INDEPENDENCE HOLDING CO
Form 10-Q
November 08, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

[X]

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

For the quarterly period ended **September 30, 2012.**

[ ]

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

For the transition period from: ________ to _________

Commission File Number: **0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **58-1407235** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT** **06902**

(Address of principal executive offices) (Zip Code)

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

**NOT APPLICABLE**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] 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 [X] 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 [X ] | 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 [X]

| **Class** | **Outstanding at November 6, 2012** |
|---|---|
| **Common stock, $ 1.00 par value** | **17,947,330 Shares** |

**INDEPENDENCE HOLDING COMPANY**

**INDEX**

Copies of the Company s SEC filings can be found on its website at www.ihcgroup.com.

**Forward-Looking Statements**

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

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

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

**PART I - FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

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

| | September 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|---|
| **ASSETS:** | | |
| Investments: | | |
| Short-term investments | $ 50 | $ 50 |
| Securities purchased under agreements to resell | 14,982 | 17,258 |
| Trading securities | 5,858 | - |
| Fixed maturities, available-for-sale | 736,584 | 842,873 |
| Equity securities, available-for-sale | 28,093 | 37,541 |
| Other investments | 34,606 | 35,223 |
| Total investments | 820,173 | 932,945 |
| | | |
| Cash and cash equivalents | 14,564 | 18,227 |
| Due from securities brokers | 6,636 | 12,106 |
| Deferred acquisition costs | 34,029 | 37,101 |
| Due and unpaid premiums | 45,507 | 37,341 |
| Due from reinsurers | 167,685 | 159,729 |
| Premium and claim funds | 39,626 | 43,604 |
| Notes and other receivables | 17,916 | 15,500 |
| Goodwill | 50,318 | 50,318 |
| Other assets | 43,054 | 51,988 |
| | | |
| **TOTAL ASSETS** | $ 1,239,508 | $ 1,358,859 |
| | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY:** | | |
| **LIABILITIES:** | | |
| Insurance reserves-health | $ 178,531 | $ 179,042 |
| Insurance reserves-life and annuity | 278,195 | 279,636 |
| Funds on deposit | 279,947 | 417,310 |
| Unearned premiums | 7,326 | 4,319 |
| Policy claims-health | 13,369 | 13,945 |
| Policy claims-life | 10,409 | 11,948 |
| Other policyholders' funds | 22,686 | 21,546 |
| Due to securities brokers | 230 | 383 |
| Due to reinsurers | 42,836 | 40,030 |
| Accounts payable, accruals and other liabilities | 64,208 | 66,410 |
| Debt | 8,000 | 10,000 |
| Junior subordinated debt securities | 38,146 | 38,146 |

| | | | | |
|---|---|---|---|---|
| **TOTAL LIABILITIES** | | 943,883 | | 1,082,715 |
| **STOCKHOLDERS EQUITY:** | | | | |
| **IHC STOCKHOLDERS' EQUITY:** | | | | |
| Preferred stock (none issued) | | - | | - |
| Common stock $1.00 par value, 23,000,000 and 20,000,000 shares authorized; 18,461,992 and 18,450,917 shares issued; 17,947,330 and 18,052,660 shares outstanding | | 18,462 | | 18,451 |
| Paid-in capital | | 126,547 | | 126,298 |
| Accumulated other comprehensive income | | 16,633 | | 7,853 |
| Treasury stock, at cost; 514,662 and 398,257 shares | | (4,397) | | (3,277) |
| Retained earnings | | 122,494 | | 111,752 |
| **TOTAL IHC STOCKHOLDERS EQUITY** | | 279,739 | | 261,077 |
| **NONCONTROLLING INTERESTS IN SUBSIDIARIES** | | 15,886 | | 15,067 |
| **TOTAL EQUITY** | | 295,625 | | 276,144 |
| **TOTAL LIABILITIES AND EQUITY** | $ | 1,239,508 | $ | 1,358,859 |

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

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

| | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| **REVENUES:** | | | | |
| Premiums earned: | | | | |
| Health | $ 83,219 | $ 76,326 | $ 233,970 | $ 226,787 |
| Life and annuity | 9,017 | 8,904 | 27,509 | 28,317 |
| Net investment income | 9,346 | 9,235 | 25,706 | 28,984 |
| Fee income | 7,754 | 7,118 | 21,064 | 22,823 |
| Other income | 1,155 | 1,259 | 3,558 | 4,562 |
| Net realized investment gains | 1,011 | 924 | 3,998 | 2,605 |
| Other-than-temporary impairment losses: | | | | |
| Total other-than-temporary impairment losses | - | (385) | (992) | (853) |
| Portion of losses recognized in other comprehensive income | - | 278 | 288 | 278 |
| Net impairment losses recognized in earnings | - | (107) | (704) | (575) |
| | 111,502 | 103,659 | 315,101 | 313,503 |
| **EXPENSES:** | | | | |
| Insurance benefits, claims and reserves: | | | | |
| Health | 53,417 | 45,560 | 149,996 | 146,639 |
| Life and annuity | 9,617 | 11,094 | 30,438 | 36,421 |
| Selling, general and administrative expenses | 39,791 | 38,958 | 109,594 | 111,275 |
| Amortization of deferred acquisitions costs | 1,587 | 1,844 | 4,812 | 5,293 |
| Interest expense on debt | 509 | 516 | 1,588 | 1,433 |
| | 104,921 | 97,972 | 296,428 | 301,061 |
| Income from operations before income taxes | 6,581 | 5,687 | 18,673 | 12,442 |
| Income taxes | 2,191 | 1,676 | 6,123 | 1,167 |
| **Net income** | 4,390 | 4,011 | 12,550 | 11,275 |
| Less: income from noncontrolling interests in subsidiaries | (472) | (457) | (1,179) | (1,497) |
| **NET INCOME ATTRIBUTABLE TO IHC** | $ 3,918 | $ 3,554 | $ 11,371 | $ 9,778 |
| **Basic income per common share** | $ .22 | $ .20 | $ .63 | $ .56 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 17,957 | 17,790 | 17,991 | 17,414 |
| **Diluted income per common share** | $ .22 | $ .20 | $ .63 | $ .56 |

| | | | | |
|---|---|---|---|---|
| WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING | 18,028 | 17,795 | 18,076 | 17,422 |

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

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

| | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Net income | $ 4,390 | $ 4,011 | $ 12,550 | $ 11,275 |
| Other comprehensive income (loss): | | | | |
| Unrealized gains on available-for-sale securities, net of taxes of $1,985, $1,987, $4,351 and $4,313 | 5,480 | 5,457 | 12,058 | 11,795 |
| Other-than-temporary impairment losses recorded in other comprehensive income, net of taxes of $0, $(111), $(41) and $(111) | - | (167) | (247) | (167) |
| Unrealized gains (losses) on derivative instruments, net of taxes of $50, $235, $47 and $235 | 76 | (354) | 71 | (354) |
| Allocation to deferred acquisition costs | (1,238) | (1,341) | (2,875) | (2,677) |
| Other comprehensive income, net of tax | 4,318 | 3,595 | 9,007 | 8,597 |
| **Comprehensive income, net of tax** | 8,708 | 7,606 | 21,557 | 19,872 |
| Comprehensive income, net of tax, attributable to noncontrolling interests: | | | | |
| Income from noncontrolling interests in subsidiaries | (472) | (457) | (1,179) | (1,497) |
| Other comprehensive income, net of tax, attributable to noncontrolling interests: | | | | |
| Unrealized gains on available-for-sale securities, net of tax | (137) | (134) | (266) | (390) |
| Other-than-temporary impairment losses recorded in other comprehensive income (loss), net of tax | - | - | 36 | - |
| Other comprehensive income, net of tax, attributable to noncontrolling interests | (137) | (134) | (230) | (390) |
| **Comprehensive income, net of tax, attributable to noncontrolling interests** | (609) | (591) | (1,409) | (1,887) |
| **Comprehensive income, net of tax, attributable to IHC** | $ 8,099 | $ 7,015 | $ 20,148 | $ 17,985 |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Unaudited)**
**NINE MONTHS ENDED SEPTEMBER 30, 2012 (In thousands)**

| | COMMON STOCK | PAID-IN CAPITAL | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | TREASURY STOCK, AT COST | RETAINED EARNINGS | TOTAL IHC STOCKHOLDERS' EQUITY | NON CONTRO INTERES SUBSIDI |
|---|---|---|---|---|---|---|---|
| **BALANCE AT DECEMBER 31, 2011** | $ 18,451 | $ 126,298 | $ 7,853 | $ (3,277) | $ 111,752 | $ 261,077 | $ |
| Net income | | | | | 11,371 | 11,371 | |
| Other comprehensive income, net of tax | | | 8,777 | | | 8,777 | |
| Repurchases of common stock | | | | (1,120) | | (1,120) | |
| Acquire noncontrolling interests in American Independence Corp. | | 29 | 3 | | | 32 | |
| Common stock dividend ($.035 per share) | | | | | (640) | (640) | |
| Share-based compensation expenses and related tax benefits | 11 | 198 | | | | 209 | |
| Distributions to noncontrolling | | | | | | | |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| interests | | | | | | | | | | | | - | |
| Other capital transactions | | | 22 | | | | | | | 11 | | 33 | |
| **BALANCE AT SEPTEMBER 30, 2012** | $ | 18,462 | $ | 126,547 | $ | 16,633 | $ | (4,397) | $ | 122,494 | $ | 279,739 | $ |

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

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

| | Nine Months Ended September 30, 2012 | 2011 |
|---|---|---|
| **CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:** | | |
| Net income | $ 12,550 | $ 11,275 |
| Adjustments to reconcile net income to net change in cash from operating activities: | | |
| Amortization of deferred acquisition costs | 4,812 | 5,293 |
| Net realized investment gains | (3,998) | (2,605) |
| Other-than-temporary impairment losses | 704 | 575 |
| Equity income from equity method investments | (1,362) | (1,512) |
| Depreciation and amortization | 3,052 | 3,183 |
| Share-based compensation expenses | 794 | 395 |
| Deferred tax (benefit) expense | 4,265 | 774 |
| Other | 5,159 | 3,162 |
| Changes in assets and liabilities: | | |
| Net sales (purchases) of trading securities | 63 | - |
| Change in insurance liabilities | (139,719) | (2,265) |
| Additions to deferred acquisition costs, net | (4,615) | (5,814) |
| Change in net amounts due from and to reinsurers | (5,150) | 2,162 |
| Change in premium and claim funds | 3,978 | (361) |
| Change in current income tax liability | 1,661 | 3,514 |
| Change in due and unpaid premiums | (8,165) | 2,948 |
| Change in other assets | (882) | (3,123) |
| Change in other liabilities | (3,591) | (7,040) |
| Net change in cash from operating activities | (130,444) | 10,561 |
| **CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:** | | |
| Change in net amount due from and to securities brokers | 5,318 | (28,346) |
| Net (purchases) sales of securities under resale and repurchase agreements | 2,276 | 23,729 |
| Sales of equity securities | 7,567 | 52,826 |
| Purchases of equity securities | (2,963) | (50,135) |
| Sales of fixed maturities | 396,579 | 284,390 |
| Maturities and other repayments of fixed maturities | 53,039 | 138,875 |
| Purchases of fixed maturities | (328,968) | (435,757) |
| Distributions from (additional investments in) other investments | 1,535 | 1,129 |
| Cash paid in acquisitions of companies, net of cash acquired | (243) | - |

| | | | | |
|---|---|---|---|---|
| Change in notes and other receivables | | (2,383) | | 1,629 |
| Other investing activities | | (3,138) | | (1,390) |
| Net change in cash from investing activities | | 128,619 | | (13,050) |
| **CASH FLOWS PROVIDED BY (USED BY) FINANCING ACTIVITIES:** | | | | |
| Repurchases of common stock | | (1,108) | | (598) |
| Excess tax expense from expired stock options and vesting of restricted stock | | (56) | | (164) |
| Cash paid in acquisitions of noncontrolling interests | | (58) | | (1,450) |
| Proceeds of investment-type insurance contracts | | 2,433 | | 5,700 |
| Proceeds of debt | | - | | 2,500 |
| Repayment of debt | | (2,000) | | - |
| Dividends paid | | (1,051) | | (777) |
| Other capital transactions | | 2 | | 57 |
| Net change in cash from financing activities | | (1,838) | | 5,268 |
| Net change in cash and cash equivalents | | (3,663) | | 2,779 |
| Cash and cash equivalents, beginning of year | | 18,227 | | 11,426 |
| Cash and cash equivalents, end of period | $ | 14,564 | $ | 14,205 |

**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 insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc. ( Health Solutions ), and Actuarial Management Corporation ("AMC"). These companies are sometimes collectively referred to as the Insurance Group , and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life. At September 30, 2012, the Company also owned a 78.6% interest in American Independence Corp. ( AMIC ).

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 51.0% of IHC's outstanding common stock at September 30, 2012.

**(B)**

**Basis of Presentation**

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

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

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and nine months ended September 30, 2012 are not necessarily indicative of the results to be anticipated for the entire year.

**(C)**

**Recent Accounting Pronouncements**

***Recently Adopted Accounting Standards***

In September 2011, the FASB issued guidance related to evaluating goodwill for impairment. The new guidance provides entities with the option to perform a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before applying the quantitative two-step goodwill impairment test. If an entity concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the quantitative two-step goodwill impairment test. Entities also have the option to bypass the assessment of qualitative factors for any reporting unit in any period and proceed directly to performing the first step of the quantitative two-step goodwill impairment test, as was required prior to the issuance of this new guidance. An entity may begin or resume performing the qualitative assessment in any subsequent period. This guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company s consolidated financial statements.

In June and December 2011, the FASB issued guidance that requires all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. For public entities, the amendments were effective for fiscal years and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. This standard only affected the Company s presentation of comprehensive income and did not affect the Company s consolidated financial statements.

In May 2011, the FASB issued guidance to achieve common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. Some of the amendments in this update clarify the FASB s intent about the application of certain existing fair value measurement requirements and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. None of the amendments in this update require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. For public entities, this guidance was effective during interim and annual periods beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company s consolidated financial statements.

In April 2011, the FASB issued guidance that amends existing standards with regards to transfers of financial assets under repurchase and other agreements that entitle and obligate the transferor to repurchase or redeem the assets prior to maturity. Specifically, with respect to assessing effective control in such agreements, the criteria that the transferor must have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even upon the transferee's default, has been eliminated; as has the corresponding criterion calling for the transferor to have obtained cash or other sufficient collateral to purchase replacement assets from a third party, which was required to demonstrate such ability. This guidance was effective for the first interim or annual period beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company s consolidated financial statements.

In October 2010, the FASB issued guidance that specifies the accounting treatment for the costs incurred by insurance entities when acquiring new and renewal insurance contracts. The guidance was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance, which was applied prospectively January 1, 2012, had a negligible impact on the Company s consolidated financial statements.

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

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

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

In July 2011, the FASB issued guidance specifying that the liability for the fees paid to the Federal Government by health insurers as a result of recent healthcare reform legislation should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. The amendments in this Update are effective for calendar years beginning after December 31, 2013, when the fee initially becomes effective. Management has not yet determined the impact that the adoption of this guidance will have on the Company s consolidated financial statements.

**Note 2.**

**American Independence Corp.**

In 2012 IHC acquired an aggregate 12,624 shares of AMIC common stock from noncontrolling interests for an aggregate of $58,000 cash consideration. As a result of these transactions, the Company: (i) recorded a $29,000 credit to paid-in capital representing the difference between the fair value of the consideration paid and the carrying value of the noncontrolling interest; and (ii) increased its ownership interest in AMIC to 78.6%.

**Note 3.**

**Income Per Common Share**

Diluted income per share, computed using the treasury stock method, include incremental shares from; (1) the assumed exercise of dilutive stock options; (ii) the assumed vesting of dilutive restricted stock; and (iii) assumed share settlement of dilutive stock appreciation rights ( SARs ) of 71,000 and 85,000 shares, respectively, for the three months and nine months ended September 30, 2012, and 6,000 and 9,000 shares, respectively, for the three months and nine months ended September 30, 2011.

**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 (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
| **FIXED MATURITIES AVAILABLE-FOR-SALE:** | | | | |
| Corporate securities | $ 340,519 | $ 11,747 | $ (725) | $ 351,541 |
| CMOs - residential (1) | 20,220 | 6,845 | (143) | 26,922 |
| CMOs - commercial | 975 | - | (415) | 560 |
| U.S. Government obligations | 16,728 | 553 | (2) | 17,279 |
| Agency MBS - residential (2) | 414 | 36 | - | 450 |
| GSEs (3) | 49,162 | 1,038 | (30) | 50,170 |
| States and political subdivisions | 280,082 | 10,201 | (621) | 289,662 |
| Total fixed maturities | $ 708,100 | $ 30,420 | $ (1,936) | $ 736,584 |
| **EQUITY SECURITIES AVAILABLE-FOR-SALE:** | | | | |
| Common stocks | $ 3,963 | $ 388 | $ (55) | $ 4,296 |
| Preferred stock - perpetual | 15,361 | 442 | (3) | 15,800 |
| Preferred stock - with maturities | 6,323 | 1,674 | - | 7,997 |
| Total equity securities | $ 25,647 | $ 2,504 | $ (58) | $ 28,093 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
| **FIXED MATURITIES AVAILABLE-FOR-SALE:** | | | | |
| Corporate securities | $ 319,343 | $ 5,873 | $ (2,076) | $ 323,140 |
| CMOs - residential (1) | 33,119 | 5,200 | (1,544) | 36,775 |
| CMOs - commercial | 1,448 | - | (910) | 538 |
| U.S. Government obligations | 164,807 | 1,775 | - | 166,582 |
| Agency MBS - residential (2) | 539 | 46 | - | 585 |
| GSEs (3) | 59,633 | 379 | (161) | 59,851 |

| | | | | |
|---|---|---|---|---|
| States and political subdivisions | 250,361 | 5,692 | (651) | 255,402 |
| Total fixed maturities | $ 829,250 | $ 18,965 | $ (5,342) | $ 842,873 |

| | | | | |
|---|---|---|---|---|
| **EQUITY SECURITIES AVAILABLE-FOR-SALE:** | | | | |
| Common stocks | $ 6,537 | $ 311 | $ (149) | $ 6,699 |
| Preferred stock - perpetual | 21,767 | 422 | (451) | 21,738 |
| Preferred stock - with maturities | 8,051 | 1,136 | (83) | 9,104 |
| Total equity securities | $ 36,355 | $ 1,869 | $ (683) | $ 37,541 |

(1)

Collateralized mortgage obligations ( CMOs ).

(2)

Mortgage-backed securities ( MBS ).

(3)

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

The unrealized gains (losses) on certain available-for-sale securities (residential CMO s and certain preferred stocks with maturities) at September 30, 2012 and December 31, 2011 include $1,560,000 and $2,625,000, respectively, of the accumulated non-credit related component of other-than-temporary impairment losses, pretax, that were recognized in other comprehensive income.

The amortized cost and fair value of fixed maturities available-for-sale at September 30, 2012, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

| | September 30, 2012 | | | | |
|---|---|---|---|---|---|
| | | **AMORTIZED COST** | | **FAIR VALUE** | **% OF TOTAL FAIR VALUE** |
| Due in one year or less | $ | 5,164 | $ | 5,254 | 0.7% |
| Due after one year through five years | | 123,053 | | 126,407 | 17.2% |
| Due after five years through ten years | | 214,055 | | 220,422 | 29.9% |
| Due after ten years | | 295,056 | | 306,397 | 41.6% |
| | | 637,328 | | 658,480 | 89.4% |
| **CMO and MBS:** | | | | | |
| 15 year | | 32,053 | | 38,539 | 5.2% |
| 20 year | | 483 | | 497 | 0.1% |
| 30 year | | 38,236 | | 39,068 | 5.3% |
| **Total fixed maturities** | $ | 708,100 | $ | 736,584 | 100.0% |

The following tables summarize, for all available-for-sale securities in an unrealized loss position at September 30, 2012 and December 31, 2011, respectively, the aggregate fair value and gross unrealized loss by length of time those securities that have continuously been in an unrealized loss position:

| | September 30, 2012 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Less than 12 Months** | | | | **12 Months or Longer** | | | | **Total** | | |
| | | **Fair Value** | | **Unrealized Losses** | | **Fair Value** | | **Unrealized Losses** | | **Fair Value** | | **Unrealized Losses** |
| Corporate securities | $ | 26,265 | $ | 367 | $ | 14,223 | $ | 358 | $ | 40,488 | $ | 725 |
| CMOs - residential | | 9 | | 29 | | 1,868 | | 114 | | 1,877 | | 143 |

| | | | | | | |
|---|---|---|---|---|---|---|
| CMO's - commercial | - | - | 560 | 415 | 560 | 415 |
| U.S. Government obligations | 3,765 | 2 | - | - | 3,765 | 2 |
| Agency MBS - residential | - | - | - | - | - | - |
| GSEs | 5,817 | 22 | 419 | 8 | 6,236 | 30 |
| States and political subdivisions | 30,877 | 323 | 22,993 | 298 | 53,870 | 621 |
| **Total fixed maturities** | 66,733 | 743 | 40,063 | 1,193 | 106,796 | 1,936 |
| Common stocks | 861 | 55 | - | - | 861 | 55 |
| Preferred stocks - perpetual | 908 | 3 | - | - | 908 | 3 |
| **Total temporarily impaired securities** | $ 68,502 | $ 801 | $ 40,063 | $ 1,193 | $ 108,565 | $ 1,994 |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities | $ 128,820 | $ 1,989 | $ 9,451 | $ 87 | $ 138,271 | $ 2,076 |
| CMOs - residential | 1,396 | 176 | 14,597 | 1,368 | 15,993 | 1,544 |
| CMOs - commercial | - | - | 538 | 910 | 538 | 910 |
| Agency MBS (2) residential | - | - | - | - | - | - |
| GSEs | 15,134 | 131 | 2,367 | 30 | 17,501 | 161 |
| States and political subdivisions | 43,978 | 291 | 20,929 | 360 | 64,907 | 651 |
| **Total fixed maturities** | 189,328 | 2,587 | 47,882 | 2,755 | 237,210 | 5,342 |
| Common stocks | 1,724 | 149 | - | - | 1,724 | 149 |
| Preferred stocks-perpetual | - | - | 4,968 | 451 | 4,968 | 451 |
| Preferred stocks-with maturities | 1,644 | 83 | - | - | 1,644 | 83 |
| **Total temporarily impaired securities** | $ 192,696 | $ 2,819 | $ 52,850 | $ 3,206 | $ 245,546 | $ 6,025 |

At September 30, 2012 and December 31, 2011, a total of 29 and 58 available-for-sale securities, respectively, were in a continuous unrealized loss position for less than 12 months. At September 30, 2012 and December 31, 2011 a total of 23 and 30 available-for-sale securities, respectively, were in a continuous unrealized loss position for 12 months or longer.

Substantially all of the unrealized losses on fixed maturities available-for-sale at September 30, 2012 and December 31, 2011 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2012.

At September 30, 2012, the Company had $13,569,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 20.5% were in CMOs that originated in 2005 or earlier and 79.5% were in CMOs that originated in 2006. The unrealized losses on all other CMO s relate to prime rate CMO s and are primarily attributed to general disruptions in the credit market subsequent to purchase. The Company s mortgage security portfolio has no exposure to sub-prime mortgages.

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

The Company reviews its investment securities regularly and determines whether other-than- temporary impairments have occurred. The factors considered by management in its regular review to identify and recognize other-than-temporary impairment losses on fixed maturities include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; subordinated credit support; whether the issuer of a debt security has remained current on principal and interest payments; current expected cash flows; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions including the effect of changes in market interest rates. If the Company intends to sell a debt security, or it is more likely than not that it would be required to sell a debt security before the recovery of its amortized cost basis, the entire difference between the security's amortized cost basis and its fair value at the balance sheet date would be recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. If a decline in fair value of a debt security is judged by management to be other-than-temporary and; (i) the Company does not intend to sell the security; and (ii) it is not more likely than not that it will be required to sell the security prior to recovery of the security s amortized cost, the Company assesses whether the present value of the cash flows to be collected from the security is less than its amortized cost basis. To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost basis, a credit loss exists. For any such security, the impairment is bifurcated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations, establishing a new cost basis for the security. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income in the Condensed Consolidated Statement of Comprehensive Income. It is reasonably possible that further declines in estimated fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further other-than-temporary impairments in the near term, which could be significant.

In assessing corporate debt securities for other-than-temporary impairment, the Company evaluates the ability of the issuer to meet its debt obligations and the value of the company or specific collateral securing the debt position. For mortgage-backed securities where loan level data is not available, the Company uses a cash flow model based on the collateral characteristics. Assumptions about loss severity and defaults used in the model are primarily based on actual losses experienced and defaults in the collateral pool. Prepayment speeds, both actual and estimated, are also considered. The cash flows generated by the collateral securing these securities are then determined with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issue s position in the overall structure, to determine the cash flows associated with the mortgage-backed security held by the Company. In addition, the Company evaluates other asset-backed securities for other-than-temporary impairment by examining similar characteristics referenced above for mortgage-backed securities. The Company evaluates U.S. Treasury securities and obligations of U.S. Government corporations, U.S. Government agencies, and obligations of states and political subdivisions for other-than-temporary impairment by examining the terms and collateral of the security.

Equity securities that are available-for-sale may experience other-than-temporary impairment in the future based on the prospects for full recovery in value in a reasonable period of time and the Company s ability and intent to hold the security to recovery. If a decline in fair value is judged by management to be other-than-temporary or management does not have the intent or ability to hold a security, a loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. For the purpose of other-than-temporary impairment evaluations, preferred stocks with maturities are treated in a manner similar to debt securities. Declines in the creditworthiness of the issuer of debt securities with both debt and equity-like features requires the use of the equity model in analyzing the security for other-than-temporary impairment.

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

For the three-month and nine-month periods ended September 30, 2012, the Company recorded other-than-temporary impairments in earnings of $0 and $704,000, respectively, consisting of credit losses recorded as a result of expected cash flows on certain debt securities less than their amortized cost. For the three-month and nine-month periods ended September 30, 2011, the Company recorded other-than-temporary impairments in earnings of $107,000 and $575,000, respectively, consisting of credit losses recorded as a result of expected cash flows of certain debt securities less than their amortized cost. The Company recognized $0 and $288,000 of non-credit related other-than-temporary impairment losses, pre-tax, in other comprehensive income for the three and nine months ended September 30, 2012, respectively, and recognized $278,000 of non-credit related other-than-temporary impairment losses, pre-tax, in other comprehensive income for both the three months and nine months ended September 30, 2011.

Credit losses were recognized on certain impaired fixed maturities and preferred stocks with maturities, for which each security also had an impairment loss recognized in other comprehensive income.

The rollforward of these credit losses were as follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Balance at beginning of year | $ 2,555 | $ 1,763 |
| Credit losses during the period for which an other-than-temporary loss was not previously recognized | 473 | 107 |
| Additional credit losses for which an other-than-temporary loss was previously recognized | 148 | - |
| Securities sold | (1,200) | (86) |
| Balance at end of period | $ 1,976 | $ 1,784 |

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

**Note 5.**

**Derivative Instruments**

In connection with its outstanding amortizing term loan, a subsidiary of IHC entered into an interest rate swap on July 1, 2011 with the commercial bank lender, for a notional amount equal to the outstanding debt principal amount ($8,000,000 and $10,000,000 at September 30, 2012 and December 31, 2011, respectively), under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate (1.60%) in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. As a result of the interest rate swap, interest payments on this debt are fixed at 4.95%. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge.  The fair value of the interest rate swap was $377,000 and $494,000 at September 30, 2012 and December 31, 2011, respectively, which is included in other liabilities on the accompanying Condensed Consolidated Balance Sheets. See Note 7 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap. For the three months and nine months ended September 30, 2012, the Company recorded gains of $76,000 and $71,000, respectively (net of related tax expense of $50,000 and $47,000, respectively), representing the after-tax change in fair value of the interest rate swap, in other comprehensive income on the accompanying Condensed Consolidated Statements of Comprehensive Income. For the three months and nine months ended September 30, 2011, the Company recorded losses of $354,000 representing the after-tax change in fair value of the interest rate swap, in other comprehensive income on the accompanying Condensed Consolidated Statements of Comprehensive Income, net of related tax benefits of $235,000.

**Note 6.**

**Net Realized Investment Gains (Losses)**

Net realized investment gains (losses) for the three months and nine months ended September 30, 2012 and 2011 are as follows (in thousands):

| | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Sales of available-for-sale securities: | | | | |
| Fixed maturities | $ 1,282 | $ 2,252 | $ 4,625 | $ 2,535 |
| Common stocks | - | (696) | - | (722) |
| Preferred stocks | (76) | (632) | (567) | 792 |
| Total sales of available-for-sale securities | 1,206 | 924 | 4,058 | 2,605 |
| Sales of trading securities | 184 | - | 289 | - |
| Total realized gains (losses) | 1,390 | 924 | 4,347 | 2,605 |
| Unrealized gains (losses) on trading securities: | | | | |
| Available-for-sale securities transferred to trading category | - | - | 138 | - |
| Change in unrealized gains (losses) on trading securities | 65 | - | (43) | - |
| Total unrealized gains (losses) on trading securities | 65 | - | 95 | - |
| Loss on other investment | (444) | - | (444) | - |
| Net realized investment gains (losses) | $ 1,011 | $ 924 | $ 3,998 | $ 2,605 |

For the three months and nine months ended September 30, 2012, the Company realized gross gains of $2,170,000 and $8,259,000, respectively, and realized gross losses of $964,000 and $4,201,000, respectively, on sales of available-for-sale securities. For the three months and nine months ended September 30, 2011, the Company realized gross gains of $3,112,000 and $9,730,000, respectively, and realized gross losses of $2,188,000 and $7,125,000, respectively, on sales of available-for-sale securities.

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

**Note 7.**

**Fair Value Disclosures of Financial Instruments**

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

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

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

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

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

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

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

**Trading securities:**

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

**Interest rate swap:**

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

The following tables present our financial assets and liabilities measured at fair value on a recurring basis, at September 30, 2012 and December 31, 2011, respectively (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **FINANCIAL ASSETS:** | | | | |
| Fixed maturities available-for-sale: | | | | |
| Corporate securities | $ - | $ 351,541 | $ - | $ 351,541 |
| CMOs - residential | - | 12,780 | 14,142 | 26,922 |
| CMOs - commercial | - | - | 560 | 560 |
| US Government obligations | - | 17,279 | - | 17,279 |
| Agency MBS - residential | - | 450 | - | 450 |
| GSEs | - | 50,170 | - | 50,170 |
| States and political subdivisions | - | 287,075 | 2,587 | 289,662 |
| Total fixed maturities | - | 719,295 | 17,289 | 736,584 |
| Equity securities available-for-sale: | | | | |
| Common stocks | 4,296 | - | - | 4,296 |
| Preferred stocks - perpetual | 15,800 | - | - | 15,800 |
| Preferred stocks - with maturities | 7,997 | - | - | 7,997 |
| Total equity securities | 28,093 | - | - | 28,093 |
| Trading securities - equities | 5,858 | - | - | 5,858 |
| Total trading securities | 5,858 | - | - | 5,858 |
| **Total Financial Assets** | $ 33,951 | $ 719,295 | $ 17,289 | $ 770,535 |
| **FINANCIAL LIABILITIES:** | | | | |
| Interest rate swap | $ - | $ 377 | $ - | $ 377 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **FINANCIAL ASSETS:** | | | | |
| Fixed maturities available-for-sale: | | | | |
| Corporate securities | $ - | $ 323,140 | $ - | $ 323,140 |
| CMOs - residential | - | 14,648 | 22,127 | 36,775 |
| CMOs - commercial | - | - | 538 | 538 |
| US Government obligations | - | 166,582 | - | 166,582 |
| Agency MBS - residential | - | 585 | - | 585 |
| GSEs | - | 59,851 | - | 59,851 |
| States and political subdivisions | - | 255,402 | - | 255,402 |
| Total fixed maturities | - | 820,208 | 22,665 | 842,873 |
| Equity securities available-for-sale: | | | | |
| Common stocks | 6,699 | - | - | 6,699 |
| Preferred stocks - perpetual | 21,738 | - | - | 21,738 |
| Preferred stocks - with maturities | 9,104 | - | - | 9,104 |
| Total equity securities | 37,541 | - | - | 37,541 |
| **Total Financial Assets** | $ 37,541 | $ 820,208 | $ 22,665 | $ 880,414 |
| **FINANCIAL LIABILITIES:** | | | | |
| Interest rate swap | $ - | $ 494 | $ - | $ 494 |

It is the Company s policy to recognize transfers of assets and liabilities between levels of the fair value hierarchy at the end of a reporting period. At September 30, 2012, there were no transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy. No securities were transferred out of Level 2 and into the Level 3 category at September 30, 2012. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow. No securities were transferred out of the Level 3 category in 2012. The changes in the carrying value of Level 3 assets and liabilities for the nine months ended September 30, 2012 are summarized as follows (in thousands):

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | CMOs | | | |
| | Residential | Commercial | States and Political Subdivisions | Total |
| Beginning balance | $ 22,127 | $ 538 | $ - | $ 22,665 |
| Purchases of securities | - | - | 2,135 | 2,135 |

| | | | | |
|---|---|---|---|---|
| Gains(losses) included in earnings: | | | | |
| Net realized investment losses | (1,212) | - | - | (1,212) |
| Other-than-temporary impairments | (231) | (473) | - | (704) |
| Net unrealized gains (losses) included in accumulated other comprehensive loss | 2,976 | 495 | 424 | 3,895 |
| Sales of securities | (7,087) | - | - | (7,087) |
| Repayments and amortization of fixed maturities | (2,431) | - | 28 | (2,403) |
| Balance at end of period | $ 14,142 | $ 560 | $ 2,587 | $ 17,289 |

The following table provides carrying values, fair values and classification in the fair value hierarchy of the Company s financial instruments that are not carried at fair value but are subject to fair value disclosure requirements at September 30, 2012 and December 31, 2011 (in thousands):

| | September 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | **Level 2 Fair Value** | **Carrying Value** | **Level 2 Fair Value** | **Carrying Value** |
| **FINANCIAL ASSETS:** | | | | |
| Policy loans | $ 28,182 | $ 22,042 | $ 29,511 | $ 23,109 |
| **FINANCIAL LIABILITIES:** | | | | |
| Funds on deposit | $ 280,367 | $ 279,947 | $ 418,823 | $ 417,310 |
| Debt and junior subordinated debt securities | $ 46,146 | $ 46,146 | $ 48,146 | $ 48,146 |

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

**(A)**

**Policy Loans**

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

**(B)**

**Funds on Deposit**

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

**(C)**

**Debt**

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

**Note 8.**

**Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill and other intangible assets (included in other assets in the Condensed Consolidated Balance Sheets) for the first nine months of 2012 is as follows (in thousands):

| | | Other Intangible Assets | | |
|---|---|---|---|---|
| | **Goodwill** | **Definitive Lives** | **Indefinite Lives** | **Total Other Intangible Assets** |
| **Balance at December 31, 2011** | $ 50,318 | $ 9,738 | $ 7,977 | $ 17,715 |
| Medical Stop-Loss: | | | | |
| Acquired broker relationships | - | 1,825 | - | 1,825 |
| Fully insured: | | | | |
| Acquired CPR | - | 327 | - | 327 |
| Capitalized software development | - | 144 | - | 144 |
| Amortization expense | - | (2,009) | - | (2,009) |
| **Balance at September 30, 2012** | $ 50,318 | $ 10,025 | $ 7,977 | $ 18,002 |

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

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

**Note 9.**

**Common Stock**

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

In February 2012, IHC announced it will increase its annual dividend from $.05 to $.07 per share.

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

**Note 10.**

**Share-Based Compensation**

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

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

Total share-based compensation expense was $153,000 and $34,000 for the three months ended September 30, 2012 and 2011, respectively, and was $770,000 and $361,000 for the nine months ended September 30, 2012 and 2011, respectively. Related tax benefits of $61,000 and $14,000 were recognized for the three months ended September 30, 2012 and 2011, respectively and $307,000 and $144,000 were recognized for the nine months ended September 30, 2012 and 2011, respectively.

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

At September 30, 2012, there were 379,819 shares available for future stock-based compensation grants under IHC s stock incentive plans.

**Stock Options**

The Company s stock option activity for the nine months ended September 30, 2012 is as follows:

| | Shares Under Option | Weighted- Average Exercise Price |
|---|---|---|
| **December 31, 2011** | 758,714 | $ 9.71 |
| Forfeited | (3,667) | 9.09 |
| Expired | (26,378) | 18.91 |
| **September 30, 2012** | 728,669 | $ 9.38 |

The following table summarizes information regarding outstanding and exercisable options:

| | September 30, 2012 | |
|---|---|---|
| | **Outstanding** | **Exercisable** |
| Number of options | 728,669 | 563,009 |

| | | | | |
|---|---|---|---|---|
| Weighted average exercise price per share | $ | 9.38 | $ | 9.47 |
| Aggregate intrinsic value for all options | $ | 511 | $ | 349 |
| Weighted average contractual term remaining | | 1.7 years | | 1.5 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 nine months ended September 30, 2012 or 2011.

Compensation expense of $56,000 and $61,000 was recognized in the three months ended September 30, 2012 and 2011, respectively, and $177,000 and $231,000 was recognized in the nine months ended September 30, 2012 and 2011, respectively, for the portion of the grant-date fair value of stock options vesting during that period.

No options were exercised during the three months and nine months ended September 30, 2012 or 2011.

As of September 30, 2012, the total unrecognized compensation expense related to non-vested stock options was $60,000 which is expected to be recognized over the remaining requisite weighted-average service period of 0.5 years.

**Restricted Stock**

IHC granted 7,425 and 6,750 shares of restricted stock awards during the nine months ended September 30, 2012 and 2011, respectively, with weighted average grant-date fair values of $9.39 and $9.84 per share, respectively. The total fair value of restricted stock that vested during each of the first nine months of 2012 and 2011 was $40,000 and $23,000, respectively. Restricted stock expense was $13,000 and $9,000 for the three months ended September 30, 2012 and 2011, respectively, and was $31,000 and $18,000 for the nine months ended September 30, 2012 and 2011, respectively.

The following table summarizes restricted stock activity for the nine months ended September 30, 2012:

| | No. of Non-vested Shares | | Weighted-Average Grant-Date Fair Value |
|---|---|---|---|
| December 31, 2011 | 9,900 | $ | 8.95 |
| Granted | 7,425 | | 9.39 |
| Vested | (4,125) | | 8.40 |
| September 30, 2012 | 13,200 | $ | 9.37 |

As of September 30, 2012, the total unrecognized compensation expense related to non-vested restricted stock awards was $109,000 which is expected to be recognized over the remaining requisite weighted-average service period of 2.2 years.

**SARs and Share-Based Performance Awards**

IHC had 274,450 and 230,450 SAR awards outstanding at September 30, 2012 and December 31, 2011, respectively. During the first nine months of 2012 and 2011, the Company granted 44,000 SAR awards and 103,950 SAR awards, respectively. The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. For the three months ended September 30, 2012 and 2011, IHC recorded $60,000 and $(43,000), respectively, of compensation costs for these awards, and for the nine months ended September 30, 2012 and 2011, recorded $511,000 and $82,000, respectively. No SARs were exercised during the nine months ended September 30, 2012 or 2011. Included in Other Liabilities in the Company s Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011 are liabilities of $799,000 and $288,000, respectively, pertaining to SARs.

Other outstanding awards include share-based performance awards. Compensation costs for these awards are recognized and accrued as performance conditions are met, based on the current share price. For the three months ended September 30, 2012 and 2011, IHC recorded $24,000 and $8,000, respectively, of compensation costs for these awards, and for the nine months ended September 30, 2012 and 2011, recorded $51,000 and $29,000. The intrinsic value of share-based performance awards paid during the nine months ended September 30, 2012 and 2011 was $57,000 and $53,000, respectively. Included in the other liabilities on the Company s Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011 are liabilities of $59,000 and $65,000, respectively, pertaining to share-based performance awards.

**B)**

**AMIC Share-Based Compensation Plans**

Total AMIC share-based compensation expense was $8,000 and $9,000 for the three months ended September 30, 2012 and 2011, respectively and was $24,000 and $34,000 for the nine months ended September 30, 2012 and 2011, respectively. Related tax benefits of $3,000 and $3,000 were recognized for the three months ended September 30, 2012 and 2011, respectively and were $9,000 and $12,000 for the nine months ended September 30, 2012 and 2011, respectively.

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

**Stock Options**

The following table summarizes information regarding AMIC s outstanding and exercisable options for the nine months ended September 30, 2012:

| | Shares Under Option | | Weighted- Average Exercise Price |
|---|---|---|---|
| **December 31, 2011** | 333,956 | $ | 10.43 |
| Forfeited | (16,668) | | 11.10 |
| **September 30, 2012** | 317,288 | $ | 10.40 |

The following table summarizes information regarding AMIC s outstanding and exercisable options:

| | September 30, 2012 | | | |
|---|---|---|---|---|
| | | **Outstanding** | | **Exercisable** |
| Number of options | | 317,288 | | 299,509 |
| Weighted average exercise price per share | $ | 10.40 | $ | 10.70 |
| Aggregate intrinsic value for all options | $ | 4 | $ | 2 |
| Weighted average contractual term remaining | | 2.43 years | | 2.08 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 nine months ended September 30, 2012. The weighted average grant-date fair value of options granted during the nine months ended September 30, 2011 was $3.02 per share. The assumptions set forth in the table below were used to value the stock options granted during the nine months ended September 30, 2011:

| | | 2011 |
|---|---|---|
| Weighted-average risk-free interest rate | | 3.11% |
| Annual dividend rate per share | $ | - |
| Weighted-average volatility factor of the Company's common stock | | 36.89 |
| Weighted-average expected term of options | | 5 years |

Compensation expense of $8,000 and $9,000 was recognized for the three months ended September 30, 2012 and 2011, respectively, and was $24,000 and $27,000 for the nine months ended September 30, 2012 and 2011, respectively, for the portion of the grant-date fair value of AMIC s stock options vesting during those periods.

No options were exercised during the nine months ended September 30, 2012. AMIC received cash proceeds of $57,000 upon the exercise of 13,611 options with an intrinsic value of $11,000 during the nine months ended September 30, 2011.

As of September 30, 2012, the total unrecognized compensation expense related to AMIC s non-vested options was $56,000 which will be recognized over the remaining requisite service periods.

**Restricted Stock**

AMIC issued 12,000 restricted stock awards in the second quarter of 2008, with a weighted average grant-date fair value of $6.92 per share. No restricted stock awards have been issued since then. AMIC had no unvested restricted stock awards outstanding at September 30, 2012 and December 31, 2011. Restricted stock expense for the three months and nine months ended September 30, 2011 was $0 and $7,000, respectively.

**Note 11.**

**Debt**

On July 1, 2012, the Company made a $2,000,000 principal debt repayment in accordance with the terms of its amortizing term note.

**Note 12.**

**Income Taxes**

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

The deferred income tax expense for the nine months ended September 30, 2012 allocated to stockholders' equity (principally for net unrealized gains on investment securities) was $4,357,000, representing the increase in the related deferred tax liability from $3,768,000 at December 31, 2011 to $8,124,000 at September 30, 2012.

In 2011, the Company recorded a deferred income tax benefit of $2,319,000 associated with IHC s investment in AMIC. As the result of management s intention to adopt tax planning strategies to recover IHC s investment in AMIC in a tax-free manner, the cumulative Federal and State deferred income tax liabilities established as of December 31, 2010 for temporary differences between IHC s book value and tax basis in AMIC became permanent. Accordingly, IHC released its previously recorded deferred income tax liabilities and will not record deferred income taxes in future periods for any earnings or stockholders equity adjustments relating to IHC s investment in AMIC.

At September 30, 2012, AMIC, had net operating loss carryforwards of approximately $272,378,000 for federal income tax purposes which expire between 2019 and 2029. The net deferred tax asset relative to AMIC included in other assets on IHC s Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011 was $6,829,000 and $8,030,000, respectively. AMIC continues to file its own separate income tax return and is not included in the consolidated tax return of IHC.

**Note 13.**

**Reinsurance**

Effective January 26, 2012, Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer to cede group annuity reserves. In accordance with the agreement, Standard Security Life transferred $143,537,000 of cash in the first quarter of 2012 and recorded a corresponding amount as due from reinsurers. The Company received final approval from the New York State Insurance Department to convert the transfer from a coinsurance to an assumption agreement. When complete, the assumption will contractually relieve Standard Security Life of liability with regards to the policies. During the third quarter of 2012, a significant portion of the reserves were assumed.

**Note 14.**

**Supplemental Disclosures of Cash Flow Information**

Tax refunds, net of tax payments, were $519,000 and $3,751,000 during the nine months ended September 30, 2012 and 2011.

Cash payments for interest were $1,601,000 and $1,420,000 during the nine months ended September 30, 2012 and 2011, respectively.

**Note 15.**

**Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months and nine months ended September 30, 2012 and 2011 is presented below (in thousands):

| | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Medical Stop-Loss | $ 38,286 | $ 32,668 | $ 107,844 | $ 93,448 |
| Fully Insured Health | 45,357 | 42,388 | 124,033 | 129,706 |
| Group disability, life, annuities and DBL | 13,160 | 14,986 | 38,901 | 45,429 |
| Individual life, annuities and other | 13,666 | 13,924 | 40,517 | 43,884 |
| Corporate | 22 | (1,124) | 512 | (994) |
| | 110,491 | 102,842 | 311,807 | 311,473 |
| Net realized investment gains | 1,011 | 924 | 3,998 | 2,605 |
| Other-than-temporary impairment losses | - | (107) | (704) | (575) |
| | $ 111,502 | $ 103,659 | $ 315,101 | $ 313,503 |
| **Income from operations before income taxes:** | | | | |
| Medical Stop-Loss | $ 2,853 | $ 2,691 | $ 12,787 | $ 4,598 |
| Fully Insured Health[(A)] | 1,461 | 2,355 | 4,619 | 7,297 |
| Group disability, life, annuities and DBL | 3,590 | 3,285 | 4,292 | 4,873 |
| Individual life, annuities and other | 852 | 308 | 1,050 | 652 |
| Corporate | (2,677) | (3,253) | (5,781) | (5,575) |

| | | | | |
|---|---|---|---|---|
| | 6,079 | 5,386 | 16,967 | 11,845 |
| Net realized investment gains | 1,011 | 924 | 3,998 | 2,605 |
| Other-than-temporary impairment losses | - | (107) | (704) | (575) |
| Interest expense | (509) | (516) | (1,588) | (1,433) |
| | $ 6,581 | $ 5,687 | $ 18,673 | $ 12,442 |

**(A)**

The Fully Insured Health segment includes amortization of intangible assets recorded as a result of acquisition accounting for the recent acquisitions. Total amortization expense was $624,000 and $592,000 for the three months ended September 30, 2012 and 2011, respectively, and was $1,829,000 and $1,804,000, respectively, for the nine months ended September 30, 2012 and 2011. Amortization expense for the other segments is insignificant.

**ITEM 2.**

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

*The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2011, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

## Overview

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc. ( Health Solutions ), and Actuarial Management Corporation ("AMC"). These companies are sometimes collectively referred to as the Insurance Group , and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life. At September 30, 2012, the Company also owned a 78.6% interest in American Independence Corp. ( AMIC ).

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

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

The results of operations for the three months and nine months ended September 30, 2012 and 2011 are summarized as follows (in thousands):

| | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Revenues | $ 111,502 | $ 103,659 | $ 315,101 | $ 313,503 |
| Expenses | 104,921 | 97,972 | 296,428 | 301,061 |
| Income from operations before income taxes | 6,581 | 5,687 | 18,673 | 12,442 |
| Income taxes (benefits) | 2,191 | 1,676 | 6,123 | 1,167 |
| **Net income** | 4,390 | 4,011 | 12,550 | 11,275 |
| Less: Income from noncontrolling interests in subsidiaries | (472) | (457) | (1,179) | (1,497) |
| **Net income attributable to IHC** | $ 3,918 | $ 3,554 | $ 11,371 | $ 9,778 |

o

Net income of $.22 per share, diluted, for the three months ended September 30, 2012 compared to $.20 per share, diluted, for the same period in 2011. Net income of $.63 per share, diluted, for the nine months ended September 30, 2012, compared to $.56 per share, diluted, for the nine months ended September 30, 2011.

o

Consolidated investment yields (on an annualized basis) of 4.6% and 4.2% for the three months and nine months ended September 30, 2012 compared to 4.0% and 4.2% for the comparable periods in 2011;

o

Declared a special 10% stock dividend to IHC shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. As a result, IHC issued 1.6 million shares of its common stock, net of treasury shares, with a fair value of $15.8 million and paid cash in-lieu of fractional shares;

o

Announced an increase IHC s annual dividend from $.05 to $.07 per share; and

o

Book value of $15.59 per common share, an increase of $1.13 per common share from $14.46 at December 31, 2011.

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

o

The Medical Stop-Loss segment reported income before taxes of $2.9 million for the third quarter of 2012 compared to $2.7 million in the same quarter in 2011, and reported income before taxes of $12.8 million for the first nine months of 2012 compared to $4.6 million for the first nine months of 2011. The increase is primarily due to increased volume and improved loss ratios in 2012;

o

Premiums earned increased $6.1 million and $17.4 million for the three months and nine months ended September 30, 2012, respectively, when compared to the same periods in 2011. The increase in premiums earned is primarily due to increased volume and retention on business underwritten by Risk Solutions.

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 September 30, 2012 | 2011 | Nine Months Ended September 30, 2012 | 2011 |
|---|---|---|---|---|
| Premiums Earned | $ 36,465 | $ 30,342 | $ 103,100 | $ 85,658 |
| Insurance Benefits, Claims & Reserves | 24,590 | 19,562 | 65,585 | 58,689 |
| Expenses | 10,718 | 9,228 | 29,193 | 25,830 |
| | | | | |
| Loss Ratio[(A)] | 67.4% | 64.5% | 63.6% | 68.5% |
| Expense Ratio [(B)] | 29.4% | 30.4% | 28.3% | 30.2% |
| Combined Ratio [(C)] | 96.8% | 94.9% | 91.9% | 98.7% |

o

Loss ratios for the nine months ended September 30, 2012 decreased due to improved underwriting results in business produced by both Risk Solutions and by independent MGUs.

o

The expense ratio decreased for the nine months ended September 30, 2012 primarily due to a decrease in profit commission expense as a result of poor performance on certain business written through one program at AMIC.

(A)

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

(B)

Expense ratio represents 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, profit commission expense ratio and the expense ratio.

.

The Fully Insured Health segment reported $1.5 million of income before taxes for the three months ended September 30, 2012 as compared to $2.4 million for the comparable period in 2011, and reported $4.6 million of income before taxes for the nine months ended September 30, 2012 compared to $7.3 million for the same period in 2011.

o

Premiums earned increased $1.5 million for the three months ended September 30, 2012 and decreased $6.7 million for the nine months ended September 30, 2012 over the comparable 2011 periods. The increased premiums during the quarter resulted primarily from the new pet insurance line of business at AMIC. The decrease in premiums earned for the nine months were primarily due to decreased volume and retentions in certain other lines of the business.

o

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Premiums Earned | $ 37,137 | $ 35,619 | $ 102,204 | $ 108,866 |
| Insurance Benefits, Claims & Reserves | 25,154 | 21,616 | 67,536 | 68,048 |
| Expenses | 11,265 | 11,563 | 30,369 | 33,782 |
| | | | | |
| Loss Ratio | 67.7% | 60.7% | 66.1% | 62.5% |
| Expense Ratio | 30.3% | 32.5% | 29.7% | 31.0% |
| Combined Ratio | 98.0% | 93.2% | 95.8% | 93.5% |

o

The increase in the loss ratio for the three and nine-month period was primarily attributable to an increase in the claims experience on major medical business for groups and individuals and dental.

o

The underwriting expense ratio decreased for the nine months ended September 30, 2012, primarily as a result of a decrease in general expenses.

.

Income before taxes from the Group disability, life, annuities and DBL segment increased $.3 million for the three months ended September 30, 2012 and decreased $.6 million for the nine months ended September 30, 2012 compared to the three months and nine months ended September 30, 2011. The increase in quarterly income was principally due to lower claims in the group life and LTD business;

.

Income before taxes from the Individual life, annuities and other segment increased $.5 million and $.4 million for the three months and nine months ended September 30, 2012 compared to the same periods in 2011 primarily due to new business written;

.

Income before taxes from the Corporate segment increased $.6 million for the three months ended September 30, 2012 and decreased $.2 million for the nine months ended September 30, 2012. The increase in the comparable quarter is primarily due to losses in a partnership investment in 2011;

.

Net realized investment gains were $1.0 million and $4.0 million for the three months and nine months ended September 30, 2012 compared to net realized investment gains of $.9 million and $2.6 million for the three months and nine months ended September 30, 2011. Other-than-temporary impairment losses recognized in earnings for the nine months ended September 30, 2012 were $.7 million, and were $.1 million and $.6 million for the three months and nine months ended September 30, 2011, respectively; and

.

Premiums by principal product for the three months and nine months ended September 30, 2012 and 2011 are as follows (in thousands):

| **Gross Direct and Assumed Earned Premiums:** | **Three Months Ended September 30, 2012** | **Three Months Ended September 30, 2011** | **Nine Months Ended September 30, 2012** | **Nine Months Ended September 30, 2011** |
|---|---|---|---|---|
| Medical Stop-Loss | $ 42,992 | $ 38,472 | $ 123,425 | $ 109,301 |
| Fully Insured Health | 58,518 | 53,276 | 163,967 | 157,052 |
| Group disability, life, annuities and DBL | 22,371 | 23,098 | 68,013 | 71,169 |
| Individual, life, annuities and other | 7,488 | 7,921 | 23,257 | 25,140 |
| | $ 131,369 | $ 122,767 | $ 378,662 | $ 362,662 |

| **Net Direct and Assumed Earned Premiums:** | **Three Months Ended September 30, 2012** | **Three Months Ended September 30, 2011** | **Nine Months Ended September 30, 2012** | **Nine Months Ended September 30, 2011** |
|---|---|---|---|---|
| Medical Stop-Loss | $ 36,465 | $ 30,342 | $ 103,100 | $ 85,658 |
| Fully Insured Health | 37,137 | 35,619 | 102,204 | 108,866 |
| Group disability, life, annuities and DBL | 12,423 | 12,416 | 36,776 | 38,078 |
| Individual, life, annuities and other | 6,211 | 6,853 | 19,399 | 22,502 |
| | $ 92,236 | $ 85,230 | $ 261,479 | $ 255,104 |

## 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, 2011. 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, 2011. During the nine months ended September 30, 2012, there were no additions to or changes in the critical accounting policies disclosed in the 2011 Form 10-K except for the recently adopted accounting standards discussed in Note 1(C) of the Notes to Condensed Consolidated Financial Statements.

**Results of Operations for the Three Months Ended September 30, 2012 Compared to the Three Months Ended September 30, 2011**

Information by business segment for the three months ended September 30, 2012 and 2011 is as follows:

| September 30, 2012 (In thousands) | Premiums Earned | Net Investment Income | Fee and Other Income | Benefits, Claims and Reserves | Amortization of Deferred Acquisition Costs | Selling, General And Administrative | Total |
|---|---|---|---|---|---|---|---|
| Medical Stop-Loss | $ 36,465 | 1,733 | 88 | 24,590 | - | 10,843 | $ 2,853 |
| Fully Insured Health | 37,137 | 477 | 7,743 | 25,154 | 6 | 18,736 | 1,461 |
| Group disability, life, annuities and DBL | 12,423 | 713 | 24 | 5,772 | - | 3,798 | 3,590 |
| Individual life, annuities and other | 6,211 | 6,401 | 1,054 | 7,518 | 1,581 | 3,715 | 852 |
| Corporate | - | 22 | - | | - | 2,699 | (2,677) |
| Sub total | $ 92,236 | $ 9,346 | $ 8,909 | $ 63,034 | $ 1,587 | $ 39,791 | 6,079 |
| | | | | | | | |
| Net realized investment gains | | | | | | | 1,011 |
| Other-than-temporary impairment losses | | | | | | | - |
| Interest expense on debt | | | | | | | (509) |
| Income from operations before income taxes | | | | | | | 6,581 |
| Income taxes | | | | | | | 2,191 |
| Net income | | | | | | | $ 4,390 |

| September 30, 2011 (In thousands) | Premiums Earned | Net Investment Income | Fee and Other Income | Benefits, Claims and Reserves | Amortization of Deferred Acquisition Costs | Selling, General And Administrative | Total |
|---|---|---|---|---|---|---|---|
| Medical Stop-Loss | $ 30,342 | 1,487 | 839 | 19,562 | - | 10,415 | $ 2,691 |
| Fully Insured Health | 35,619 | 367 | 6,402 | 21,616 | 8 | 18,409 | 2,355 |
| Group disability, life, annuities | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| and DBL | 12,416 | 2,528 | 42 | 7,520 | 133 | 4,048 | 3,285 |
| Individual life, annuities and other | 6,853 | 5,977 | 1,094 | 7,956 | 1,703 | 3,957 | 308 |
| Corporate | - | (1,124) | - | - | - | 2,129 | (3,253) |
| Sub total | $ 85,230 | $ 9,235 | $ 8,377 | $ 56,654 | $ 1,844 | $ 38,958 | 5,386 |

| | |
|---|---|
| Net realized investment losses | 924 |
| Other-than-temporary impairment losses | (107) |
| Interest expense on debt | (516) |
| Income from operations before income taxes | 5,687 |
| Income tax benefits | 1,676 |
| Net income | $ 4,011 |

33

***Premiums Earned***

In the third quarter of 2012, premiums earned increased $7.0 million over the comparable period of 2011. The increase is primarily due to: (i) a $6.1 million increase in the Medical Stop-Loss segment due to increased volume and retention of business in 2012; (ii) a $1.5 million increase in the Fully Insured Health segment which had increased premiums of $3.0 million, from the new 2012 pet and international lines of business; $.5 million in increased premiums in ancillary medical and other minor lines; offset by $2.0 million in decreased premiums as a result of lower retentions and volume in the short term medical business, major medical business for groups and individuals, limited medical and dental lines of business; and (iii) a decrease of $.6 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the transfer of certain annuity contracts in the fourth quarter of 2011. The Group disability, life, annuities and DBL segment stayed constant.

***Net Investment Income***

Total net investment income increased $.1 million.  The overall annualized investment yields were 4.6% and 4.0% (approximately 4.8% and 4.1%, on a tax advantaged basis) in the third quarter of 2012 and 2011, respectively. The slight increase was primarily a result of higher returns on a partnership investment. The annualized investment yields on bonds, equities and short-term investments were 4.3% in both the third quarter of 2012 and 2011. IHC has approximately $185.1 million in highly rated shorter duration securities earning on average 1.8%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

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

The Company had net realized investment gains of $1.0 million and $.9 million in the third quarter of 2012 and 2011, respectively. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

No other-than-temporary impairment losses were recorded for the three months ended September 2012. For the three months ended September 30, 2011, the Company recorded $.1 million of other-than-temporary impairment losses, pre-tax. Other-than-temporary impairment losses in 2011 consist of credit losses resulting from expected cash flows of debt securities that are less than their amortized cost basis.

***Fee Income and Other Income***

Fee income increased $.6 million for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 primarily as a result of higher agency referral fees and medical management fees.

Total other income decreased $.1 million in the three months ended September 30, 2012 to $1.2 million from $1.3 million in the three months ended September 30, 2011.

***Insurance Benefits, Claims and Reserves***

In the third quarter of 2012, insurance, benefits, claims and reserves increased $6.3 million over the comparable period in 2011. The increase is primarily attributable to: (i) an increase of $5.0 million in the Medical Stop-Loss segment as a result of an increase in premium volume by Risk Solutions partially offset by improved loss ratios; (ii) an increase of $3.5 million in the Fully Insured Health segment, principally due to increased claims on the major medical business for groups and individuals and short term medical lines of business, increased premium volume associated with the new pet line of business; partially offset due to decreased dental premiums; (ii) a $1.8 million decrease in the Group disability, life, annuities and DBL segment primarily as a result of the transfer of certain annuity contracts in the fourth quarter of 2011 and reduced production; and (iii) a $.4 million decrease in the Individual life, annuity and other segment primarily resulting from the transfer of certain group annuity contracts in the fourth quarter of 2011 and decreased premium volume from other lines in run-off.

***Amortization of Deferred Acquisition Costs***

Amortization of deferred acquisition costs decreased $.2 million primarily as a result of the write-off, in the fourth quarter of 2011, of certain deferred acquisition costs in connection with a coinsurance agreement.

-

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

Selling, general and administrative expenses increased $.8 million. The increase is primarily due to: (i) a $.4 million increase in expenses due to volume as a result of increased production, in the Medical Stop-Loss segment; (ii) a $.3 million increase in the Fully Insured Health segment largely due to employee costs related to an increased sales and marketing force; and (iii) an increase of $.6 million in corporate employee benefit related expenses; partially offset by (iv) a decrease of $.3 million in Group, life, annuities and other lines of business primarily as a result of the transfer of certain annuity contracts in the fourth quarter of 2011; and (v) a decrease of $.2 million principally due to Individual annuities, and other run off lines.

***Income Taxes***

The effective tax rate for the three months ended September 30, 2012 was 33.3% compared to 29.8% in 2011. The lower effective tax rate in 2011 was due to a higher benefit from tax advantaged securities as a percentage of income due to lower income in 2011.

**Results of Operations for the Nine Months Ended September 30, 2012 Compared to the Nine Months Ended September 30, 2011**

Information by business segment for the nine months ended September 30, 2012 and 2011 is as follows:

| September 30, 2012 (In thousands) | Premiums Earned | Net Investment Income | Fee and Other Income | Benefits, Claims and Reserves | Amortization of Deferred Acquisition Costs | Selling, General And Administrative | Total |
|---|---|---|---|---|---|---|---|
| Medical Stop-Loss | $ 103,100 | 4,119 | 625 | 65,585 | - | 29,472 | $ 12.787 |
| Fully Insured Health | 102,204 | 1,123 | 20,706 | 67,536 | 18 | 51,860 | 4.619 |
| Group disability, life, annuities and DBL | 36,776 | 2,035 | 90 | 22,876 | - | 11,733 | 4.292 |
| Individual life, annuities and other | 19,399 | 17,917 | 3,201 | 24,437 | 4,794 | 10,236 | 1.050 |
| Corporate | - | 512 | - | - | - | 6,293 | (5,781) |
| Sub total | $ 261,479 | $ 25,706 | $ 24,622 | $ 180,434 | $ 4,812 | $ 109,594 | 16.967 |
| | | | | | | | |
| Net realized investment gains | | | | | | | 3,998 |
| Other-than-temporary impairment losses | | | | | | | (704) |
| Interest expense on debt | | | | | | | (1,588) |
| Income from operations before income taxes | | | | | | | 18,673 |
| Income taxes | | | | | | | 6,123 |
| Net income | | | | | | | $ 12,550 |

| September 30, 2011 (In thousands) | Premiums Earned | Net Investment Income | Fee and Other Income | Benefits, Claims and Reserves | Amortization of Deferred Acquisition Costs | Selling, General And Administrative | Total |
|---|---|---|---|---|---|---|---|
| Medical Stop-Loss | $ 85,658 | 3,679 | 4,111 | 58,689 | - | 30,161 | $ 4,598 |
| Fully Insured Health | 108,866 | 1,117 | 19,723 | 68,048 | 23 | 54,338 | 7,297 |
| Group disability, life, annuities | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| and DBL | 38,078 | 7,231 | 120 | 28,654 | 397 | 11,505 | 4,873 |
| Individual life, annuities and other | 22,502 | 17,951 | 3,431 | 27,669 | 4,873 | 10,690 | 652 |
| Corporate | - | (994) | - | - | - | 4,581 | (5,575) |
| Sub total | $ 255,104 | $ 28,984 | $ 27,385 | $ 183,060 | $ 5,293 | $ 111,275 | 11,845 |

| | |
|---|---|
| Net realized investment losses | 2,605 |
| Other-than-temporary impairment losses | (575) |
| Interest expense on debt | (1,433) |
| Income from operations before income taxes | 12,442 |
| Income tax benefits | 1,167 |
| Net income | $ 11,275 |

***Premiums Earned***

In the first nine months of 2012, premiums earned increased $6.4 million over the comparable period of 2011. The increase is primarily due to: (i) an $17.4 million increase in the Medical Stop-Loss segment due to increased volume and retention of business in 2012; partially offset by (ii) the Fully Insured Health segment which had a $6.6 million decrease in premiums primarily as a result of decreased retentions and volume in the short term medical business, major medical business for groups and individuals, limited medical and dental lines of business, partially offset by the new 2012 pet and international lines of business; (iii) a decrease of $3.1 million of earned premiums in the Individual life, annuities and other segment primarily as a result of the transfer of certain annuity contracts in the fourth quarter of 2011and decreased premium volume from other lines in run-off; and (iv) a $1.3 million decrease in the Group disability, life, annuities and DBL segment primarily due to decreased premiums from the group term life and LTD lines due in part to reduced production sources, partially offset by premiums generated by a new line of international LTD and life business.

***Net Investment Income***

Total net investment income decreased $3.3 million. The overall annualized investment yields were 4.2% (approximately 4.3%, on a tax advantaged basis) in the first nine months of both 2012 and 2011. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due the transfer of $143.5 million of assets related to the coinsurance treaty in the fourth quarter of 2011. The annualized investment yields on bonds, equities and short-term investments were 3.9% and 4.2% in the first nine months of 2012 and 2011, respectively. IHC has approximately $185.1 million in highly rated shorter duration securities earning on average 1.8%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

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

The Company had net realized investment gains of $4.0 million in 2012 compared to $2.6 million in 2011. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

For the nine months ended September 30, 2012 and 2011, the Company recorded $.7 million and $.6 million, respectively, of other-than-temporary impairment losses, pre-tax. Other-than-temporary impairment losses in both 2012 and 2011 consist of credit losses resulting from expected cash flows of debt securities that are less than their amortized cost.

***Fee Income and Other Income***

Fee income decreased $1.7 million for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 primarily as a result of increased retentions and therefore an increase in the elimination of intercompany fee income.

Total other income decreased $1.0 million in the nine months ended September 30, 2012 to $3.6 million from $4.6 million in the nine months ended September 30, 2011.

***Insurance Benefits, Claims and Reserves***

In the first nine months of 2012, insurance, benefits, claims and reserves decreased $2.6 million over the comparable period in 2011. The decrease is primarily attributable to: (i) a $5.8 million decrease in the Group disability, life, annuities and DBL segment as a result of lower production coupled with lower loss ratios in the LTD line and the transfer of certain annuity contracts in the fourth quarter of 2011; (ii) a $3.2 million decrease in the Individual life, annuity and other segment primarily resulting from the transfer of certain group annuity contracts in the fourth quarter of 2011 and decreased premium volume from other lines in run-off; and (iii) a decrease of $.5 million in the Fully Insured Health segment, principally due to the decrease in premiums on the short term medical, major medical business for groups and individuals, limited medical and dental lines of business, slightly offset by increases due to premium volume on the new pet line of business; and (iv) partially offset by an increase of $6.9 million in the Medical Stop-Loss segment as a result of improved loss ratios offset by an increase in premium volume by Risk Solutions.

***Amortization of Deferred Acquisition Costs***

Amortization of deferred acquisition costs decreased $.5 million primarily as a result of the write-off, in the fourth quarter of 2011, of certain deferred acquisition costs in connection with a coinsurance agreement.

-

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

Selling, general and administrative expenses decreased $1.7 million. The decrease is primarily due to: (i) a $.7 million decrease in commissions and other general expenses in the Medical Stop-Loss segment due to increased retentions partially offset by increases in expenses due to volume as a result of increased production; and (ii) a $2.5 million decrease in the Fully Insured Health segment largely due to decreased volume of business in the short term medical, major medical business for groups and individuals, limited medical and dental lines of business in 2012; partially offset by (iii) an increase of $1.7 million in corporate overhead expenses due to employee, option, SAR and benefit related expenses.

***Income Taxes***

The effective tax rate for the nine months ended September 30, 2012 was 32.6%. In 2011, IHC eliminated $2.3 million of previously recorded deferred income taxes due to management s intention to adopt tax planning strategies to recover its investment in AMIC in a tax-free manner. Excluding this transaction, the effective tax rate for the nine months ended September 30, 2011 was 28.2%. The lower effective tax rate in 2011 was due to a higher benefit from tax advantaged securities as a percentage of income in 2011.

**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. The insurance group declared and paid $6.5 million and $2.0 million of cash dividends to Corporate in the first nine months of 2012 and 2011, respectively.

**Cash Flows**

The Company had $14.6 million and $18.2 million of cash and cash equivalents as of September 30, 2012 and December 31, 2011, respectively.

In February 2012, Standard Security Life transferred $143.5 million cash to an unaffiliated reinsurer in connection with a coinsurance agreement, representing a significant portion of the $130.4 million decrease in cash from operating activities. Cash provided by investing activities of $128.6 million consists primarily of proceeds from the net sales of investments in preparation for such transfer of funds.

The Company has $456.7 million of insurance reserves that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the nine months ended September 30, 2012, cash received from the maturities and other repayments of fixed maturities was $53.0 million.

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

## BALANCE SHEET

The Company had net receivables from reinsurers of $124.8 million at September 30, 2012 compared to $119.7 million at December 31, 2011. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2012.

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

| | Total Health Reserves | |
|---|---|---|
| | **September 30, 2012** | **December 31, 2011** |
| Medical Stop-Loss | $ 54,393 | $ 58,741 |
| Fully Insured Health | 37,717 | 32,508 |
| Group Disability | 92,213 | 93,278 |
| Individual A&H and Other | 7,577 | 8,460 |

| | | | |
|---|---|---|---|
| $ | 191,900 | $ | 192,987 |

Major factors that affect the Projected Net Loss Ratio assumption in reserving for medical stop-loss relate to: (i) frequency and severity of claims; (ii) changes in medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, the impact of new medical technology and changes in medical treatment protocols; and (ii) the adherence 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 $18.6 million increase in IHC s stockholders' equity in the first nine months of 2012 is primarily due to $11.4 million of net income and $8.8 million of other comprehensive income, partially offset by $1.1 million of treasury share purchases.

**Asset Quality and Investment Impairments**

The nature and quality of insurance company investments must comply with all applicable statutes and regulations, which have been promulgated primarily for the protection of policyholders. Although the Company's gross unrealized losses on available-for-sale securities totaled $2.0 million at September 30, 2012, approximately 98.2% of the Company s fixed maturities were investment grade and continue to be rated on average AA. The Company marks all of its available-for-sale securities to fair value through accumulated other comprehensive income or loss. These investments tend to carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At September 30, 2012, approximately 1.8% (or $13.6 million) of the carrying value of fixed maturities was invested in non-investment grade fixed maturities (primarily mortgage securities) (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any non-performing fixed maturities at September 30, 2012.

The Company reviews its investments regularly and monitors its investments continually for impairments. For the nine months ended September 30, 2012 and 2011, the Company recorded $.7 million and $.6 million of losses for other-than-temporary impairments in earnings. The Company also recognized $.3 million and $.2 million of other-than-temporary impairments in other comprehensive income for the nine months ended September 30, 2012 and 2011, respectively. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at September 30, 2012 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

| | Less than 3 months | Greater than 3 months, less than 6 months | Greater than 6 months, less than 12 months | Greater than 12 months | Total |
|---|---|---|---|---|---|
| Fixed maturities | $ 7 | $ - | $ 68 | $ 415 | $ 490 |

The unrealized losses on all remaining available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at September 30, 2012. In 2012, the Company experienced an increase in net unrealized gains of $16.1 million which was offset by $4.4 million of deferred taxes and $2.9 million of deferred policy acquisition costs. From time to time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalances in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

## CAPITAL RESOURCES

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

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC s future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company s obligations, as of September 30, 2012, is not materially different from that reported in the schedule of such obligations at December 31, 2011 which was included in Item **7** of the Company s Annual Report on Form 10-K.

## OUTLOOK

For 2012, we will continue to emphasize:

.

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

.

Leveraging our strategy of directly distributing our Medical Stop-Loss products through Risk Solutions to organically generate additional Medical Stop-Loss business while maintaining the profitability of the block.

.

Seeking to acquire additional stop-loss blocks through transactions such as the acquisition by Risk Solutions in July 2012 of the assets of an MGU with a block of approximately $10 million of Medical Stop-Loss premiums.

.

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

.

Continuing to increase the efficiency of our administrative companies.

The Company remained highly liquid in 2012 with a shorter duration portfolio. As a result, the yields on our investment portfolio were, and continue to remain, lower than in prior years and investment income may continue to be depressed for the balance of the year. IHC has approximately $185.1 million in highly rated shorter maturity securities earning on average 1.8%; our portfolio as a whole is rated, on average, AA. The low duration of our portfolio enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income. A low duration portfolio such as ours also mitigates the adverse impact of potential inflation. IHC will continue to monitor the financial markets and invest accordingly.

In the fourth quarter of 2011, Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer effective January 26, 2012 and transferred approximately $143.5 million of group annuity reserves in the first quarter of 2012.

At September 30, 2012, IHC owned approximately 78.6% of the outstanding common stock of AMIC.

We will continue to focus on our strategic objectives, including expanding our distribution network. However, the success of a portion of our Fully Insured Health business may be affected by the implementation of the Patient Protection and Affordable Care and Education Reconciliation Act of 2010 signed by President Obama in March 2010, and its subsequent interpretations by state and federal regulators. The regulations proposed to-date (including those mandating minimum loss ratios) seem to have validated our strategy of pursuing niche lines of business across many states utilizing multiple carriers. We have begun a comprehensive review of all the options for IHC and we are continuing a thorough evaluation of our options for those health insurance products that may be affected. Although the law will generally require insurers to operate with a lower expense structure for major medical plans in the small employer and individual markets, the law may make exceptions for carriers, such as ours, that have a minimal presence in any one state. Additional regulations that have not yet been released may require IHC to pursue different strategies for a portion of tis fully insured business. Non-essential lines of business and Medical Stop-Loss have been impacted by health care reform minimally or not at all.

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

**ITEM 3.**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at September 30, 2012 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2011 included in Item 7A of the Company s Annual Report on Form 10-K.

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

**ITEM 4.**

**CONTROLS AND PROCEDURES**

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

There has been no change in IHC s internal control over financial reporting during the nine months ended September 30, 2012 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, 2011 in Item 1A to Part 1 of Form 10-K.

**ITEM 2.**

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

**Share Repurchase Program**

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In January 2010, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC s common stock, inclusive of prior authorizations, under the 1991 plan. There were no share repurchases during the third quarter of 2012. As of September 30, 2012, there were 97,926 shares still authorized to be repurchased under the plan.

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**ITEM 4.**

**MINE SAFETY DISCLOSURES**

Not applicable

**ITEM 5.**

**OTHER INFORMATION**

Not applicable

**ITEM 6.**

**EXHIBITS**

31.1

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

31.2

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

32.1

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

32.2

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

101.INS

XBRL Instance Document.

101.SCH

XBRL Taxonomy Extension Schema Document.

101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document.

101.LAB

XBRL Taxonomy Extension Label Linkbase Document.

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document.

101.DEF

XBRL Taxonomy Extension Definition Linkbase Document.

**SIGNATURES**

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

**INDEPENDENCE HOLDING COMPANY**

(REGISTRANT)

By:

/s/Roy T. K. Thung

Date:

November 8, 2012

Roy T.K. Thung

Chief Executive Officer, President

and Chairman

By:

/s/Teresa A. Herbert

Date:

November 8, 2012

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer