

INDEPENDENCE HOLDING CO
Form 10-Q
November 07, 2013

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

FORM 10-Q

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

For the quarterly period ended **September 30, 2013**.

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

For the transition period from: _____ to _____

Commission File Number: **0-10306**

INDEPENDENCE HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

58-1407235

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

96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT

06902

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(Address of principal executive offices)

(Zip Code)

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

NOT APPLICABLE

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

Class
Common stock, \$ 1.00 par value

Outstanding at November 1, 2013
17,687,669 Shares

INDEPENDENCE HOLDING COMPANY

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

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, 2013 (Unaudited) | December 31, 2012 |
|--|---|------------------------------|
| ASSETS: | | |
| Investments: | | |
| Short-term investments | \$ 50 | \$ 50 |
| Securities purchased under agreements to resell | 34,036 | 33,956 |
| Trading securities | 6,394 | 7,016 |
| Fixed maturities, available-for-sale | 546,707 | 719,602 |
| Equity securities, available-for-sale | 5,605 | 15,598 |
| Other investments | 26,302 | 35,134 |
| Total investments | 619,094 | 811,356 |
| | | |
| Cash and cash equivalents | 16,835 | 23,945 |
| Deferred acquisition costs | 29,578 | 33,401 |
| Due and unpaid premiums | 58,343 | 49,430 |
| Due from reinsurers | 377,802 | 166,880 |
| Premium and claim funds | 40,795 | 40,596 |
| Goodwill | 50,318 | 50,318 |
| Other assets | 83,984 | 86,382 |
| | | |
| TOTAL ASSETS | \$ 1,276,749 | \$ 1,262,308 |
| | | |
| LIABILITIES AND STOCKHOLDERS EQUITY: | | |
| LIABILITIES: | | |
| Claims and claim adjustment expenses-health | \$ 232,688 | \$ 194,480 |
| Future policy benefits-life and annuity | 285,175 | 290,238 |
| Funds on deposit | 276,379 | 278,084 |
| Unearned premiums | 10,970 | 8,453 |
| Other policyholders' funds | 24,975 | 22,373 |
| Due to reinsurers | 36,734 | 48,192 |
| Accounts payable, accruals and other liabilities | 75,861 | 71,495 |
| Debt | 6,000 | 8,000 |
| Junior subordinated debt securities | 38,146 | 38,146 |
| | | |
| TOTAL LIABILITIES | 986,928 | 959,461 |
| | | |
| STOCKHOLDERS EQUITY: | | |
| IHC STOCKHOLDERS' EQUITY: | | |

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| | | |
|---|---------------------|---------------------|
| Preferred stock (none issued) | -- | - |
| Common stock \$1.00 par value, 23,000,000 shares authorized; | | |
| 18,520,433 and 18,461,992 shares issued; 17,711,526 and 17,932,954 shares outstanding | 18,520 | 18,462 |
| Paid-in capital | 127,683 | 126,589 |
| Accumulated other comprehensive income (loss) | (5,922) | 15,013 |
| Treasury stock, at cost; 808,907 and 529,038 shares | (7,431) | (4,533) |
| Retained earnings | 141,564 | 130,153 |
| TOTAL IHC STOCKHOLDERS EQUITY | 274,414 | 285,684 |
| NONCONTROLLING INTERESTS IN SUBSIDIARIES | 15,407 | 17,163 |
| TOTAL EQUITY | 289,821 | 302,847 |
| TOTAL LIABILITIES AND EQUITY | \$ 1,276,749 | \$ 1,262,308 |

See the accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-----------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| REVENUES: | | | | |
| Premiums earned | \$ 125,174 | \$ 92,236 | \$ 368,007 | \$ 261,479 |
| Net investment income | 6,841 | 9,346 | 21,844 | 25,706 |
| Fee income | 6,290 | 7,754 | 18,871 | 21,064 |
| Other income | 922 | 1,155 | 3,933 | 3,558 |
| Net realized investment gains | 2,417 | 1,011 | 18,771 | 3,998 |
| Other-than-temporary impairment losses: | | | | |
| Total other-than-temporary impairment losses | - | - | - | (992) |
| Portion of losses recognized in other comprehensive income | - | - | - | 288 |
| Net impairment losses recognized in earnings | - | - | - | (704) |
| | 141,644 | 111,502 | 431,426 | 315,101 |
| EXPENSES: | | | | |
| Insurance benefits, claims and reserves | 88,177 | 63,034 | 262,913 | 180,434 |
| Selling, general and administrative expenses | 45,597 | 39,791 | 133,339 | 109,594 |
| Amortization of deferred acquisitions costs | 1,404 | 1,587 | 13,792 | 4,812 |
| Interest expense on debt | 470 | 509 | 1,447 | 1,588 |
| | 135,648 | 104,921 | 411,491 | 296,428 |
| Income from operations before income taxes | 5,996 | 6,581 | 19,935 | 18,673 |
| Income taxes | 2,080 | 2,191 | 6,821 | 6,123 |
| Net income | 3,916 | 4,390 | 13,114 | 12,550 |
| Less: Income from noncontrolling interests in subsidiaries | (277) | (472) | (1,083) | (1,179) |
| | 3,639 | 3,918 | 12,031 | 11,371 |
| | \$ 3,639 | \$ 3,918 | \$ 12,031 | \$ 11,371 |
| | | | | |
| Basic income per common share | \$.21 | \$.22 | \$.68 | \$.63 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 17,683 | 17,957 | 17,784 | 17,991 |
| Diluted income per common share | \$.21 | \$.22 | \$.67 | \$.63 |
| WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING | 17,735 | 18,028 | 17,890 | 18,076 |

See the accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Three Months Ended September 30, 2013 2012 | | Nine Months Ended September 30, 2013 2012 | |
|--|--|----------|---|-----------|
| Net income | \$ 3,916 | \$ 4,390 | \$3,114 | \$ 12,550 |
| Other comprehensive income (loss): | | | | |
| Available-for-sale securities: | | | | |
| Unrealized gains (losses) on available-for-sale securities, pre-tax | (3,969) | 6,227 | (31,965) | 13,534 |
| Tax expense (benefit) on unrealized gains (losses) on available-for-sale securities | (1,454) | 1,985 | (10,359) | 4,351 |
| Unrealized gains (losses) on available-for-sale securities, net of taxes | (2,515) | 4,242 | (21,606) | 9,183 |
| Other-than-temporary impairment losses, pre-tax | - | - | - | (288) |
| Tax benefit on other-than-temporary impairment losses | - | - | - | (41) |
| Other-than-temporary impairment losses, net of taxes | - | - | - | (247) |
| Cash flow hedge: | | | | |
| Unrealized gains (losses) on cash flow hedge, pre-tax | 97 | 126 | 142 | 118 |
| Tax expense (benefit) on unrealized gains (losses) on cash flow hedge | 39 | 50 | 57 | 47 |
| Unrealized gains (losses) on cash flow hedge, net of taxes | 58 | 76 | 85 | 71 |
| Other comprehensive income (loss), net of tax | (2,457) | 4,318 | (21,521) | 9,007 |
| COMPREHENSIVE INCOME (LOSS), NET OF TAX | 1,459 | 8,708 | (8,407) | 21,557 |
| Comprehensive income, net of tax, attributable to noncontrolling interests: | | | | |
| Income from noncontrolling interests in subsidiaries | (277) | (472) | (1,083) | (1,179) |
| Other comprehensive loss, net of tax, attributable to noncontrolling interests: | | | | |
| Unrealized (income) loss on available-for-sale securities, net of tax | (6) | (137) | 550 | (230) |
| Other comprehensive (income) loss, net of tax, attributable to noncontrolling interests | (6) | (137) | 550 | (230) |

| | | | | |
|---|----------|---------|----------|-----------|
| COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO NONCONTROLLING INTERESTS | (283) | (609) | (533) | (1,409) |
| COMPREHENSIVE INCOME (LOSS), NET OF TAX, ATTRIBUTABLE TO IHC | \$ 1,176 | \$8,099 | \$8,940) | \$ 20,148 |

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, 2013 (In thousands)

| | COMMON STOCK | PAID-IN CAPITAL | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | TREASURY STOCK, AT COST | RETAINED EARNINGS | TOTAL IHC STOCKHOLDERS' EQUITY | NON- CONTROLLING INTERESTS SUBSIDIARIES |
|--|-----------------|--------------------|--|-------------------------------|----------------------|--------------------------------------|--|
| BALANCE AT DECEMBER 31, 2012 | 18,462\$ | 126,589\$ | 15,013 \$ | (4,533)\$ | 130,153 \$ | 285,684 \$ | |
| Net income | | | | | 12,031 | 12,031 | |
| Other comprehensive loss, net of tax | | | (20,971) | | | (20,971) | |
| Repurchases of common stock | | | | (2,898) | | (2,898) | |
| Common stock dividend (\$.035 per share) | | | | | (620) | (620) | |
| Share-based compensation expenses and related tax benefits | 58 | 677 | | | | 735 | |
| Acquire noncontrolling interests | | 403 | 36 | | | 439 | |
| Distributions to noncontrolling interests | | | | | | - | |
| Other capital transactions | | 14 | | | | 14 | |

BALANCE

AT
SEPTEMBER 30, 2013 18,520\$ 127,683\$ (5,922)\$ (7,431)\$ 141,564 \$ 274,414 \$

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, | |
| | 2013 | 2012 |
| CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES: | | |
| Net income | \$ 13,114 | \$ 12,550 |
| Adjustments to reconcile net income to net change in cash from operating activities: | | |
| Amortization of deferred acquisition costs | 13,792 | 4,812 |
| Net realized investment gains | (18,771) | (3,998) |
| Other-than-temporary impairment losses | - | 704 |
| Equity income from equity method investments | (2,150) | (1,362) |
| Depreciation and amortization | 3,483 | 3,052 |
| Share-based compensation expenses | 956 | 794 |
| Deferred tax expense | 3,891 | 4,265 |
| Other | 3,689 | 5,159 |
| Changes in assets and liabilities: | | |
| Net sales of trading securities | 1,747 | 63 |
| Change in insurance liabilities | 27,441 | (139,719) |
| Additions to deferred acquisition costs, net | (4,382) | (4,615) |
| Change in amounts due from reinsurers | (210,922) | (5,150) |
| Change in premium and claim funds | (199) | 3,978 |
| Change in current income tax liability | 2,761 | 1,661 |
| Change in due and unpaid premiums | (8,913) | (8,165) |
| Change in other assets | (196) | (882) |
| Change in other liabilities | 1,326 | (3,591) |
| | Net change in cash from operating activities | (173,333) (130,444) |
| CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES: | | |
| Change in net amount due from and to securities brokers | 7,621 | 5,318 |
| Net (purchases) sales of securities under resale and repurchase agreements | (80) | 2,276 |
| Sales of equity securities | 10,029 | 7,567 |
| Purchases of equity securities | - | (2,963) |
| Sales of fixed maturities | 518,399 | 396,579 |
| Maturities and other repayments of fixed maturities | 44,692 | 53,039 |
| Purchases of fixed maturities | (413,937) | (328,968) |
| Change in other investments | - | 1,535 |
| Cash paid in acquisitions of companies, net of cash acquired | - | (243) |
| Other investing activities | 9,103 | (5,521) |

| | | | |
|---|---|-----------|-----------|
| | Net change in cash from investing activities | 175,827 | 128,619 |
| CASH FLOWS PROVIDED BY (USED BY) FINANCING ACTIVITIES: | | | |
| | Repurchases of common stock | (2,898) | (1,108) |
| | Cash paid in acquisitions of noncontrolling interests | (1,199) | (58) |
| | Proceeds (withdrawals) of investment-type insurance contracts | (2,342) | 2,433 |
| | Repayment of debt | (2,000) | (2,000) |
| | Dividends paid | (620) | (1,051) |
| | Proceeds from stock options exercised | 400 | - |
| | Other capital transactions | (945) | (54) |
| | Net change in cash from financing activities | (9,604) | (1,838) |
| | Net change in cash and cash equivalents | (7,110) | (3,663) |
| | Cash and cash equivalents, beginning of year | 23,945 | 18,227 |
| | Cash and cash equivalents, end of period | \$ 16,835 | \$ 14,564 |

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"), Independence American Insurance Company (Independence American); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC, IHC Health Solutions, Inc. and IHC Specialty Benefits, Inc. 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, 2013, the Company also owned an 80.6% interest in American Independence Corp. ("AMIC").

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 51.6% of IHC's outstanding common stock at September 30, 2013.

(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 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, 2013 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

Recent Accounting Pronouncements

Recently Adopted Accounting Standards

In February 2013, the Financial Accounting Standards Board (FASB) issued guidance requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. For other amounts, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. The adoption of this guidance, effective January 1, 2013, only affected the Company's presentation of

information pertaining to other comprehensive income (loss) and did not affect the Company's consolidated financial statements.

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 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 adoption of this guidance, effective January 1, 2013, did not have a material effect on the Company's consolidated financial statements.

In December 2011 and March 2013, 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. The adoption of this guidance, effective January 1, 2013, did not have a material effect on the Company's consolidated financial statements.

Recently Issued Accounting Standards Not Yet Adopted

In July 2013, the FASB issued guidance for the presentation of unrecognized tax benefits to better reflect the manner in which an entity would settle, at the reporting date, any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 31, 2013. The Company's presentation of unrecognized tax benefits is consistent with this guidance and therefore the adoption of such guidance will not have an effect on the Company's consolidated financial statements.

In July 2013, the FASB issued guidance that permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes and removes the restriction on using different benchmark rates for similar hedges. This guidance is effective prospectively for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013 and is not expected to have an impact 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.

(D)

Reclassifications

Certain amounts in prior year's Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2013 presentation.

Note 2.

American Independence Corp.

As a result of share repurchases by AMIC in January 2013, (i) noncontrolling interests decreased by \$1,638,000; (ii) the Company recorded a \$403,000 credit to its paid-in capital; and (iii) IHC's ownership interest in AMIC increased to 80.6%.

In October 2013, IHC purchased 762,640 shares of AMIC common stock in connection with a tender offer for such shares and, as a result, IHC and its subsidiaries further increased its ownership of AMIC to 90.0%.

Note 3.

Income Per Common Share

Diluted income per share, computed using the treasury stock method, include incremental shares from; (i) 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 52,000 and 106,000 shares, respectively, for the three months and nine months ended September 30, 2013, and 71,000 and 85,000 shares, respectively, for the three months and nine months ended September 30, 2012.

Note 4.

Investments

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

| | September 30, 2013 | | | |
|---|---------------------------|---------------------------------------|--|-----------------------|
| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
| FIXED MATURITIES | | | | |
| AVAILABLE-FOR-SALE: | | | | |
| Corporate securities | \$ 216,279 | \$ 1,895 | \$ (6,513) | \$ 211,661 |
| CMOs - residential ⁽¹⁾ | 3,338 | 714 | - | 4,052 |
| CMOs - commercial | 975 | - | (403) | 572 |
| U.S. Government obligations | 19,298 | 332 | (71) | 19,559 |
| Agency MBS - residential ⁽²⁾ | 99 | 6 | - | 105 |
| GSEs ⁽³⁾ | 31,572 | 132 | (299) | 31,405 |
| States and political subdivisions | 249,622 | 2,825 | (5,699) | 246,748 |
| Foreign governments | 30,574 | 24 | (1,810) | 28,788 |
| Redeemable preferred stocks | 4,036 | 73 | (292) | 3,817 |
| Total fixed maturities | \$ 555,793 | \$ 6,001 | \$ (15,087) | \$ 546,707 |
| EQUITY SECURITIES | | | | |
| AVAILABLE-FOR-SALE: | | | | |
| Nonredeemable preferred stocks | \$ 5,504 | \$ 112 | \$ (11) | \$ 5,605 |
| Total equity securities | \$ 5,504 | \$ 112 | \$ (11) | \$ 5,605 |

| | December 31, 2012 | | | | | |
|---|---------------------------|--|---------------------------------------|--|--|-----------------------|
| | AMORTIZED COST | | GROSS UNREALIZED GAINS | | GROSS UNREALIZED LOSSES | FAIR VALUE |
| FIXED MATURITIES | | | | | | |
| AVAILABLE-FOR-SALE: | | | | | | |
| Corporate securities | \$ 343,529 | | \$ 11,247 | | \$ (953) | \$ 353,823 |
| CMOs - residential ⁽¹⁾ | 12,993 | | 7,166 | | (65) | 20,094 |
| CMOs - commercial | 975 | | - | | (405) | 570 |
| U.S. Government obligations | 18,376 | | 492 | | (2) | 18,866 |
| Agency MBS - residential ⁽²⁾ | 397 | | 31 | | - | 428 |
| GSEs ⁽³⁾ | 48,598 | | 1,075 | | (67) | 49,606 |
| States and political subdivisions | 260,086 | | 9,134 | | (995) | 268,225 |
| Redeemable preferred stocks | 6,323 | | 1,667 | | - | 7,990 |
| Total fixed maturities | \$ 691,277 | | \$ 30,812 | | \$ (2,487) | \$ 719,602 |
| EQUITY SECURITIES | | | | | | |
| AVAILABLE-FOR-SALE: | | | | | | |
| Nonredeemable preferred stocks | \$ 15,355 | | \$ 253 | | \$ (10) | \$ 15,598 |
| Total equity securities | \$ 15,355 | | \$ 253 | | \$ (10) | \$ 15,598 |

(1)

Collateralized mortgage obligations (CMOs).

(2)

Mortgage-backed securities (MBS).

(3)

Government-sponsored enterprises (GSEs) are private enterprises established and chartered by the Federal Government or its various insurance and lease programs which carry the full faith and credit obligation of the U.S. Government.

The amortized cost and fair value of fixed maturities available-for-sale at September 30, 2013, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. CMOs and

MBSs are shown separately, as they are not due at a single maturity.

| | AMORTIZED COST | FAIR VALUE |
|---|---------------------------|-----------------------|
| Due in one year or less | \$ 2,350 | \$ 2,635 |
| Due after one year through five years | 54,528 | 55,024 |
| Due after five years through ten years | 183,314 | 178,605 |
| Due after ten years | 279,616 | 274,308 |
| CMOs and MBSs | 35,985 | 36,135 |
| | \$ 555,793 | \$ 546,707 |

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

September 30, 2013

| | Less than 12 Months | | 12 Months or Longer | | Total | |
|--|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities | \$ 142,526 | \$ 6,169 | \$ 4,684 | \$ 344 | \$ 147,210 | \$ 6,513 |
| CMOs - commercial | - | - | 572 | 403 | 572 | 403 |
| U.S. Government obligations | 4,127 | 71 | - | - | 4,127 | 71 |
| GSEs | 3,574 | 91 | 5,482 | 208 | 9,056 | 299 |
| States and political subdivisions | 139,702 | 4,801 | 22,687 | 898 | 162,389 | 5,699 |
| Foreign governments | 26,215 | 1,684 | 1,327 | 126 | 27,542 | 1,810 |
| Redeemable preferred stocks | 3,471 | 292 | - | - | 3,471 | 292 |
| Total fixed maturities | 319,615 | 13,108 | 34,752 | 1,979 | 354,367 | 15,087 |
| Nonredeemable preferred stocks | 1,238 | 11 | - | - | 1,238 | 11 |
| Total temporarily impaired securities | \$ 320,853 | \$ 13,119 | \$ 34,752 | \$ 1,979 | \$ 355,605 | \$ 15,098 |
| Number of securities in an unrealized loss position | 109 | | 16 | | 125 | |

December 31, 2012

| | Less than 12 Months | | 12 Months or Longer | | Total | |
|-----------------------------|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities | \$ 61,386 | \$ 953 | \$ - | \$ - | \$ 61,386 | \$ 953 |
| CMOs - residential | 2,416 | 21 | 1,138 | 44 | 3,554 | 65 |
| CMOs - commercial | - | - | 570 | 405 | 570 | 405 |
| U.S. Government obligations | 5,667 | 2 | - | - | 5,667 | 2 |

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| | | | | | | |
|--|------------|----------|-----------|--------|------------|----------|
| GSEs | 6,162 | 40 | 2,784 | 27 | 8,946 | 67 |
| States and political subdivisions | 53,036 | 657 | 17,707 | 338 | 70,743 | 995 |
| Total fixed maturities | 128,667 | 1,673 | 22,199 | 814 | 150,866 | 2,487 |
| Nonredeemable preferred stocks | 1,378 | 10 | - | - | 1,378 | 10 |
| Total temporarily impaired securities | \$ 130,045 | \$ 1,683 | \$ 22,199 | \$ 814 | \$ 152,244 | \$ 2,497 |
| Number of securities in an unrealized loss position | 45 | | 23 | | 68 | |

Substantially all of the unrealized losses on fixed maturities available-for-sale at September 30, 2013 and December 31, 2012 relate to investment grade securities and are attributable to changes in market interest rates. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Sales of available-for-sale securities: | | | | |
| Fixed maturities | \$ 2,045 | \$ 1,282 | \$ 18,321 | \$ 4,625 |
| Preferred stocks | - | (76) | 177 | (567) |
| Total sales of available-for-sale securities | 2,045 | 1,206 | 18,498 | 4,058 |
| Sales of trading securities | 744 | 184 | 1,129 | 289 |
| Other gains (losses) | (199) | - | (853) | - |
| Total realized gains (losses) | 2,590 | 1,390 | 18,774 | 4,347 |
| Unrealized gains (losses) on trading securities: | | | | |
| Available-for-sale securities transferred to trading category | - | - | - | 138 |
| Change in unrealized gains (losses) on trading securities | (173) | 65 | (3) | (43) |
| Total unrealized gains (losses) on trading securities | (173) | 65 | (3) | 95 |
| Loss on other investment | - | (444) | - | (444) |
| Net realized investment gains (losses) | \$ 2,417 | \$ 1,011 | \$ 18,771 | \$ 3,998 |

For the three months and nine months ended September 30, 2013, the Company realized gross gains of \$2,324,000 and \$21,060,000, respectively, and realized gross losses of \$279,000 and \$2,562,000, respectively, on sales of available-for-sale securities. 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.

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 Income. These gains and losses were previously included in accumulated other comprehensive income.

Other-Than-Temporary Impairment Evaluations

We recognize an other-than-temporary impairment loss in earnings in the period that we determine: 1) we intend to sell the security; 2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis; or 3) the security has a credit loss. Any non-credit portion of the other-than-temporary impairment loss is recognized in other comprehensive income (loss). See Note 1E(vi) to the Consolidated Financial Statements in the 2012 Annual Report for further discussion of the factors considered by management in its regular review to identify and recognize other-than-temporary impairments on available-for-sale securities. Our other-than-temporary impairment losses were as follows for the periods indicated (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Total other-than-temporary impairment losses | \$ - | \$ - | \$ - | \$ 992 |
| Portion of losses recognized in other comprehensive income (loss) | - | - | - | (288) |
| Net impairment losses recognized in earnings | \$ - | \$ - | \$ - | \$ 704 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Balance at beginning of year | \$ 563 | \$ 2,600 | \$ 1,976 | \$ 2,555 |
| Credit losses during the period for which an other-than-temporary loss was not previously recognized | - | - | - | 473 |
| Additional credit losses for which an other-than-temporary loss was previously recognized | - | - | - | 148 |
| Securities sold | - | (624) | (1,413) | (1,200) |
| Balance at end of period | \$ 563 | \$ 1,976 | \$ 563 | \$ 1,976 |

The after-tax portion of other-than-temporary impairments included in accumulated other comprehensive income (loss) at September 30, 2013 and December 31, 2012 consists of \$345,000 and \$389,000, respectively, related to CMO securities; and \$0 and \$684,000, respectively, related to redeemable preferred stock.

Note 5.

Cash Flow Hedge

In connection with its outstanding amortizing term loan, a subsidiary of IHC entered into an interest rate swap on July 1, 2011 with the commercial bank lender, for a notional amount equal to the debt principal amount (\$6,000,000 and \$8,000,000 at September 30, 2013 and December 31, 2012, 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. At September 30, 2013 and December 31, 2012, the fair value of interest rate swap was \$221,000 and \$363,000, respectively, which is included in other liabilities on the accompanying Consolidated Balance Sheets. See Note 6 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap.

Note 6.

Fair Value Disclosures

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

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

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

Level 3 - Instruments where significant value drivers are unobservable.

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

Investments in fixed maturities and equity securities:

Available-for-sale securities included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, collateralized mortgage obligations, municipals, GSEs and certain preferred stocks that were priced with observable market inputs. Level 3 securities consist primarily of CMO securities 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 CMOs are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite

change in the assumption used for prepayment rates. Further we retain independent pricing vendors to assist in valuing certain instruments.

Trading securities:

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

Interest rate swap:

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

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

| | September 30, 2013 | | | Total |
|---------------------------------------|---------------------------|-------------------|-----------------|-------------------|
| | Level 1 | Level 2 | Level 3 | |
| FINANCIAL ASSETS: | | | | |
| Fixed maturities available-for-sale: | | | | |
| Corporate securities | \$ - | \$ 211,661 | \$ - | \$ 211,661 |
| CMOs - residential | - | 2,503 | 1,549 | 4,052 |
| CMOs - commercial | - | - | 572 | 572 |
| US Government obligations | - | 19,559 | - | 19,559 |
| Agency MBS - residential | - | 105 | - | 105 |
| GSEs | - | 31,405 | - | 31,405 |
| States and political subdivisions | - | 244,275 | 2,473 | 246,748 |
| Foreign governments | - | 28,788 | - | 28,788 |
| Redeemable preferred stocks | 3,817 | - | - | 3,817 |
| Total fixed maturities | 3,817 | 538,296 | 4,594 | 546,707 |
| Equity securities available-for-sale: | | | | |
| Nonredeemable preferred stocks | 5,605 | - | - | 5,605 |
| Total equity securities | 5,605 | - | - | 5,605 |
| Trading securities - equities | 6,394 | - | - | 6,394 |
| Total trading securities | 6,394 | - | - | 6,394 |
| Total Financial Assets | \$ 15,816 | \$ 538,296 | \$ 4,594 | \$ 558,706 |
| FINANCIAL LIABILITIES: | | | | |
| Interest rate swap | \$ - | \$ 221 | \$ - | \$ 221 |

| | December 31, 2012 | | | Total |
|--------------------------------------|--------------------------|----------------|----------------|--------------|
| | Level 1 | Level 2 | Level 3 | |
| FINANCIAL ASSETS: | | | | |
| Fixed maturities available-for-sale: | | | | |
| Corporate securities | \$ - | \$ 353,823 | \$ - | \$ 353,823 |
| CMOs - residential | - | 6,041 | 14,053 | 20,094 |
| CMOs - commercial | - | - | 570 | 570 |
| US Government obligations | - | 18,866 | - | 18,866 |
| Agency MBS - residential | - | 428 | - | 428 |
| GSEs | - | 49,606 | - | 49,606 |
| States and political subdivisions | - | 265,667 | 2,558 | 268,225 |
| Redeemable preferred stocks | 7,990 | - | - | 7,990 |

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| | | | | |
|---------------------------------------|-----------|------------|-----------|------------|
| Total fixed maturities | 7,990 | 694,431 | 17,181 | 719,602 |
| Equity securities available-for-sale: | | | | |
| Nonredeemable preferred stocks | 15,598 | - | - | 15,598 |
| Total equity securities | 15,598 | - | - | 15,598 |
| Trading securities - equities | 7,016 | - | - | 7,016 |
| Total trading securities | 7,016 | - | - | 7,016 |
| Total Financial Assets | \$ 30,604 | \$ 694,431 | \$ 17,181 | \$ 742,216 |
| FINANCIAL LIABILITIES: | | | | |
| Interest rate swap | \$ - | \$ 363 | \$ - | \$ 363 |

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, 2013, 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, 2013. 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 2013 or 2012. The changes in the carrying value of Level 3 assets and liabilities, for the periods indicated, are summarized as follows (in thousands):

| | Three Months Ended September 30, 2013 | | | |
|---|--|-------------------|--|--------------|
| | CMOs | | States and Political Subdivisions | |
| | Residential | Commercial | Subdivisions | Total |
| Beginning balance | \$ 4,370 | \$ 571 | \$ 2,501 | \$ 7,442 |
| Gains (losses) included in earnings: | | | | |
| Net realized investment gains | 1,882 | - | - | 1,882 |
| Gains (losses) included in other comprehensive income (loss): | | | | |
| Net unrealized gains (losses) | (2,140) | 1 | (18) | (2,157) |
| Sales of securities | (2,343) | - | - | (2,343) |
| Repayments and amortization of fixed maturities | (220) | - | (10) | (230) |
| Balance at end of period | \$ 1,549 | \$ 572 | \$ 2,473 | \$ 4,594 |

| | Three Months Ended September 30, 2012 | | | |
|---|--|-------------------|--|--------------|
| | CMOs | | States and Political Subdivisions | |
| | Residential | Commercial | Subdivisions | Total |
| Beginning balance | \$ 12,969 | \$ 551 | \$ 2,614 | \$ 16,134 |
| Gains (losses) included in other comprehensive income (loss): | | | | |
| Net unrealized gains (losses) | 1,906 | 9 | (30) | 1,885 |
| Repayments and amortization of fixed maturities | (733) | - | 3 | (730) |

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| | | | | | | | | |
|--------------------------|----|--------|----|-----|----|-------|----|--------|
| Balance at end of period | \$ | 14,142 | \$ | 560 | \$ | 2,587 | \$ | 17,289 |
|--------------------------|----|--------|----|-----|----|-------|----|--------|

| | Nine Months Ended September 30, 2013 | | | | |
|---|---|-------------------|--|--|--------------|
| | CMOs | | States and Political Subdivisions | | Total |
| | Residential | Commercial | | | |
| Beginning balance | \$ 14,053 | \$ 570 | \$ 2,558 | | \$ 17,181 |
| Gains (losses) included in earnings: | | | | | |
| Net realized investment gains | 6,517 | - | - | | 6,517 |
| Gains (losses) included in other comprehensive income (loss): | | | | | |
| Net unrealized gains (losses) | (6,389) | 2 | (60) | | (6,447) |
| Sales of securities | (11,663) | - | - | | (11,663) |
| Repayments and amortization of fixed maturities | (969) | - | (25) | | (994) |
| Balance at end of period | \$ 1,549 | \$ 572 | \$ 2,473 | | \$ 4,594 |

| | Nine Months Ended September 30, 2012 | | | | |
|---|---|-------------------|--|--|--------------|
| | CMOs | | States and Political Subdivisions | | Total |
| | Residential | Commercial | | | |
| 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) |
| Gains (losses) included in other comprehensive income (loss): | | | | | |
| Net unrealized gains (losses) | 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, for the periods indicated, that are not carried at fair value but are subject to fair value

disclosure requirements (in thousands):

| | September 30, 2013 | | December 31, 2012 | |
|---|--------------------------|-------------------|--------------------------|-------------------|
| | Level 2 Fair Value | Carrying Value | Level 2 Fair Value | Carrying Value |
| FINANCIAL ASSETS: | | | | |
| Policy loans | \$ 14,462 | \$ 11,182 | \$ 28,748 | \$ 22,165 |
| FINANCIAL LIABILITIES: | | | | |
| Funds on deposit | \$ 277,327 | \$ 276,379 | \$ 279,125 | \$ 278,084 |
| Debt and junior subordinated debt securities | \$ 44,146 | \$ 44,146 | \$ 46,146 | \$ 46,146 |

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 7.

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 2013 is as follows (in thousands):

| | Other Intangible Assets | | | |
|-------------------------------|--------------------------------|-----------------------------|-----------------------------|--|
| | Goodwill | Definitive Lives | Indefinite Lives | Total Other Intangible Assets |
| Balance at December 31, 2012 | \$ 50,318 | \$ 10,294 | \$ 7,977 | \$ 18,271 |
| Medical Stop-Loss: | | | | |
| Broker relationships | - | (183) | - | (183) |
| Amortization expense | - | (2,443) | - | (2,443) |
| Balance at September 30, 2013 | \$ 50,318 | \$ 7,668 | \$ 7,977 | \$ 15,645 |

Note 8.**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 was \$436,000 and \$153,000 for the three months ended September 30, 2013 and 2012, respectively, and was \$926,000 and \$770,000 for the nine months ended September 30, 2013 and 2012,

respectively. Related tax benefits of \$174,000 and \$61,000 were recognized for the three months ended September 30, 2013 and 2012, respectively, and \$369,000 and \$307,000 were recognized for the nine months ended September 30, 2013 and 2012, 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, 2013, there were 380,970 shares available for future stock-based compensation grants under IHC's stock incentive plans.

Stock Options

IHC's stock option activity for the nine months ended September 30, 2013 is as follows:

| | Shares Under Option | Weighted- Average Exercise Price |
|---------------------------|--------------------------------|---|
| December 31, 2012 | 693,836 | \$ 9.36 |
| Exercised | (44,000) | 9.09 |
| Forfeited | (27,500) | 9.99 |
| Expired | (2,178) | 10.47 |
| September 30, 2013 | 620,158 | \$ 9.35 |

The total intrinsic value of options exercised during the nine months ended September 30, 2013 was \$228,000. In March 2013, 192,500 share options held by 5 employees were modified to extend the expiration term 5 years. The incremental cost of the modified awards was \$618,000, which will be recognized over a new 2-year vesting period starting from the date of the modification.

The following table summarizes information regarding outstanding and exercisable options as of September 30, 2013:

| | Outstanding | Exercisable |
|--|--------------------|--------------------|
| Number of options | 620,158 | 455,158 |
| Weighted average exercise price per share | \$ 9.35 | \$ 9.12 |
| Aggregate intrinsic value for all options (in thousands) | \$ 3,058 | \$ 2,351 |
| Weighted average contractual term remaining | 2.1 years | 1.2 years |

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model.

Compensation expense of \$53,000 and \$56,000 was recognized in the three months ended September 30, 2013 and 2012, respectively, and \$143,000 and \$177,000 was recognized in the nine months ended September 30, 2013 and 2012, respectively, for the portion of the grant-date fair value of stock options vesting during that period.

As of September 30, 2013, the total unrecognized compensation expense related to non-vested stock options was \$386,000, which is expected to be recognized over the remaining requisite weighted-average service period of 1.46 years.

Restricted Stock

The following table summarizes restricted stock activity for the nine months ended September 30, 2013:

| | No. of Non-vested Shares | Weighted-Average Grant-Date Fair Value |
|--------------------|---|---|
| December 31, 2012 | 13,200 | \$ 9.37 |
| Granted | 7,425 | 11.66 |
| Vested | (5,775) | 9.15 |
| September 30, 2013 | 14,850 | \$ 10.60 |

IHC granted 7,425 shares of restricted stock awards during each of the nine months ended September 30, 2013 and 2012 with a weighted average grant-date fair value of \$11.66 and \$9.39, respectively, per share. The total fair value of restricted stock that vested during each of the first nine months of 2013 and 2012 was \$69,000 and \$40,000, respectively. Restricted stock expense was \$19,000 and \$13,000 for the three months ended September 30, 2013 and 2012, respectively, and was \$47,000 and \$31,000 for the nine months ended September 30, 2013 and 2012, respectively.

As of September 30, 2013, the total unrecognized compensation expense related to non-vested restricted stock awards was \$136,000 which is expected to be recognized over the remaining requisite weighted-average service period of 2.0 years.

SARs and Share-Based Performance Awards

IHC had 251,800 and 269,950 SAR awards outstanding at September 30, 2013 and December 31, 2012, respectively. No SARs awards were granted during the nine months ended September 30, 2013. During the nine months ended September 30, 2012, the Company granted 44,000 SAR awards. The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. For three months ended September 30, 2013, and 2012, IHC recorded \$363,000, and \$60,000, respectively, of compensation costs for these awards. For nine months ended September 30, 2013, and 2012, IHC recorded \$741,000, and \$511,000, respectively, of compensation costs for these awards. In the first nine months of

2013, 14,850 SARs were exercised with an aggregate intrinsic value of \$74,000. No SARs were exercised during the nine months ended September 30, 2012. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at September 30, 2013 and December 31, 2012 are liabilities of \$1,350,000 and \$683,000, 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. IHC discontinued these award programs in 2013. For the three months ended September 30, 2013, and 2012, IHC recorded \$0 and \$24,000, respectively, of compensation costs for these awards, and for the nine months ended September 30, 2013, and 2012, IHC recorded \$(5,000) and \$51,000, respectively. The intrinsic value of share-based performance awards paid during the nine months ended September 30, 2013 and 2012 was \$83,000 and \$57,000, respectively. Included in the other liabilities on the Company's Condensed Consolidated Balance Sheets at September 30, 2013 and December 31, 2012 are liabilities of \$10,000 and \$97,000, respectively, pertaining to share-based performance awards.

B)

AMIC Share-Based Compensation Plans

Total AMIC share-based compensation expense was \$13,000 and \$8,000 the three months ended September 30, 2013 and 2012, respectively, and was \$30,000 and \$24,000 for the nine months ended September 30, 2013 and 2012, respectively. Related tax benefits of \$4,000 and \$3,000 were recognized for the three months ended September 30, 2013 and 2012; and were \$10,000 and \$9,000 for the nine months ended September 30, 2013 and 2012.

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

AMIC's stock option activity for the nine months ended September 30, 2013 is as follows:

| | Shares Under Option | Weighted- Average Exercise Price | |
|---------------------------|--------------------------------|---|-------|
| December 31, 2012 | 227,285 | \$ | 11.40 |
| Granted | 13,334 | | 7.01 |
| Expired | (18,334) | | 7.50 |
| September 30, 2013 | 222,285 | \$ | 11.46 |

The following table summarizes information regarding AMIC's outstanding and exercisable options as of September 30, 2013:

| | Outstanding | Exercisable |
|--|--------------------|--------------------|
| Number of options | 222,285 | 203,395 |
| Weighted average exercise price per share | \$ 11.46 | \$ 11.91 |
| Aggregate intrinsic value for all options (in thousands) | \$ 236 | \$ 173 |
| Weighted average contractual term remaining | 3.02 years | 2.46 years |

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. The weighted average grant-date fair-value of options granted during the nine months ended September 30, 2013 was \$4.04 per share. No options were granted during the nine months ended September 30, 2012. The assumptions set forth in the table below were used to value the stock options granted during the nine months ended September 30, 2013:

| | September 30 2013 |
|--|------------------------------|
| Weighted-average risk-free interest rate | 2.30% |
| Annual dividend rate per share | - |
| Weighted-average volatility factor of the Company's common stock | 45.00% |
| Weighted-average expected term of options | 5 years |

Compensation expense of \$13,000 and \$8,000 was recognized for the three-month periods ended September 30, 2013 and 2012, respectively, and was \$30,000 and \$24,000 for the nine-month periods ended September 30, 2013 and 2012, respectively, for the portion of the grant-date fair value of AMIC's stock options vesting during the period.

As of September 30, 2013, the total unrecognized compensation expense related to AMIC's non-vested options was \$72,000 which will be recognized over the remaining requisite service periods.

Note 9.

Debt

In July 2013, the Company made a \$2,000,000 principal debt repayment in accordance with the terms of its amortizing term note.

Note 10.

Income Taxes

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

At September 30, 2013, AMIC had net operating loss carryforwards of approximately \$268,808,000 for federal income tax purposes, expiring in varying amounts through the year 2031, with a significant portion expiring in 2021. The net deferred tax asset relative to AMIC included in other assets on IHC's Condensed Consolidated Balance Sheets was \$10,885,000 and \$12,173,000 at September 30, 2013 and December 31, 2012, respectively. Effective January 15, 2013, AMIC will be included in the consolidated Federal income tax returns of IHC on a June 30 fiscal year as a result of the increase in IHC's ownership interest in AMIC to over 80%.

Note 11.

Reinsurance

Effective May 31, 2013, Madison National Life entered into a coinsurance agreement with an unaffiliated reinsurer, Guggenheim Life and Annuity Company, to cede approximately \$218,633,000 of life and annuity reserves and, in accordance with its terms, transferred net cash and other assets, with an aggregate value of \$215,137,000, to the reinsurer during the second quarter of 2013. As a result of this transaction, the Company: (i) recorded estimated amounts due from reinsurers of \$218,296,000; (ii) recorded \$6,643,000 of estimated deferred expenses (included in other assets) which will be amortized over the life of the underlying reinsured contracts; and (iii) wrote-off \$9,307,000 of deferred acquisition costs associated with this block of policies. The write-off was more than offset by gains realized by the Company in the transaction, most of which resulted from the required sale and transfer of invested assets.

Note 12.

Supplemental Disclosures of Cash Flow Information

Tax refunds, net of tax payments, were \$612,000 and \$519,000 during the nine months ended September 30, 2013 and 2012.

Cash payments for interest were \$1,458,000 and \$1,601,000 during the nine months ended September 30, 2013 and 2012, respectively.

Note 13.

Contingencies

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

Note 14.**Other Comprehensive Income (Loss)**

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

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

| | Three Months Ended September 30, 2013 | | |
|--|---|----------------------------|--------------|
| | Unrealized Gains (Losses) on Available-for Sale Securities | Cash Flow Hedge | Total |
| Beginning balance | \$ (3,268) | \$ (191) | \$ (3,459) |
| Other comprehensive income (loss) before reclassifications | (1,364) | 58 | (1,306) |
| Amounts reclassified from accumulated OCI | (1,151) | - | (1,151) |
| Net other comprehensive income (loss) | (2,515) | 58 | (2,457) |
| Less other comprehensive loss attributable to noncontrolling interests | (6) | - | (6) |
| Ending balance | \$ (5,789) | \$ (133) | \$ (5,922) |

Three Months Ended September 30, 2012

| | Unrealized Gains (Losses) on Available-for Sale Securities | Cash Flow Hedge | Total |
|---|---|----------------------------|--------------|
| Beginning balance | \$ 12,754 | \$ (302) | \$ 12,452 |
| Other comprehensive income (loss) before reclassifications | 5,017 | 76 | 5,093 |
| Amounts reclassified from accumulated OCI | (775) | - | (775) |
| Net other comprehensive income (loss) | 4,242 | 76 | 4,318 |
| Less other comprehensive loss attributable to noncontrolling interests | (137) | - | (137) |
| Acquired from noncontrolling interests | - | - | - |
| Ending balance | \$ 16,859 | \$ (226) | \$ 16,633 |

Nine Months Ended September 30, 2013

| | Unrealized Gains (Losses) on Available-for- Sale Securities | Cash Flow Hedge | Total |
|---|--|----------------------------|--------------|
| Beginning balance | \$ 15,231 | \$ (218) | \$ 15,013 |
| Other comprehensive income (loss) before reclassifications | (9,908) | 85 | (9,823) |
| Amounts reclassified from accumulated OCI | (11,698) | - | (11,698) |
| Net other comprehensive income (loss) | (21,606) | 85 | (21,521) |
| Less other comprehensive loss attributable to noncontrolling interests | 550 | - | 550 |
| Acquired from noncontrolling interests | 36 | - | 36 |
| Ending balance | \$ (5,789) | \$ (133) | \$ (5,922) |

Nine Months Ended September 30, 2012

| | Unrealized Gains (Losses) on Available-for-Sale Securities | Cash Flow Hedge | Total |
|---|---|----------------------------|--------------|
| Beginning balance | \$ 8,150 | \$ (297) | \$ 7,853 |
| Other comprehensive income (loss) before reclassifications | 11,190 | 71 | 11,261 |
| Amounts reclassified from accumulated OCI | (2,254) | - | (2,254) |
| Net other comprehensive income (loss) | 8,936 | 71 | 9,007 |
| Less other comprehensive loss attributable to noncontrolling interests | (230) | - | (230) |
| Acquired from noncontrolling interests | 3 | - | 3 |
| Ending balance | \$ 16,859 | \$ (226) | \$ 16,633 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Unrealized gains (losses) on available-for-sale securities reclassified during the period to the following income statement line items: | | | | |
| Net realized investment gains | \$ 1,846 | \$ 1,205 | \$ 17,647 | \$ 4,195 |
| Net impairment losses recognized in earnings | - | - | - | (704) |
| Income from operations before income tax | 1,846 | 1,205 | 17,647 | 3,491 |
| Tax effect | 695 | 430 | 5,949 | 1,237 |
| Net income | \$ 1,151 | \$ 775 | \$ 11,698 | \$ 2,254 |

Note 15.

Segment Reporting

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|-------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues: | | | | |
| Medical Stop-Loss | \$ 42,043 | \$ 38,286 | \$ 127,833 | \$ 107,844 |
| Fully Insured Health | 71,778 | 45,357 | 203,896 | 124,033 |
| Group disability, life, annuities and DBL | 15,842 | 13,160 | 46,685 | 38,901 |
| Individual life, annuities and other | 9,542 | 13,666 | 34,162 | 40,517 |
| Corporate | 22 | 22 | 79 | 512 |
| | 139,227 | 110,491 | 412,655 | 311,807 |
| Net realized investment gains | 2,417 | 1,011 | 18,771 | 3,998 |
| Other-than-temporary impairment losses | - | - | - | (704) |
| Total revenues | \$ 141,644 | \$ 111,502 | \$ 431,426 | \$ 315,101 |
| Income from operations | | | | |
| before income taxes: | | | | |
| Medical Stop-Loss | \$ 3,404 | \$ 2,853 | \$ 9,836 | \$ 12,787 |
| Fully Insured Health ^(A) | 615 | 1,461 | 474 | 4,619 |
| Group disability, life, annuities and DBL | 2,555 | 3,590 | 6,530 | 4,292 |
| Individual life, annuities and other ^(B) | (40) | 852 | (9,207) | 1,050 |
| Corporate | (2,485) | (2,677) | (5,022) | (5,781) |
| | 4,049 | 6,079 | 2,611 | 16,967 |
| Net realized investment gains | 2,417 | 1,011 | 18,771 | 3,998 |
| Other-than-temporary impairment losses | - | - | - | (704) |
| Interest expense | (470) | (509) | (1,447) | (1,588) |
| Income from operations before | | | | |
| income taxes | \$ 5,996 | \$ 6,581 | \$ 19,935 | \$ 18,673 |

(A)

The Fully Insured Health segment includes amortization of intangible assets. Total amortization expense was \$602,000 and \$624,000 for the three months ended September 30, 2013 and 2012, respectively, and was \$1,810,000 and \$1,829,000, respectively, for the nine months ended September 30, 2013 and 2012. Amortization expense for the other segments is not material to their operating results.

(B)

For the nine months ended September 30, 2013, the Individual life, annuities and other segment includes the write-off of \$9,307,000 of deferred acquisition costs in connection with a coinsurance agreement. See Note 11 for more reinsurance information.

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, 2012, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.

Overview

Independence Holding Company, a Delaware corporation (IHC), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company (Independence American); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC, IHC Health Solutions, Inc. and IHC Specialty Benefits, Inc. 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, 2013, the Company also owned an 80.6% 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, 2013 and 2012 are summarized as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-----------------|--|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues | \$ 141,644 | \$ 111,502 | \$ 431,426 | \$ 315,101 |
| Expenses | 135,648 | 104,921 | 411,491 | 296,428 |
| Income from operations before income taxes | 5,996 | 6,581 | 19,935 | 18,673 |
| Income taxes | 2,080 | 2,191 | 6,821 | 6,123 |
| Net income | 3,916 | 4,390 | 13,114 | 12,550 |
| Less: Income from noncontrolling interests in subsidiaries | (277) | (472) | (1,083) | (1,179) |
| Net income attributable to IHC | \$ 3,639 | \$ 3,918 | \$ 12,031 | \$ 11,371 |

o

Net income of \$.21 per share, diluted, for the three months ended September 30, 2013 compared to \$.22 per share, diluted, for the same period in 2012. Net income of \$.67 per share, diluted, for the nine months ended September 30, 2013, compared to \$.63 per share, diluted, for the nine months ended September 30, 2012.

o

Consolidated investment yields (on an annualized basis) of 4.2% and 3.8% for the three months and nine months ended September 30, 2013 compared to 4.6% and 4.2% for the comparable periods in 2012;

o

Increased IHC's ownership in AMIC to 80.6% as a result of AMIC's share repurchases in the first quarter of 2013. In October 2013, IHC acquired 762,640 shares of AMIC common stock in connection with a tender offer for such shares and, as a result, further increased its ownership of AMIC to 90.0%;

o

In the second quarter of 2013, Madison National Life entered into a coinsurance agreement with an unaffiliated reinsurer, effective May 31, 2013, to cede approximately \$218.6 million of life and annuity reserves. Net realized investment gains were \$18.8 million for the nine months ended September 30, 2013, of which a significant portion resulted from sales of invested assets in connection with the transfer of assets in accordance with the terms of such coinsurance agreement. In addition, the Company wrote-off \$9.3 million of deferred acquisition costs as a result of this coinsurance agreement, which was more than offset by the net realized investment gains in the period; and

o

Book value of \$15.49 per common share, a decrease of \$.44 per common share from \$15.93 at December 31, 2012 primarily due to an increase in interest rates.

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

o

The Medical Stop-Loss segment reported income before taxes of \$3.4 million for the third quarter of 2013 compared to \$2.9 million in the same quarter in 2012, and reported income before taxes of \$9.8 million for the first nine months of 2013 compared to \$12.8 million for the first nine months of 2012. The decrease is primarily due to higher loss ratios in 2013;

o

Premiums earned increased \$4.0 million and \$20.2 million for the three months and nine months ended September 30, 2013, respectively, when compared to the same periods in 2012. The increase in premiums earned is primarily due to increased volume.

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, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Premiums Earned | \$ 40,534 | \$ 36,465 | \$ 123,328 | \$ 103,100 |
| Insurance Benefits, Claims & Reserves Expenses | 27,996 | 24,590 | 85,490 | 65,585 |
| | 10,482 | 10,718 | 31,711 | 29,193 |
| Loss Ratio ^(A) | 69.1% | 67.4% | 69.3% | 63.6% |
| Expense Ratio ^(B) | 25.8% | 29.4% | 25.7% | 28.3% |
| Combined Ratio ^(C) | 94.9% | 96.8% | 95.0% | 91.9% |

(A)

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

(B)

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

(C)

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

o

The Company recorded an increase in the loss ratio in the medical stop-loss line of business for the nine months ended September 30, 2013 due to slightly higher loss ratios on direct written business and an unfavorable reserve development related to business written with a certain producer which resulted in a \$2.1 million increase in claim reserves on this program. We have ceased writing new business with this producer.

The Fully Insured Health segment reported \$0.6 million of income before taxes for the three months ended September 30, 2013 as compared to \$1.5 million for the comparable period in 2012, and reported \$0.5 million of income before taxes for the nine months ended September 30, 2013 compared to \$4.6 million for the same period in 2012. The decrease is primarily due to higher loss ratios in 2013;

o

Premiums earned increased \$27.4 million and \$81.0 million for the three months and nine months ended September 30, 2013 over the comparable 2012 periods primarily due to premiums generated by new lines of business (pet and international lines) combined with increased 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, | |
|---|-------------------------------------|-----------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Premiums Earned | \$ 64,470 | \$ 37,137 | \$ 183,221 | \$ 102,204 |
| Insurance Benefits, Claims & Reserves Expenses | 46,142 | 25,154 | 129,600 | 67,536 |
| | 19,490 | 11,265 | 56,584 | 30,369 |
| Loss Ratio | 71.6% | 67.7% | 70.7% | 66.1% |
| Expense Ratio | 30.2% | 30.3% | 30.9% | 29.7% |
| Combined Ratio | 101.8% | 98.0% | 101.6% | 95.8% |

o

The increase in the loss ratio was primarily attributable to an increase in the claims experience on major medical business for groups and individuals primarily due to unfavorable development on business that is produced by certain non-owned third party administrators, a reserve adjustment for a potential lawsuit related to business written through an MGU that was previously terminated and due to changes brought about by certain aspects of health care reform.

Income before taxes from the Group disability, life, annuities and DBL segment decreased \$1.0 million for the three months ended September 30, 2013 and increased \$2.2 million for the nine months ended September 30, 2013 compared to the same periods in 2012 primarily as a result of loss ratio fluctuations in the LTD business;

Income before taxes from the Individual life, annuities and other segment decreased \$0.9 million and \$10.3 million for the three-month and nine-month periods ended September 30, 2013 as compared to the same periods in 2012. Nine month results include \$9.3 million of deferred acquisition costs that were written off in connection with a coinsurance agreement during the second quarter of 2013;

Losses before tax from the Corporate segment in the third quarter of 2013 remained comparable to the same period in 2012, and decreased \$0.8 million in the nine-month period ended September 30, 2013 over the same period of 2012, primarily due to a decrease in corporate overhead;

Net realized investment gains were \$2.4 million and \$18.8 million for the three months and nine months ended September 30, 2013 compared to net realized investment gains of \$1.0 million and \$4.0 million for the three months and nine months ended September 30, 2012. A significant portion of the net realized investment gains in the first nine months of 2013 resulted from sales of invested assets in connection with the transfer of assets in accordance with the terms of a coinsurance agreement. The Company did not record any other-than-temporary impairment losses in 2013. Other-than-temporary impairment losses recognized in earnings for the nine months ended September 30, 2012 were \$0.7 million; and

Premiums by principal product for the three months and nine months ended September 30, 2013 and 2012 are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Gross Direct and Assumed Earned Premiums: | | | | |
| Medical Stop-Loss | \$ 48,153 | \$ 42,992 | \$ 146,664 | \$ 123,425 |
| Fully Insured Health | 74,837 | 58,518 | 212,683 | 163,967 |
| Group disability, life, annuities and DBL | 25,634 | 22,371 | 76,050 | 68,013 |
| Individual, life, annuities and other | 7,081 | 7,488 | 23,442 | 23,257 |
| | \$ 155,705 | \$ 131,369 | \$ 458,839 | \$ 378,662 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net Direct and Assumed Earned Premiums: | | | | |
| Medical Stop-Loss | \$ 40,534 | \$ 36,465 | \$ 123,328 | \$ 103,100 |
| Fully Insured Health | 64,470 | 37,137 | 183,221 | 102,204 |
| Group disability, life, annuities and DBL | 15,205 | 12,423 | 44,295 | 36,776 |
| Individual, life, annuities and other | 4,965 | 6,211 | 17,163 | 19,399 |
| | \$ 125,174 | \$ 92,236 | \$ 368,007 | \$ 261,479 |

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, 2012.

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, 2012. During the nine months ended September 30, 2013, there were no additions to or changes in the critical accounting policies disclosed in the 2012 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, 2013 Compared to the Three Months Ended September 30, 2012

Information by business segment for the three months ended September 30, 2013 and 2012 is as follows:

| <u>September 30,</u> <u>2013</u> (In thousands) | <u>Premiums</u> <u>Earned</u> | <u>Net</u> <u>Investment</u> <u>Income</u> | <u>Fee and</u> <u>Other</u> <u>Income</u> | <u>Benefits,</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of Deferred</u> <u>Acquisition</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|---|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health | \$ 40,534 | 1,402 | 107 | 27,996 | - | 10,643 | \$ 3,404 |
| Group disability, life, annuities and DBL | 64,470 | 1,031 | 6,277 | 46,142 | 4 | 25,017 | 615 |
| Individual life, annuities and other | 15,205 | 608 | 29 | 9,062 | - | 4,225 | 2,555 |
| Corporate | 4,965 | 3,778 | 799 | 4,977 | 1,400 | 3,205 | (40) |
| Sub total | - | 22 | - | - | - | 2,507 | (2,485) |
| | \$ 125,174 | \$ 6,841 | \$ 7,212 | \$ 88,177 | \$ 1,404 | \$ 45,597 | 4,049 |
| Net realized investment gains | | | | | | | 2,417 |
| Interest expense on debt | | | | | | | (470) |
| Income from operations before income taxes | | | | | | | 5,996 |
| Income taxes | | | | | | | 2,080 |
| Net income | | | | | | | \$ 3,916 |

| <u>September 30,</u> <u>2012</u> (In thousands) | <u>Premiums</u> <u>Earned</u> | <u>Net</u> <u>Investment</u> <u>Income</u> | <u>Fee and</u> <u>Other</u> <u>Income</u> | <u>Benefits,</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of Deferred</u> <u>Acquisition</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|---|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health | \$ 36,465 | 1,733 | 88 | 24,590 | - | 10,843 | \$ 2,853 |
| Group disability, life, annuities and DBL | 37,137 | 477 | 7,743 | 25,154 | 6 | 18,736 | 1,461 |
| | 12,423 | 713 | 24 | 5,772 | - | 3,798 | 3,590 |

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| | | | | | | | |
|--|-----------|----------|---------|-----------|----------|-----------|---------|
| 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 |
| Interest expense on debt | | | | | | | (509) |
| Income from operations before income taxes | | | | | | | 6,581 |
| Income taxes | | | | | | | 2,191 |
| Net income | | | | | | | \$ 4,390 |

Premiums Earned

In the third quarter of 2013, premiums earned increased \$33.0 million over the comparable period of 2012. The increase is primarily due to: (i) the Fully Insured Health segment which had a \$27.4 million increase in premiums primarily as a result of increased retentions on most lines of business and increased volume in the short term medical business and major medical business for groups and individuals in addition to premiums from the new pet and international lines of business; (ii) a \$4.0 million increase in the Medical Stop-Loss segment due to increased volume of business in 2013; and (iii) a \$2.8 million increase in the Group disability, life, annuities and DBL segment primarily due to increased premiums from the DBL line; partially offset by (iv) a decrease of \$1.2 million of earned premiums in the Individual life, annuities and other segment primarily as a result of decreased premium volume from the second quarter coinsurance agreement and lines in run-off.

Net Investment Income

Total net investment income decreased \$2.5 million. The overall annualized investment yields were 4.2% and 4.6% (approximately 4.3% and 4.8%, on a tax advantaged basis) in the third quarter of 2013 and 2012, respectively. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due to the transfer of \$215.1 million of invested assets in the second quarter of 2013 related to a coinsurance treaty. The annualized investment yields on bonds, equities and short-term investments were 3.7% and 4.3% in the third quarter of 2013 and 2012, respectively. IHC has approximately \$141.6 million in highly rated shorter duration securities earning on average 1.4%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

Net Realized Investment Gains

The Company had net realized investment gains of \$2.4 million in 2013 compared to \$1.0 million in 2012. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

Fee Income and Other Income

Fee income decreased \$1.5 million for the three-month period ended September 30, 2013 compared to the three-month period ended September 30, 2012 as a result of increased retentions in certain lines of the Fully Insured Health segment.

Other income decreased \$0.2 million in the third quarter of 2013 compared to the same period in 2012.

Insurance Benefits, Claims and Reserves

In the third quarter of 2013, insurance, benefits, claims and reserves increased \$25.2 million over the comparable period in 2012. The increase is primarily attributable to: (i) an increase of \$21.0 million in the Fully Insured Health segment, principally due to the increase in premiums on the major medical business for groups and individuals and short term medical lines of business in addition to the new pet and international lines of business and higher loss

ratios; (ii) an increase of \$3.4 million in the Medical Stop-Loss segment as a result of an increase in premium volume and higher loss ratios; (iii) an increase of \$3.3 million in the group disability, life, annuities and DBL segment primarily due to increases in the DBL line of \$2.0 million as a result of increased volume and \$1.2 million in the LTD line as a result of higher loss ratios in 2013; partially offset by (iv) a \$2.5 million decrease in the Individual life, annuity and other segment primarily a result of decreased volume from the second quarter coinsurance agreement and from lines in run-off.

Amortization of Deferred Acquisition Costs

Amortization of deferred acquisition costs was comparable to the same period in 2012.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$5.8 million. The increase is primarily due to: (i) a \$6.3 million increase in the Fully Insured Health segment largely due to an increase in commission and other general expenses in the major medical business for groups and individuals and short-term medical lines of business in addition to commission and other general expenses related to the new pet and

international lines in 2013; offset by (ii) a decrease of \$0.4 million in Individual life, annuity and other segment.

Income Taxes

The effective tax rate for the three months ended September 30, 2013 and 2012 was 34.7% and 33.3%, respectively. The lower effective tax rate in 2012 was due to a higher benefit from tax-advantaged securities as a percentage of income in 2012.

Results of Operations for the Nine Months Ended September 30, 2013 Compared to the Nine Months Ended September 30, 2012

Information by business segment for the nine months ended September 30, 2013 and 2012 is as follows:

| <u>September 30, 2013</u> (In thousands) | <u>Premiums Earned</u> | <u>Net Investment Income</u> | <u>Fee and Other Income</u> | <u>Benefits, Claims and Reserves</u> | <u>Amortization of Deferred Acquisition Costs</u> | <u>Selling, General And Administrative</u> | <u>Total</u> |
|---|----------------------------|--------------------------------------|-------------------------------------|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health | \$ 123,328 | 4,102 | 403 | 85,490 | - | 32,507 | \$ 9,836 |
| Group disability, life, annuities and DBL | 183,221 | 2,048 | 18,627 | 129,600 | 14 | 73,808 | 474 |
| Individual life, annuities and other | 44,295 | 2,186 | 204 | 27,596 | - | 12,559 | 6,530 |
| Corporate | 17,163 | 13,429 | 3,570 | 20,227 | 13,778 | 9,364 | (9,207) |
| Sub total | - | 79 | - | - | - | 5,101 | (5,022) |
| | \$ 368,007 | \$ 21,844 | \$ 22,804 | \$ 262,913 | \$ 13,792 | \$ 133,339 | 2,611 |
| Net realized investment gains | | | | | | | 18,771 |
| Interest expense on debt | | | | | | | (1,447) |
| Income from operations before income taxes | | | | | | | 19,935 |
| Income taxes | | | | | | | 6,821 |
| Net income | | | | | | | \$ 13,114 |

| <u>September 30,</u> <u>2012</u> (In thousands) | <u>Premiums</u> <u>Earned</u> | <u>Net</u> <u>Investment</u> <u>Income</u> | <u>Fee and</u> <u>Other</u> <u>Income</u> | <u>Benefits,</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of Deferred</u> <u>Acquisition</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|---|--|---|--|--------------|
| Medical Stop-Loss Fully Insured Health | \$ 103,100 | 4,119 | 625 | 65,585 | - | 29,472 | \$ 12,787 |
| Group disability, life, annuities and DBL | 102,204 | 1,123 | 20,706 | 67,536 | 18 | 51,860 | 4,619 |
| Individual life, annuities and other | 36,776 | 2,035 | 90 | 22,876 | - | 11,733 | 4,292 |
| Corporate | 19,399 | 17,917 | 3,201 | 24,437 | 4,794 | 10,236 | 1,050 |
| Sub total | - | 512 | - | - | - | 6,293 | (5,781) |
| | \$ 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 |

Premiums Earned

In the first nine months of 2013, premiums earned increased \$106.5 million over the comparable period of 2012. The increase is primarily due to: (i) the Fully Insured Health segment which had a \$81.0 million increase in premiums primarily as a result of increased retentions on most lines of business and increased volume in the short term medical business and major medical business for groups and individuals in addition to premiums from the new pet and international lines of business; (ii) a \$20.2 million increase in the Medical Stop-Loss segment due to increased volume of business in 2013; and (iii) a \$7.5 million increase in the Group disability, life, annuities and DBL segment primarily due to increased premiums from the DBL line; partially offset by (iv) a decrease of \$2.2 million of earned premiums in the Individual life, annuities and other segment primarily as a result of decreased premium volume from the coinsurance agreement and from lines in run-off.

Net Investment Income

Total net investment income decreased \$3.9 million. The overall annualized investment yields were 3.8% and 4.2% (approximately 3.9% and 4.3%, on a tax advantaged basis) in the first nine months of 2013 and 2012, respectively. The overall decrease was primarily a result of a decrease in investment income on bonds, equities and short-term investments due to the transfer of \$215.1 million of invested assets in the second quarter of 2013 related to a coinsurance treaty. The annualized investment yields on bonds, equities and short-term investments were 3.5% and 3.9% in the first nine months of 2013 and 2012, respectively. IHC has approximately \$141.6 million in highly rated shorter duration securities earning on average 1.4%. 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 Impairments

The Company had net realized investment gains of \$18.8 million in 2013 compared to \$4.0 million in 2012. 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. A significant portion of the net realized investment gains in 2013 resulted from sales of invested assets in connection with the transfer of assets, during the second quarter, in accordance with the terms of a coinsurance agreement.

The Company did not record any other-than-temporary impairment losses in the nine months ended September 30, 2013. During the nine months ended September 30, 2012, the Company recorded \$0.7 million of other-than-temporary impairment losses, pre-tax. Other-than-temporary impairment losses in 2012 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 decreased \$2.2 million for the nine-month period ended September 30, 2013 compared to the nine-month period ended September 30, 2012 as a result of increased retentions in certain lines of the Fully Insured Health segment.

Total other income increased \$0.4 million in the nine-month period ended September 30, 2013 compared to the nine-month period ended September 3, 2012.

Insurance Benefits, Claims and Reserves

In the first nine months of 2013, insurance, benefits, claims and reserves increased \$82.5 million over the comparable period in 2012. The increase is primarily attributable to: (i) an increase of \$62.1

million in the Fully Insured Health segment, principally due to the increase in premiums on the major medical business for groups and individuals and short term medical lines of business in addition to the new pet and international lines of business and higher loss ratios; (ii) an increase of \$19.9 million in the Medical Stop-Loss segment as a result of an increase in premium volume and higher loss ratios; (iii) an increase of \$4.7 million in the group disability, life, annuities and DBL segment primarily due to an increase in the DBL line as a result of increased volume; offset by (iv) a \$4.2 million decrease in the Individual life, annuity and other segment primarily a result of decreased volume from the coinsurance agreement and from lines in run-off.

Amortization of Deferred Acquisition Costs

In the second quarter of 2013, the Company wrote-off \$9.3 million of deferred acquisition costs in connection with a coinsurance agreement. Excluding this write-off, amortization of deferred acquisition costs decreased \$0.3 million.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$23.7 million. The increase is primarily due to: (i) a \$21.9 million increase in the Fully Insured Health segment largely a result of an increase in commission and other general expenses in the major medical business due to the increase in volume for groups and individuals and short term medical lines of business in addition to commission and other general expenses related to the new pet and international lines in 2013; (ii) a \$3.0 million increase in commissions and other general expenses in the Medical Stop-Loss segment due to the increase in volume; partially offset by (iii) a decrease of \$1.2 million in corporate overhead expenses due to a reduction in employment and consulting related expenses.

Income Taxes

The effective tax rate for the nine months ended September 30, 2013 and 2012 was 34.2% and 32.8%, respectively. The lower effective tax rate in 2012 was due to a higher benefit from tax-advantaged securities as a percentage of income in 2012.

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 \$12.0 million and \$6.5 million of cash dividends to Corporate in the nine months ended September 30, 2013 and 2012, respectively.

Cash Flows

The Company had \$16.8 million and \$23.9 million of cash and cash equivalents as of September 30, 2013 and December 31, 2012, respectively.

For the nine months ended September 30, 2013, operating activities of the Company utilized \$173.3 million of cash, whereas \$175.8 million of cash was provided by investing activities. In the second quarter of 2013, the Company liquidated investments to fund a \$215.1 million payment to an unaffiliated reinsurer in accordance with the terms of a coinsurance agreement causing the increase in investing activities and corresponding decrease in operating activities. Financing activities, which utilized \$9.6 million for the period, includes a \$2.0 million debt repayment, \$2.9 million utilized by IHC to acquire treasury shares and \$1.2 million utilized by AMIC to purchase shares of its common stock from noncontrolling interests.

The Company has \$517.9 million of future policy benefits and claims and claim adjustment expenses that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the nine months ended September 30, 2013, cash received from the maturities and other repayments of fixed maturities was \$44.7 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

Cash and investments decreased \$199.4 million from December 31, 2012 largely due to the transfer of \$215.1 million of cash and investments to an unaffiliated reinsurer in connection with a coinsurance agreement during the second quarter of 2013.

The Company had net receivables from reinsurers of \$341.1 million at September 30, 2013 compared to \$118.7 million at December 31, 2012. The Company recorded \$218.3 million of estimated reinsurance recoverables in connection with a coinsurance agreement during the second quarter of 2013. All of such reinsurance receivables are highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2013.

In connection with the coinsurance agreement mentioned above, the Company wrote-off \$9.3 million of deferred acquisition costs and recorded \$6.6 million of estimated deferred expenses (included in other assets on the Condensed Consolidated Balance Sheet) which will be amortized over the life of the underlying reinsured contracts.

Debt decreased as a result of a \$2.0 million principal repayment in the third quarter of 2013.

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

| | Total Health Reserves | |
|--------------------------|-------------------------------|------------------------------|
| | September 30, 2013 | December 31, 2012 |
| Medical Stop-Loss | \$ 69,641 | \$ 59,029 |
| Fully Insured Health | 52,905 | 40,747 |
| Group Disability | 103,017 | 87,171 |
| Individual A&H and Other | 7,125 | 7,533 |
| | \$ 232,688 | \$ 194,480 |

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 \$11.3 million decrease in IHC's stockholders' equity in the first nine months of 2013 is primarily due a \$21.0 million decrease in other comprehensive income (loss) for the period, common stock dividends of \$0.6 million and \$2.9 million of treasury stock purchases, partially offset by net income of \$12.0 million.

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 \$15.1 million at September 30, 2013, approximately 99.6% 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, 2013, approximately 0.4% (or \$2.1 million) of the carrying value of fixed maturities was invested in non-investment grade fixed maturities (primarily mortgage securities) (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any non-performing fixed maturities at September 30, 2013.

The Company reviews its investments regularly and monitors its investments continually for impairments. The Company did not record any other-than-temporary impairment losses in the nine months ended September 30, 2013. For the nine months ended September 30, 2012, the Company recorded \$0.7 million of losses for other-than-temporary impairments in earnings and \$0.3 million of losses for other-than-temporary impairments in other comprehensive income (loss). The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at September 30, 2013 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

Greater than Greater than

| | Less than 3 months | 3 months, less than 6 months | 6 months, less than 12 months | Greater than 12 months | Total |
|------------------|-------------------------------|---|--|-----------------------------------|--------------|
| Fixed maturities | \$ - | \$ - | \$ - | \$ 403 | \$ 403 |

The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at September 30, 2013. In 2013, the Company recorded \$19.8 million of net unrealized losses on available-for sale securities, pre-tax, in other comprehensive income (loss) prior to DAC and reclassification adjustments. From time to time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further

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

CAPITAL RESOURCES

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

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of September 30, 2013, is not materially different from that reported in the schedule of such obligations at December 31, 2012 which was included in Item 7 of the Company's Annual Report on Form 10-K.

OUTLOOK

We will continue to emphasize:

.

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

.

Our individual major medical premiums will decline in the fourth quarter of 2013, and more rapidly dissipate in 2014 as we exit this line of business;

.

Further 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;

Continued growth in pet insurance;

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

Growth in small group major medical premiums in 2013, but a decline in this line of business in 2014 as employers may choose to drop group health coverage or self-fund;

Increasing sales of short-term, limited medical and supplemental health products, such as dental, hospital indemnity and critical illness and international products to offset the reduction in major medical premiums in 2014;

Selling non-subscriber occupational accident insurance in Texas;

Increasing sales in our DBL line of business; and

Continued focus on administrative efficiencies.

The Company remained highly liquid in 2013 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 \$141.6 million in

highly rated shorter maturity securities earning on average 1.4%; 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.

At September 30, 2013, IHC owned 80.6% of AMIC's outstanding common stock. In October 2013, IHC acquired 762,640 shares of the common stock of AMIC for \$10.00 per share in cash in connection with a tender offer for such shares. As a result, IHC and its subsidiaries currently own 90.0% of AMIC's outstanding common stock.

We had a significant increase in the profitability and growth of our stop-loss business in 2012, our largest core business, which we attribute to the more efficient and controlled model of writing the majority of our medical stop-loss on a direct basis. At present, all indicators point to a continuation of this growth and higher level of profitability. There are a number of market forces that support this expectation. We have observed a trend on the part of our producers of stop-loss to consolidate their business with a smaller number of stop-loss carriers. The direct writing model employed by Risk Solutions is well suited to take advantage of this trend. There is an increased interest in self-funded options to address concerns about cost and regulatory burdens and we have developed targeted programs to address these needs. Finally there appears to be a market recognition that stop loss buying decisions need to be more about price. Service and fair claims payment practices are also important considerations and the partnership model under which Risk Solutions operates is increasingly recognized as addressing those issues.

We will continue to focus on our strategic objectives, including expanding our distribution network. However, the success of a portion of our Fully Insured Health business may be affected by the passage of the Patient Protection and Affordable Care Act of 2010, as amended, signed by President Obama in March 2010 and its subsequent interpretations by state and federal regulators. The appropriate regulatory agencies have now issued their proposed regulations. The regulations proposed to-date, including those mandating minimum loss ratios (MLRs) seem to have validated our strategy of pursuing niche lines of business not subject to MLRs. We are continuing our comprehensive review of all the options for IHC and we our evaluation of our portfolio of health insurance products. While the law has influenced our decision, and that of many other insurers, to exit or reduce their presence in major medical essential health benefit (EHB) plans in the small employer and individual markets, non-EHB lines of business and Medical Stop-Loss have been impacted by health care reform minimally or not at all.

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

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

assigned to specific insurance blocks in the model using appropriate prepayment schedules and future reinvestment patterns.

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at September 30, 2013 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2012 included in Item 7A of the Company's Annual Report on Form 10-K.

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

ITEM 4.

CONTROLS AND PROCEDURES

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

There has been no change in IHC's internal control over financial reporting during the quarter ended September 30, 2013 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, 2012 in Item 1A to Part 1 of Form 10-K.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Share Repurchase Program

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In March 2013, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC's common stock, in addition to prior authorizations, under the 1991 plan. As of September 30, 2013, 319,429 shares were still authorized to be repurchased under the plan. There were no share repurchases during the third quarter of 2013.

ITEM 3.

DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4.

MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5.

OTHER INFORMATION

The Board of Directors amended the By-laws, effective as of November 6, 2013. A copy of the Amendment to Bylaws is submitted hereto as Exhibit 3.2.

ITEM 6.

EXHIBITS

3.2

Amendment to By-Laws of Independence Holding Company.

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 7, 2013

Roy T.K. Thung

Chief Executive Officer, President

and Chairman

By:

/s/Teresa A. Herbert_____

Date:

November 7, 2013

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer