | <b>June 30, 2009</b> |           | <b>December 31,<br/>2008</b> |
|--|----------------------|-----------|------------------------------|
|  | <b>(unaudited)</b>   |           |                              |
| <b>ASSETS:</b>                                     |                      |           |                              |
| Investments:                                       |                      |           |                              |
| Short-term investments                             | \$ 52                | \$        | 52                           |
| Securities purchased under agreements to resell    | 23,798               |           | 60,823                       |
| Fixed maturities, available for sale               | 678,775              |           | 608,487                      |
| Equity securities, available for sale              | 46,588               |           | 54,007                       |
| Other investments                                  | 38,070               |           | 37,724                       |
| Total investments                                  | 787,283              |           | 761,093                      |
| <br>   |                      |           |                              |
| Cash and cash equivalents                          | 6,877                |           | 7,767                        |
| Due from securities brokers                        | 6,308                |           | 2,598                        |
| Investment in American Independence Corp. ("AMIC") | 42,892               |           | 41,217                       |
| Deferred acquisition costs                         | 54,516               |           | 62,401                       |
| Due and unpaid premiums                            | 51,036               |           | 55,663                       |
| Due from reinsurers                                | 186,635              |           | 139,052                      |
| Premium and claim funds                            | 45,716               |           | 52,171                       |
| Notes and other receivables                        | 15,107               |           | 16,000                       |
| Goodwill   | 53,081               |           | 52,331                       |
| Other assets                                       | 59,227               |           | 83,601                       |
| <br>   |                      |           |                              |
| <b>TOTAL ASSETS</b>                                | <b>\$ 1,308,678</b>  | <b>\$</b> | <b>1,273,894</b>             |
| <br>   |                      |           |                              |
| <b>LIABILITIES AND EQUITY:</b>                     |                      |           |                              |
| <b>LIABILITIES:</b>                                |                      |           |                              |
| Insurance reserves-health                          | \$ 194,313           | \$        | 199,160                      |
| Insurance reserves-life and annuity                | 278,582              |           | 279,731                      |
| Funds on deposit                                   | 406,221              |           | 411,188                      |

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|  |                     |                     |
|--|---------------------|---------------------|
| Unearned premiums  | 14,388              | 16,727              |
| Policy claims-health   | 15,733              | 12,158              |
| Policy claims-life   | 13,251              | 10,738              |
| Other policyholders' funds   | 20,850              | 21,888              |
| Due to securities brokers  | 8,500               | -                   |
| Due to reinsurers  | 38,880              | 38,406              |
| Accounts payable, accruals and other liabilities   | 70,839              | 69,260              |
| Liabilities related to discontinued operations   | 2,489               | 3,542               |
| Debt   | 10,000              | 10,000              |
| Junior subordinated debt securities  | 38,146              | 38,146              |
| <b>TOTAL LIABILITIES</b>   | <b>1,112,192</b>    | <b>1,110,944</b>    |
| <b>EQUITY:</b>   |                     |                     |
| <b>IHC STOCKHOLDERS' EQUITY:</b>   |                     |                     |
| Preferred stock (none issued)  | -                   | -                   |
| Common stock \$1.00 par value, 20,000,000 shares authorized;<br>15,453,186 and 15,434,891 shares issued, respectively; |                     |                     |
| 15,420,431 and 15,402,136 shares outstanding, respectively   | 15,453              | 15,435              |
| Paid-in capital  | 101,315             | 101,086             |
| Accumulated other comprehensive loss   | (27,566)            | (54,291)            |
| Treasury stock, at cost 32,755 shares  | (326)               | (326)               |
| Retained earnings  | 106,982             | 100,798             |
| <b>TOTAL IHC STOCKHOLDERS EQUITY</b>   | <b>195,858</b>      | <b>162,702</b>      |
| <b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>  | <b>628</b>          | <b>248</b>          |
| <b>TOTAL EQUITY</b>  | <b>196,486</b>      | <b>162,950</b>      |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$ 1,308,678</b> | <b>\$ 1,273,894</b> |

See the accompanying notes to condensed consolidated financial statements.



**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>June 30,</b>           |                | <b>June 30,</b>         |                |
|  | <b>2009</b>               | <b>2008</b>    | <b>2009</b>             | <b>2008</b>    |
| <b>REVENUES:</b>   |                           |                |                         |                |
| Premiums earned:   |                           |                |                         |                |
| Health   | \$ 68,287                 | \$ 71,858      | \$ 134,925              | \$ 144,512     |
| Life and annuity   | 8,794                     | 9,826          | 18,589                  | 18,826         |
| Net investment income  | 11,428                    | 11,156         | 22,147                  | 21,801         |
| Fee income   | 8,486                     | 10,218         | 17,521                  | 21,417         |
| Net realized investment gains  | 1,262                     | 2,306          | 2,927                   | 2,501          |
| Total other-than-temporary impairment losses (no current period impairment losses were recognized in other comprehensive income) | -                         | (17,393)       | (271)                   | (17,474)       |
| Equity income from AMIC  | 235                       | 389            | 928                     | 790            |
| Other income   | 2,107                     | 958            | 3,204                   | 1,363          |
|  | 100,599                   | 89,318         | 199,970                 | 193,736        |
| <b>EXPENSES:</b>   |                           |                |                         |                |
| Insurance benefits, claims and reserves:   |                           |                |                         |                |
| Health   | 48,444                    | 48,758         | 92,240                  | 98,306         |
| Life and annuity   | 11,979                    | 12,857         | 24,379                  | 24,093         |
| Selling, general and administrative expenses   | 35,607                    | 35,915         | 72,661                  | 72,752         |
| Amortization of deferred acquisitions costs  | 1,300                     | 1,955          | 2,350                   | 3,409          |
| Interest expense on debt   | 761                       | 909            | 1,531                   | 1,895          |
|  | 98,091                    | 100,394        | 193,161                 | 200,455        |
| Income (loss) from continuing operations before income taxes (benefits)  | 2,508                     | (11,076)       | 6,809                   | (6,719)        |
| Income taxes (benefits)  | 545                       | (4,409)        | 1,497                   | (3,056)        |
| <b>Income (loss) from continuing operations</b>  | <b>1,963</b>              | <b>(6,667)</b> | <b>5,312</b>            | <b>(3,663)</b> |
| <b>Discontinued operations:</b>  |                           |                |                         |                |
| Loss from discontinued operations, net of tax  | (117)                     | -              | (354)                   | -              |

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|   |                 |                   |                 |                   |
|---|-----------------|-------------------|-----------------|-------------------|
| <b>Net income (loss)</b>                                    | 1,846           | (6,667)           | 4,958           | (3,663)           |
| (Income) loss from noncontrolling interests in subsidiaries | 13              | (26)              | 20              | 42                |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO IHC</b>                | <b>\$ 1,859</b> | <b>\$ (6,693)</b> | <b>\$ 4,978</b> | <b>\$ (3,621)</b> |
| <b>Basic income (loss) per common share:</b>                |                 |                   |                 |                   |
| Income (loss) from continuing operations                    | \$ .13          | \$ (.43)          | \$ .35          | \$ (.24)          |
| Loss from discontinued operations                           | (.01)           | -                 | (.03)           | -                 |
| Basic income (loss) per common share                        | \$ .12          | \$ (.43)          | \$ .32          | \$ (.24)          |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>                  | <b>15,419</b>   | <b>15,388</b>     | <b>15,413</b>   | <b>15,359</b>     |
| <b>Diluted income (loss) per common share</b>               |                 |                   |                 |                   |
| Income (loss) from continuing operations                    | \$ .13          | \$ (.43)          | \$ .35          | \$ (.24)          |
| Loss from discontinued operations                           | (.01)           | -                 | (.03)           | -                 |
| Diluted income (loss) per common share                      | \$ .12          | \$ (.43)          | \$ .32          | \$ (.24)          |
| <b>WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING</b>          | <b>15,419</b>   | <b>15,388</b>     | <b>15,415</b>   | <b>15,359</b>     |

See the accompanying notes to condensed consolidated financial statements.

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Unaudited)**

|  | <b>COMMON<br/>STOCK</b> | <b>PAID-IN<br/>CAPITAL</b> | <b>ACCUMULATED<br/>OTHER<br/>COMPREHENSIVE<br/>INCOME (LOSS)</b> | <b>TREASURY<br/>STOCK,<br/>AT COST</b> | <b>RETAINED<br/>EARNINGS</b> | <b>TOTAL IHC<br/>STOCKHOLDERS'<br/>EQUITY</b> |
|--|-------------------------|----------------------------|--|--|------------------------------|---|
| <b>BALANCE<br/>AT</b>  |                         |                            |  |  |                              |   |
| <b>DECEMBER<br/>31, 2008</b>   | 15,435 \$               | 101,086 \$                 | (54,291) \$  | (326) \$                               | 100,798 \$                   | 162,702 \$                                    |
| Adjustment<br>to April 1,<br>2009  |                         |                            |  |  |                              |   |
| balance<br>for<br>adoption<br>of<br>FSP<br>FAS<br>115-2<br>and<br>FAS<br>124-2,<br>net of<br>tax |                         |                            | (1,591)  |  | 1,591                        | -   |
| Net<br>income<br>(loss)  |                         |                            |  |  | 4,978                        | 4,978   |
| Net<br>change in<br>unrealized<br>gains<br>(losses)  |                         |                            | 28,316   |  |                              | 28,316  |
| Total<br>comprehensive<br>income   |                         |                            |  |  |                              | 33,294  |

|   |                  |                   |                    |                 |                   |                   |
|---|------------------|-------------------|--------------------|-----------------|-------------------|-------------------|
| Acquisition<br>of<br>Wisconsin<br>Underwriting<br>Associates,<br>LLC<br>Common<br>Stock<br>Dividend<br>(\$0.25<br>per<br>share) |                  |                   |                    |                 | (385)             | (385)             |
| Share-based<br>compensation<br>expenses<br>and<br>related<br>tax<br>benefits  | 18               | 209               |                    |                 |                   | 227               |
| Other<br>capital<br>transactions  |                  | 20                |                    |                 |                   | 20                |
| <b>BALANCE<br/>AT</b>   |                  |                   |                    |                 |                   |                   |
| <b>JUNE 30, 2009</b>  | <b>\$ 15,453</b> | <b>\$ 101,315</b> | <b>\$ (27,566)</b> | <b>\$ (326)</b> | <b>\$ 106,982</b> | <b>\$ 195,858</b> |

See the accompanying notes to condensed consolidated financial statements.



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

(In thousands)

(Unaudited)

**Six Months Ended June 30,**  
**2009**                      **2008**

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

|   |    |          |    |          |
|---|----|----------|----|----------|
| Net income  | \$ | 4,958    | \$ | (3,663)  |
| Adjustments to reconcile net income to net change in cash from<br>operating activities: |    |          |    |          |
| Loss from discontinued operations   |    | 354      |    | -        |
| Amortization of deferred acquisition costs  |    | 2,350    |    | 3,409    |
| Net realized investment gains   |    | (2,927)  |    | (2,501)  |
| Other-than-temporary impairment losses  |    | 271      |    | 17,474   |
| Equity income from AMIC and other equity method<br>investments                          |    | (1,346)  |    | (1,049)  |
| Depreciation and amortization   |    | 2,742    |    | 2,479    |
| Share-based compensation expenses   |    | 341      |    | 645      |
| Deferred tax benefit  |    | (996)    |    | (6,273)  |
| Other   |    | 296      |    | (1,064)  |
| Changes in assets and liabilities:  |    |          |    |          |
| Net sales of trading securities   |    | -        |    | 429      |
| Change in insurance liabilities   |    | (8,724)  |    | (9,901)  |
| Additions to deferred acquisition costs, net  |    | (1,477)  |    | (2,136)  |
| Change in net amounts due from and to reinsurers  |    | (47,109) |    | (141)    |
| Change in premium and claim funds   |    | 6,455    |    | (1,296)  |
| Change in income tax liability  |    | 4,526    |    | 3,247    |
| Change in due and unpaid premiums   |    | 4,627    |    | 6,546    |
| Change in other assets  |    | 3,768    |    | (6,963)  |
| Change in other liabilities   |    | 1,582    |    | (3,197)  |
| Net change in cash from operating activities of continuing<br>operations                |    | (30,309) |    | (3,955)  |
| Net change in cash from operating activities of discontinued<br>operations              |    | (1,598)  |    | (12,347) |
| Net change in cash from operating activities  |    | (31,907) |    | (16,302) |

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

|  |           |           |
|--|-----------|-----------|
| Change in net amount due from and to securities brokers                    | 4,790     | 3,642     |
| Net proceeds of short-term investments                                     | (1)       | (37)      |
| Net (purchases) sales of securities under resale and repurchase agreements | 37,025    | (3,429)   |
| Sales of equity securities   | 13,672    | 39,393    |
| Purchases of equity securities   | -         | (35,300)  |
| Sales of fixed maturities  | 273,842   | 267,479   |
| Maturities and other repayments of fixed maturities                        | 77,557    | 39,173    |
| Purchases of fixed maturities  | (375,372) | (416,136) |
| Additional investments in other investments, net of distributions          | 74        | 4,010     |
| Cash paid in acquisitions of companies, net of cash acquired               | (275)     | (998)     |
| Cash received in acquisition of policy blocks                              | -         | 57,279    |
| Investment in AMIC   | -         | (1,401)   |
| Change in notes and other receivables                                      | 893       | (2,491)   |
| Other  | (1,182)   | (1,273)   |
| Net change in cash from investing activities                               | 31,023    | (50,089)  |

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

|  |          |          |
|--|----------|----------|
| Proceeds from issuance of common stock   | 1        | 1,401    |
| Exercises of common stock options  | -        | 173      |
| Excess tax expense from exercises of stock options and vesting of restricted stock | (95)     | (363)    |
| Proceeds (withdrawals) of investment-type insurance contracts                      | 473      | (105)    |
| Dividends paid   | (385)    | (382)    |
| Net change in cash from financing activities                                       | (6)      | 724      |
| Net change in cash and cash equivalents  | (890)    | (65,667) |
| Cash and cash equivalents, beginning of year                                       | 7,767    | 72,823   |
| Cash and cash equivalents, end of period   | \$ 6,877 | \$ 7,156 |

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





**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

**Significant Accounting Policies and Practices**

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation ( IAC ), managing general underwriters ("MGUs") in which it owns a significant voting interest, Health Plan Administrators, Inc. ( HPA ), GroupLink, Inc. ( GroupLink ), IHC Health Solutions, Inc. ( IHC Health Solutions ) and Actuarial Management Corporation ( AMC ). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." At June 30, 2009, the Company also owned a 49.7% equity interest in American Independence Corp. ("AMIC"), which owns Independence American Insurance Company ( Independence American ), three MGUs and controlling interests in two agencies.

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 53% of IHC's outstanding common stock at June 30, 2009.

**(B)**

**Basis of Presentation**

The condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") and include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could

differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying condensed consolidated financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and six months ended June 30, 2009 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

### **Recent Accounting Pronouncements**

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

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 168, *"The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a Replacement of FASB Statement No. 162"*, ("SFAS 168"). SFAS 168 establishes the Accounting Standards Codification ("Codification"), which was officially released on July 1, 2009, to become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. The subsequent issuances of new standards will be in the form of

Accounting Standards Updates that will be included in the Codification. The Codification is not expected to change U.S. GAAP as it does not include any guidance or interpretations of U.S. GAAP beyond what is already reflected in the existing FASB literature. All other accounting literature excluded from the Codification will be considered nonauthoritative. SFAS 168 is effective for interim and annual reporting periods ending after September 15, 2009. The adoption of SFAS 168 is not expected to have an effect on the Company's consolidated financial statements. However, because the Codification completely replaces existing standards, it will affect the way U.S. GAAP is referenced by the Company in its consolidated financial statements and accounting policies.

In June 2009, the FASB issued SFAS No. 167, "*Amendments to FASB Interpretation No. 46(R)*", ("SFAS 167) which, among other things, amends FASB Interpretation No. 46(R), "*Consolidation of Variable Interest Entities -- An Interpretation of ARB No. 51*" ("FIN 46(R)") to (i) require an entity to perform an analysis to determine whether an entity's variable interest or interests give it a controlling financial interest in a variable interest entity; (ii) require ongoing reassessments of whether an entity is the primary beneficiary of a variable interest entity and eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; (iii) amend certain guidance in FIN 46(R) for determining whether an entity is a variable interest entity; and (iv) require enhanced disclosure that will provide users of financial statements with more transparent information about an entity's involvement in a variable interest entity. SFAS 167 is to be effective for the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter with earlier application prohibited.. The adoption of SFAS 167 is not expected to have a material effect on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, "*Accounting for Transfers of Financial Assets - an Amendment of FASB Statement No. 140*", ("SFAS 166"). SFAS 166 removes the concept of a qualifying special-purpose entity from SFAS 140 and removes the exception from applying FIN 46(R) to qualifying special-purpose entities. SFAS 166 changes the requirements for derecognizing financial assets modifying the financial-components approach used in SFAS 140 and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset. SFAS 166 removes the special provisions in SFAS 140 and SFAS 65 for guaranteed mortgage securitizations, and as a result, requires those securitizations to be treated the same as any other transfer of financial assets within the scope of SFAS 140. Additional disclosures are required to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. SFAS 166 is effective for the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter with earlier application prohibited. The recognition and measurement provisions of SFAS 166 shall be applied to transfers that occur on or after the effective date. The adoption of SFAS 166 is not expected to have a material effect on the Company's consolidated financial statements

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

In May 2009, the FASB issued SFAS 165, "*Subsequent Events*", ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 sets forth the period after the balance sheet date during

which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. The adoption of SFAS 165, effective April 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly*", ("FSP FAS 157-4"). FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, "*Fair Value Measurements*", when the volume and level of activity for the asset or liability have significantly decreased, and guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. For comparative purposes, FSP FAS 157-4 does not require disclosures for earlier periods presented at initial adoption. For periods after initial adoption, comparative disclosures are required only for those periods ending after initial adoption. The adoption of FSP FAS 157-4 did not have a material effect on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "*Recognition and Presentation of Other-Than-Temporary Impairments*", ("FSP FAS 115-2 and FAS 124-2"). FSP FAS 115-2 and FAS 124-2 applies to debt securities classified as available-for-sale and held-to-maturity that are subject to other-than-temporary impairment guidance. FSP FAS 115-2 and FAS 124-2 modifies the existing requirement whereby an investor must assert that it has both the intent and ability to hold a security for a period of time sufficient to allow for an anticipated recovery in its fair value to its amortized cost basis in order to avoid recognizing an other-than-temporary impairment. Instead, an entity must assess whether (a) it has the intent to sell the debt security, or (b) it more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the entity must recognize an other-than-temporary impairment. In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security and, if the expected cash flows is less than the amortized cost basis, a credit loss exists, and an other-than-temporary impairment shall be considered to have occurred. The guidance provides numerous factors to be considered when estimating whether a credit loss exists and the period over which the debt security is expected to recover. If an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the entire difference between the security's amortized cost basis and its fair value at the balance sheet date shall be recognized in earnings. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss, and (b) the amount related to all other factors. The amount related to the credit loss shall be recognized in earnings and the amount related to all other factors shall be recognized in other comprehensive income, net of applicable income taxes. The new amortized cost basis of the investment shall be the previous amortized cost basis less the other-than-temporary impairment recognized in earnings. FSP FAS 115-2 and FAS 124-2 also expands and increases the frequency of existing disclosures about other-than-temporary impairments for both debt and equity securities and requires new disclosures pertaining to the significant inputs used in determining a credit loss, as well as a rollforward of that amount each period. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual reporting periods ending after June 15, 2009 and shall be applied to existing and new investments held by an entity as of the beginning of the interim period in which it is adopted. For debt securities held at the beginning of the interim period for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this FSP as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income, net of tax. The amortized cost basis of the security shall be adjusted by the cumulative-effect adjustment before taxes. As of March

31, 2009, the Company had previously recognized \$18,123,000 and \$4,788,000 of other-than-temporary impairments on available-for-sale fixed maturities and certain preferred stocks evaluated as debt securities,

respectively, in the Consolidated Statement of Operations. The Company has determined that (a) the portion of the previously recorded losses on debt securities and preferred stocks evaluated as debt securities representing a credit loss is \$20,517,000, and (b) the amount of a cumulative-effect adjustment to the opening balance of retained earnings and corresponding adjustment to accumulated other comprehensive income representing the amount of previously recorded losses on debt securities and preferred stocks evaluated as debt securities related to all other factors is \$1,542,000, net of \$852,000 of tax benefits. The Company also recorded an additional \$49,000 adjustment to the opening balance of retained earnings and a corresponding adjustment to accumulated other comprehensive income representing its proportionate share of AMIC's cumulative-effect adjustment as a result of its adoption of FSP FAS 115-2 and FAS 124-2.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "*Interim Disclosures about Fair Value of Financial Instruments*", ("FSP FAS 107-1 and APB 28-1"). FSP FAS 107-1 and APB 28-1 require public companies to include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. Such disclosures should include the fair value of all financial instruments for which it is practicable, together with the related carrying values, and disclosure of the methods and significant assumptions used to estimate the fair value and changes in the methods and significant assumptions, if any, during the period. FSP FAS 107-1 and APB 28-1 are effective for interim reporting periods ending after June 15, 2009. Disclosures are not required for earlier periods presented at initial adoption. In periods after initial adoption, comparative disclosures are required only for periods ending after initial adoption. The adoption of FSP FAS 107-1 and APB 28-1 did not have a material effect on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 141(R)-1, "*Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*" ("FSP FAS 141(R)-1"). FSP FAS 141(R)-1 amends and clarifies Statement of Financial Accounting Standards ("SFAS") No. 141, "*Business Combinations*", to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosures of assets and liabilities arising from contingencies in a business combination. FSP FAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of FSP FAS 141(R)-1, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In November 2008, the FASB issued EITF Issue No. 08-6, "*Equity Method Investment Accounting*" ( EITF No. 08-6 ). EITF No. 08-6 requires that the cost basis of an equity method investment be determined by using a cost-accumulation model, which would continue the practice of including transaction costs in the cost of the investment and would exclude the value of contingent consideration. Equity method investments are subject to other-than-temporary impairment analysis. However, an equity investor shall not separately test an investee's underlying assets for impairment. EITF No. 08-6 also requires an equity investor to account for a share issuance by an investee as if the investor had sold a proportionate share if its investment. Any gain or loss to the investor resulting from an investee's share issuance shall be recognized in earnings. The adoption of EITF No. 08-6, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In June 2008, the FASB issued FSP EITF No. 03-6-1, "*Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*" ( FSP EITF No. 03-6-1 ). FSP EITF No. 03-6-1 addresses whether

instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, *Earnings per Share*. FSP EITF No. 03-6-1 requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The adoption of FSP EITF No. 03-6-1, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible*



*Assets.* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets.* FSP FAS 142-3 applies prospectively to intangible assets that are acquired, individually or with a group of other assets, after the effective date in either a business combination or asset acquisition. The adoption of FSP FAS 142-3, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* ( SFAS 161 ). SFAS 161 expands the current disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. In addition, SFAS 161 requires disclosure of fair values of derivative instruments, and their gains and losses, in a tabular format as well as cross-referencing within the footnotes to allow users of financial statements to locate important information about derivative instruments. The adoption of SFAS 161, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In February 2008, the FASB issued FSP SFAS No. 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* ( FSP SFAS 140-3 ). The objective of FSP SFAS 140-3 is to provide guidance on accounting for a transfer of a financial asset and a repurchase financing. FSP SFAS 140-3 presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS 140"). However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under SFAS 140. The adoption of FSP SFAS 140-3, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

In November 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141(R) ) and SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51 ( SFAS 160 ). These standards aim to improve, simplify, and converge internationally the accounting for business combinations and the reporting of non-controlling interests in consolidated financial statements. SFAS 141(R) changes how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 141(R) will be applied prospectively. SFAS 160 changed the accounting and reporting for minority interests, which have been re-characterized as non-controlling interests and classified as a component of equity. Management has applied the presentation and disclosure requirements retroactively for existing minority interests in accordance with SFAS 160. All other requirements of SFAS 160 will be applied prospectively. The adoption of SFAS 141(R) and SFAS 160, effective January 1, 2009, did not have a material effect on the Company's consolidated financial statements.

(D)

## Reclassifications

Certain amounts in prior years' Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2009 presentation, primarily relating to the adoption of SFAS 160.

(E)

**Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company has evaluated all such events occurring subsequent to the balance sheet date herein of June 30, 2009 and through the issuance date of August 10, 2009. The effects of all subsequent events that provided additional evidence about conditions that existed at the date of the balance sheet, including estimates, if any, have been recognized in the

accompanying Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Operations as of and for the three-month and six-month periods ended June 30, 2009. The Company did not recognize subsequent events that provided evidence about conditions that arose after the balance sheet date.

**Note 2.**

**American Independence Corp.**

AMIC is an insurance holding company engaged in the insurance and reinsurance business. AMIC does business with the Insurance Group, including reinsurance treaties under which, in 2008, Standard Security Life and Madison National Life ceded to Independence American an average of 23% of their medical stop-loss business, 10% of certain of their fully insured health business and 20% of their New York Statutory Disability business. IHC owned 49.7% of AMIC's outstanding common stock at June 30, 2009 and December 31, 2008 which was purchased in various transactions from 2002 through 2008. IHC accounts for its investment in AMIC under the equity method. At June 30, 2009 and December 31, 2008, IHC's investment in AMIC had a total carrying value of \$47,114,000 and \$45,439,000 respectively, including goodwill of \$4,222,000. This goodwill represents the excess of IHC's cost over the underlying equity in AMIC's net assets at the respective purchase dates. At June 30, 2009 and December 31, 2008, based on the closing market price of AMIC's common stock, the fair value of the AMIC shares owned by IHC was approximately \$19,657,000 and \$11,541,000, respectively.

For the three months ended June 30, 2009 and 2008, IHC recorded \$235,000 and \$389,000, respectively, of equity income from its investment in AMIC, representing IHC's proportionate share of income based on its ownership interests during those periods. IHC's equity income for the six months ended June 30, 2009 and 2008 was \$928,000 and \$790,000, respectively. AMIC paid no dividends on its common stock in the three-month and six-month periods ended June 30, 2009 and 2008.

IHC and its subsidiaries earned \$271,000 and \$195,000 for the quarters ended June 30, 2009 and 2008, respectively, and \$506,000 and \$413,000 for the six months ended June 30, 2009 and 2008, respectively, from service agreements with AMIC and its subsidiaries. These are reimbursements to IHC and its subsidiaries, at agreed upon rates including an overhead factor, for management services provided by IHC and its subsidiaries, including accounting, legal, compliance, underwriting and claims. The Company ceded premiums to AMIC of \$11,840,000 and \$15,105,000 for the three months ended June 30, 2009 and 2008, respectively, and \$23,734,000 and \$30,795,000 for the six months ended June 30, 2009 and 2008, respectively. Benefits to policyholders on business ceded to AMIC were \$7,969,000 and \$10,491,000 in the second quarter of 2009 and 2008, respectively, and \$14,655,000 and \$21,116,000 for the six months ended June 30, 2009 and 2008, respectively. Additionally, AMIC subsidiaries market, underwrite and provide administrative services (including premium collection, medical management and claims adjudication) for a substantial portion of the Medical Stop-Loss business written by the insurance subsidiaries of IHC. IHC recorded gross premiums of \$15,977,000 and \$19,702,000 in the second quarters of 2009 and 2008, respectively, and net commission expense of \$666,000 and \$935,000 in the second quarters of 2009 and 2008, respectively, for these services. For the six months ended June 30, 2009 and 2008, IHC recorded gross premiums of \$32,849,000 and \$40,282,000, respectively, and net commission expense of \$1,408,000 and \$1,886,000, respectively, for these services. The Company also

contracts for several types of insurance coverage (e.g. directors and officers and professional liability coverage) jointly with AMIC. The cost of this coverage is allocated between the Company and AMIC according to the type of risk, and IHC's portion is recorded in Selling, General and Administrative Expenses.

Included in the Company's Condensed Consolidated Balance Sheets at June 30, 2009 and December 31, 2008, respectively, are the following balances arising from transactions in the normal course of business with AMIC and its subsidiaries: Due from reinsurers \$16,378,000 and \$18,394,000; Other assets \$4,039,000 and \$3,009,000; and Other liabilities of \$386,000 and \$404,000.

**Note 3.****Income Per Common Share**

Income per share calculations are based on income from continuing operations attributable to the common shareholders of IHC for the three and six months ended June 30, 2009 and 2008, as shown below (in thousands):

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |
| Income (loss) from continuing operations  | \$ 1,963                  | \$ (6,667)  | \$ 5,312                | \$ (3,663)  |
| (Income) loss from noncontrolling interests<br>in subsidiaries                              | 13                        | (26)        | 20                      | 42          |
| Income (loss) from continuing operations<br>attributable to IHC shareholders, net of<br>tax | 1,976                     | (6,693)     | 5,332                   | (3,621)     |
| Loss from discontinued operations, net of tax   | (117)                     | -           | (354)                   | -           |
| Net income (loss) attributable to IHC<br>shareholders                                       | \$ 1,859                  | \$ (6,693)  | \$ 4,978                | \$ (3,621)  |

Included in the diluted income per share calculations for the six months ended June 30, 2009 are 2,000 incremental shares from the assumed exercise of options and vesting of restricted stock using the treasury stock method. Such shares were deemed anti-dilutive for the three-month period ended June 30, 2009 and for the three-month and six-month periods ended June 30, 2008.

**Note 4.****Investments**

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

|   | <b>June 2009</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>(In thousands)</b>     |        |                                       |        |  |                       |
| <b>FIXED MATURITIES</b>                 |                           |        |                                       |        |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |        |                                       |        |  |                       |
| Corporate securities                    | \$ 211,290                | \$     | 83                                    | \$     | (19,559)                               | \$ 191,814            |
| CMOs- residential <sup>(1)</sup>        | 93,178                    |        | 3,127                                 |        | (9,379)                                | 86,926                |
| CMOs - commercial                       | 868                       |        | -                                     |        | (494)                                  | 374                   |
| U.S. Government obligations             | 6,361                     |        | 130                                   |        | -                                      | 6,491                 |
| Agency MBS - residential <sup>(2)</sup> | 49,840                    |        | 12                                    |        | (630)                                  | 49,222                |
| GSEs <sup>(3)</sup>                     | 5,962                     |        | -                                     |        | (156)                                  | 5,806                 |
| States and political<br>subdivisions    | 350,060                   |        | 2,515                                 |        | (14,433)                               | 338,142               |
| <br>Total fixed maturities              | <br>\$ 717,559            | <br>\$ | <br>5,867                             | <br>\$ | <br>(44,651)                           | <br>\$ 678,775        |
| <b>EQUITY SECURITIES</b>                |                           |        |                                       |        |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |        |                                       |        |  |                       |
| Preferred stock - perpetuals            | \$ 35,981                 | \$     | -                                     | \$     | (7,782)                                | \$ 28,199             |
| Preferred stock - with<br>maturities    | 20,996                    |        | -                                     |        | (2,607)                                | 18,389                |
| <br>Total equity securities             | <br>\$ 56,977             | <br>\$ | <br>-                                 | <br>\$ | <br>(10,389)                           | <br>\$ 46,588         |

|   | <b>December 31, 2008</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>(In thousands)</b>     |                                       |  |                       |
| <b>FIXED MATURITIES</b>                 |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |                                       |  |                       |
| Corporate securities                    | \$ 212,620                | \$ 895                                | \$ (32,876)                            | \$ 180,639            |
| CMOs - residential <sup>(1)</sup>       | 133,201                   | 711                                   | (13,229)                               | 120,683               |
| CMOs - commercial                       | 867                       | -                                     | (237)                                  | 630                   |
| U.S. Government obligations             | 6,402                     | 199                                   | -                                      | 6,601                 |
| Agency MBS - residential <sup>(2)</sup> | 44,733                    | 515                                   | -                                      | 45,248                |
| GSEs <sup>(3)</sup>                     | 9,815                     | -                                     | (242)                                  | 9,573                 |
| States and political subdivisions       | 283,237                   | 3                                     | (38,127)                               | 245,113               |
| <br>                                    |                           |                                       |  |                       |
| Total fixed maturities                  | \$ 690,875                | \$ 2,323                              | \$ (84,711)                            | \$ 608,487            |
| <br>                                    |                           |                                       |  |                       |
| <b>EQUITY SECURITIES</b>                |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |                                       |  |                       |
| Preferred stock - perpetuals            | \$ 49,943                 | \$ -                                  | \$ (12,489)                            | \$ 37,454             |
| Preferred stock - with maturities       | 18,595                    | -                                     | (2,042)                                | 16,553                |
| <br>                                    |                           |                                       |  |                       |
| Total equity securities                 | \$ 68,538                 | \$ -                                  | \$ (14,531)                            | \$ 54,007             |

(1)

Collateralized mortgage obligations ( CMOs ).

(2)

Mortgage-backed securities ( MBS ).

(3)

Government-sponsored enterprises ( GSEs ) which are the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Federal Home Loan Banks. GSEs are private enterprises established and chartered by the Federal Government.

Gross unrealized losses at June 30, 2009 include \$2,394,000 of other-than-temporary impairment losses related to certain preferred stocks with maturities recorded in connection with the adoption of FSP FAS 115-2 and FAS 124-2 on April 1, 2009.

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

The amortized cost and fair value of fixed maturities at June 30, 2009, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

|  | <b>AMORTIZED<br/>COST</b> | <b>FAIR<br/>VALUE</b> | <b>% OF<br/>TOTAL<br/>FAIR<br/>VALUE</b> |
|--|---------------------------|-----------------------|--|
|  | <b>(In thousands)</b>     |                       |  |
| Due in one year or less                | \$ 6,588                  | \$ 11,696             | 1.7%                                     |
| Due after one year through five years  | 78,544                    | 71,881                | 10.6%                                    |
| Due after five years through ten years | 72,417                    | 68,055                | 10.0%                                    |
| Due after ten years                    | 410,162                   | 384,817               | 56.7%                                    |
|  | 567,711                   | 536,449               | 79.0%                                    |
| CMO and MBS                            |                           |                       |  |
| 15 year                                | 95,211                    | 88,431                | 13.0%                                    |
| 20 year                                | 975                       | 948                   | .2%                                      |
| 30 year                                | 53,662                    | 52,947                | 7.8%                                     |
|  | \$ 717,559                | \$ 678,775            | 100.0%                                   |



The following tables summarize, for all securities in an unrealized loss position at June 30, 2009 and December 31, 2008, respectively, the aggregate fair value and gross unrealized loss by length of time those securities had continuously been in an unrealized loss position:

|                                       | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                       | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| <b>June 30, 2009</b>                  |                     |                   |                     |                   |            |                   |
|                                       |                     |                   | (In thousands)      |                   |            |                   |
| Corporate securities                  | \$ 47,876           | \$ 3,469          | \$ 124,075          | \$ 16,090         | \$ 171,951 | \$ 19,559         |
| CMOs - residential                    | 1,409               | 193               | 41,647              | 9,186             | 43,056     | 9,379             |
| CMO's - commercial                    | -                   | -                 | 374                 | 494               | 374        | 494               |
| Agency MBS - residential              | 48,359              | 630               | -                   | -                 | 48,359     | 630               |
| GSEs                                  | -                   | -                 | 5,806               | 156               | 5,806      | 156               |
| States and political subdivisions     | 113,051             | 2,406             | 142,433             | 12,027            | 255,484    | 14,433            |
| Total fixed maturities                | 210,695             | 6,698             | 314,335             | 37,953            | 525,030    | 44,651            |
| Preferred stocks-perpetual            | 10,040              | 2,504             | 18,159              | 5,278             | 28,199     | 7,782             |
| Preferred stocks-with maturities      | 8,140               | 1,651             | 10,249              | 956               | 18,389     | 2,607             |
| Total temporarily impaired securities | \$ 228,875          | \$ 10,853         | \$ 342,743          | \$ 44,187         | \$ 571,618 | \$ 55,040         |

|                          | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|--------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                          | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| <b>December 31, 2008</b> |                     |                   |                     |                   |            |                   |
|                          |                     |                   | (In thousands)      |                   |            |                   |

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|                                       |            |           |            |           |            |           |
|---------------------------------------|------------|-----------|------------|-----------|------------|-----------|
| Corporate securities                  | \$ 44,316  | \$ 6,681  | \$ 117,035 | \$ 26,195 | \$ 161,351 | \$ 32,876 |
| CMOs - residential                    | 12,566     | 2,853     | 38,332     | 10,376    | 50,898     | 13,229    |
| CMOs - commercial                     | -          | -         | 630        | 237       | 630        | 237       |
| GSEs                                  | 4,311      | 119       | 5,262      | 123       | 9,573      | 242       |
| States and political subdivisions     | 218,106    | 36,330    | 11,911     | 1,797     | 230,017    | 38,127    |
| Total fixed maturities                | 279,299    | 45,983    | 173,170    | 38,728    | 452,469    | 84,711    |
| Preferred stocks-perpetual            | 33,231     | 12,003    | 4,223      | 486       | 37,454     | 12,489    |
| Preferred stocks-with maturities      | 8,616      | 1,377     | 7,937      | 665       | 16,553     | 2,042     |
| Total temporarily impaired securities | \$ 321,146 | \$ 59,363 | \$ 185,330 | \$ 39,879 | \$ 506,476 | \$ 99,242 |

At June 30, 2009 and December 31, 2008, a total of 57 and 110 securities, respectively, were in a continuous unrealized loss position for less than 12 months and 176 and 64 securities, respectively, had continuous unrealized losses for 12 months or longer. The Company has only one non-performing fixed maturity investment at June 30, 2009 with an adjusted cost basis of \$650,000, or 0.1% of total fixed maturities.

Substantially all of the unrealized losses at June 30, 2009 and December 31, 2008 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. The unrealized losses on corporate securities and state and political subdivisions are due to wider spreads. Spreads have widened as investors shifted funds to US Treasuries in response to the current market turmoil. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell, such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2009.

At June 30, 2009, the Company had \$29,595,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 39% were in CMOs that originated in 2005 or earlier and 61% were in CMOs that originated in 2006. The Company's mortgage security portfolio has no direct exposure to sub-prime mortgages. The decline in market value for the equity securities was primarily due to wider spreads from preferred stocks issued by financial institutions following the disruption in credit markets. Some of these financial institutions have exposure to sub-prime mortgages.

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

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

The Company reviews its investment securities regularly and determines whether other-than-temporary impairments have occurred. For fixed maturities, if a decline in fair value is judged by management to be other-than-temporary, and the Company does not intend to sell the security and it is not more likely than not that it will be required to sell the security prior to recovery of the security's amortized cost, the impairment is bifurcated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized by a charge to total other-than-temporary impairment losses in the Consolidated Statements of Operations, establishing a new cost basis for the security. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income in the Consolidated Balance Sheets. The factors considered by management in its regular review include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; subordinated credit support; whether the issuer of a debt security has remained current on principal and interest payments; current expected cash flows; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions (including, in the case of fixed maturities, the effect of changes in market interest rates); and the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis.

In assessing corporate debt securities for other-than-temporary impairment, the Company evaluates the ability of the issuer to meet its debt obligations and the value of the company or specific collateral securing the debt position. When evaluating whether a mortgage-backed security is other-than-temporarily impaired, the Company examines characteristics of the underlying collateral, such as delinquency and default rates, the quality of the underlying borrower, the type of collateral in the pool, the vintage year of the collateral, subordination levels within the structure of the collateral pool, the Company's intent to sell the security and whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis. For all debt securities evaluated for other-than-temporary impairment (for which the Company does not have the intent to sell and it is not more likely than not that it will be required to sell the security before the recovery of its amortized cost basis), the Company considers the timing and amount of the cash flows.

The Company evaluates its mortgage-backed securities for other-than-temporary impairment using multiple inputs. Loan level defaults are estimated using an option pricing approach in which the probability of borrower default increases as home equity declines. Other factors which influence the probability of default are debt-servicing, missed refinancing opportunities and geography. Loan level characteristics such as issuer, FICO, payment terms, level of documentation, residency type, dwelling type and loan purpose are also utilized in the model along with historical performance, to estimate or measure the loan's propensity to

default. Additionally, the model takes into account loan age, seasonality, payment changes and exposure to refinancing as additional drivers of default. For transactions where loan level data is not available, the model uses a proxy based on the collateral characteristics. Loss severity in the model is a function of multiple factors including but not limited to the unpaid balance, interest rate, mortgage insurance ratios, assessed property value at origination, change in property valuation and loan-to-value ratio at origination. Prepayment speeds, both actual and estimated, are also considered. The cash flows generated by the collateral securing these securities are then determined with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issuer's position in the overall structure, to determine the cash flows associated with the mortgage-backed security held by the Company.

To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost, a credit loss exists, and an other-than-temporary impairment is recognized through earnings. It is reasonably possible that further declines in estimated fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further other-than-temporary impairments in the near term, which could be significant.

In addition, the Company evaluates other asset-backed securities for other-than-temporary impairment by examining similar characteristics referenced above for mortgage-backed securities. The Company evaluates U.S. Treasury securities and obligations of U.S. Government corporations, U.S. Government agencies, and obligations of states and political subdivisions for other-than-temporary impairment by examining similar characteristics referenced above for corporate debt securities.

Equity securities may experience other-than-temporary impairment in the future based on the prospects for full recovery in value in a reasonable period of time and the Company's ability and intent to hold the security to recovery. If a decline in fair value is judged by management to be other-than-temporary, a loss is recognized by a charge to total other-than-temporary impairment losses in the Consolidated Statements of Operations. For the purpose of other-than-temporary impairment evaluations, preferred stocks are treated in a manner similar to debt securities. Declines in the creditworthiness of the issuer of debt securities with both debt and equity-like features requires the use of the equity model in analyzing the security for other-than-temporary impairment.

Based on management's review of the portfolio, which considered these factors, the Company recorded the following losses for other-than-temporary impairments in the Condensed Consolidated Statements of Operations for the three months and six months ended June 30, 2009 and 2008 (in thousands):

| <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---------------------------|-------------|-------------------------|-------------|
| <b>June 30,</b>           |             | <b>June 30,</b>         |             |
| <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |

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Other-than-temporary impairments:

|                  |    |   |    |          |    |       |    |          |
|------------------|----|---|----|----------|----|-------|----|----------|
| Common stocks    | \$ | - | \$ | (2,058)  | \$ | -     | \$ | (2,139)  |
| Preferred stocks |    |   |    | (15,335) |    | (271) |    | (15,335) |
|                  | \$ | - | \$ | (17,393) | \$ | (271) | \$ | (17,474) |

As of March 31, 2009, the Company had previously recognized a total of \$18,123,000 and \$4,788,000 of other-than-temporary impairments on available-for-sale fixed maturities and certain preferred stocks evaluated as debt securities, respectively, in the Consolidated Statements of Operations. As a result of the adoption of FSP FAS 115-2 and FAS 124-2 on April 1, 2009, the Company has determined that (a) the portion of the previously recorded losses on debt securities, and preferred stocks evaluated as debt securities, representing a credit loss is \$20,517,000, and (b) the amount of a cumulative-effect adjustment to the opening balance of retained earnings and corresponding adjustment to accumulated other

comprehensive income representing the amount of previously recorded losses on debt securities, and preferred stocks evaluated as debt securities, related to all other factors is \$1,542,000, net of \$852,000 of tax benefits. The Company also recorded an additional \$49,000 adjustment to the opening balance of retained earnings and a corresponding adjustment to accumulated other comprehensive income representing its proportionate share of AMIC's cumulative-effect adjustment as a result of its adoption of FSP FAS 115-2 and FAS 124-2. Since the adoption of FSP FAS 115-2 and FAS 124-2, no additional other-than-temporary impairment losses were recorded and therefore the amount of the cumulative credit loss remains \$20,517,000 at June 30, 2009. No losses for other-than-temporary impairments were recognized in other comprehensive income in the three months or six months ended June 30, 2009.

Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalance in liquidity that 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.

#### Note 5.

#### Net Realized Investment Gains

Net realized investment gains (losses) for the three months and six months ended June, 30, 2009 and 2008 are as follows (in thousands):

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2009                           | 2008     | 2009                         | 2008     |
| Net realized investment gains (losses):      |                                |          |                              |          |
| Fixed maturities                             | \$ 1,274                       | \$ 655   | \$ 2,939                     | \$ 743   |
| Common stocks                                | -                              | 1,304    | -                            | 904      |
| Preferred stocks                             | (12)                           | (10)     | (12)                         | 711      |
|  | 1,262                          | 1,949    | 2,927                        | 2,358    |
| Sales of trading securities                  | -                              | 429      | -                            | 429      |
| IHC stock puts/call and other gains (losses) | -                              | (72)     | -                            | (286)    |
| Net realized investment gains                | \$ 1,262                       | \$ 2,306 | \$ 2,927                     | \$ 2,501 |

For the three months and six months ended June 30, 2009, the Company realized gross gains of \$3,131,000 and \$4,829,000, respectively, and gross losses of \$1,869,000 and \$1,902,000, respectively, on sales of available-for-sale securities. For the three months and six months ended June 30, 2008, the Company realized gross gains of \$2,555,000 and \$6,004,000, respectively, and gross losses of \$606,000 and \$3,646,000, respectively, on sales of available-for-sale securities. As of December 31, 2008, the Company no longer has any trading accounts.

**Note 6.**

**Derivative Instruments**

In connection with its currently outstanding \$10,000,000 line of credit, a subsidiary of IHC entered into an interest rate swap with the commercial bank lender, for a notional amount equal to the debt principal amount, under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate (6.65%) in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. There was no hedge ineffectiveness on this interest rate swap which is accounted for as a cash flow hedge. At June 30, 2009 and December 31, 2008, the fair value of the interest rate swap was \$64,000 and \$260,000, respectively, which is included in other liabilities on the accompanying Condensed Consolidated Balance Sheets. See Note 6 for further discussion on the valuation techniques utilized to



determine the fair value of the interest rate swap. For the six months ended June 30, 2009 and 2008, the Company recorded \$118,000 and \$(116,000) respectively, of gains (losses) on the effective portion of the interest rate swap in accumulated other comprehensive loss on the accompanying Condensed Consolidated Balance Sheets, net of related taxes (benefits) of \$78,000 and \$(77,000), respectively.

At June 30, 2009 and December 31, 2008, the Company held no other derivative instruments and, for the three months and six months ended June 30, 2009, recorded no gains or losses related to derivative instruments in the accompanying Condensed Consolidated Statements of Operations. For the three months and six months ended June 30, 2008, the Company recorded losses of \$66,000 and \$311,000, respectively, in net realized investment gains representing the net change in fair value of a stock put on IHC shares of common stock issued in connection with the acquisition of IAC in 2006. All of the shares subject to the IHC stock put were subsequently exercised during 2008.

#### **Note 7.**

#### **Fair Value Disclosures of Financial Instruments**

For all financial and non-financial instruments 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.

When available, we use quoted market prices to determine fair value and classify such items in Level 1. In some cases, we use quoted market prices for similar instruments in active markets and/or model-derived valuations where inputs are observable in active markets and classify such items in Level 2. When there are limited or inactive trading markets, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management's assumptions and available market information. These items are classified in level 3. Further, we retain independent pricing vendors to assist in valuing certain instruments.

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

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

Investments included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, collateralized mortgage obligations, municipals, GSEs and certain preferred stocks that were priced with observable market inputs. Level 3 securities consist of CMO securities, primarily Alt-A mortgages.

**Other:**

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, at June 30, 2009 and December 31, 2008, respectively (in thousands):

**June 30, 2009**

|                                    | Level 1   | Level 2    | Level 3   | Total      |
|------------------------------------|-----------|------------|-----------|------------|
| <b>FINANCIAL ASSETS:</b>           |           |            |           |            |
| Fixed maturities held for sale:    |           |            |           |            |
| Corporate securities               | \$ -      | \$ 191,814 | \$ -      | \$ 191,814 |
| CMOs - residential                 | -         | 51,121     | 35,805    | 86,926     |
| CMOs - commercial                  | -         | -          | 374       | 374        |
| US Government obligations          | -         | 6,491      | -         | 6,491      |
| Agency MBS - residential           | -         | 49,222     | -         | 49,222     |
| GSEs                               | -         | 5,806      | -         | 5,806      |
| States and political subdivisions  | -         | 338,142    | -         | 338,142    |
| Total fixed maturities             | -         | 642,596    | 36,179    | 678,775    |
| Equity securities held for sale:   |           |            |           |            |
| Preferred stocks - perpetual       | 28,199    | -          | -         | 28,199     |
| Preferred stocks - with maturities | 16,277    | 2,112      | -         | 18,389     |
| Total equity securities            | 44,476    | 2,112      | -         | 46,588     |
| Total                              | \$ 44,476 | \$ 644,708 | \$ 36,179 | \$ 725,363 |
| <b>FINANCIAL LIABILITIES:</b>      |           |            |           |            |
| Interest rate swap                 | \$ -      | \$ 64      | \$ -      | \$ 64      |

**December 31, 2008**

|                                 | Level 1 | Level 2    | Level 3 | Total      |
|---------------------------------|---------|------------|---------|------------|
| <b>FINANCIAL ASSETS:</b>        |         |            |         |            |
| Fixed maturities held for sale: |         |            |         |            |
| Corporate securities            | \$ -    | \$ 180,639 | \$ -    | \$ 180,639 |
| CMOs - residential              | -       | 95,981     | 24,702  | 120,683    |
| CMOs - commercial               | -       | -          | 630     | 630        |
| US Government obligations       | -       | 6,601      | -       | 6,601      |

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|                                    |           |            |           |            |
|------------------------------------|-----------|------------|-----------|------------|
| Agency MBS - residential           | -         | 45,248     | -         | 45,248     |
| GSEs                               | -         | 9,573      | -         | 9,573      |
| States and political subdivisions  | -         | 245,113    | -         | 245,113    |
| Total fixed maturities             | -         | 583,155    | 25,332    | 608,487    |
| Equity securities held for sale:   |           |            |           |            |
| Preferred stocks - perpetual       | 37,454    | -          | -         | 37,454     |
| Preferred stocks - with maturities | 14,397    | 2,156      | -         | 16,553     |
| Total equity securities            | 51,851    | 2,156      | -         | 54,007     |
| Total                              | \$ 51,851 | \$ 585,311 | \$ 25,332 | \$ 662,494 |
| <b>FINANCIAL LIABILITIES:</b>      |           |            |           |            |
| Interest rate swap                 | \$ -      | \$ 260     | \$ -      | \$ 260     |

Inputs for certain fixed maturity securities that were observable at December 31, 2008 were not observable at June 30, 2009 as a result of limited or inactive markets. These securities were transferred out of Level 2 and into the Level 3 category during 2009. No securities were sold or transferred out of the Level 3 category in 2009. Changes in the carrying value of Level 3 financial assets and liabilities for the six months ended June 30, 2009 are summarized as follows (in thousands):

|   | <b>CMOs</b>        |                   |              |
|---|--------------------|-------------------|--------------|
|   | <b>Residential</b> | <b>Commercial</b> | <b>Total</b> |
| Balance at beginning of year  | \$ 24,702          | \$ 630            | \$ 25,332    |
| Transfers into Level 3  | 7,532              | -                 | 7,532        |
| Net realized investment gains (losses) included in earnings:  |                    |                   |              |
| Net realized investment gains   | -                  | -                 | -            |
| Other-than-temporary impairments  | -                  | -                 | -            |
|   | -                  | -                 | -            |
| Net unrealized gains (losses) included in accumulated other comprehensive loss:                                     |                    |                   |              |
| Net unrealized gains  | 5,973              | (256)             | 5,717        |
| Reclassification of unrealized losses deemed to be other-than-temporary to net realized losses included in earnings | -                  | -                 | -            |
|   | 5,973              | (256)             | 5,717        |
| Repayments of fixed maturities  | (2,402)            | -                 | (2,402)      |
| Balance at end of period  | \$ 35,805          | \$ 374            | \$ 36,179    |

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

(A)

**Policy Loans**

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

(B)

**Funds on Deposit**

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

(C)

**Debt**

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

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

|  | <b>JUNE 30, 2009</b>       |                       | <b>DECEMBER 31, 2008</b>   |                       |
|--|----------------------------|-----------------------|----------------------------|-----------------------|
|  | <b>CARRYING<br/>AMOUNT</b> | <b>FAIR<br/>VALUE</b> | <b>CARRYING<br/>AMOUNT</b> | <b>FAIR<br/>VALUE</b> |
|  | <b>(In thousands)</b>      |                       |                            |                       |
| <b>FINANCIAL ASSETS:</b>                           |                            |                       |                            |                       |
| Policy loans                                       | \$ 24,329                  | \$ 31,991             | \$ 24,947                  | \$ 32,914             |
| <b>FINANCIAL<br/>LIABILITIES:</b>                  |                            |                       |                            |                       |
| Funds on deposit                                   | \$ 406,221                 | \$ 408,227            | \$ 411,188                 | \$ 407,767            |
| Debt and junior<br>subordinated debt<br>securities | 48,146                     | 48,378                | 48,146                     | 48,620                |

**Note 8.****Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill and other intangible assets (included in other assets in the Condensed Consolidated Balance Sheets) for the second quarter of 2009 is as follows (in thousands):

| <b>Goodwill</b> | <b>Other Intangible<br/>Assets</b> |
|-----------------|------------------------------------|
|-----------------|------------------------------------|

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|  |    |        |    |         |
|--|----|--------|----|---------|
| Balance at December 31, 2008                   | \$ | 52,331 | \$ | 15,308  |
| Acquire Wisconsin Underwriting Associates, LLC |    | 750    |    | -       |
| Capitalized software development               |    | -      |    | 281     |
| Amortization expense                           |    | -      |    | (1,293) |
| Balance at June 30, 2009                       | \$ | 53,081 | \$ | 14,296  |

In January 2009, Wisconsin Underwriting Associates, Inc., a newly formed wholly owned subsidiary of IHC Health Holdings Corp., ("IHC Health Holdings") acquired the assets of Wisconsin Underwriting Associates, LLC ("WUA") in exchange for \$300,000, \$100,000 of contingent consideration and 49% of its capital stock. The addition of \$750,000 of goodwill above represents the excess fair value of the consideration transferred over the total fair value of the net assets of WUA acquired.

**Note 9.**

**Discontinued Operations**

The Company sold its credit life and disability segment by entering into a 100% coinsurance agreement with an unaffiliated insurer effective December 31, 2007. Unearned premium reserves of this block and the corresponding amount in due from reinsurers of \$10,719,000 and \$12,781,000 are included in the Condensed Consolidated Balance Sheets at June 30, 2009 and December 31, 2008, respectively.



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During the three and six months ended June 30, 2009, the Company recorded losses from discontinued operations of \$117,000 and \$354,000, respectively, net of \$64,000 and \$191,000, respectively, of income tax benefits, which represent expenses and changes in claims and reserves related to the insurance liabilities (currently in run-off status) for claims incurred prior to December 31, 2007 and an adjustment to previously accrued exit costs. The Company did not record income or loss from discontinued operations during the three months or six months ended June 30, 2008.

Changes in the liabilities related to discontinued operations for the six months ended June 30, 2009 were as follows (in thousands):

|   | <b>Claims<br/>Liability</b> | <b>Accrued<br/>Expenses</b> | <b>Termination<br/>Benefits</b> | <b>Total</b> |
|---|-----------------------------|-----------------------------|---------------------------------|--------------|
| <b>Balance at beginning of year</b>                             | \$ 3,328                    | \$ -                        | \$ 214                          | \$ 3,542     |
| <b>Loss from discontinued operations:</b>                       |                             |                             |                                 |              |
| Changes in claims and reserves<br>related to block in run-off   | 471                         |                             |                                 | 471          |
| Expenses incurred related to block in run-off                   |                             | 42                          |                                 | 42           |
| Adjustment to accrued exit costs                                |                             | 32                          |                                 | 32           |
|   |                             |                             |                                 | 545          |
| Payments of expenses accrued to administer<br>the business sold |                             | (74)                        | (118)                           | (192)        |
| Claim payments related to block in run-off                      | (1,406)                     |                             |                                 | (1,406)      |
| <b>Balance at June 30, 2009</b>                                 | \$ 2,393                    | \$ -                        | \$ 96                           | \$ 2,489     |

The Company believes that the net liabilities of discontinued operations at June 30, 2009 adequately estimate the remaining costs associated with the credit life and disability discontinued operations.

**Note 10.**

**Share-Based Compensation**

Total share-based compensation was \$74,000 and \$353,000 for the three months ended June 30, 2009 and 2008, respectively, and \$341,000 and \$645,000 for the six months ended June 30, 2009 and 2008, respectively. Related tax

benefits of \$29,000 and \$141,000, were recognized for the three months ended June 30, 2009 and 2008, respectively, and \$136,000 and \$257,000 for the six months ended June 30, 2009 and 2008, respectively.

Under the terms of the Company's stock-based compensation plans, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three years for employee options. The Company may also grant shares of restricted stock, share appreciation rights ( SARs ) and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period. Exercise prices of SARs are equal to the quoted market price of the shares at the date of the grant and have three year vesting periods. At June 30, 2009, there were 779,535 shares available for future grants under the Company's 2006 Stock Incentive.

**Stock Options**

The Company's stock option activity for the six months ended June 30, 2009 is as follows:

|                          | <b>Shares<br/>Under Option</b> | <b>Weighted- Average<br/>Exercise Price</b> |
|--------------------------|--------------------------------|---|
| <b>December 31, 2008</b> | 759,093                        | \$ 17.94                                    |
| Forfeited                | (33,333)                       | 16.07                                       |
| Expired                  | (252,923)                      | 20.86                                       |
| <b>June 30, 2009</b>     | 472,837                        | 16.50                                       |

The following table summarizes information regarding outstanding and exercisable options as of June 30, 2009:

|   | <b>Outstanding</b> | <b>Exercisable</b> |
|---|--------------------|--------------------|
| Number of options                           | 472,837            | 330,169            |
| Weighted average exercise price per share   | \$ 16.50           | \$ 18.59           |
| Aggregate intrinsic value for all options   | \$ -               | \$ -               |
| Weighted average contractual term remaining | 2.7 years          | 2.3 years          |

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. No options were granted during the six months ended June 30, 2009. The weighted average grant-date fair-value of options granted during the six months ended June 30, 2008 was \$3.44 per share. The assumptions set forth in the table below were used to value the stock options granted during the six-month period ended June 30, 2008:

|  |           |
|--|-----------|
| Weighted-average risk-free interest rate                         | 2.21%     |
| Annual dividend rate per share                                   | \$ .05    |
| Weighted-average volatility factor of the Company's common stock | 36.6%     |
| Weighted-average expected term of options                        | 4.5 years |

Compensation expense of \$15,000 and \$240,000 was recognized in the three months ended June 30, 2009 and 2008, respectively, and \$206,000 and \$427,000 in the six months ended June 30, 2009 and 2008, respectively, for the

portion of the grant-date fair value of stock options vesting during that period.

No options were exercised during the three months and six months ended June 30, 2009. During the three months and six months ended June 30, 2008, the Company received cash proceeds of \$173,000 upon the exercise of 15,608 options with an intrinsic value of \$31,000. In addition, another 276,192 options were exercised and, pursuant to the terms of the Company's applicable stock option plans, payments were made equal to the difference between the fair value of such shares, with respect to the options at such exercise date, and the aggregate option strike price. The intrinsic value of such totaled \$640,000 and the payments were made in the form of IHC common stock totaling 29,486 shares after deducting applicable income taxes.

As of June 30, 2009, the total unrecognized compensation expense related to non-vested stock options was \$453,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.6 years.

**Restricted Stock**

The Company issued 2,250 shares of restricted stock during both the six months ended June 30, 2009 and 2008, with weighted average grant-date fair values of \$6.74 and \$12.26 per share, respectively. The total fair value of restricted stock that vested during the first six months of 2009 and 2008 was \$70,000 and \$223,000, respectively. Restricted stock expense was \$28,000 and \$100,000, respectively, for the three months ended June 30, 2009 and 2008, respectively, and \$80,000 and \$200,000 for the six months ended June 30, 2009 and 2008, respectively.

The following table summarizes restricted stock activity for the six months ended June 30, 2009:

|                   | <b>No. of<br/>Shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair Value</b> |
|-------------------|--------------------------|---|
| December 31, 2008 | 18,976                   | \$ 20.66  |
| Granted           | 2,250                    | \$ 6.74   |
| Vested            | (15,846)                 | \$ 21.48  |
| June 30, 2009     | 5,380                    | \$ 12.43  |

As of June 30, 2009, the total unrecognized compensation expense related to non-vested restricted stock awards was \$61,000 which is expected to be recognized over the remaining requisite weighted-average service period of 0.8 years.

**SARs and Share-Based Performance Awards**

The fair value SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. No SARs were exercised in the six months ended June 30, 2009 or 2008. Other liability-classified awards include share-based performance awards. Compensation costs for these plans are recognized and accrued as performance conditions are met, based on the current share price. The intrinsic value of all share-based liabilities paid in the six months ended June 30, 2009 and 2008 was \$35,000 and \$76,000, respectively. Included in Other Liabilities on the Company's Condensed Consolidated Balance Sheets at June 30, 2009 and December 31, 2008 are liabilities of \$67,000 and \$47,000, respectively, pertaining to SARs and share-based performance awards.

**Note 11.**

## **Income Taxes**

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

The deferred income taxes for the six months ended June 30, 2009 allocated to stockholders' equity (principally for net unrealized gains on investment securities) was \$14,872,000, representing the decrease in the related net deferred tax asset to \$15,395,000 at June 30, 2009 from \$30,267,000 at December 31, 2008.

Interest expense and penalties for the three months and six months ended June 30, 2009 and 2008 are insignificant, however \$36,000 of interest income related to tax refunds received is included in selling, general and administrative expenses on the Condensed Consolidated Statement of Operations for the three months and six months ended June 30, 2009.

**Note 12.**

**Supplemental Disclosures of Cash Flow Information**

Tax refunds, net of tax payments, were \$1,961,000 during the six months ended June 30, 2009. Net cash payments for income taxes during the six months ended June 30, 2008 were \$7,000.

Cash payments for interest were \$1,687,000 and \$1,899,000 during the six months ended June 30, 2009 and 2008, respectively.

**Note 13.**

**Reinsurance**

Madison National Life entered into a reinsurance treaty with an unaffiliated reinsurer to cede \$48,837,000 of life reserves, effective April 1, 2009, in exchange for transferring \$40,639,000 to such reinsurer. Madison National Life recorded a net deferred gain of \$8,198,000 which will be amortized over the life of the contract. In accordance with the terms of the agreement, Madison National Life will continue to administer this block of business.

**Note 14.**

**Comprehensive Income (Loss)**

The components of comprehensive income (loss) include (i) net income or loss reported in the Condensed Consolidated Statements of Operations, (ii) certain amounts reported directly in stockholders' equity, principally the after-tax net unrealized gains and losses on securities available for sale (net of deferred acquisition costs), and (iii) the portion of other-than-temporary impairments of fixed maturities related to all other factors than those deemed to be a credit loss.

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No losses for other-than-temporary impairments were recognized in other comprehensive income during the three months or six months ended June 30, 2009. The comprehensive income (loss) for the three months and six months ended June 30, 2009 and 2008 is summarized as follows (in thousands):

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |
| Net income (loss)   | \$ 1,859                  | \$ (6,693)  | \$ 4,978                | \$ (3,621)  |
| Unrealized gains (losses) arising<br>during the period, net of income taxes | 20,913                    | 3,987       | 28,316                  | (6,396)     |
| Comprehensive income (loss) attributable to IHC                             | \$ 22,772                 | \$ (2,706)  | \$ 33,294               | \$ (10,017) |



**Note 15.****Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months and six months ended June 30, 2009 and 2008 is presented below:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |
| <b>Revenues:</b>   |                           |             |                         |             |
| Medical Stop-Loss <sup>(A)</sup>                         | \$ 35,879                 | \$ 42,292   | \$ 72,314               | \$ 85,745   |
| Fully Insured Health <sup>(B)</sup>                      | 30,992                    | 31,486      | 60,703                  | 63,506      |
| Group disability, life, annuities and DBL <sup>(C)</sup> | 16,632                    | 14,235      | 32,858                  | 29,205      |
| Individual life, annuities and other                     | 14,961                    | 16,569      | 30,785                  | 31,436      |
| Corporate  | 873                       | (177)       | 654                     | (1,183)     |
|  | 99,337                    | 104,405     | 197,314                 | 208,709     |
| Net realized investment gains                            | 1,262                     | 2,306       | 2,927                   | 2,501       |
| Other-than-temporary impairment losses, net              | -                         | (17,393)    | (271)                   | (17,474)    |
|  | \$ 100,599                | \$ 89,318   | \$ 199,970              | \$ 193,736  |
| <b>Income Before Income Taxes:</b>                       |                           |             |                         |             |
| Medical Stop-Loss <sup>(A)</sup>                         | \$ 1,127                  | \$ 1,114    | \$ 2,776                | \$ 3,435    |
| Fully Insured Health <sup>(B)</sup> <sup>(D)</sup>       | (751)                     | 1,071       | (750)                   | 2,304       |
| Group disability, life, annuities and DBL <sup>(C)</sup> | 1,027                     | 2,222       | 3,381                   | 3,858       |
| Individual life, annuities and other                     | 491                       | 1,560       | 1,801                   | 4,105       |
| Corporate  | 113                       | (1,047)     | (1,524)                 | (3,553)     |
|  | 2,007                     | 4,920       | 5,684                   | 10,149      |
| Net realized investment gains                            | 1,262                     | 2,306       | 2,927                   | 2,501       |
| Other-than-temporary impairment losses, net              | -                         | (17,393)    | (271)                   | (17,474)    |
| Interest expense   | (761)                     | (909)       | (1,531)                 | (1,895)     |
|  | \$ 2,508                  | \$ (11,076) | \$ 6,809                | \$ (6,719)  |

(A)

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The amount includes equity income from AMIC of \$165,000 and \$277,000 for the three months ended June 30, 2009 and 2008, respectively, and \$653,000 and \$624,000 for the six months ended June 30, 2009 and 2008, respectively.

**(B)**

The amount includes equity income from AMIC of \$47,000 and \$98,000 for the three months ended June 30, 2009 and 2008, respectively, and \$186,000 and \$121,000 for six months ended June 30, 2008 and 2007, respectively.

**(C)**

The amount includes equity income from AMIC of \$23,000 and \$14,000 for the three months ended June 30, 2009 and 2008, respectively, and \$89,000 and \$45,000 for six months ended June 30, 2009 and 2008, respectively.

**(D)**

The Fully Insured Health segment includes amortization of intangible assets recorded as a result of purchase accounting for the recent acquisitions. Total amortization expense was \$616,000 and \$667,000 for the three months ended June 30, 2009 and 2008, respectively, and \$1,228,000 and \$1,368,000 for the six months ended June 30, 2009 and 2008, respectively. Amortization expense for the other segments is insignificant.

**Note 16.**

**Non-Recognized Subsequent Event**

On July 1, 2009, IHC Health Holdings acquired the remaining non-controlling interest in GroupLink, effectively making the administrative company a wholly owned subsidiary as of such date. The non-controlling interest, consisting of 250 shares of GroupLink common stock, was purchased from a senior officer of GroupLink for a purchase price of \$500,000.

**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, 2008, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

**Overview**

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation ( IAC ), managing general underwriters ("MGUs") in which it owns a significant voting interest, Health Plan Administrators, Inc. ( HPA ), GroupLink, Inc. ( GroupLink ), IHC Health Solutions, Inc. ( IHC Health Solutions ) and Actuarial Management Corporation ( AMC ). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." At June 30, 2009, the Company also owned a 49.7% equity interest in American Independence Corp. ("AMIC"), which owns Independence American Insurance Company ( Independence American ), three MGUs and controlling interests in two agencies.

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



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

The results of operations for the three months and six months ended June 30, 2009 and 2008 are summarized as follows (in thousands):

|   | Three Months Ended |            | Six Months Ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,           |            | June 30,         |            |
|   | 2009               | 2008       | 2009             | 2008       |
| Revenues  | \$ 100,599         | \$ 89,318  | \$ 199,970       | \$ 193,736 |
| Expenses  | 98,091             | 100,394    | 193,161          | 200,455    |
| Income (loss) from continuing operations        |                    |            |                  |            |
| before income taxes (benefit)                   | 2,508              | (11,076)   | 6,809            | (6,719)    |
| Income taxes (benefit)                          | 545                | (4,409)    | 1,497            | (3,056)    |
| <b>Income (loss) from continuing operations</b> | 1,963              | (6,667)    | 5,312            | (3,663)    |
| <b>Discontinued operations:</b>                 |                    |            |                  |            |
| Income (loss) from discontinued operations      | (117)              | -          | (354)            | -          |
| <b>Net income (loss)</b>                        | 1,846              | (6,667)    | 4,958            | (3,663)    |
| (Income) loss from noncontrolling interests     |                    |            |                  |            |
| in subsidiaries                                 | 13                 | (26)       | 20               | 42         |
| <b>Net income (loss) attributable to IHC</b>    | \$ 1,859           | \$ (6,693) | \$ 4,978         | \$ (3,621) |

Income from continuing operations increased \$8.7 million to \$2.0 million for the three months ended June 30, 2009 compared to a loss of \$6.7 million for the three months ended June 30, 2008. Income from continuing operations increased \$9.0 million to \$5.3 million for the six months ended June 20, 2009 compared to a loss of \$3.7 million for the six months ended June 30, 2008. Included in the 2008 results are losses for other-than-temporary impairments of \$17.4 million and \$17.5 million in the three months and six months ended June 30, due to the write down in value of preferred stocks of certain financial institutions. Included in the 2009 results are losses of \$.3 million for

other-than-temporary impairments in the six-month period ended June 30;

Consolidated investment yields (on an annualized basis) of 5.3% and 5.1% for the three months and six months ended June 30, 2009 compared to 4.9% and 4.8% for the comparable periods in 2008:

Revenues of \$100.6 million and \$200.0 million for the three months and six months ended June 30, 2009, respectively, representing increases of 12.7% and 3.3% over the respective three-month and six-month periods in 2008; and

Book value of \$12.70 per common share, representing a 20.3% increase from December 31, 2008, primarily reflecting net income and net unrealized gains on securities for the six months ended June 30, 2009.

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

The Medical Stop-Loss segment reported income before taxes of \$1.1 million for both the three months ended June 30, 2009 and 2008 and reported \$2.8 million of income before taxes for the six

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months ended June 30, 2009, as compared to \$3.4 million in the same period in 2008. The decrease is primarily a result of reduced production due to stricter underwriting guidelines;

o

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

|  | Three Months Ended |           | Six Months Ended |           |
|--|--------------------|-----------|------------------|-----------|
|  | June 30,           |           | June 30,         |           |
|  | 2009               | 2008      | 2009             | 2008      |
| Premiums Earned                                | \$ 34,361          | \$ 40,902 | \$ 69,289        | \$ 82,621 |
| Insurance Benefits, Claims & Reserves Expenses | 24,850             | 30,039    | 49,363           | 59,846    |
|  | 9,302              | 10,103    | 18,931           | 20,890    |
| Loss Ratio <sup>(A)</sup>                      | 72.3%              | 73.4%     | 71.3%            | 72.4%     |
| Expense Ratio <sup>(B)</sup>                   | 27.1%              | 24.7%     | 27.3%            | 25.3%     |
| Combined Ratio <sup>(C)</sup>                  | 99.4%              | 98.1%     | 98.6%            | 97.7%     |

(A)

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

(B)

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

(C)

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

The Fully Insured Health segment reported \$.8 million of loss before taxes for the three months ended June 30, 2009 as compared to income before taxes \$1.1 million for the comparable period in 2008, and a loss before taxes of \$.8 million for the six months ended June 30, 2009 as compared to \$2.3 million of income before taxes for the six months ended June 30, 2008;



o

Fee and other income decreased \$1.3 million and \$3.3 million for the three months and six months ended June 30, 2009, respectively, as compared to the same periods in 2008 due to a decrease in gross premiums. The Company also experienced a decrease in general expenses due to a reduction in work force and related expenses in response to its lower volume of business.

o

Underwriting experience, as indicated by its GAAP Combined Ratios, for the Fully Insured segment for the three months and six months ended June 30, 2009 and 2008 is as follows (in thousands):

|                                       | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---------------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                       | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                       | <b>2009</b>               | <b>2008</b> | <b>2009</b>             | <b>2008</b> |
| Premiums Earned                       | \$ 21,765                 | \$ 20,909   | \$ 42,253               | \$ 41,749   |
| Insurance Benefits, Claims & Reserves | 15,329                    | 12,835      | 28,577                  | 26,461      |
| Expenses                              | 6,267                     | 6,634       | 13,082                  | 11,588      |
| Loss Ratio                            | 70.4%                     | 61.4%       | 67.6%                   | 63.4%       |
| Expense Ratio                         | 28.8%                     | 31.7%       | 31.0%                   | 27.8%       |
| Combined Ratio                        | 99.2%                     | 93.1%       | 98.6%                   | 91.2%       |

o

The loss ratio increased due to unusually large claims in the small group medical line and an increase in the frequency of claims in the dental line.

o

The underwriting expense ratio increased primarily as a result of: (i) an increase in premium taxes and assessments due in part to a true-up of 2007 expenses recorded in the first quarter of 2008 thereby reducing the 2008 expense combined with higher state taxes and assessments recorded in the first quarter of 2009; (ii) an increase in profit commissions due to better loss ratios on certain lines of fully insured health business; and (iii) an increase in general expenses.

Income before taxes from the Group disability, life, annuities and DBL segment decreased \$1.2 million and \$.5 million for the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008, primarily from decreased profitability in DBL and group term life lines of business partially offset by an increase in the LTD business. The DBL business has experienced decreases in group sizes coupled with rate reductions as a result of the overall economic downturn while the group term life business has experienced higher loss ratios;

Income before taxes from the Individual life, annuities and other segment decreased \$1.1 million and \$2.3 million for the three months and six months ended June 30, 2009 compared to the same periods in 2008, primarily as a result of a decrease in investment income on fixed maturities due to lower yields and an increase in administrative expenses associated with the acquisition of a block of life and annuity policies in 2008;

Loss before taxes from the Corporate segment decreased \$1.1 million and \$2.1 million for the three months and six months ended June 30, 2009, primarily as a result of income from partnership investments recorded in 2009 versus losses from partnership investments recorded in the same periods of 2008;

Net realized investment gains were \$1.3 million and \$2.9 million for the three months and six months ended June 30, 2009, respectively, compared to \$2.3 million and \$2.5 million for the comparable periods in 2008. Other-than-temporary impairment losses for the six months ended June 30, 2009 were \$.3 million. No other-than-temporary impairment losses were recorded in the three months ended June 30, 2009. For the three months and six months ended June 30, 2008, other-than-temporary impairment losses were \$17.4 million and \$17.5 million, respectively, primarily due to the write down in value of preferred stocks of certain financial institutions due to the severity of the decrease in market value and length of time that these securities were in a loss position; and

Premiums by principal product for the three months and six months 2009 and 2008 are as follows (in thousands):

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2009</b>                            | <b>2008</b> | <b>2009</b>                          | <b>2008</b> |
| <b>Gross Direct and Assumed<br/>Earned Premiums:</b> |  |             |                                      |             |
| Medical Stop-Loss                                    | \$ 54,119                              | \$ 65,256   | \$ 108,447                           | \$ 133,385  |
| Fully Insured Health                                 | 48,978                                 | 51,653      | 95,431                               | 103,258     |
| Group disability, life, annuities and<br>DBL         | 25,846                                 | 19,445      | 51,483                               | 39,559      |
| Individual, life, annuities and other                | 7,690                                  | 8,722       | 15,557                               | 16,405      |
|  | \$ 136,633                             | \$ 145,076  | \$ 270,918                           | \$ 292,607  |

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2009</b>                            | <b>2008</b> | <b>2009</b>                          | <b>2008</b> |
| <b>Net Premiums Earned:</b>                  |  |             |                                      |             |
| Medical Stop-Loss                            | \$ 34,361                              | \$ 40,902   | \$ 69,289                            | \$ 82,621   |
| Fully Insured Health                         | 21,765                                 | 20,909      | 42,253                               | 41,749      |
| Group disability, life, annuities and<br>DBL | 14,091                                 | 11,605      | 27,815                               | 23,673      |
| Individual, life, annuities and other        | 6,864                                  | 8,268       | 14,157                               | 15,295      |
|  | \$ 77,081                              | \$ 81,684   | \$ 153,514                           | \$ 163,338  |

**CRITICAL ACCOUNTING POLICIES**

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Reserves, Deferred Acquisition Costs, Investments, Goodwill and Other Intangible Assets, and Deferred Income Taxes* as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, *Critical Accounting Policies* in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2008. During the six months ended June 30, 2009, there were no additions to or changes in the critical accounting policies disclosed in the 2008 Form 10-K except for the recently adopted accounting standards discussed in Note 1(C) of the Notes to Condensed Consolidated Financial Statements



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| <b>June 30, 2008</b>                      | <b>Premiums</b>      | <b>Net</b>               | <b>Income</b>      | <b>Fee and</b>       | <b>Claims</b>          | <b>of Deferred</b>        | <b>General</b>               |    |                     |
|---|----------------------|--------------------------|--------------------|----------------------|------------------------|---------------------------|------------------------------|----|---------------------|
| <b>(In thousands)</b>                     | <b><u>Earned</u></b> | <b><u>Investment</u></b> | <b><u>From</u></b> | <b><u>Other</u></b>  | <b><u>and</u></b>      | <b><u>Acquisition</u></b> | <b><u>And</u></b>            |    |                     |
|   |                      | <b><u>Income</u></b>     | <b><u>AMIC</u></b> | <b><u>Income</u></b> | <b><u>Reserves</u></b> | <b><u>Costs</u></b>       | <b><u>Administrative</u></b> |    | <b><u>Total</u></b> |
| Medical Stop-Loss                         | \$ 40,902            | 664                      | 277                | 449                  | 30,039                 | -                         | 11,139                       | \$ | 1,114               |
| Fully Insured Health                      | 20,909               | 215                      | 98                 | 10,264               | 12,835                 | 30                        | 17,550                       |    | 1,071               |
| Group disability, life, annuities and DBL | 11,605               | 2,541                    | 14                 | 75                   | 8,451                  | 38                        | 3,524                        |    | 2,222               |
| Individual life, annuities and other      | 8,268                | 7,916                    | -                  | 385                  | 10,290                 | 1,887                     | 2,832                        |    | 1,560               |
| Corporate                                 | -                    | (180)                    | -                  | 3                    | -                      | -                         | 870                          |    | (1,047)             |
| Sub total                                 | \$ 81,684            | \$ 11,156                | \$ 389             | \$ 11,176            | \$ 61,615              | \$ 1,955                  | \$ 35,915                    |    | 4,920               |

|   |  |  |  |  |  |  |  |    |          |
|---|--|--|--|--|--|--|--|----|----------|
| Net realized investment gains                       |  |  |  |  |  |  |  |    | 2,306    |
| Other-than-temporary impairment losses, net         |  |  |  |  |  |  |  |    | (17,393) |
| Interest expense                                    |  |  |  |  |  |  |  |    | (909)    |
| Loss from continuing operations before income taxes |  |  |  |  |  |  |  |    | (11,076) |
| Income tax benefits                                 |  |  |  |  |  |  |  |    | (4,409)  |
| Loss from continuing operations                     |  |  |  |  |  |  |  | \$ | (6,667)  |

**Premiums Earned**

Total premiums earned decreased \$4.6 million to \$77.1 million in the second quarter of 2009 from \$81.7 million in the comparable period of 2008. The decrease is primarily due to: (i) the Medical Stop-Loss segment which decreased \$6.5 million, primarily due to reduced production from stricter underwriting guidelines; and (ii) a decrease of \$1.5 million in premiums earned in the individual life, annuities and other segment primarily as a result of the ceding of a block of ordinary life and annuities business effective April 1, 2009; offset by (iii) the Fully Insured Health segment which had a \$.9 million increase in premiums in the second quarter of 2009 compared to the second quarter of 2008, comprised primarily of a \$1.3 million decrease in student accident premiums as a result of the cancellation of a producer of this product, offset by a \$1.0 million increase in dental premiums as a result of increased production, a \$1.0 million increase in small group premiums as a result of new production sources and increased retention, and a \$.2 million net increase in all other lines of this segment; and (iii) a \$2.5 million increase in the group disability, life, annuities and DBL segment primarily from the LTD line due to an increase in retention and new business written.

**Net Investment Income**

Total net investment income increased \$.2 million. The overall annualized investment yields were 5.3% and 4.9% (approximately 5.6% and 5.0%, on a tax advantaged basis) in the second quarter of 2009 and 2008, respectively. The annualized investment yields on bonds, equities and short-term investments were 4.9% and 5.1% in the second quarter of 2009 and 2008, respectively. A decrease in interest and dividend income, as a result of a reallocation of the investment portfolio toward more liquid assets during 2009, was more than offset by a decrease in losses from partnership investments. In addition, the Company experienced unprecedented pre-payments in GNMA's during the quarter resulting in significantly reduced yields on such investments.

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

Net realized investment gains decreased \$1.0 million to \$1.3 million in 2009 compared to \$2.3 million in 2008. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, as well as trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period. No other-than-temporary impairments were recorded in the three months ended June 30, 2009. For the three months ended June 30, 2008, the Company recorded pretax losses of \$17.4 million from other-than-temporary impairments.

**Fee Income and Other Income**



Fee income decreased \$1.7 million to \$8.5 million in the three months ended June 30, 2009 from \$10.2 million in the three months ended June 30, 2008 primarily as a result of a decrease in gross premiums from the small group line of business in the Fully Insured Health segment due in part to stricter underwriting guidelines and downward pressure on enrollment in medical plans due to the recession.

Total other income increased \$1.1 million in the three months ended June 30, 2009 to \$2.1 million from \$1.0 million in the three months ended June 30, 2008, primarily due to administrative fees associated with a coinsurance agreement and deferred gain amortization associated with a block of ordinary life and annuities business ceded in second quarter of 2009.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves decreased \$1.2 million. The decrease is primarily due to: (i) a decrease of \$5.1 million in the Medical Stop-Loss segment, largely resulting from a decrease in premiums earned; and (ii) a decrease of \$1.2 million in the individual life, annuities and other segment, primarily

resulting from a decrease in premiums earned in the ordinary life and annuity lines; partially offset by (iii) an increase of \$2.5 million in the Fully Insured Health segment, primarily as a result of the increase in claims and reserves of dental and small group businesses; and (iv) an increase of \$2.6 million in the Group disability, life, annuities and DBL segment as a result of increased LTD retention and new LTD business written.

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

Amortization of deferred acquisition costs decreased \$.7 million primarily due to lower investment income assumptions used in making this calculation in 2009 as a result of a decrease in yields on insurance investments.

#### **Interest Expense on Debt**

Interest expense decreased \$.1 million, primarily due to a \$2.5 million decrease in outstanding debt under a line of credit from \$12.5 million to \$10.0 million during the third quarter of 2008. In addition, the interest rates on \$10.3 million and \$12.4 million of floating rate junior subordinated debt both averaged 5.1% in the second quarter of 2009, as compared to 6.8% and 6.7%, respectively, during the second quarter of 2008.

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

Total selling, general and administrative expenses decreased \$.3 million in the second quarter of 2009 as compared to the second quarter of 2008. The decrease is primarily due to: (i) a \$1.2 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$1.2 million decrease in the Fully Insured Health segment primarily consisting of a decrease in general expenses resulting from a lower volume of business and a reduction in work force; offset by (iii) a \$1.3 million increase in compensation, commission and administrative expenses associated with the individual life, annuities and other segment, primarily as a result of the acquisition of a block of life and annuity business in the second quarter of 2008; and (iv) a net \$.8 million increase in all other segments primarily due to an increase in legal and separation expenses.

#### **Income Taxes**

Income tax expense increased \$4.9 million to \$.5 million for the second quarter ended June 30, 2009 from a tax benefit of \$4.4 million for the second quarter of 2008. The effective tax rate was 20.0% for the second quarter of 2009 compared to (39.6) % for the second quarter of 2008. The difference in the effective tax rates is primarily attributable to a higher level of tax benefits derived from tax exempt interest in 2009. The Company has significantly increased its position in state and political subdivision investments that generate tax exempt interest thus creating a greater benefit

in 2009 than in 2008 in proportion to the level of income before taxes recorded.



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| <b>June 30, 2008</b>                      | <b>Premiums</b> | <b>Net</b>        | <b>Income</b> | <b>Fee and</b> | <b>Claims</b>   | <b>of Deferred</b> | <b>General</b>        |    |              |
|---|-----------------|-------------------|---------------|----------------|-----------------|--------------------|-----------------------|----|--------------|
| <b>(In thousands)</b>                     | <b>Earned</b>   | <b>Investment</b> | <b>From</b>   | <b>Other</b>   | <b>and</b>      | <b>Acquisition</b> | <b>And</b>            |    |              |
|   |                 | <b>Income</b>     | <b>AMIC</b>   | <b>Income</b>  | <b>Reserves</b> | <b>Costs</b>       | <b>Administrative</b> |    | <b>Total</b> |
| Medical Stop-Loss                         | \$ 82,621       | 1,710             | 624           | 790            | 59,846          | -                  | 22,464                | \$ | 3,435        |
| Fully Insured Health                      | 41,749          | 430               | 121           | 21,206         | 26,461          | 78                 | 34,663                |    | 2,304        |
| Group disability, life, annuities and DBL | 23,673          | 5,314             | 45            | 173            | 17,117          | 73                 | 8,157                 |    | 3,858        |
| Individual life, annuities and other      | 15,295          | 15,533            | -             | 608            | 18,975          | 3,258              | 5,098                 |    | 4,105        |
| Corporate                                 | -               | (1,186)           | -             | 3              | -               | -                  | 2,370                 |    | (3,553)      |
| Sub total                                 | \$ 163,338      | \$ 21,801         | \$ 790        | \$ 22,780      | \$ 122,399      | \$ 3,409           | \$ 72,752             |    | 10,149       |

|   |  |  |  |  |  |  |  |    |          |
|---|--|--|--|--|--|--|--|----|----------|
| Net realized investment                             |  |  |  |  |  |  |  |    | 2,501    |
| Other-than-temporary impairment losses, net         |  |  |  |  |  |  |  |    | (17,474) |
| Interest expense                                    |  |  |  |  |  |  |  |    | (1,895)  |
| Loss from continuing operations before income taxes |  |  |  |  |  |  |  |    | (6,719)  |
| Income tax benefits                                 |  |  |  |  |  |  |  |    | (3,056)  |
| Loss from continuing operations                     |  |  |  |  |  |  |  | \$ | (3,663)  |

**Premiums Earned**

Total premiums earned decreased \$9.8 million to \$153.5 million in the second quarter of 2009 from \$163.3 million in the comparable period of 2008. The decrease is largely due to: (i) the Medical Stop-Loss segment which decreased \$13.3 million, primarily due to reduced production from stricter underwriting guidelines; and (ii) the individual life, annuities and other segment which decreased \$1.1 million, primarily due to the ceding of a block of ordinary life and annuities business effective April 1, 2009; offset by (iii) the Fully Insured Health segment which had a \$.5 million increase in premiums in the first six months of 2009 compared to the first six months of 2008, comprised primarily of a \$2.4 million decrease in student accident premiums as a result of the cancellation of a producer of this product, offset by a \$2.2 million increase in dental premiums as a result of increased production, a \$.8 million increase in small group premiums earned as a result of new production sources and increased retention, and a \$.1 million net decrease in all other lines of this segment; and (iv) a \$4.1 million increase in the group disability, life, annuities and DBL segment primarily from the LTD line due to an increase in retention and new business written.

**Net Investment Income**

Total net investment income increased \$.3 million. The overall annualized investment yields were 5.1% and 4.8% (approximately 5.4% and 4.9%, on a tax advantaged basis) in the first six months of 2009 and 2008, respectively. The annualized investment yields on bonds, equities and short-term investments were 5.0% and 5.2% in the first six months of 2009 and 2008, respectively. A decrease in interest and dividend income, as a result of a reallocation of the investment portfolio towards more liquid assets during 2009, was more than offset by a decrease in losses from partnership investments. In addition, the Company experienced unprecedented pre-payments in GNMA's during the quarter resulting in significantly reduced yields on such investments.

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

Net realized investment gains increased \$.4 million to \$2.9 million in 2009 compared to \$2.5 million in 2008. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, as well as trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period. For the six months ended June 30, 2009 and 2008, the Company recorded pretax losses of \$.3 million and \$17.5 million, respectively, from other-than-temporary impairments.

**Fee Income and Other Income**

Fee income decreased \$3.9 million to \$17.5 million in the six months ended June 30, 2009 from \$21.4 million in the six months ended June 30, 2008 primarily as a result of a decrease in gross premiums from the small group line of

business in the Fully Insured Health segment due in part to stricter underwriting guidelines and downward pressure on enrollment due to the recession.

Total other income increased \$1.8 million in the three months ended June 30, 2009 to \$3.2 million from \$1.4 million in the six months ended June 30, 2008, primarily due to administrative fees associated with a coinsurance agreement and deferred gain amortization associated with a block of ordinary life and annuities business ceded in second quarter of 2009.

**Insurance Benefits, Claims and Reserves**

Benefits, claims and reserves decreased \$5.8 million. The decrease is primarily due to: (i) a decrease of \$10.4 million in the Medical Stop-Loss segment, primarily resulting from a decrease in premiums earned; offset by (ii) an increase of \$2.1 million in the Fully Insured Health segment, primarily as a result of the increase in claims and reserves in dental and small group businesses; (iii) an increase of \$2.8

million in the group disability, life, annuities and DBL segment primarily as a result of increased LTD retention and new LTD business written; and (iv) a \$.3 million decrease in the individual life, annuities and other segment.

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

Amortization of deferred acquisition costs decreased \$1.0 million primarily due to lower investment income assumptions used in making this calculation in 2009 as a result of a decrease in yields on insurance investments.

#### **Interest Expense on Debt**

Interest expense decreased \$.4 million, primarily due to a \$2.5 million decrease in outstanding debt under a line of credit from \$12.5 million to \$10.0 million during the third quarter of 2008. In addition, the interest rates on \$10.3 million and \$12.4 million of floating rate junior subordinated debt averaged 5.3% and 5.2%, respectively, in the first six months of 2009, as compared to 7.1% and 7.5%, respectively, during the first six months of 2008.

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

Total selling, general and administrative expenses decreased \$.1 million in the first six months of 2009 as compared to the first six months of 2008. The decrease is primarily due to: (i) a \$2.3 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to a decrease in volume as a result of reduced production; (ii) a \$1.8 million decrease in the Fully Insured Health segment primarily consisting of a decrease in general expenses resulting from a lower volume of business and a reduction in work force; offset by (iii) a \$2.9 million increase in compensation, commission and administrative expenses associated with the individual life, annuities and other segment, primarily as a result of the acquisition of a block of life and annuity business in the second quarter of 2008; and (iv) a net \$1.1 million increase in all other segments primarily due to an increase in legal and separation expenses.

#### **Income Taxes**

Income tax expense increased \$4.6 million to \$1.5 million for the six months ended June 30, 2009 from a tax benefit of \$3.1 million for the first six months of 2008. The effective tax rate was 22.1% for the first six months of 2009 compared to (45.8) % for the first six months of 2008. The difference in the effective tax rates is primarily attributable to a higher level of tax benefits derived from tax exempt interest in 2009. The Company has significantly increased its position in state and political subdivision investments that generate tax exempt interest thus creating a greater benefit in 2009 than in 2008 in proportion to the level of income before taxes recorded.





## **LIQUIDITY**

### **Insurance Group**

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

### **Corporate**

Corporate derives its funds principally from: (i) dividends from the Insurance Group; (ii) management fees from its subsidiaries; and (iii) investment income from Corporate liquidity. Regulatory constraints historically have not affected the Company's consolidated liquidity, although state insurance laws have provisions relating to the ability of the parent company to use cash generated by the Insurance Group.

### **Cash Flows**

As of June 30, 2009, the Company had \$6.9 million of cash and cash equivalents compared with \$7.8 million as of December 31, 2008.

Net cash used by operating activities of continuing operations for the six months ended June 30, 2009 was \$30.3 million largely as a result of a \$47.1 million increase in net amounts due from reinsurers. Net cash used by operating activities of discontinued operations for the six months ended June 30, 2009 was \$1.6 million.

Net cash provided by investing activities of continuing operations for the six months ended June 30, 2009 was \$31.0 million primarily as a result of \$50.7 million in net proceeds on sales of equity securities and securities under resale and repurchase agreements and a \$4.8 million decrease in net amounts due from brokers, partially offset by \$24.0 million in net purchases of fixed maturities.

The Company has \$472.9 million of insurance reserves that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the six months ended June 30, 2009, cash received from the maturities

and other repayments of fixed maturities was \$77.6 million.

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

### **BALANCE SHEET**

Total investments, net of amounts due from brokers, increased \$21.4 million to \$785.1 million during the six months ended June 30, 2009 from \$763.7 million at December 31, 2008 largely due to a \$50.1 million decrease in unrealized losses on available-for-sale securities offset by net sales of investment securities of \$31.5 million.

The Company had net receivables from reinsurers of \$147.8 million at June 30, 2009. Substantially all of the business ceded to such reinsurers is of short duration. All of such receivables are either due from the Company's affiliate, Independence American, highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at June 30, 2009.

Other assets decreased \$24.4 million primarily due to a \$19.1 million decrease in net deferred tax assets. Of this amount, \$15.7 million represents the deferred taxes on the net unrealized gains on investment securities allocated to stockholders' equity arising during the six months ended June 30, 2009.

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

|                          | <b>Total Health Reserves</b> |                              |
|--------------------------|------------------------------|------------------------------|
|                          | <b>June 30,<br/>2009</b>     | <b>December 31,<br/>2008</b> |
| Medical Stop-Loss        | \$ 80,151                    | \$ 89,684                    |
| Fully Insured Health     | 38,740                       | 38,168                       |
| Group Disability         | 78,871                       | 71,643                       |
| Individual A&H and Other | 12,284                       | 11,823                       |
|                          | <b>\$ 210,046</b>            | <b>\$ 211,318</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 by the MGUs that produce and administer this business to the Company's underwriting guidelines. Changes in these underlying factors are what determine the reasonably likely changes in the Projected Net Loss Ratio.

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

The \$33.2 million increase in IHC's stockholders' equity in the first six months of 2009 is primarily due to \$5.0 million in net income and a \$28.3 million decrease in net unrealized losses on investments.

### **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. Of the aggregate carrying value of the Company's cash and investment assets, approximately 90.1% was invested in investment grade fixed maturities, resale agreements, policy loans and cash and cash equivalents at June 30, 2009. Although the Company's gross unrealized losses on available-for-sale securities totaled \$55.0 million at June 30, 2009, also at such date, approximately 97.3% of the Company's fixed maturities were investment grade and continue to be rated on average AA. The Company marks all of its available-for-sale securities to fair value through accumulated other comprehensive income or loss. These investments tend to carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At June 30, 2009, approximately 2.7% (or \$18.3 million) of the carrying value of fixed maturities was invested in diversified non-investment grade fixed maturities (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company has only one non-performing fixed maturity at June 30, 2009 with a cost of \$.7 million, or .1% of total fixed maturities.

The Company reviews its investments regularly and monitors its investments continually for impairments. For the six months ended June 30, 2009 and 2008, the Company recorded losses of \$.3 million and \$17.5 million, respectively, for other-than-temporary impairments. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at June 30, 2009 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

|                   |                               |           | <b>Greater than<br/>3 months,<br/>less than<br/>6 months</b> |           | <b>Greater than<br/>6 months,<br/>less than<br/>12 months</b> |           | <b>Greater than<br/>12 months</b> |           | <b>Total</b>  |
|-------------------|-------------------------------|-----------|--|-----------|---|-----------|-----------------------------------|-----------|---------------|
|                   | <b>Less than<br/>3 months</b> |           |  |           |   |           |                                   |           |               |
| Fixed maturities  | \$ 4,420                      | \$        | 1,015  | \$        | 7,700   | \$        | 2,042                             | \$        | 15,177        |
| Equity securities | 746                           |           | 1,197  |           | 5,436   |           |                                   |           | 7,379         |
| <b>Total</b>      | <b>\$ 5,166</b>               | <b>\$</b> | <b>2,212</b>   | <b>\$</b> | <b>13,136</b>   | <b>\$</b> | <b>2,042</b>                      | <b>\$</b> | <b>22,556</b> |

The unrealized losses on all remaining available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at June 30, 2009. In 2009, the Company experienced a decrease in net unrealized losses of \$51.0 million which, net of deferred taxes of \$15.7 million, net of deferred policy acquisition costs of \$7.0 million, and net of the net cumulative effect adjustment of \$1.5 million for the adoption of recent investment accounting pronouncements, increased stockholders' equity by \$26.7 million (reflecting net unrealized losses of \$27.6 million at June 30, 2009 compared to net unrealized losses of \$54.3 million at December 31, 2008). 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 June 30, 2009, is not materially different from that reported in the schedule of such obligations at December 31, 2008 which was included in Item 7 of the Company's Annual Report on Form 10-K.

## OUTLOOK

For the balance of 2009, IHC's business plan is to: (i) improve the profitability of our Fully Insured Health business, while selectively pursuing new opportunities that leverage our vertically integrated strategy of generating fee income at multiple levels of marketing and administration, as well as risk profit and profit commission income, (ii) expand the distribution and continue to improve the profitability of our Medical Stop-Loss business, (iii) proactively adjust our mix of business to take advantage of market conditions, and (iv) continue to expand the distribution of our life and disability products. Like many other insurance companies, our gross premiums have been adversely impacted by the current economic downturn.

The following summarizes what IHC has accomplished and the outlook for 2009 and beyond by segment.

### Historic Core Lines of Business

IHC has historically been a life and health insurance holding company for two insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"), which relied on independent general agents, managing general underwriters ("MGUs") and administrators to perform the majority of all marketing, underwriting, claims and administrative functions for our two primary product segments (Medical Stop-Loss and group disability, life, annuities and DBL). While it is always our intent to emphasize underwriting profits and not top line growth, the medical stop-loss industry as a whole succumbed to pricing pressures caused by an unexpectedly long down cycle (or "soft" market) from 2004 through 2008. As a consequence of these market conditions, we made a decision to curtail our growth and our 2008 loss ratios improved. Due to stricter underwriting guidelines and the termination of several MGUs in 2008, we have experienced a decline in stop-loss premiums in the second quarter of 2009, which we anticipate will continue throughout this year. The Company has experienced an increase in its gross group life and disability premiums in 2009 as a result of taking over an estimated \$18 million block from an insurer that exited the market, of which we are retaining approximately 20%.

With respect to distribution, Standard Security Life is approved to write Medical Stop-Loss in all 50 states and Madison National Life in most states. Standard Security Life is currently contracted to write this product through eight MGUs, and Madison National Life through one. The Company has a significant ownership interest in five of these MGUs (including those owned by AMIC), which produced \$99.8 million (approximately 54 %) of Medical Stop-Loss premiums written on IHC paper in 2008.

### Fully Insured Health Segment



The Fully Insured Health market (estimated at \$500 billion) in the U.S. is a much larger market than the Medical Stop-Loss market (estimated at \$4 billion). The Company experienced a decrease in gross premiums during the second quarter of 2009, primarily in its small group line of business. This decrease is due to a general decrease in premiums resulting from stricter underwriting guidelines and the downward pressure on enrollment caused by the recession. Net premiums remained constant due to an increase in retention. The Company limited the amount of its growth in this segment in 2008 and expects to continue to do so in 2009. In the event we determine to accelerate our growth, we are optimistic that (as a result of its multiple product filings, distribution sources, and the sheer size of the market) our Fully Insured Health business could grow while maintaining profitable underwriting results.

## Investments

Our fixed maturity portfolio continues to be rated on average AA. Approximately 4% of our total investment portfolio is Alt-A mortgages. While these mortgages have seen lower market values in 2008 they have rebounded slightly in 2009 and we believe that the unrealized losses on these securities are not necessarily indicative of their ultimate performance. The Company also has approximately 3% of its total investment portfolio in preferred stocks of financial institutions which also realized significant losses in 2008. The market for these securities showed significant improvement in 2009 and the Company reduced its exposure from 4% at December 31, 2008, through either tender offers or sales of such securities at amounts greater than their adjusted cost basis. Our book value per share increased to \$12.70 at June 30, 2009 from \$10.56 at December 31, 2008 due to net income and positive changes in the fair value of our investment portfolio. To the extent that the capital markets remain unsettled, we may continue to see volatility in the market price of our equity and fixed maturity securities, which could have a negative impact on our net income and book value per share.

## Summary

In summary, the Company has begun to see improved performance in 2009 from continuing operations primarily as a result of (i) continuing profitability of the group disability, life, annuities and DBL (ii) better performance from investment partnerships (iii) improved performance on our investment portfolio; and (iv) decreases in overhead due to subsidiary consolidation and cost cutting measures.

## ITEM 3.

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

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

The Company monitors its investment portfolio on a continuous basis and believes that the liquidity of the Insurance Group will not be adversely affected by its current investments. This monitoring includes the maintenance of an asset-liability model that matches current insurance liability cash flows with current investment cash flows. This is accomplished by first creating an insurance model of the Company's in-force policies using current assumptions on mortality, lapses and expenses. Then, current investments are assigned to specific insurance blocks in the model using appropriate prepayment schedules and future reinvestment patterns. The results of the model specify whether the investments and their related cash flows can support the related current insurance cash flows. Additionally, various scenarios are developed changing interest rates and other related assumptions. These scenarios help evaluate the

market risk due to changing interest rates in relation to the business of the Insurance Group.

The expected change in fair value as a percentage of the Company's fixed income portfolio at June 30, 2009 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2008 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 fiscal quarter ended June 30, 2009 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, 2008 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. As of June 30, 2009, 108,642 shares were still authorized to be repurchased under the plan. There were no share repurchases during the second quarter of 2009.

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**ITEM 4.**

**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At its Annual Meeting of Stockholders held on June 19, 2009, the following seven nominees were re-elected for one-year terms on the Board of Directors:

Larry R. Graber, Allan C. Kirkman, John L. Lahey, Steven B. Lapin, Edward Netter, James G. Tatum, Roy T.K. Thung.

The vote on the election of the above nominees was:

For

At least 12,913,337 shares

Withheld

No more than 1,631,861 shares

In addition, at such meeting, the appointment of KPMG LLP as independent auditors for 2009 was ratified by a vote of 14,460,455 shares for, 83,536 shares against, and 1,207 shares abstaining. There were no broker non-votes.

**ITEM 5.**

**OTHER INFORMATION**

Not applicable

**ITEM 6.**

**EXHIBITS**

31.1

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

31.2

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

32.1

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

32.2

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

**SIGNATURES**

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

**INDEPENDENCE HOLDING COMPANY**

(REGISTRANT)

By:

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

Date:

August 10, 2009

Roy T.K. Thung

Chief Executive Officer and President

By:

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

Date:

August 10, 2009

Teresa A. Herbert



Senior Vice President and

Chief Financial Officer