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INDEPENDENCE HOLDING CO

Form 10-Q

June 16, 2017

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**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 **March 31, 2017**.

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

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

Commission File Number: **001-32244**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**581407235**

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

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

(Address of principal executive offices)

**06902**

(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.



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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

| <b>Class</b>                           | <b>Outstanding at June 15, 2017</b> |
|--|-------------------------------------|
| <b>Common stock, \$ 1.00 par value</b> | <b>16,377,756 Shares</b>            |

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**INDEPENDENCE HOLDING COMPANY**

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

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## 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,” “plan,” “probably” or similar expressions, we are making forward-looking statements.*

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

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

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

|   | <b>March 31, 2017</b><br>(Unaudited) | <b>December 31, 2016</b> |
|---|--------------------------------------|--------------------------|
| <b>ASSETS:</b>                                      |                                      |                          |
| Investments:  |                                      |                          |
| Short-term investments                              | \$ 804                               | \$ 6,912                 |
| Securities purchased under agreements to resell     | 18,221                               | 28,962                   |
| Trading securities                                  | 567                                  | 592                      |
| Fixed maturities, available-for-sale                | 415,712                              | 449,487                  |
| Equity securities, available-for-sale               | 5,360                                | 5,333                    |
| Other investments                                   | 23,060                               | 23,534                   |
| Total investments                                   | 463,724                              | 514,820                  |
| <br>  |                                      |                          |
| Cash and cash equivalents                           | 51,160                               | 22,010                   |
| Due and unpaid premiums                             | 25,422                               | 42,896                   |
| Due from reinsurers                                 | 409,806                              | 440,285                  |
| Premium and claim funds                             | 8,735                                | 17,952                   |
| Goodwill  | 50,691                               | 41,573                   |
| Other assets  | 55,728                               | 54,928                   |
| <br>  |                                      |                          |
| <b>TOTAL ASSETS</b>                                 | <b>\$ 1,065,266</b>                  | <b>\$ 1,134,464</b>      |
| <br>  |                                      |                          |
| <b>LIABILITIES AND EQUITY:</b>                      |                                      |                          |
| <b>LIABILITIES:</b>                                 |                                      |                          |
| Policy benefits and claims                          | \$ 182,292                           | \$ 219,113               |
| Future policy benefits                              | 219,105                              | 219,450                  |
| Funds on deposit                                    | 146,723                              | 145,749                  |
| Unearned premiums                                   | 10,663                               | 9,786                    |
| Other policyholders' funds                          | 9,781                                | 9,769                    |
| Due to reinsurers                                   | 10,789                               | 35,796                   |
| Accounts payable, accruals and other liabilities    | 51,420                               | 55,477                   |
| Liabilities attributable to discontinued operations | 38                                   | 68                       |

|   |                     |                     |
|---|---------------------|---------------------|
| <b>TOTAL LIABILITIES</b>  | <b>630,811</b>      | <b>695,208</b>      |
| Commitments and contingencies (Note 14)   |                     |                     |
| Redeemable noncontrolling interest  | <b>2,008</b>        | <b>-</b>            |
| <b>STOCKHOLDERS' EQUITY:</b>  |                     |                     |
| Preferred stock \$1.00 par value, 100,000 shares authorized;<br>none issued or outstanding  | <b>-</b>            | <b>-</b>            |
| Common stock \$1.00 par value, 23,000,000 shares authorized;<br>18,620,508 shares issued; and 16,377,756 and<br>17,102,525 shares outstanding | <b>18,620</b>       | <b>18,620</b>       |
| Paid-in capital   | <b>126,534</b>      | <b>126,468</b>      |
| Accumulated other comprehensive loss  | <b>(4,443)</b>      | <b>(6,964)</b>      |
| Treasury stock, at cost; 2,242,752 and 1,517,983 shares   | <b>(31,885)</b>     | <b>(17,483)</b>     |
| Retained earnings   | <b>320,854</b>      | <b>315,918</b>      |
| <b>TOTAL IHC STOCKHOLDERS' EQUITY</b>   | <b>429,680</b>      | <b>436,559</b>      |
| <b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>   | <b>2,767</b>        | <b>2,697</b>        |
| <b>TOTAL EQUITY</b>   | <b>432,447</b>      | <b>439,256</b>      |
| <b>TOTAL LIABILITIES AND EQUITY</b>   | <b>\$ 1,065,266</b> | <b>\$ 1,134,464</b> |

See the accompanying Notes to Condensed Consolidated Financial Statements.

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

|  | <b>Three Months Ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>March 31,</b>          |                   |
|  | <b>2017</b>               | <b>2016</b>       |
| <b>REVENUES:</b>   |                           |                   |
| Premiums earned  | \$ 62,941                 | \$ 62,562         |
| Net investment income                                      | 3,911                     | 4,436             |
| Fee income   | 3,225                     | 5,079             |
| Other income   | 1,591                     | 3,258             |
| Net realized investment gains                              | 172                       | 560               |
|  | <b>71,840</b>             | <b>75,895</b>     |
| <b>EXPENSES:</b>   |                           |                   |
| Insurance benefits, claims and reserves                    | 32,211                    | 30,743            |
| Selling, general and administrative expenses               | 32,082                    | 35,227            |
| Interest expense on debt                                   | -                         | 453               |
|  | <b>64,293</b>             | <b>66,423</b>     |
| Income from continuing operations, before income taxes     | 7,547                     | 9,472             |
| Income taxes   | 2,538                     | 3,576             |
| <b>Income from continuing operations, net of tax</b>       | <b>5,009</b>              | <b>5,896</b>      |
| <b>Discontinued operations:</b>                            |                           |                   |
| Income from discontinued operations, before income taxes   | -                         | 117,636           |
| Income taxes on discontinued operations                    | -                         | 7,866             |
| Income from discontinued operations, net of tax            | -                         | 109,770           |
| <b>Net income</b>  | <b>5,009</b>              | <b>115,666</b>    |
| Less: Income from noncontrolling interests in subsidiaries | (73)                      | (9,656)           |
| <b>NET INCOME ATTRIBUTABLE TO IHC</b>                      | <b>\$ 4,936</b>           | <b>\$ 106,010</b> |
| <b>Basic income per common share:</b>                      |                           |                   |
| Income from continuing operations                          | \$ 0.30                   | \$ 0.34           |
| Income from discontinued operations                        | -                         | 5.81              |
| Basic income per common share                              | \$ 0.30                   | \$ 6.15           |

|                                     |        |        |
|-------------------------------------|--------|--------|
| WEIGHTED AVERAGE SHARES OUTSTANDING | 16,701 | 17,243 |
|-------------------------------------|--------|--------|

**Diluted income per common share:**

|                                   |         |         |
|-----------------------------------|---------|---------|
| Income from continuing operations | \$ 0.29 | \$ 0.33 |
|-----------------------------------|---------|---------|

|                                     |   |      |
|-------------------------------------|---|------|
| Income from discontinued operations | - | 5.75 |
|-------------------------------------|---|------|

|                                 |         |         |
|---------------------------------|---------|---------|
| Diluted income per common share | \$ 0.29 | \$ 6.08 |
|---------------------------------|---------|---------|

|   |        |        |
|---|--------|--------|
| WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING | 16,978 | 17,449 |
|---|--------|--------|

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



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

|   | <b>Three Months Ended</b> |                   |
|---|---------------------------|-------------------|
|   | <b>March 31,</b>          |                   |
|   | <b>2017</b>               | <b>2016</b>       |
| Net income  | \$ 5,009                  | \$ 115,666        |
| Other comprehensive income:   |                           |                   |
| <b>Available-for-sale securities:</b>   |                           |                   |
| Unrealized gains on available-for-sale securities, pre-tax                            | 3,981                     | 4,703             |
| Tax expense on unrealized gains on available-for-sale securities                      | 1,460                     | 1,685             |
| Unrealized gains on available-for-sale securities, net of taxes                       | 2,521                     | 3,018             |
| Other comprehensive income, net of tax  | 2,521                     | 3,018             |
| <b>COMPREHENSIVE INCOME, NET OF TAX</b>   | <b>7,530</b>              | <b>118,684</b>    |
| Comprehensive income, net of tax, attributable to noncontrolling interests:           |                           |                   |
| Income from noncontrolling interests in subsidiaries                                  | (73)                      | (9,656)           |
| Other comprehensive income, net of tax, attributable to noncontrolling interests:     |                           |                   |
| Unrealized gains on available-for-sale securities, net of tax                         | -                         | (57)              |
| Other comprehensive income, net of tax, attributable to noncontrolling interests      | -                         | (57)              |
| <b>COMPREHENSIVE INCOME, NET OF TAX,<br/>ATTRIBUTABLE TO NONCONTROLLING INTERESTS</b> | <b>(73)</b>               | <b>(9,713)</b>    |
| <b>COMPREHENSIVE INCOME, NET OF TAX,<br/>ATTRIBUTABLE TO IHC</b>                      | <b>\$ 7,457</b>           | <b>\$ 108,971</b> |

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

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## INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Unaudited) (In thousands)

|   | COMMON<br>STOCK  | PAID-IN<br>CAPITAL | ACCUMULATED<br>OTHER<br>COMPREHENSIVE<br>INCOME | TREASURY<br>STOCK,<br>AT COST | RETAINED<br>EARNINGS | TOTAL IHC<br>STOCKHOLDER<br>EQUITY |
|---|------------------|--------------------|---|-------------------------------|----------------------|------------------------------------|
| <b>BALANCE<br/>AT<br/>DECEMBER<br/>31, 2016</b> | <b>\$ 18,620</b> | <b>\$ 126,468</b>  | <b>\$ (6,964)</b>                               | <b>\$ (17,483)</b>            | <b>\$ 315,918</b>    | <b>\$ 436,559</b>                  |
| Net income                                      |                  |                    |   |                               | 4,936                | 4,936                              |
| Other<br>comprehensive<br>income, net of<br>tax |                  |                    | 2,521   |                               |                      | 2,521                              |
| Repurchases of<br>common stock                  |                  |                    |   | (14,402)                      |                      | (14,402)                           |
| Share-based<br>compensation<br>expenses         |                  | 66                 |   |                               |                      | 66                                 |
| <b>BALANCE<br/>AT<br/>MARCH 31,<br/>2017</b>    | <b>\$ 18,620</b> | <b>\$ 126,534</b>  | <b>\$ (4,443)</b>                               | <b>\$ (31,885)</b>            | <b>\$ 320,854</b>    | <b>\$ 429,680</b>                  |

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

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

|   | <b>Three Months Ended March</b> |             |
|---|---------------------------------|-------------|
|   | <b>31,</b>                      |             |
|   | <b>2017</b>                     | <b>2016</b> |
| <b>CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:</b>                               |                                 |             |
| Net income  | \$ 5,009                        | 115,666     |
| <b>Adjustments to reconcile net income to net change in cash from operating activities:</b> |                                 |             |
| Gain on disposal of discontinued operations, net of tax                                     | –                               | (109,304)   |
| Amortization of deferred acquisition costs  | 91                              | 86          |
| Net realized investment gains   | (172)                           | (560)       |
| Equity (income) loss from equity method investments   | (201)                           | 30          |
| Depreciation and amortization   | 299                             | 472         |
| Deferred tax expense (benefit)  | 889                             | (901)       |
| Other   | 1,285                           | 3,105       |
| Changes in assets and liabilities:  |                                 |             |
| Net (purchases) sales of trading securities   | –                               | 3,180       |
| Change in insurance liabilities   | (59,880)                        | (31,725)    |
| Change in amounts due from reinsurers   | 30,479                          | 20,985      |
| Change in premium and claim funds   | 17,474                          | (19,562)    |
| Change in current income tax liability  | 1,087                           | (1,428)     |
| Change in due and unpaid premiums   | 9,217                           | 4,430       |
| Other operating activities  | (5,666)                         | (6,057)     |
| Net change in cash from operating activities  | (89)                            | (21,583)    |
| <b>CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:</b>                               |                                 |             |
| Net sales and maturities of short-term investments  | 6,099                           | –           |
| Net (purchases) sales of securities under resale agreements                                 | 10,741                          | 7,089       |
| Sales of fixed maturities   | 78,313                          | 32,447      |
| Maturities and other repayments of fixed maturities   | 4,132                           | 10,342      |
| Purchases of fixed maturities   | (41,741)                        | (30,723)    |
| Proceeds on sales of subsidiaries, net of cash divested                                     | –                               | 134,625     |
| Payments to acquire business, net of cash acquired  | (12,287)                        | –           |
| Other investing activities  | (157)                           | (1,107)     |

|  |        |         |
|--|--------|---------|
| Net change in cash from investing activities | 45,100 | 152,673 |
|--|--------|---------|

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

|                             |          |       |
|-----------------------------|----------|-------|
| Repurchases of common stock | (14,402) | (821) |
|-----------------------------|----------|-------|

|  |       |       |
|--|-------|-------|
| Withdrawals of investment-type insurance contracts | (433) | (500) |
|--|-------|-------|

|                    |   |       |
|--------------------|---|-------|
| Repayments of debt | - | (939) |
|--------------------|---|-------|

|                |         |       |
|----------------|---------|-------|
| Dividends paid | (1,026) | (779) |
|----------------|---------|-------|

|                            |   |     |
|----------------------------|---|-----|
| Other financing activities | - | 145 |
|----------------------------|---|-----|

|  |          |         |
|--|----------|---------|
| Net change in cash from financing activities | (15,861) | (2,894) |
|--|----------|---------|

|   |        |         |
|---|--------|---------|
| Net change in cash and cash equivalents | 29,150 | 128,196 |
|---|--------|---------|

|  |        |        |
|--|--------|--------|
| Cash and cash equivalents, beginning of year | 22,010 | 17,500 |
|--|--------|--------|

|  |           |         |
|--|-----------|---------|
| Cash and cash equivalents, end of period | \$ 51,160 | 145,696 |
|--|-----------|---------|

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

## INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

(Unaudited)

#### Note 1. Organization, Consolidation, Basis of Presentation and Accounting Policies

##### (A) Business and Organization

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ("Independence American"); and (ii) its marketing and administrative companies, including IHC Specialty Benefits Inc., IHC Carrier Solutions, Inc. and PetPartners, Inc. IHC also owns a significant equity interest in Ebix Health Exchange Holdings, LLC ("Ebix Health Exchange"), an administration exchange for health insurance. Standard Security Life, Madison National Life and Independence American are sometimes collectively referred to as the "Insurance Group". IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or "IHC", or are implicit in the terms "we", "us" and "our".

Geneve Corporation, a diversified financial holding company, and its affiliated entities, held approximately 56% of IHC's outstanding common stock at March 31, 2017.

##### (B) Basis of Presentation

The unaudited 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 unaudited Condensed Consolidated Financial Statements include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements; and (ii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying unaudited Condensed Consolidated Financial Statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results to be anticipated for the entire year.

**(C) Reclassifications**

Certain amounts in prior year's consolidated financial statements and Notes thereto have been reclassified to conform to the 2017 presentation.

**(D) Recent Accounting Pronouncements**

*Recently Adopted Accounting Standards*

In October 2016, the Financial Accounting Standards Board ("FASB") issued guidance that amends the consolidation analysis for a reporting entity that is the single decision maker of a variable interest entity. The amendments in this guidance require the decision maker's evaluation of its interests held through related



parties that are under common control on a proportionate basis rather than in their entirety when determining whether it is the primary beneficiary of that variable interest entity. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

In March 2016, the FASB issued guidance that simplify several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the statement of cash flows. New guidance related to the classifications in the statement of cash flows were applied on a prospective transition basis. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

In March 2016, the FASB issued guidance that eliminates the requirement for retroactive adjustments on the date that a previously held investment qualifies for the equity method of accounting as a result of an increase in ownership interest or degree of influence. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

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

In May 2017, the FASB issued guidance to provide clarity and reduce both (i) diversity in practice; and (ii) cost and complexity when accounting for a change in the terms or conditions of a share-based payment award. The amendments in this guidance should be applied prospectively in annual periods beginning after December 15, 2017, including interim periods within those periods, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In March 2017, the FASB issued guidance requiring premium amortization on callable debt securities to be amortized to the earliest call date to more closely align the amortization period with expectations incorporated in market pricing of the underlying securities. The amendments in this guidance should be applied using a modified retrospective approach for annual periods beginning after December 15, 2018, including interim periods within those periods. Additional disclosures are required in the period of adoption. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In February 2017, the FASB issued guidance to simplify the accounting for sales of nonfinancial assets by clarifying the definition of nonfinancial assets and adding guidance pertaining to partial sales of nonfinancial assets. The amendments in this guidance can be applied using either a retrospective approach or a modified retrospective approach in annual periods beginning after December 15, 2017, including interim periods within those periods. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In January 2017, the FASB issued guidance to simplify the test for goodwill impairment by eliminating Step 2 in the goodwill impairment test. Instead, under the amendments in this Update, an entity should perform its annual or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. Additionally, an entity should consider income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. The amendments in this guidance are effective for public business entities for annual, or any interim, goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In January 2017, the FASB issued guidance that clarifies the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. The amendments in this guidance should be applied prospectively in annual periods beginning after December 15, 2017, including interim periods within those periods, with early adoption permitted. The adoption of this guidance is not expected to

have a material effect on the Company's consolidated financial statements.

In November 2016, the FASB issued guidance requiring entities to show the changes in the total cash, cash equivalents, restricted cash and restricted cash equivalent in the statement of cash flows. The amendments in this guidance should be applied retrospectively and is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In October 2016, the FASB issued guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption and are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In August 2016, the FASB issued guidance that changes how certain cash receipts and cash payments are presented and classified in the cash flows statement. The amendments in this Update are effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In June 2016, the FASB issued guidance requiring financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. An allowance for credit losses will be deducted from the amortized cost basis to present the net carrying value at the amount expected to be collected with changes in the allowance recorded in earnings. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than the currently applied U.S. GAAP method of taking a permanent impairment of the security, which would be limited to the amount by which fair value is below the amortized cost. Certain existing requirements used to evaluate credit losses have been removed. For public entities that are SEC filers, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those years. Early adoption is permitted for fiscal years beginning after December 15, 2018. The amendments in this guidance should be applied through a cumulative effect adjustment to retained earnings upon adoption as of the beginning of the first reporting period in which the guidance is effective. Management is evaluating the requirements and potential impact that the adoption of this guidance will have on the Company's consolidated financial statements.

In February 2016, the FASB issued guidance that requires lessees to recognize the assets and liabilities that arise from leases, including operating leases, on the statement of financial position. The amendments in this guidance are effective for fiscal years beginning after December 31, 2018, including interim periods within those fiscal years, using a modified retrospective approach. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In January 2016, the FASB issued guidance that eliminates the requirement to classify equity securities with readily determinable fair values as trading or available-for-sale. The guidance requires equity securities, other than those that result in consolidation or are accounted for under the equity method, (including other ownership interests, such as partnerships, unincorporated joint ventures, and limited liability companies) to be measured at fair value with changes in the fair value recognized through net income, simplifies the impairment assessment of equity securities without readily determinable fair values and requires changes in disclosure requirements. For public entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted in certain circumstances. The amendments in this Update should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure

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requirements) should be applied prospectively to equity investments that exist as of the date of adoption of the guidance. The adoption of this guidance is not expected to have a material effect on the Company's Consolidated Balance Sheet or IHC's stockholders' equity.

In May 2014, the FASB issued revenue recognition guidance for entities that either enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards such as insurance contracts or lease contracts. The amendment provides specific steps that an entity should apply in order to achieve its main objective which is recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In 2016, additional guidance and technical corrections were issued to clarify certain aspects of the implementation guidance and to clarify the identification of performance obligations. In August 2015, the effective date of this guidance has been deferred. For public entities, this guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, and requires one of two specified retrospective methods of application. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company anticipates that any impact will only relate to contracts with customers outside the scope of Accounting Standards Codification Topic 944, Financial Services - Insurance. Our administrative and other service contracts that will be subject to the amendments in this Update are recorded in the Fee Income line item of the Condensed Consolidated Statement of Income and represents approximately 4% of our consolidated revenues for the three months ended March 31, 2017. Management is still in the process of evaluating the impact that the adoption of this guidance will have on the Company's consolidated financial statements and the method of adoption that we will ultimately choose.

**Note 2. Income Per Common Share**

Diluted income per share was computed using the treasury stock method and includes incremental common shares, primarily from the dilutive effect of share-based payment awards, amounting to 277,000 and 206,000 shares for the three months ended March 31, 2017 and 2016.

The following is a reconciliation of income available to common shareholders used to calculate income per share for the periods indicated (in thousands):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31</b>           |             |
|   | <b>2017</b>               | <b>2016</b> |
| Income from continuing operations, net of tax | \$ 5,009                  | \$ 5,896    |

|  |                 |                   |
|--|-----------------|-------------------|
| Less: Income from continuing operations attributable to noncontrolling interests   | (73)            | (106)             |
| <b>Income from continuing operations attributable to IHC common shareholders</b>   | <b>\$ 4,936</b> | <b>\$ 5,790</b>   |
| Income from discontinued operations, net of tax                                    | \$ -            | \$ 109,770        |
| Less: Income from discontinued operations attributable to noncontrolling interests | -               | (9,550)           |
| <b>Income from discontinued operations attributable to IHC common shareholders</b> | <b>\$ -</b>     | <b>\$ 100,220</b> |
| <b>Net income attributable to IHC</b>  | <b>\$ 4,936</b> | <b>\$ 106,010</b> |

**Note 3. Discontinued Operations**

On March 31, 2016, IHC and its subsidiary Independence American sold the stock of Risk Solutions to Swiss Re Corporate Solutions, a division of Swiss Re (“Swiss Re”). In addition, under the purchase and sale agreement, all of the in-force stop-loss business of Standard Security Life and Independence American produced by Risk Solutions is co-insured by Westport Insurance Corporation (“Westport”), Swiss Re’s largest US carrier, as of January 1, 2016. The aggregate purchase price was \$152,500,000 in cash, subject to adjustments and settlements. Approximately 89% of the purchase price was allocated to AMIC, with the balance being paid to Standard Security Life and other IHC subsidiaries. In the three months ended March 31, 2016, the Company recorded a gain of \$99,793,000, net of taxes and amounts attributable to noncontrolling interests, as a result of the transaction. The aforementioned transaction, which includes the sale of Risk Solutions and the corresponding coinsurance agreement, is collectively referred to as the “Risk Solutions Sale and Coinsurance Transaction”. IHC’s block of Medical Stop-Loss business is in run-off. The sale of Risk Solutions and exit from the medical stop-loss business represented a strategic shift that has had a major effect on the Company’s operations and financial results. The disposal transaction qualified for reporting as a discontinued operation in the first quarter of 2016 as a result of the Board of Directors commitment to a plan for its disposal in January 2016. Aside from reinsurance and marketing of Westport small group stop-loss, there has been no further involvement with the discontinued operation.

The following is a reconciliation of the major line items constituting the pretax profit of discontinued operations included in the Condensed Consolidated Statement of Income for the three months ended March 31, 2016 (in thousands):

|  | <b>2016</b>       |
|--|-------------------|
| Revenue  | <b>\$ 6,406</b>   |
| Selling, general and administrative expenses             | <b>5,689</b>      |
| Pretax profit of discontinued operations                 | <b>717</b>        |
| Gain on disposal of discontinued operations, pretax      | <b>116,919</b>    |
| Income from discontinued operations, before income taxes | <b>117,636</b>    |
| Income taxes on discontinued operations                  | <b>7,866</b>      |
| Income from discontinued operations                      | <b>\$ 109,770</b> |

Liabilities attributable to discontinued operations at March 31, 2017 and December 31, 2016 consist of \$38,000 and \$68,000, respectively, of accounts payable and accrued liabilities.

Total operating cash flows from discontinued operations for the three months ended March 31, 2016 amounted to \$339,000. The Company elected to classify the proceeds received from the sale of discontinued operations in the

investing activities section of Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2016.

In connection with the Risk Solutions Sale and Coinsurance Transaction in March 2016, AMIC utilized a significant amount of its Federal NOL carryforwards and made a corresponding adjustment to its valuation allowance. On a consolidated basis, the Company recorded income taxes on discontinued operations of \$7,866,000 for the three months ended March 31, 2016, consisting of \$5,799,000 of state taxes and \$2,067,000 of Federal taxes, net of a \$38,565,000 decrease in AMIC's valuation allowance.

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**Note 4. Investment Securities**

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

|                                   | <b>March 31, 2017</b>     |                                       |  |                       |
|-----------------------------------|---------------------------|---------------------------------------|--|-----------------------|
|                                   | <b>AMORTIZED<br/>COST</b> | <b>GROSS<br/>UNREALIZED<br/>GAINS</b> | <b>GROSS<br/>UNREALIZED<br/>LOSSES</b> | <b>FAIR<br/>VALUE</b> |
| <b>FIXED MATURITIES</b>           |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>        |                           |                                       |  |                       |
| Corporate securities              | \$ 162,187                | \$ 974                                | \$ (3,970)                             | \$ 159,191            |
| CMOs - residential (1)            | 7,377                     | –                                     | (142)                                  | 7,235                 |
| U.S. Government obligations       | 37,632                    | 117                                   | (382)                                  | 37,367                |
| Agency MBS - residential (2)      | 20                        | –                                     | –                                      | 20                    |
| GSEs (3)                          | 10,229                    | 1                                     | (233)                                  | 9,997                 |
| States and political subdivisions | 190,883                   | 764                                   | (4,078)                                | 187,569               |
| Foreign government obligations    | 4,372                     | 17                                    | (107)                                  | 4,282                 |
| Redeemable preferred stocks       | 10,006                    | 125                                   | (80)                                   | 10,051                |
| Total fixed maturities            | \$ 422,706                | \$ 1,998                              | \$ (8,992)                             | \$ 415,712            |
| <b>EQUITY SECURITIES</b>          |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>        |                           |                                       |  |                       |
| Common stocks                     | \$ 1,612                  | \$ 154                                | \$ –                                   | \$ 1,766              |
| Nonredeemable preferred stocks    | 3,588                     | 49                                    | (43)                                   | 3,594                 |
| Total equity securities           | \$ 5,200                  | \$ 203                                | \$ (43)                                | \$ 5,360              |

|                            | <b>December 31, 2016</b>  |                                       |  |                       |
|----------------------------|---------------------------|---------------------------------------|--|-----------------------|
|                            | <b>AMORTIZED<br/>COST</b> | <b>GROSS<br/>UNREALIZED<br/>GAINS</b> | <b>GROSS<br/>UNREALIZED<br/>LOSSES</b> | <b>FAIR<br/>VALUE</b> |
| <b>FIXED MATURITIES</b>    |                           |                                       |  |                       |
| <b>AVAILABLE-FOR-SALE:</b> |                           |                                       |  |                       |

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|                                   |            |       |          |         |
|-----------------------------------|------------|-------|----------|---------|
| Corporate securities              | \$ 192,976 | 209   | (5,490)  | 187,695 |
| CMOs - residential (1)            | 6,021      | 8     | (116)    | 5,913   |
| U.S. Government obligations       | 43,417     | 133   | (441)    | 43,109  |
| Agency MBS - residential (2)      | 22         | 1     | –        | 23      |
| GSEs (3)                          | 10,301     | 1     | (422)    | 9,880   |
| States and political subdivisions | 191,146    | 780   | (5,115)  | 186,811 |
| Foreign government obligations    | 5,098      | 13    | (157)    | 4,954   |
| Redeemable preferred stocks       | 11,454     | 96    | (448)    | 11,102  |
| <br>                              |            |       |          |         |
| Total fixed maturities            | \$ 460,435 | 1,241 | (12,189) | 449,487 |

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

|                                |          |     |      |       |
|--------------------------------|----------|-----|------|-------|
| Common stocks                  | \$ 1,612 | 178 | –    | 1,790 |
| Nonredeemable preferred stocks | 3,588    | 30  | (75) | 3,543 |
| <br>                           |          |     |      |       |
| Total equity securities        | \$ 5,200 | 208 | (75) | 5,333 |

(1) Collateralized mortgage obligations (“CMOs”).

(2) Mortgage-backed securities (“MBS”).

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

The amortized cost and fair value of fixed maturities available-for-sale at March 31, 2017, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. CMOs and MBSs are shown separately, as they are not due at a single maturity.

|  | <b>AMORTIZED<br/>COST</b> | <b>FAIR<br/>VALUE</b> |
|--|---------------------------|-----------------------|
| Due in one year or less                | \$ 8,303                  | \$ 8,319              |
| Due after one year through five years  | 125,951                   | 124,869               |
| Due after five years through ten years | 129,017                   | 126,441               |
| Due after ten years                    | 141,809                   | 138,830               |
| CMOs and MBSs                          | 17,626                    | 17,253                |
|  | <b>\$ 422,706</b>         | <b>\$ 415,712</b>     |

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

### March 31, 2017

|                             | <b>Less than 12 Months</b> |                              | <b>12 Months or Longer</b> |                              | <b>Total</b>          |                              |
|-----------------------------|----------------------------|------------------------------|----------------------------|------------------------------|-----------------------|------------------------------|
|                             | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>      | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| Corporate securities        | \$ 110,148                 | \$ 2,557                     | \$ 14,565                  | \$ 1,413                     | \$ 124,713            | \$ 3,970                     |
| CMOs - residential          | 7,138                      | 142                          | -                          | -                            | 7,138                 | 142                          |
| U.S. Government obligations | 24,076                     | 382                          | -                          | -                            | 24,076                | 382                          |
| GSEs                        | -                          | -                            | 9,980                      | 233                          | 9,980                 | 233                          |

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|  |            |                 |           |                 |            |                 |
|--|------------|-----------------|-----------|-----------------|------------|-----------------|
| States and political subdivisions            | 119,213    | <b>3,194</b>    | 29,118    | <b>884</b>      | 148,331    | <b>4,078</b>    |
| Foreign government obligations               | 3,067      | <b>107</b>      | -         | -               | 3,067      | <b>107</b>      |
| Redeemable preferred stocks                  | -          | -               | 3,683     | <b>80</b>       | 3,683      | <b>80</b>       |
| <b>Total fixed maturities</b>                | 263,642    | <b>6,382</b>    | 57,346    | <b>2,610</b>    | 320,988    | <b>8,992</b>    |
| Nonredeemable preferred stocks               | 833        | <b>18</b>       | 1,301     | <b>25</b>       | 2,134      | <b>43</b>       |
| <b>Total equity securities</b>               | 833        | <b>18</b>       | 1,301     | <b>25</b>       | 2,134      | <b>43</b>       |
| <b>Total temporarily impaired securities</b> | \$ 264,475 | <b>\$ 6,400</b> | \$ 58,647 | <b>\$ 2,635</b> | \$ 323,122 | <b>\$ 9,035</b> |

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

|     |    |     |
|-----|----|-----|
| 109 | 25 | 134 |
|-----|----|-----|

**December 31, 2016**

|  | <b>Less than 12 Months</b> |                          | <b>12 Months or Longer</b> |                          | <b>Total</b>      |                          |
|--|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
|  | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b>          | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> |
| Corporate securities                                       | \$ 145,205                 | 3,818                    | 19,841                     | 1,672                    | 165,046           | 5,490                    |
| CMO's - residential  | 5,038                      | 116                      | -                          | -                        | 5,038             | 116                      |
| U.S. Government obligations                                | 28,406                     | 441                      | -                          | -                        | 28,406            | 441                      |
| GSEs   | 3,640                      | 166                      | 6,220                      | 256                      | 9,860             | 422                      |
| States and political subdivisions                          | 144,357                    | 4,561                    | 18,132                     | 554                      | 162,489           | 5,115                    |
| Foreign government obligations                             | 3,738                      | 157                      | -                          | -                        | 3,738             | 157                      |
| Redeemable preferred stocks                                | -                          | -                        | 3,315                      | 448                      | 3,315             | 448                      |
| <b>Total fixed maturities</b>                              | <b>330,384</b>             | <b>9,259</b>             | <b>47,508</b>              | <b>2,930</b>             | <b>377,892</b>    | <b>12,189</b>            |
| Nonredeemable preferred stocks                             | 826                        | 25                       | 1,277                      | 50                       | 2,103             | 75                       |
| <b>Total equity securities</b>                             | <b>826</b>                 | <b>25</b>                | <b>1,277</b>               | <b>50</b>                | <b>2,103</b>      | <b>75</b>                |
| <b>Total temporarily impaired securities</b>               | <b>\$ 331,210</b>          | <b>9,284</b>             | <b>48,785</b>              | <b>2,980</b>             | <b>379,995</b>    | <b>12,264</b>            |
| <b>Number of securities in an unrealized loss position</b> | <b>156</b>                 |                          | <b>23</b>                  |                          | <b>179</b>        |                          |

Substantially all of the unrealized losses on fixed maturities available-for-sale at March 31, 2017 and December 31, 2016 relate to investment grade securities and are attributable to changes in market interest rates. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2017.

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

**Three Months  
Ended  
March 31,**

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|   | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|
| Available-for-sale securities:                            |             |             |
| Fixed maturities  | \$ 197      | \$ 628      |
| Total sales of available-for-sale securities              | 197         | 628         |
| Trading securities  | -           | -           |
| Total realized gains                                      | 197         | 628         |
| Unrealized gains (losses) on trading securities:          |             |             |
| Change in unrealized gains (losses) on trading securities | (25)        | (70)        |
| Total unrealized gains (losses) on trading securities     | (25)        | (70)        |
| Gains (losses) on other investments                       | -           | 2           |
| Net realized investment gains                             | \$ 172      | \$ 560      |

For the three months ended March 31, 2017 and 2016, proceeds from sales of available-for-sale securities were \$77,456,000 and \$31,494,000, respectively, and the Company realized gross gains of \$956,000 and \$615,000, respectively, and gross losses of \$724,000 and \$17,000, respectively, on those sales.

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

We recognize other-than-temporary impairment losses in earnings in the period that we determine: 1) we intend to sell the security; 2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis; or 3) the security has a credit loss. Any non-credit portion of the other-than-temporary impairment loss is recognized in other comprehensive income (loss). See Note 1G(iv) to the Consolidated Financial Statements in the 2016 Annual Report for further discussion of the factors considered by management in its regular review to identify and recognize other-than-temporary impairments on available-for-sale securities. The Company did not recognize any other-than-temporary impairments on available-for-sale securities in the first three months of 2017 or 2016.

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

|                              | <b>Three Months<br/>Ended<br/>March 31,<br/>2017    2016</b> |        |
|------------------------------|--|--------|
| Balance at beginning of year | \$ -   | \$ 473 |
| Securities sold              | -  | (473)  |
| Balance at end of period     | \$ -   | \$ -   |

**Note 5. Fair Value Disclosures**

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

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

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

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

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

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

Available-for-sale securities included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, foreign government obligations, collateralized mortgage obligations, municipals and GSEs that were priced with observable market inputs. Level 3 securities consist of municipal tax credit strips. The valuation method used to determine the fair value of municipal tax credit strips is the present value of the remaining future tax credits (at the original issue discount rate) as presented in the redemption tables in the Municipal Prospectuses. This original issue discount is accreted into income on a constant yield basis over the term of the debt instrument. 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.

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

|                                       | <b>March 31, 2017</b> |                   |                 |                   |
|---------------------------------------|-----------------------|-------------------|-----------------|-------------------|
|                                       | <b>Level 1</b>        | <b>Level 2</b>    | <b>Level 3</b>  | <b>Total</b>      |
| <b>FINANCIAL ASSETS:</b>              |                       |                   |                 |                   |
| Fixed maturities available-for-sale:  |                       |                   |                 |                   |
| Corporate securities                  | \$ –                  | \$ 159,191        | \$ –            | \$ 159,191        |
| CMOs - residential                    | –                     | 7,235             | –               | 7,235             |
| US Government obligations             | –                     | 37,367            | –               | 37,367            |
| Agency MBS - residential              | –                     | 20                | –               | 20                |
| GSEs                                  | –                     | 9,997             | –               | 9,997             |
| States and political subdivisions     | –                     | 185,574           | 1,995           | 187,569           |
| Foreign government obligations        | –                     | 4,282             | –               | 4,282             |
| Redeemable preferred stocks           | 10,051                | –                 | –               | 10,051            |
| Total fixed maturities                | 10,051                | 403,666           | 1,995           | 415,712           |
| Equity securities available-for-sale: |                       |                   |                 |                   |
| Common stocks                         | 1,766                 | –                 | –               | 1,766             |
| Nonredeemable preferred stocks        | 3,594                 | –                 | –               | 3,594             |
| Total equity securities               | 5,360                 | –                 | –               | 5,360             |
| Trading securities - equities         | 567                   | –                 | –               | 567               |
| Total trading securities              | 567                   | –                 | –               | 567               |
| <b>Total Financial Assets</b>         | <b>\$ 15,978</b>      | <b>\$ 403,666</b> | <b>\$ 1,995</b> | <b>\$ 421,639</b> |

|  | <b>December 31, 2016</b> |                       |                     |                       |
|--|--------------------------|-----------------------|---------------------|-----------------------|
|  | <b>Level 1</b>           | <b>Level 2</b>        | <b>Level 3</b>      | <b>Total</b>          |
| <b>FINANCIAL ASSETS:</b>                         |                          |                       |                     |                       |
| <b>Fixed maturities available-for-sale:</b>      |                          |                       |                     |                       |
| Corporate securities                             | \$ -                     | \$ 187,695            | \$ -                | \$ 187,695            |
| CMOs - residential                               | -                        | 5,913                 | -                   | 5,913                 |
| US Government obligations                        | -                        | 43,109                | -                   | 43,109                |
| Agency MBS - residential                         | -                        | 23                    | -                   | 23                    |
| GSEs   | -                        | 9,880                 | -                   | 9,880                 |
| States and political subdivisions                | -                        | 184,778               | 2,033               | 186,811               |
| Foreign government obligations                   | -                        | 4,954                 | -                   | 4,954                 |
| Redeemable preferred stocks                      | 11,102                   | -                     | -                   | 11,102                |
| <b>Total fixed maturities</b>                    | <b>11,102</b>            | <b>436,352</b>        | <b>2,033</b>        | <b>449,487</b>        |
| <br><b>Equity securities available-for-sale:</b> |                          |                       |                     |                       |
| Common stocks                                    | 1,790                    | -                     | -                   | 1,790                 |
| Nonredeemable preferred stocks                   | 3,543                    | -                     | -                   | 3,543                 |
| <b>Total equity securities</b>                   | <b>5,333</b>             | <b>-</b>              | <b>-</b>            | <b>5,333</b>          |
| <br><b>Trading securities - equities</b>         |                          |                       |                     |                       |
| Trading securities - equities                    | 592                      | -                     | -                   | 592                   |
| <b>Total trading securities</b>                  | <b>592</b>               | <b>-</b>              | <b>-</b>            | <b>592</b>            |
| <br><b>Total Financial Assets</b>                | <br><b>\$ 17,027</b>     | <br><b>\$ 436,352</b> | <br><b>\$ 2,033</b> | <br><b>\$ 455,412</b> |

It is the Company's policy to recognize transfers of assets and liabilities between levels of the fair value hierarchy at the end of a reporting period. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow. The Company did not transfer any securities between Level 1, Level 2 or Level 3 in either 2017 or 2016.

The following table presents the changes in fair value of our Level 3 financial assets for the periods indicated (in thousands):

|                                     |             |
|-------------------------------------|-------------|
| <b>Three Months Ended March 31,</b> |             |
| <b>2017</b>                         | <b>2016</b> |

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|   | <b>States and<br/>Political<br/>Subdivisions</b> | <b>Total<br/>Level 3<br/>Assets</b> | <b>CMOs<br/>Commercial</b> | <b>States and<br/>Political<br/>Subdivisions</b> | <b>Total<br/>Level 3<br/>Assets</b> |
|---|--|-------------------------------------|----------------------------|--|-------------------------------------|
| <b>Beginning balance</b>                                      | \$ 2,033   | \$ 2,033                            | \$ 1,195                   | \$ 2,179   | \$ 3,374                            |
| Increases (decreases) recognized in earnings:                 |  |                                     |                            |  |                                     |
| Net realized investment gains                                 | -  | -                                   | 141                        | -  | 141                                 |
| Gains (losses) included in other comprehensive income (loss): |  |                                     |                            |  |                                     |
| Net unrealized gains (losses)                                 | (9)  | (9)                                 | (296)                      | (11)   | (307)                               |
| Repayments and amortization of fixed maturities               |  |                                     |                            |  |                                     |
|   | (29)   | (29)                                | (74)                       | (25)   | (99)                                |
| Sales   | -  | -                                   | (966)                      | -  | (966)                               |
| <b>Balance at end of period</b>                               | \$ 1,995   | \$ 1,995                            | \$ -                       | \$ 2,143   | \$ 2,143                            |

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During 2016, the Company had contingent liabilities classified in Level 3 of the fair value hierarchy. These liabilities were paid out by December 31, 2016; there were no comparable amounts in 2017. The following table presents the changes in fair value of our Level 3 financial liabilities for the periods indicated (in thousands):

|                                      | <b>Three Months Ended</b>     |                                  |
|--------------------------------------|-------------------------------|----------------------------------|
|                                      | <b>March 31, 2016</b>         |                                  |
|                                      | <b>Contingent Liabilities</b> | <b>Total Level 3 Liabilities</b> |
| <b>Beginning balance</b>             | \$ 1,650                      | \$ 1,650                         |
| Gains (losses) included in earnings: |                               |                                  |
| Net investment income                | (633)                         | (633)                            |
| Other income                         | 538                           | 538                              |
| <b>Balance at end of period</b>      | \$ 1,555                      | \$ 1,555                         |

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

|                               | <b>March 31, 2017</b>     |                           |                       | <b>December 31, 2016</b>  |                           |                       |
|-------------------------------|---------------------------|---------------------------|-----------------------|---------------------------|---------------------------|-----------------------|
|                               | <b>Level 1 Fair Value</b> | <b>Level 2 Fair Value</b> | <b>Carrying Value</b> | <b>Level 1 Fair Value</b> | <b>Level 2 Fair Value</b> | <b>Carrying Value</b> |
| <b>FINANCIAL ASSETS:</b>      |                           |                           |                       |                           |                           |                       |
| Short-term investments        | \$ 804                    | \$ -                      | \$ 804                | \$ 6,912                  | \$ -                      | \$ 6,912              |
| <b>FINANCIAL LIABILITIES:</b> |                           |                           |                       |                           |                           |                       |
| Funds on deposit              | \$ -                      | \$ 147,049                | \$ 146,723            | \$ -                      | \$ 146,098                | \$ 145,749            |

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:

**Short-term Investments**

Investments with original maturities of 91 days to one year are considered short-term investments and are carried at cost, which approximates fair value.

### **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.

**Note 6. Variable Interest Entities**

The Company has a minority interest in certain limited partnerships that we have determined to be Variable Interest Entities (“VIEs”). The aforementioned VIEs are not required to be consolidated in the Company’s condensed consolidated financial statements as we are not the primary beneficiary since we do not have the power to direct the activities that most significantly impact the VIEs’ economic performance.

The Company will periodically reassess whether we are the primary beneficiary in any of these investments. The reassessment process will consider whether we have acquired the power to direct the most significant activities of the VIE through changes in governing documents or other circumstances. Our maximum loss exposure is limited to our combined \$9,255,000 carrying value in these equity investments that are included in other investments in the Condensed Consolidated Balance Sheet as of March 31, 2017.

**Note 7. Acquisition of PetPartners, Inc.**

On March 24, 2017 (the "Acquisition Date"), the Company acquired 85% of the stock of PetPartners, Inc. (“PetPartners”), a pet insurance marketing and administration company, for a purchase price of \$12,677,000, including and subject to certain post-closing and working capital adjustments. The Company acquired PetPartners for the purpose of owning additional distribution and administration sources for its pet insurance. Any time after March 24, 2019, shares owned by the noncontrolling interest are puttable to the Company at fair value and are therefore presented on the balance sheet as redeemable noncontrolling interest.

Upon the acquisition, the Company consolidated the assets and liabilities of PetPartners. The following table presents the identifiable assets acquired and liabilities assumed in the acquisition of PetPartners on the Acquisition Date based on their respective fair values (in thousands):

|                               |                  |
|-------------------------------|------------------|
| Cash                          | <b>\$ 390</b>    |
| Intangible assets             | <b>5,880</b>     |
| Other assets                  | <b>567</b>       |
| <br>Total identifiable assets | <br><b>6,837</b> |
| <br>Other liabilities         | <br><b>174</b>   |

|                                    |                 |
|------------------------------------|-----------------|
| Deferred tax liability             | <b>1,099</b>    |
| Total liabilities                  | <b>1,273</b>    |
| Net identifiable assets acquired   | <b>\$ 5,564</b> |
| Redeemable noncontrolling interest | <b>\$ 2,005</b> |

In connection with the acquisition, the Company recorded \$9,118,000 of goodwill and \$5,880,000 of intangible assets (see Note 8). Goodwill reflects the synergies between PetPartners and Independence American as PetPartners will provide Independence American with increased distribution sources for its pet insurance business through its marketing relationship with the American Kennel Club. Goodwill was calculated as the excess of the sum of: (i) the acquisition date fair value of total cash consideration transferred of \$12,677,000; and (ii) the fair value of the redeemable noncontrolling interest in PetPartners of \$2,005,000 on the acquisition date; over (iii) the net identifiable assets of \$5,564,000 that were acquired. The enterprise value of PetPartners was determined by an independent appraisal using a discounted cash flow model based upon the projected future earnings of PetPartners including a control premium. The fair value of the redeemable noncontrolling interest was determined based upon their percentage of the PetPartners enterprise value discounted for a lack of control. The fair value of the acquired identifiable intangible assets

and deferred taxes are provisional pending receipt of the final valuations for those assets and liabilities. The Company expects to finalize the preliminary estimates of the fair value of the intangible assets and deferred taxes by the end of this year. Acquisition-related costs, primarily legal and consulting fees, were expensed and are included in selling, general and administrative expenses in the Condensed Consolidated Statement of Income.

For the period from the Acquisition Date to March 31, 2017, the Company's Condensed Consolidated Statement of Income includes revenues and net income of \$114,000 and \$15,000, respectively, from PetPartners.

Pro forma adjustments to present the Company's consolidated revenues and net income as if the acquisition date was January 1, 2016 are not material.

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

The carrying amount of goodwill was \$50,691,000 and \$41,573,000 at March 31, 2017 and December 31, 2016, respectively.

The Company has net other intangible assets of \$15,848,000 and \$10,122,000 at March 31, 2017 and December 31, 2016, respectively, which are included in other assets in the Condensed Consolidated Balance Sheets. These intangible assets consist of: (i) finite-lived intangible assets, principally the fair value of acquired agent and broker relationships, which are subject to amortization; and (ii) indefinite-lived intangible assets which consist of the estimated fair value of insurance licenses that are not subject to amortization.

The gross carrying amounts of these other intangible assets are as follows for the periods indicated (in thousands):

|  | <b>March 31, 2017</b> |                     | <b>December 31, 2016</b> |                     |
|--|-----------------------|---------------------|--------------------------|---------------------|
|  | <b>Gross</b>          |                     | <b>Gross</b>             |                     |
|  | <b>Carrying</b>       | <b>Accumulated</b>  | <b>Carrying</b>          | <b>Accumulated</b>  |
|  | <b>Amount</b>         | <b>Amortization</b> | <b>Amount</b>            | <b>Amortization</b> |
| <b>Finite-lived Intangible Assets:</b> |                       |                     |                          |                     |
| Agent and broker relationships         | \$ 18,153             | \$ 12,012           | \$ 13,052                | \$ 11,882           |



|                    |        |           |           |           |
|--------------------|--------|-----------|-----------|-----------|
| Domain             | 1,000  | 50        | 1,000     | 25        |
| Software systems   | 780    | -         | -         | -         |
| Total finite-lived | 19,933 | \$ 12,062 | \$ 14,052 | \$ 11,907 |

|  | March 31,<br>2017 | December 31,<br>2016 |
|--|-------------------|----------------------|
| <b>Indefinite-lived Intangible Assets:</b> |                   |                      |
| Insurance licenses                         | \$ 7,977          | \$ 7,977             |
| Total indefinite-lived                     | \$ 7,977          | \$ 7,977             |

In connection with the acquisition of PetPartners in the first quarter of 2017 discussed in Note 7, the Company recorded \$9,118,000 of goodwill and \$5,880,000 of intangible assets associated with the Specialty Health segment. None of the goodwill is deductible for income tax purposes. The intangible assets primarily represent the fair value of customer relationships and are being amortized over a weighted average period of 9.6 years.

Amortization expense was \$154,000 and \$340,000 for the three months ended March 31, 2017 and 2016, respectively.

**Note 9. 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. The differences between the Federal statutory income tax rate of 35% and the Company's effective income tax rate resulted principally from the dividends received deduction and tax exempt interest income, state and local income taxes, and health insurer specific tax provisions.

**Note 10. Policy Benefits and Claims**

Policy benefits and claims is the liability for unpaid loss and loss adjustment expenses. It is comprised of unpaid claims and estimated IBNR reserves. Summarized below are the changes in the total liability for policy benefits and claims for the periods indicated (in thousands).

|                                  | <b>Three Months Ended</b> |             |
|----------------------------------|---------------------------|-------------|
|                                  | <b>March 31,</b>          |             |
|                                  | <b>2017</b>               | <b>2016</b> |
| Balance at beginning of year     | \$ 219,113                | \$ 245,443  |
| Less: reinsurance recoverable    | 88,853                    | 65,362      |
| Net balance at beginning of year | 130,260                   | 180,081     |
| Amount incurred, related to:     |                           |             |
| Current year                     | 38,882                    | 36,425      |
| Prior years                      | (5,756)                   | (6,231)     |
| Total incurred                   | 33,126                    | 30,194      |
| Amount paid, related to:         |                           |             |
| Current year                     | 7,258                     | 7,238       |
| Prior years                      | 30,081                    | 64,105      |
| Total paid                       | 37,339                    | 71,343      |

|                               |                   |                   |
|-------------------------------|-------------------|-------------------|
| Net balance at end of year    | <b>126,047</b>    | <b>138,932</b>    |
| Plus: reinsurance recoverable | <b>56,245</b>     | <b>108,968</b>    |
| Balance at end of year        | <b>\$ 182,292</b> | <b>\$ 247,900</b> |

Since unpaid loss and loss adjustment expenses are estimates, actual losses incurred may be more or less than the Company's previously developed estimates and is referred to as either unfavorable or favorable development, respectively. The overall net favorable development of \$5,756,000 in 2017 related to prior years consists of favorable developments of \$1,636,000 in the Specialty Health reserves, \$2,896,000 in the group disability reserves and \$2,048,000 in the other individual life, annuities and other reserves, partially offset by an unfavorable development of \$824,000 in Medical Stop-Loss reserves. The overall net favorable development of \$6,231,000 in 2016 related to prior years primarily consists of favorable developments of \$2,109,000 in the Specialty Health reserves, \$3,617,000 in the group disability reserves, and \$494,000 in Medical Stop-Loss reserves.

Included in the preceding rollforward of the Company's liability for policy benefits and claims are the policy benefits and claims activity associated with the Company's health insurance lines. These are embedded within the Specialty Health segment. The table below summarizes the components of the change in the liability for policy benefits and claims that are specific to health insurance claims for the periods indicated (in thousands).

|                                  | <b>Specialty Health Segment<br/>Health Insurance Claims<br/>Three Months Ended<br/>March 31,</b> |             |
|----------------------------------|--|-------------|
|                                  | <b>2017</b>  | <b>2016</b> |
| Balance at beginning of year     | \$ 27,183  | \$ 23,425   |
| Less: reinsurance recoverable    | 1,179  | 1,362       |
| Net balance at beginning of year | 26,004   | 22,063      |
| Amount incurred, related to:     |  |             |
| Current year                     | 11,776   | 10,196      |
| Prior years                      | (1,200)  | (5,232)     |
| Total incurred                   | 10,576   | 4,964       |
| Amount paid, related to:         |  |             |
| Current year                     | 153  | 417         |
| Prior years                      | 10,338   | 7,957       |
| Total paid                       | 10,491   | 8,374       |
| Net balance at end of year       | 26,089   | 18,653      |
| Plus: reinsurance recoverable    | 427  | 906         |
| Balance at end of year           | \$ 26,516  | \$ 19,559   |

The liability for the IBNR plus expected development on reported claims associated with the Company's health insurance claims was \$26,089,000 at March 31, 2017.

**Note 11. Stockholders' Equity**

*Treasury Stock*

In the first quarter of 2017, the Company paid \$14,402,000 for repurchases of its common stock; and of that amount, 703,000 shares of its common stock were repurchased in private transactions for an aggregate cost of \$13,975,000.

*Accumulated Other Comprehensive Income (Loss)*

Other comprehensive income (loss) includes 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.

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

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2017</b>               | <b>2016</b> |
| Beginning balance   | \$ (6,964)                | \$ (3,440)  |
| Other comprehensive income (loss) before reclassifications                | 2,669                     | 3,424       |
| Amounts reclassified from accumulated OCI                                 | (148)                     | (406)       |
| Net other comprehensive income  | 2,521                     | 3,018       |
| Less: Other comprehensive income attributable to noncontrolling interests | -                         | (57)        |
| Ending balance  | \$ (4,443)                | \$ (479)    |

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):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2017</b>               | <b>2016</b> |
| Unrealized gains (losses) on available-for-sale securities reclassified during the period to the following income statement line items: |                           |             |
| Net realized investment gains   | \$ 197                    | \$ 628      |
| Income before income tax  | 197                       | 628         |
| Tax effect  | 49                        | 222         |

|            |        |        |
|------------|--------|--------|
| Net income | \$ 148 | \$ 406 |
|------------|--------|--------|

**Note 12. Share-Based Compensation**

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

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

Under the terms of IHC's share-based compensation plans: (i) the exercise price of an option may not be less than the fair market value of an IHC share on the grant date and the terms of an option may not exceed 10 years from the grant date; and (ii) the exercise price of a SAR may not be less than the fair market value of an IHC share on the grant date and SAR terms may not exceed 10 years from the date of grant.

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. In general, the vesting period for an option grant is 3years. Restricted share units are valued at the quoted market price of the shares at the date of grant and generally vest over 3years. Compensation costs for options and restricted share units are recognized over the stated vesting periods on a straight-line basis. The fair value of a SAR 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 the fair value of a SAR continue to be recognized as compensation expense in the period of the change until settlement. The

Company accounts for forfeitures of share-based compensation awards in the period that they occur.

At March 31, 2017, there were 1,133,100 shares available for future stock-based compensation grants under IHC's stock incentive plan. The following table summarizes share-based compensation expense, which is included in selling, general and administrative expenses on the Condensed Consolidated Statements of Income, applicable to the IHC plans, by award type for each of the periods indicated (in thousands):

|   | <b>Three Months<br/>Ended<br/>March 31,<br/>2017      2016</b> |        |
|---|--|--------|
| <b>IHC's Share-based Compensation Plan:</b> |  |        |
| Stock options                               | \$ 35  | \$ 170 |
| Restricted stock units                      | 31   | 23     |
| SARs  | (65)   | 258    |
| Share-based compensation expense, pre-tax   | 1  | 451    |
| Tax benefits                                | -  | 180    |
| Share-based compensation expense, net       | \$ 1   | \$ 271 |

### Stock Options

The IHC's stock option activity during 2017 was as follows:

| Shares | Weighted-<br>Average |
|--------|----------------------|
|--------|----------------------|



|                          | <b>Under Option</b> | <b>Exercise Price</b> |
|--------------------------|---------------------|-----------------------|
| <b>December 31, 2016</b> | <b>697,180</b>      | <b>\$ 11.75</b>       |
| Exercised                | -                   | -                     |
| <b>March 31, 2017</b>    | <b>697,180</b>      | <b>\$ 11.75</b>       |

In the first quarter of 2016, option agreements affecting 13 employees were modified to extend the expirations of their terms from 2017 to 2019 and as a result, the Company recorded incremental compensation costs of \$170,000.

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

|  | <b>March 31, 2017</b> |                    |
|--|-----------------------|--------------------|
|  | <b>Outstanding</b>    | <b>Exercisable</b> |
| Number of options  | 697,180               | 540,180            |
| Weighted average exercise price per share                | \$ 11.75              | \$ 9.37            |
| Aggregate intrinsic value for all options (in thousands) | \$ 4,988              | \$ 4,988           |
| Weighted average contractual term remaining              | 2.2 years             | 1.5 years          |

At March 31, 2017, the total unrecognized compensation cost related to IHC's non-vested stock options was \$370,000 and it is expected to be recognized as compensation expense over a weighted average period of 2.7 years.

## **Restricted Stock**

At March 31, 2017 and December 31, 2016, there were 17,325 unvested restricted stock units outstanding with a weighted average grant-date fair value of \$16.20 per share.

At March 31, 2017, the total unrecognized compensation cost related to non-vested restricted stock unit awards was \$204,000 which is expected to be recognized as compensation expense over a weighted average period of 1.9 years.

## **SARs**

IHC had 64,900 and 71,500 of SAR awards outstanding at March 31, 2017 and December 31, 2016, respectively. In the first quarter of 2017, 6,600 SARs were exercised with an aggregate intrinsic value of \$64,000. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at March 31, 2017 and December 31, 2016 are liabilities of \$747,000 and \$876,000, respectively, pertaining to SARs.

## **B) AMIC Share-Based Compensation Plan**

AMIC's share-based compensation plan was terminated in 2016. During the first quarter of 2016, the AMIC recorded \$7,000 of share-based compensation expense, net of tax benefits of \$4,000, in selling, general and administrative expenses, and

AMIC received \$145,000 in cash from the exercise of stock options

## **Note 13. Supplemental Disclosures of Cash Flow Information**

Net cash payments (receipts) for income taxes were \$222,000 and \$5,591,000 during the three months ended March 31, 2017 and 2016.

Cash payments for interest were \$0 and \$505,000 during the three months ended March 31, 2017 and 2016, respectively.

**Note 14. Contingencies**

A third party administrator with whom we formerly did business (“Plaintiff”) filed a Complaint dated May 17, 2017 in the United States District Court, Northern District of Texas, Dallas Division, naming IHC, Madison National Life, Standard Security Life, and IHC Carrier Solutions, Inc. (collectively referred to as “Defendants”). The Complaint concerns agreements entered into by Standard Security Life and Madison National Life with Plaintiff, as well as other allegations made by Plaintiff against the Defendants. The Complaint seeks injunctive relief and damages in an amount exceeding \$50,000,000, profit share payments allegedly owed to Plaintiff under the agreements totaling at least \$3,082,000 through 2014, plus additional amounts for 2015 and 2016, and exemplary and punitive damages as allowed by law and fees and costs. The Defendants have until July 31, 2017 to answer or otherwise respond. The Defendants intend to vigorously contest the claims.

**Note 15. Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Interest expense, taxes, and general expenses associated with parent company activities are included in Corporate. Identifiable assets by segment are those assets that are utilized in each segment and are allocated based upon the mean reserves and liabilities of each such segment. Corporate assets are composed principally of cash equivalents, resale agreements, fixed maturities, equity securities, partnership interests and certain other investments.

Information by business segment is presented below for the periods indicated (in thousands):

|  | <b>Three Months Ended</b> |                  |
|--|---------------------------|------------------|
|  | <b>March 31,</b>          |                  |
|  | <b>2017</b>               | <b>2016</b>      |
| <b>Revenues:</b>                             |                           |                  |
| Specialty Health                             | \$ 42,217                 | \$ 40,087        |
| Group disability; life and DBL               | 26,406                    | 25,536           |
| Individual life, annuities and other (A)     | 530                       | 751              |
| Medical Stop-Loss (A)                        | 1,859                     | 7,850            |
| Corporate                                    | 656                       | 1,111            |
|  | <b>71,668</b>             | <b>75,335</b>    |
| Net realized investment gains                | 172                       | 560              |
| <b>Total revenues</b>                        | <b>\$ 71,840</b>          | <b>\$ 75,895</b> |
| <b>Income from continuing operations</b>     |                           |                  |
| <b>before income taxes:</b>                  |                           |                  |
| Specialty Health (B)                         | \$ 2,643                  | \$ 395           |
| Group disability; life and DBL               | 5,482                     | 6,701            |
| Individual life, annuities and other (A) (C) | (230)                     | (1,793)          |
| Medical Stop-Loss (A)                        | 825                       | 7,802            |
| Corporate                                    | (1,345)                   | (3,740)          |
|  | <b>7,375</b>              | <b>9,365</b>     |
| Net realized investment gains                | 172                       | 560              |
| Interest expense                             | -                         | (453)            |
| <b>Income from continuing operations</b>     |                           |                  |
| <b>before income taxes</b>                   | <b>\$ 7,547</b>           | <b>\$ 9,472</b>  |

**(A)** Substantially all of the business in the segment is coinsured. Activity in this segment primarily reflects income or expenses related to the coinsurance and the run-off of any remaining blocks that were not coinsured.

**(B)** The Specialty Health segment includes amortization of intangible assets. Total amortization expense was \$154,000 and \$340,000 for the three months ended March 31, 2017 and 2016.

**(C)** For the three months ended March 31, 2017 and 2016, the Individual life, annuities and other segment includes \$284,000 and \$1,370,000 of amortization of deferred charges in connection with the assumptions of certain ceded life and annuity policies.

## 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, 2016, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

### Overview

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ("Independence American"); and (ii) its marketing and administrative companies, including IHC Specialty Benefits Inc., IHC Carrier Solutions, Inc. and a majority interest in PetPartners, Inc. IHC also owns a significant equity interest in: (i) Ebix Health Exchange Holdings, LLC ("Ebix Health Exchange"), an administration exchange for health insurance. Standard Security Life, Madison National Life and Independence American are sometimes collectively referred to as the "Insurance Group". IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or "IHC", or are implicit in the terms "we", "us" and "our".

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 specialty medical, disability and New York short-term disability ("DBL"); mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. Management has always focused on managing the costs of its operations.

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

Results of operations are summarized as follows for the periods indicated (in thousands):

|  | <b>Three Months Ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>March 31,</b>          |                   |
|  | <b>2017</b>               | <b>2016</b>       |
| Revenues   | \$ 71,840                 | \$ 75,895         |
| Expenses   | 64,293                    | 66,423            |
| Income from continuing operations before income taxes      | 7,547                     | 9,472             |
| Income taxes   | 2,538                     | 3,576             |
| <b>Income from continuing operations, net of tax</b>       | <b>5,009</b>              | <b>5,896</b>      |
| Income from discontinued operations                        | -                         | 109,770           |
| <b>Net income</b>  | <b>5,009</b>              | <b>115,666</b>    |
| Less: Income from noncontrolling interests in subsidiaries | (73)                      | (9,656)           |
| <b>Net income attributable to IHC</b>                      | <b>\$ 4,936</b>           | <b>\$ 106,010</b> |

Income from continuing operations of \$.29 per share, diluted, for the three months ended March 31, 2017 compared to \$.33 per share, diluted, for the same period in 2016.

Consolidated investment yields (on an annualized basis) of 2.9% for the three months ended March 31, 2017 compared to 2.8% for the comparable period in 2016;

Book value of \$26.24 per common share at March 31, 2017 compared to \$25.53 at December 31, 2016.

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

The Specialty Health segment reported \$2.6 million of income before taxes for the three months ended March 31, 2017 as compared to \$.4 million for the comparable period in 2016;

○ Premiums earned increased \$2.8 million for the three months ended March 31, 2017 over the comparable period in 2016. Short term medical premiums increased \$4.0 million as a result of the strategic decision to focus on ancillary products was partially offset by reductions in the certain vision and international lines of business which are in run-off.

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

|                                       | <b>Three Months Ended</b> |             |
|---------------------------------------|---------------------------|-------------|
|                                       | <b>March 31,</b>          |             |
|                                       | <b>2017</b>               | <b>2016</b> |
| Premiums Earned                       | \$ 37,982                 | \$ 35,167   |
| Insurance Benefits, Claims & Reserves | 18,078                    | 18,169      |
| Expenses                              | 18,673                    | 16,578      |
| Loss Ratio (A)                        | 47.6%                     | 51.7%       |
| Expense Ratio (B)                     | 49.2%                     | 47.1%       |
| Combined Ratio (C)                    | 96.8%                     | 98.8%       |

**(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.

○ Although the loss ratio in 2017 was lower than in 2016, the expense ratio is higher in 2017 because of changes in the mix of products within the Specialty Health segment and as a result of the reallocation of certain fixed costs from the Medical Stop-Loss segment to the Specialty Health segment as the premium volume of one segment shrinks and the other one grows.



Income before taxes from the Group disability, life, annuities and DBL segment decreased \$1.2 million for the three months ended March 31, 2017 compared to the same period in 2016. The decrease in the first-quarter results primarily reflects a decrease in the group term life lines due to higher claims in the first quarter of 2017 and lower income from the international line due to run-off of that line of business;

The Individual life, annuities and other segment reported losses before income taxes of \$.2 million for the three months ended March 31, 2017 and \$1.8 million for the three months ended March 31, 2016. The losses in 2016 were related to the accelerated amortization of deferred costs in connection with the assumption of certain ceded life and annuity policies for which there are no comparable amounts in 2017.

The Medical Stop-Loss segment reported income before taxes of \$.8 million for the three months ended March 31, 2017 as compared to \$7.8 million for the comparable period in 2016. Income from the Medical Stop-loss segment is principally due to ceding commissions on coinsurance due to the sale of Risk Solutions and exit from the medical stop-loss business. Premiums earned and amounts

recorded for benefits, claims and reserves in the Medical Stop-Loss segment represent the activity of the remaining blocks of medical stop-loss business in run-off.

Losses before tax from the Corporate segment decreased \$2.4 million in the three months ended March 31, 2017 over the same period of 2016 primarily due to decreased share-based compensation, consulting, legal and accounting expenses; and

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

|  | <b>Three Months Ended<br/>March 31,</b> |                   |
|--|---|-------------------|
| <b>Gross Direct and<br/>Assumed</b>      |   |                   |
| <b>Earned Premiums:</b>                  | <b>2017</b>                             | <b>2016</b>       |
| Specialty Health                         | \$ 39,879                               | \$ 37,866         |
| Group disability, life<br>and DBL        | 32,020                                  | 30,276            |
| Individual, life,<br>annuities and other | 6,998                                   | 4,753             |
| Medical Stop-Loss                        | 7,558                                   | 83,344            |
|  | <b>\$ 86,455</b>                        | <b>\$ 156,239</b> |

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
| <b>Net Direct and<br/>Assumed</b>        |   |             |
| <b>Earned Premiums:</b>                  | <b>2017</b>                             | <b>2016</b> |
| Specialty Health                         | \$ 37,982                               | \$ 35,167   |
| Group disability, life<br>and DBL        | 24,691                                  | 23,627      |
| Individual, life,<br>annuities and other | 15                                      | 15          |
| Medical Stop-Loss                        | 253                                     | 3,753       |

\$ 62,941 \$ 62,562

## CRITICAL ACCOUNTING POLICIES

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2016. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges, Insurance Liabilities, 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, 2016. During the three months ended March 31, 2017, there were no additions to or changes in the critical accounting policies disclosed in the 2016 Form 10-K except for the recently adopted accounting standards discussed in Note 1(E) of the Notes to Condensed Consolidated Financial Statements.

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**Results of Operations for the Three Months Ended March 31, 2017 Compared to the Three Months Ended March 31, 2016**

Information by business segment for the periods indicated is as follows:

| <b>March 31, 2017</b><br><b>(In thousands)</b>        | <b>Premiums</b><br><b>Earned</b> | <b>Net</b><br><b>Investment</b><br><b>Income</b> | <b>Fee and</b><br><b>Other</b><br><b>Income</b> | <b>Benefits,</b><br><b>Claims</b><br><b>and</b><br><b>Reserves</b> | <b>Selling,</b><br><b>General</b><br><b>and</b><br><b>Administrative</b> | <b>Total</b> |
|---|----------------------------------|--|---|--|--|--------------|
| Specialty Health                                      | \$ 37,982                        | 920  | 3,315   | 18,078   | 21,496   | \$ 2,643     |
| Group disability,<br>life and DBL                     | 24,691                           | 1,564  | 151   | 12,838   | 8,086  | 5,482        |
| Individual life,<br>annuities and other               | 15                               | 408  | 107   | 242  | 518  | (230)        |
| Medical Stop-Loss                                     | 253                              | 363  | 1,243   | 1,053  | (19)   | 825          |
| Corporate   | -                                | 656  | -   | -  | 2,001  | (1,345)      |
| Sub total   | \$ 62,941                        | \$ 3,911   | \$ 4,816  | \$ 32,211  | \$ 32,082  | 7,375        |
| Net realized investment gains                         |                                  |  |   |  |  | 172          |
| Income from continuing operations before income taxes |                                  |  |   |  |  | 7,547        |
| Income taxes  |                                  |  |   |  |  | 2,538        |
| Income from continuing operations, net of tax         |                                  |  |   |  |  | \$ 5,009     |

| <b>March 31, 2016</b><br><b>(In thousands)</b> | <b>Premiums</b><br><b>Earned</b> | <b>Net</b><br><b>Investment</b><br><b>Income</b> | <b>Fee and</b><br><b>Other</b><br><b>Income</b> | <b>Benefits,</b><br><b>Claims</b><br><b>and</b><br><b>Reserves</b> | <b>Selling,</b><br><b>General</b><br><b>and</b><br><b>Administrative</b> | <b>Total</b> |
|--|----------------------------------|--|---|--|--|--------------|
| Specialty Health                               | \$ 35,167                        | 356  | 4,564   | 18,169   | 21,523   | \$ 395       |
| Group disability,<br>life and DBL              | 23,627                           | 1,595  | 314   | 10,487   | 8,348  | 6,701        |
| Individual life,<br>annuities and other        | 15                               | 388  | 348   | 254  | 2,290  | (1,793)      |
| Medical Stop-Loss                              | 3,753                            | 1,036  | 3,061   | 1,833  | (1,785)  | 7,802        |
| Corporate                                      | -                                | 1,061  | 50  | -  | 4,851  | (3,740)      |
| Sub total                                      | \$ 62,562                        | \$ 4,436   | \$ 8,337  | \$ 30,743  | \$ 35,227  | 9,365        |

|   |          |
|---|----------|
| Net realized investment gains                         | 560      |
| Interest expense on debt                              | (453)    |
| Income from continuing operations before income taxes | 9,472    |
| Income taxes  | 3,576    |
| Income from continuing operations, net of tax         | \$ 5,896 |

### *Premiums Earned*

In the first quarter of 2017, premiums earned increased \$.4 million over the comparable period of 2016. The increase is primarily due to: (i) an increase of \$2.8 million in the Specialty Health segment principally as a result of a \$4.0 million increase in premiums from the short term medical line of business, a \$1.5 million increase in the fixed indemnity limited benefit line and a \$.9 million increase in the pet line of business, partially offset by a decrease of \$1.7 million in the dental line of business and a \$1.6 million decrease in the international medical business premiums due to the run-off of the line; and (ii) a \$1.1 million increase in earned premiums from the Group disability, life, annuities and DBL segment primarily due to increased volume in the LTD and group term life lines, partially offset by (iii) a decrease of \$3.5 million in the Medical Stop Loss segment as a result of the sale of Risk Solutions and exit from the medical stop-loss business, further described in Note 3.

### *Net Investment Income*

Total net investment income decreased \$.5 million. The overall annualized investment yields were 2.9% and 2.8% in the first quarter of 2017 and 2016, respectively. The overall decrease was primarily the result of a decrease in average invested assets largely due to the retirement of debt in the fourth quarter of 2016.

The annualized investment yields on bonds, equities and short-term investments were 3.1% and 3.0% in the first quarter of 2017 and 2016, respectively. IHC has approximately \$150.9 million in highly rated shorter duration securities earning on average 1.6%. 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 million in 2017 compared to \$.6 million in 2016. 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 \$1.9 million for the three-month period ended March 31, 2017 compared to the three-month period ended March 31, 2016 primarily due to the sale of Accident Insurance Services, Inc., our primary producer of Occupational Accident line of business, in the third quarter of 2016.

Other income in the first quarter of 2017 decreased \$1.7 million from the same period in 2016 primarily due to the run-off of fees received in conjunction with the diminished administration of the Medical Stop Loss segment.

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

In the first quarter of 2017, insurance benefits, claims and reserves increased \$1.5 million over the comparable period in 2016. The increase is primarily attributable to: (i) an increase of \$2.4 million in benefits, claims and reserves in the Group disability, life, annuities and DBL segment, primarily due to growth in this line and increased loss ratios on group term life and LTD lines and DBL business; partially offset by (ii) a decrease of \$.8 million in the Medical Stop Loss segment primarily as a result of the sale of Risk Solutions and exit from the medical stop-loss business, further described in Note 3; and (iii) a decrease of \$.1 million in the Specialty Health segment, primarily due to a decrease of \$5.1 million in benefits, claims and reserves related to the run-off of the occupational accident line of business, a decrease of \$.9 million in the dental line due to lower premiums, and \$1.0 million of lower claims on the fixed indemnity limited benefit line of business; partially offset by increases of \$4.1 million in the major medical line of business due to favorable development of this line in 2016 with no comparable amount in 2017, \$2.0 million in claims in the short term medical line of business due to the increase in volume, and an increase of \$1.0 million due to volume in the pet line.

*Selling, General and Administrative Expenses*

Total selling, general and administrative expenses decreased \$3.1 million over the comparable period in 2016. The decrease is primarily attributable to: (i) a decrease of \$2.8 million in Corporate due to a decrease in audit, legal, share-based compensation and consulting fees; (ii) a decrease of \$1.8 million in the Individual life, annuity and other segment largely due to lower amortization of deferred costs and general expenses from business in run-off; (iii) an insignificant decrease in the Specialty Health line of business due to an increase in underwriting expenses partially offset by a decrease in agency expenses; and (iv) a decrease of \$.3 million in the Group disability, life, annuities and DBL segment primarily due to decreased commission expense; partially offset by (iv) an increase of \$1.8 million in the Medical Stop Loss segment primarily due to a credit in premium taxes in 2016 with no comparable amount for 2017.

## ***Income Taxes***

The effective tax rate for the three months ended March 31, 2017 was 33.6% compared to 37.8% for the three months ended 2016. The lower tax rate is primarily due to: (i) an increase in benefits from tax-advantaged securities as a percentage of income in 2017; (ii) a decrease in state taxes as a percentage of income; and (iii) a decrease in non-deductible expenses.

## **LIQUIDITY**

### **Insurance Group**

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

### **Corporate**

Corporate derives its funds principally from: (i) dividends from the Insurance Group; (ii) management fees from its subsidiaries; and (iii) investment income from Corporate liquidity. Regulatory constraints historically have not affected the Company's consolidated liquidity, although state insurance laws have provisions relating to the ability of the parent company to use cash generated by the Insurance Group. No dividends were declared or paid by the Insurance Group during the three months ended March 31, 2017 or 2016.

### **Cash Flows**

The Company had \$51.2 million and \$22.0 million of cash and cash equivalents as of March 31, 2017 and December 31, 2016, respectively.

For the three months ended March 31, 2017, investment activities provided \$45.1 million of cash, primarily the result of sales of investment securities, net of \$12.3 million cash paid to acquire PetPartners. Financing activities utilized \$15.9 million of cash, of which \$14.4 million was utilized for treasury share purchases.



The Company has \$401.4 million of liabilities for future policy benefits and policy benefits and claims that it expects to ultimately pay out of current assets and cash flows from future business. If necessary, the Company could utilize the cash received from maturities and repayments of its fixed maturity investments if the timing of claim payments associated with the Company's insurance resources does not coincide with future cash flows. For the three months ended March 31, 2017, cash received from the maturities and other repayments of fixed maturities was \$4.1 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.

On May 26, 2017, IHC commenced a tender offer to purchase up to 2,000,000 shares of its common stock at a price per share of \$20.00, net, to the seller in cash. Assuming the maximum number of shares is tendered, the gross aggregate purchase price will be \$40.0 million. The tender offer will be funded out of corporate liquidity.

**BALANCE SHEET**

The Company had receivables due from reinsurers of \$409.8 million at March 31, 2017 compared to \$440.3 million at December 31, 2016. The decrease is primarily attributable to the decrease in medical stop-loss reserves that are 100% coinsured. All of such reinsurance receivables are from highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at March 31, 2017.

The Company's liability for policy benefits and claims by segment are as follows (in thousands):

|                          | <b>Policy Benefits and Claims</b> |                     |
|--------------------------|-----------------------------------|---------------------|
|                          | <b>March 31,</b>                  | <b>December 31,</b> |
|                          | <b>2017</b>                       | <b>2016</b>         |
| Specialty Health         | \$ 47,657                         | \$ 50,237           |
| Group Disability         | 103,948                           | 104,428             |
| Individual A&H and Other | 9,830                             | 9,688               |
| Medical Stop-Loss        | 20,857                            | 54,760              |
|                          | <b>\$ 182,292</b>                 | <b>\$ 219,113</b>   |

The primary assumption in the determination of Specialty Health reserves is that historical claim development patterns are representative of future claim development patterns. Factors that may affect this assumption include changes in claim payment processing times and procedures, changes in time delay in submission of claims, and the incidence of unusually large claims. Liabilities for policy benefits and claims for specialty health medical and disability coverage are computed using completion factors and expected Net Loss Ratios derived from actual historical premium and claim data. 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 not material. The Company has business that is serviced by third-party administrators. From time to time, there are changes in the timing of claims processing due to any number of factors including, but not limited to, system conversions and staffing changes during the year. These changes are monitored by the Company and the effects of these changes are taken into consideration during the claim reserving process. 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 Company's disability business is comprised of group disability and DBL. The two "primary" assumptions on which disability policy benefits and claims are based are: (i) morbidity levels; and (ii) recovery rates. If morbidity levels increase, for example due to an epidemic or a recessionary environment, the Company would increase reserves because there would be more new claims than expected. In regard to the assumed recovery rate, if disabled lives recover more quickly than anticipated then the existing claims reserves would be reduced; if less quickly, the existing

claims reserves would be increased. Advancements in medical treatments could affect future recovery, termination, and mortality rates. The Company does not believe that reasonably likely changes in its “primary” assumptions would have a material effect on the Company’s financial condition, results of operations, or liquidity.

The \$6.9 million decrease in IHC’s stockholders' equity in the first three months of 2017 is primarily due to \$4.9 million of net income attributable to IHC and \$2.5 million of other comprehensive income attributable to IHC, reduced by \$14.4 million of treasury stock purchases.

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

The nature and quality of insurance company investments must comply with all applicable statutes and regulations, which have been promulgated primarily for the protection of policyholders. Although the Company's gross unrealized losses on available-for-sale securities totaled \$9.0 million at March 31, 2017, 100% 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. The Company does not have any non-performing fixed maturities at March 31, 2017.

The Company reviews its investments regularly and monitors its investments continually for impairments. There were no securities with fair values less than 80% of their amortized cost at March 31, 2017 and the Company did not record any other-than-temporary impairment losses in the three months ended March 31, 2017 or 2016.

The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's impairment policy and were determined to be temporary in nature at March 31, 2017. In 2017, the Company recorded \$4.2 million of net unrealized gains on available-for sale securities, pre-tax, in other comprehensive income (loss) prior to reclassification adjustments. From time to time, as warranted, the Company may employ investment strategies to mitigate interest rate and other market exposures. Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalances in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

## **CAPITAL RESOURCES**

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

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash flow requirements can be fully assessed based solely upon an analysis of these obligations.

Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of March 31, 2017, is not materially different from that reported in the schedule of such obligations at December 31, 2016 which was included in Item 7 of the Company's Annual Report on Form 10-K.

## **OUTLOOK**

For 2017, the Company anticipates that it will:

Continue to experience an overall decrease in premiums and earnings due to exiting the medical stop-loss business as a result of the Risk Solutions Sale and Coinsurance Transaction.

Continue to show significant increases in specialty health premiums (including hospital indemnity, group limited medical and group gap and other supplemental health products, such as accident medical, gap and critical illness products). We have seen an increase in demand for these products this year, which appears to be accelerating given the disruption in the market for ACA plans. In the event that carriers continue to exit the ACA market and get approval for substantial rate increases in those markets in which they remain, IHC believes it is possible that we will experience significant increases in sales of our products during Open Enrollment and throughout 2018.

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Continue to increase IHC's emphasis on lead generation for its direct-to-consumer and career advisor distribution initiatives, as well as expanding our controlled sales through our call center, career model and transactional websites as a result of the acquisition of PetPlace.com, IHC's ownership of HealtheDeals.com, and AspiraAmas and its investment in HealthInsurance.org.

Expand sales of our specialty health products as a result of private-label and white-label distribution arrangements with large national partners and our equity investments last year in two call center agencies and a worksite marketing company.

Diversify the distribution and administration of our pet insurance as a result of the acquisition of Pet Partners Inc.

Experience continued increases in premiums from group long-term and short-term disability driven by higher retention amounts and a full year of premiums generated by a relatively new distribution partnership.

Continue to evaluate strategic transactions. We plan to continue to deploy some of our cash to make additional investments and acquisitions that will continue to bolster existing or new lines of business.

Continue to focus on administrative efficiencies.

On March 31, 2016, IHC and a subsidiary of AMIC sold the stock of Risk Solutions. In addition, under the purchase and sale agreement, all of the in-force stop-loss business of Standard Security Life and Independence American produced by Risk Solutions was co-insured by Westport as of January 1, 2016. The aggregate purchase price was \$152.5 million in cash, subject to adjustments and settlements. This transaction resulted in a gain of \$100.8 million for the year ended December 31, 2016, net of taxes and amounts attributable to noncontrolling interests. As a result, IHC is highly liquid and has excess capital; however its Medical Stop-Loss line of business is in run-off, which will have a negative impact on future earnings.

Subject to making additional repurchases, acquisitions and investments, the Company will remain highly liquid in 2017 as a result of the continuing shorter duration of the portfolio. IHC has approximately \$150.9 million in highly rated shorter duration securities earning on average 1.6%; our portfolio as a whole is rated, on average, AA. The low duration of our portfolio enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income in the future. A low duration portfolio such as ours also mitigates the adverse impact of potential inflation. IHC will continue to monitor the financial markets and invest accordingly.

On May 26, 2017, IHC commenced a tender offer to purchase up to 2,000,000 shares of its common stock at a price per share of \$20.00, net, to the seller in cash. The maximum number of shares proposed to be purchased in the tender offer represents approximately 12.21% of the 16,377,756 shares of IHC common stock outstanding as of April 30, 2017 and involves a gross aggregate purchase price of \$40 million, assuming the maximum number of shares is tendered. The tender offer will be funded out of corporate liquidity.

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 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. Factors affecting these items, as well as unemployment and global financial markets, may have a material adverse effect on our results of operations and financial condition.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at March 31, 2017 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2016 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**



*Evaluation of Disclosure 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.

As previously disclosed in Item 9A of our Form 10-K for the year ended December 31, 2016, management concluded that there were material weaknesses in internal control over financial reporting for income taxes. Management determined that we did not maintain effective controls over the accounting for and disclosures of technical accounting matters as they relate to income taxes.

A material weakness is a deficiency or combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

### ***Remediation of Material Weakness***

The Company has made significant progress in remediating its material weaknesses in internal control over financial reporting for income taxes, specifically (i) strengthening existing tax staff with consulting tax accounting resources. Additionally, financial reporting staff attended training related to the design and operation of tax related financial reporting and corresponding internal controls; (ii) implementing enhanced risk assessment processes over accounting for income taxes, with a focus on tax accounting and disclosure for unusual and complex transactions; and (iii) improving existing or establishing new processes and controls to measure and record transactions related to tax accounting to enhance the effectiveness of the design and operation of those controls.

While the Company has made significant progress in implementing the remediation efforts described above; until those actions are fully implemented and the operational effectiveness of related internal controls validated through testing, the material weaknesses described above will continue to exist. Management anticipates that all remediation efforts will be fully implemented and validated by the fourth quarter of 2017.

### **Changes in Internal Control Over Financial Reporting**

Except as noted above, our Management, including the CEO and CFO, identified no change in our internal control over financial reporting that occurred during our fiscal quarter ended March 31, 2017, that has materially affected or is reasonably likely to materially affect, our 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.

A third party administrator with whom we formerly did business (“Plaintiff”) filed a Complaint dated May 17, 2017 in the United States District Court, Northern District of Texas, Dallas Division, naming IHC, Madison National Life, Standard Security Life, and IHC Carrier Solutions, Inc. (collectively referred to as “Defendants”). The Complaint concerns agreements entered into by Standard Security Life and Madison National Life with Plaintiff, as well as other allegations made by Plaintiff against the Defendants. The Complaint seeks injunctive relief and damages in an amount exceeding \$50,000,000, profit share payments allegedly owed to Plaintiff under the agreements totaling at least \$3,082,000 through 2014, plus additional amounts for 2015 and 2016, and exemplary and punitive damages as allowed by law and fees and costs. The Defendants have until July 31, 2017 to answer or otherwise respond. The Defendants intend to vigorously contest the claims.

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**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, 2016 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 August 2016, the Board of Directors increased the number of shares that can be repurchased to 3,000,000 shares of IHC common stock. As of March 31, 2017, 2,170,673 shares were still authorized to be repurchased.

Share repurchases during the first quarter of 2017 are summarized as follows:

**2017**

| <b>Month of Shares</b> | <b>of</b>          | <b>Average</b> | <b>Maximum</b>     |
|------------------------|--------------------|----------------|--------------------|
| <b>Repurchase</b>      | <b>Repurchased</b> | <b>Price</b>   | <b>Number</b>      |
|                        |                    |                | <b>Of Shares</b>   |
|                        |                    |                | <b>Which</b>       |
|                        |                    |                | <b>Can be</b>      |
|                        |                    |                | <b>Repurchased</b> |
| January                | 308,629            | \$ 19.97       | 2,586,813          |
| February               | 246,140            | \$ 20.00       | 2,340,673          |
| March                  | 170,000            | \$ 19.50       | 2,170,673          |

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

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**ITEM 6. EXHIBITS**

- 3.1** Restated Certificate of Incorporation of Independence Holding Company (Filed as Exhibit 3(i) to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1996 and incorporated herein by reference).
- 3.2** Certificate of Amendment of Restated Certificate of Incorporation of Independence Holding Company (Filed as Exhibit 3.1 to our Current Report on Form 8-K filed with the SEC on July 29, 2004 and incorporated herein by reference).
- 3.3** By-Laws of Independence Holding Company (Filed as Exhibit 3.3 to our Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference), as amended by Amendment to By-Laws of Independence Holding Company (Filed as Exhibit 3.2 to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 and incorporated herein by reference).
- 10.1** Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, Standard Security Life Insurance Company of New York and Mr. David T. Kettig (Filed as Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).
- 10.2** Officer Employment Agreement, made as of April 18, 2011, by and among Independence Holding Company, Madison National Life Insurance Company, Inc. and Mr. Larry R. Graber (Filed as Exhibit 10.2 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).
- 10.3** Officer Employment Agreement, made as of April 18, 2011, by and between Independence Holding Company and Ms. Teresa A. Herbert (Filed as Exhibit 10.5 to our Current Report on Form 8-K filed with the SEC on April 22, 2011 and incorporated herein by reference).
- 10.4** Officer Employment Agreement, made as of May 11, 2011, by and between Independence Holding Company and Mr. Roy T.K. Thung (Filed as Exhibit 10.1 to our Quarterly Report on Form 10-Q for the period ended March 31, 2011 that was filed with the SEC on May 12, 2011, and incorporated herein by reference).
- 10.5** Officer Employment Agreement, by and among Independence Holding Company, IHC Risk Solutions, LLC and Mr. Michael A. Kemp, dated as of May 22, 2012 (Filed as Exhibit 10.3 to our Current Report on Form 8-K filed with the SEC on May 29, 2012, and incorporated herein by reference).
- 10.6** Retirement Benefit Agreement, dated as of September 30, 1991, between Independence Holding Company and Mr. Roy T.K. Thung, as amended. (Filed as an Exhibit to our Annual Report on Form 10-K for the year ended December 31, 1993 and incorporated herein by reference; Amendment No. 1 filed as Exhibit 10(iii)(A)(4a) to our Annual Report on Form 10-K for the year ended December 31, 2003 and incorporated herein by reference; Amendment No. 2 filed as Exhibit 10(iii)(4)(b) to our Current Report on Form 8-K filed with the SEC on June 22, 2005 and incorporated herein by reference; Amendment No. 3 filed as Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on January 7, 2009 and incorporated herein by reference.)
- 10.7** Purchase Agreement, made and entered into on June 15, 2015, by and among Madison National Life Insurance Company, Inc., Standard Security Life Insurance Company of New York and National Guardian Life Insurance Company (Filed as Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on June 16, 2015, and incorporated herein by reference).
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10.8 Sale Bonus Agreement, dated November 7, 2016, by and between Independence American Holdings Corp. and David T. Kettig (Filed as Exhibit 10.8 to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 and incorporated herein by reference).

**10.9** Officer Employment Agreement, made as of May 25, 2011, by and among Independence Holding Company, Standard Security Life and Mr. Gary J. Balzofiore.

**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. The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.

**101.SCH** XBRL Taxonomy Extension Schema Document. \*

**101.CAL** XBRL Taxonomy Extension Calculation Linkbase Document. \*

**101.LAB** XBRL Taxonomy Extension Label Linkbase Document. \*

**101.PRE** XBRL Taxonomy Extension Presentation Linkbase Document. \*

**101.DEF** XBRL Taxonomy Extension Definition Linkbase Document. \*



\* Filed herewith.

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**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:** June 16, 2017

Roy T.K. Thung

Chief Executive Officer, President

and Chairman

**By: /s/Teresa A. Herbert**

**Date:** June 16, 2017

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer

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