

INDEPENDENCE HOLDING CO  
Form 10-Q  
August 15, 2016

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

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**FORM 10-Q**

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

For the quarterly period ended **June 30, 2016**.

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)

**58-1407235**  
(I.R.S. Employer Identification No.)

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

**06902**

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(Address of principal executive offices)

(Zip Code)

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

**NOT APPLICABLE**

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

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

**Outstanding at August 12, 2016**  
**17,170,933 Shares**

**INDEPENDENCE HOLDING COMPANY**

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

### Forward-Looking Statements

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

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

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

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

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

|  | <b>June 30, 2016</b> | <b>December 31,</b> |
|--|----------------------|---------------------|
|  | <b>(Unaudited)</b>   | <b>2015</b>         |
| <b>ASSETS:</b>   |                      |                     |
| Investments:   |                      |                     |
| Short-term investments                                       | \$ 50                | \$ 50               |
| Securities purchased under agreements to resell              | 16,232               | 28,285              |
| Trading securities   | 1,216                | 1,259               |
| Fixed maturities, available-for-sale                         | 560,135              | 428,601             |
| Equity securities, available-for-sale                        | 8,941                | 8,426               |
| Other investments  | 20,294               | 21,538              |
| Total investments  | 606,868              | 488,159             |
| Cash and cash equivalents                                    | 26,624               | 17,500              |
| Due and unpaid premiums                                      | 59,386               | 69,075              |
| Due from reinsurers  | 488,337              | 483,073             |
| Premium and claim funds                                      | 24,671               | 22,015              |
| Goodwill   | 47,276               | 47,276              |
| Other assets   | 44,718               | 57,934              |
| Assets attributable to discontinued operations (Note 3)      | -                    | 12,931              |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,297,880</b>  | <b>\$ 1,197,963</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>                  |                      |                     |
| <b>LIABILITIES:</b>  |                      |                     |
| Policy benefits and claims                                   | \$ 247,568           | \$ 245,443          |
| Future policy benefits                                       | 233,603              | 270,624             |
| Funds on deposit   | 150,040              | 173,350             |
| Unearned premiums  | 11,747               | 10,236              |
| Other policyholders' funds                                   | 9,695                | 11,822              |
| Due to reinsurers  | 81,550               | 46,355              |
| Accounts payable, accruals and other liabilities             | 60,406               | 64,109              |
| Liabilities attributable to discontinued operations (Note 3) | 2,410                | (15)                |
| Debt   | 4,025                | 5,189               |
| Junior subordinated debt securities                          | 38,146               | 38,146              |
| <b>TOTAL LIABILITIES</b>                                     | <b>839,190</b>       | <b>865,259</b>      |

**STOCKHOLDERS' EQUITY:**

**IHC STOCKHOLDERS' EQUITY:**

|  |          |          |
|--|----------|----------|
| Preferred stock (none issued)                                | -        | -        |
| Common stock \$1.00 par value, 23,000,000 shares authorized; |          |          |
| 18,584,358 and 18,569,183 shares issued;                     |          |          |
| 17,170,933 and   |          |          |
| 17,265,758 shares outstanding                                | 18,584   | 18,569   |
| Paid-in capital  | 128,303  | 127,733  |
| Accumulated other comprehensive income (loss)                | 4,054    | (3,440)  |
| Treasury stock, at cost; 1,413,425 and 1,303,425 shares      | (15,753) | (13,961) |
| Retained earnings  | 304,075  | 194,450  |

|   |         |         |
|---|---------|---------|
| <b>TOTAL IHC STOCKHOLDERS' EQUITY</b>           | 439,263 | 323,351 |
| <b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b> | 19,427  | 9,353   |

|                     |         |         |
|---------------------|---------|---------|
| <b>TOTAL EQUITY</b> | 458,690 | 332,704 |
|---------------------|---------|---------|

|                                     |              |              |
|-------------------------------------|--------------|--------------|
| <b>TOTAL LIABILITIES AND EQUITY</b> | \$ 1,297,880 | \$ 1,197,963 |
|-------------------------------------|--------------|--------------|

**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>Six Months Ended</b> |               |
|---|---------------------------|---------------|-------------------------|---------------|
|   | <b>June 30,</b>           |               | <b>June 30,</b>         |               |
|   | <b>2016</b>               | <b>2015</b>   | <b>2016</b>             | <b>2015</b>   |
| <b>REVENUES:</b>  |                           |               |                         |               |
| Premiums earned   | \$ 65,627                 | \$ 120,443    | \$ 128,189              | \$ 242,557    |
| Net investment income   | 4,260                     | 4,488         | 8,696                   | 9,910         |
| Fee income  | 3,412                     | 4,417         | 8,491                   | 6,994         |
| Other income  | 3,379                     | 1,567         | 6,637                   | 2,559         |
| Net realized investment gains                                   | 1,018                     | 2,100         | 1,578                   | 4,100         |
|   | 77,696                    | 133,015       | 153,591                 | 266,120       |
| <b>EXPENSES:</b>  |                           |               |                         |               |
| Insurance benefits, claims and reserves                         | 40,477                    | 79,380        | 71,220                  | 159,000       |
| Selling, general and administrative expenses                    | 29,897                    | 44,954        | 65,124                  | 90,438        |
| Interest expense on debt  | 473                       | 478           | 926                     | 910           |
|   | 70,847                    | 124,812       | 137,270                 | 250,348       |
| Income from continuing operations before income taxes           | 6,849                     | 8,203         | 16,321                  | 15,772        |
| Income taxes  | 2,354                     | 2,981         | 5,930                   | 5,849         |
| <b>Income from continuing operations</b>                        | <b>4,495</b>              | <b>5,222</b>  | <b>10,391</b>           | <b>9,923</b>  |
| <b>Discontinued operations: (Note 3)</b>                        |                           |               |                         |               |
| Income (loss) from discontinued operations, before income taxes | -                         | (82)          | 117,636                 | 949           |
| Income taxes (benefits) on discontinued operations              | (142)                     | (16)          | 7,724                   | 385           |
| Income (loss) from discontinued operations                      | 142                       | (66)          | 109,912                 | 564           |
| <b>Net income</b>   | <b>4,637</b>              | <b>5,156</b>  | <b>120,303</b>          | <b>10,487</b> |
| Less: Income from noncontrolling interests in subsidiaries      | (201)                     | (124)         | (9,857)                 | (236)         |
|   | \$ 4,436                  | \$ 5,032      | \$ 110,446              | \$ 10,251     |
| <b>NET INCOME ATTRIBUTABLE TO IHC</b>                           |                           |               |                         |               |
| <b>Basic income per common share: (Note 2)</b>                  |                           |               |                         |               |
| Income from continuing operations                               | \$ .25                    | \$ .29        | \$ .59                  | \$ .56        |
| Income (loss) from discontinued operations                      | .01                       | (.00)         | 5.83                    | .03           |
| Basic income per common share                                   | \$ .26                    | \$ .29        | \$ 6.42                 | \$ .59        |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>                      | <b>17,204</b>             | <b>17,338</b> | <b>17,223</b>           | <b>17,351</b> |
| <b>Diluted income per common share: (Note 2)</b>                |                           |               |                         |               |



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|  |        |        |         |        |
|--|--------|--------|---------|--------|
| Income from continuing operations                      | \$ .25 | \$ .29 | \$ .58  | \$ .56 |
| Income (loss) from discontinued operations             | .01    | (.00)  | 5.76    | .03    |
| Diluted income per common share                        | \$ .26 | \$ .29 | \$ 6.34 | \$ .59 |
| <b>WEIGHTED AVERAGE DILUTED SHARES<br/>OUTSTANDING</b> | 17,417 | 17,501 | 17,433  | 17,516 |

**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>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2016</b>               | <b>2015</b> | <b>2016</b>             | <b>2015</b> |
| Net income   | \$ 4,637                  | \$ 5,156    | \$ 120,303              | \$ 10,487   |
| Other comprehensive income (loss):   |                           |             |                         |             |
| <b>Available-for-sale securities:</b>  |                           |             |                         |             |
| Unrealized gains (losses) on available-for-sale securities, pre-tax                      | 7,204                     | (6,432)     | 11,907                  | (5,112)     |
| Tax expense (benefit) on unrealized gains (losses) on available-for-sale securities      | 2,563                     | (2,281)     | 4,248                   | (1,878)     |
| Unrealized gains (losses) on available-for-sale securities, net of taxes                 | 4,641                     | (4,151)     | 7,659                   | (3,234)     |
| Other comprehensive income (loss), net of tax  | 4,641                     | (4,151)     | 7,659                   | (3,234)     |
| <b>COMPREHENSIVE INCOME, NET OF TAX</b>  | 9,278                     | 1,005       | 127,962                 | 7,253       |
| Comprehensive income, net of tax, attributable to noncontrolling interests:              |                           |             |                         |             |
| Income from noncontrolling interests in subsidiaries                                     | (201)                     | (124)       | (9,857)                 | (236)       |
| Other comprehensive (income) loss, net of tax, attributable to noncontrolling interests: |                           |             |                         |             |
| Unrealized (gains) losses on available-for-sale securities, net of tax                   | (108)                     | 33          | (165)                   | (10)        |
| Other comprehensive (income) loss, net of tax, attributable to noncontrolling interests  | (108)                     | 33          | (165)                   | (10)        |
| <b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO NONCONTROLLING INTERESTS</b>        | (309)                     | (91)        | (10,022)                | (246)       |
| <b>COMPREHENSIVE INCOME, NET OF TAX, ATTRIBUTABLE TO IHC</b>                             | \$ 8,969                  | \$ 914      | \$ 117,940              | \$ 7,007    |

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

**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 (LOSS) | TREASURY<br>STOCK,<br>AT COST | RETAINED<br>EARNINGS | TOTAL IHC<br>STOCKHOLDERS'<br>EQUITY | NON<br>CONTRO<br>INTERES<br>SUBSIDIA |
|--|-----------------|--------------------|--|-------------------------------|----------------------|--------------------------------------|--------------------------------------|
| <b>BALANCE<br/>AT<br/>DECEMBER<br/>31, 2015</b>                              | 18,569\$        | 127,733\$          | (3,440)\$  | (13,961)\$                    | 194,450 \$           | 323,351 \$                           |                                      |
| Net<br>income  |                 |                    |  |                               | 110,446              | 110,446                              |                                      |
| Other<br>comprehensive<br>income,<br>net of<br>tax                           |                 |                    | 7,494  |                               |                      | 7,494                                |                                      |
| Repurchases<br>of<br>common<br>stock   |                 |                    |  | (1,792)                       |                      | (1,792)                              |                                      |
| Common<br>stock<br>dividend<br>(\$0.045<br>per<br>share)                     |                 |                    |  |                               | (773)                | (773)                                |                                      |
| Share-based<br>compensation<br>expenses<br>and<br>related<br>tax<br>benefits | 15              | 292                |  |                               |                      | 307                                  |                                      |
| Other<br>capital<br>transactions   |                 | 278                |  |                               | (48)                 | 230                                  |                                      |
| <b>BALANCE<br/>AT<br/>JUNE<br/>30, 2016</b>                                  | 18,584\$        | 128,303\$          | 4,054\$  | (15,753)\$                    | 304,075 \$           | 439,263 \$                           |                                      |

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

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

|   | <b>Six Months Ended June 30,</b>             |             |
|---|--|-------------|
|   | <b>2016</b>                                  | <b>2015</b> |
| <b>CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:</b>                               |  |             |
| Net income  | \$ 120,303                                   | \$ 10,487   |
| <b>Adjustments to reconcile net income to net change in cash from operating activities:</b> |  |             |
| Gain on disposal of discontinued operations, net of tax                                     | (109,447)                                    | -           |
| Amortization of deferred acquisition costs  | 173  | 2,888       |
| Net realized investment gains   | (1,578)                                      | (4,100)     |
| Equity (income) loss from equity method investments   | 24   | (577)       |
| Depreciation and amortization   | 958  | 1,173       |
| Deferred tax expense  | 1,062  | 1,052       |
| Other   | 4,700  | 2,999       |
| <b>Changes in assets and liabilities:</b>   |  |             |
| Net (purchases) sales of trading securities   | 3,180  | 2,173       |
| Change in insurance liabilities   | (22,650)                                     | 9,603       |
| Change in amounts due from reinsurers   | (5,264)                                      | 11,646      |
| Change in premium and claim funds   | (2,657)                                      | 47          |
| Change in current income tax liability  | (1,303)                                      | 3,890       |
| Change in due and unpaid premiums   | 9,689  | (3,845)     |
| Other operating activities  | (8,954)                                      | (3,824)     |
|   | Net change in cash from operating activities | 33,612      |
|   | (11,764)                                     | (11,764)    |
| <b>CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:</b>                               |  |             |
| Net (purchases) sales of securities under resale agreements                                 | 12,053                                       | (6,639)     |
| Sales of equity securities  | -  | 9,187       |
| Purchases of equity securities  | -  | (4,423)     |
| Sales of fixed maturities   | 159,973                                      | 377,835     |
| Maturities and other repayments of fixed maturities   | 30,892                                       | 32,019      |
| Purchases of fixed maturities   | (305,798)                                    | (437,826)   |
| Proceeds on sales of subsidiaries, net of cash divested                                     | 130,950                                      | -           |
| Acquisition of subsidiary, net of cash acquired   | -  | 511         |
| Other investing activities  | (2,824)                                      | (693)       |
|   | Net change in cash from investing activities | (30,029)    |
|   | 25,246                                       | 25,246      |

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

|   |           |           |
|---|-----------|-----------|
| Repurchases of common stock                           | (1,792)   | (667)     |
| Cash paid in acquisitions of noncontrolling interests | -         | (1,734)   |
| Withdrawals of investment-type insurance contracts    | (978)     | (1,191)   |
| Repayments of debt                                    | (1,164)   | -         |
| Dividends paid  | (780)     | (609)     |
| Other financing activities                            | 356       | 144       |
| Net change in cash from financing activities          | (4,358)   | (4,057)   |
| Net change in cash and cash equivalents               | 9,124     | (474)     |
| Cash and cash equivalents, beginning of year          | 17,500    | 23,408    |
| Cash and cash equivalents, end of period              | \$ 26,624 | \$ 22,934 |

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

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

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

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Specialty Benefits Inc. and IHC Carrier Solutions, Inc. IHC also owns a significant equity interest in: (i) Ebix Health Exchange Holdings, LLC ( Ebix Health Exchange ), an administration exchange for health and pet insurance; and (ii) a managing general underwriter ( MGU ) that writes medical stop-loss. On March 31, 2016, the Company sold IHC Risk Solutions, LLC ( Risk Solutions ), its managing general underwriter of excess or stop-loss insurance. In addition, all of the in-force stop-loss business of Standard Security Life and Independence American produced by Risk Solutions is 100% co-insured as of January 1, 2016 and IHC 's block of Medical Stop-Loss business is in run-off. 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 53% of IHC's outstanding common stock at June 30, 2016.

**(B)**

**Consolidation**

**American Independence Corp.**



American Independence Corp. ( AMIC ) is an insurance holding company engaged in the insurance and reinsurance business. At June 30, 2016 and December 31, 2015, the Company owned approximately 91% and 92%, respectively, of the outstanding common stock of AMIC. IHC intends to take AMIC private on or about August 31, 2016 by way of a statutory "short-form" merger. As a result, IHC will indirectly own all of the outstanding shares of AMIC's common stock.

### Effects of Ownership Changes in Subsidiaries

The following table summarizes the effects of changes in the Company's ownership interests in its subsidiaries on IHC's equity for the periods indicated (in thousands):

|  | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |          |
|--|--------------------------------|--------|------------------------------|----------|
|  | 2016                           | 2015   | 2016                         | 2015     |
| <b>Changes in IHC's paid-in capital:</b>           |                                |        |                              |          |
| Purchase of AMIC shares                            | \$ -                           | \$ -   | \$ -                         | \$ (199) |
| Purchase remaining IPA Family, LLC interests       | -                              | 311    | -                            | 311      |
| <b>Net transfers from noncontrolling interests</b> | \$ -                           | \$ 311 | \$ -                         | \$ 112   |

(C)

### **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.

On March 31, 2016, the Company sold Risk Solutions, its managing general underwriter of excess or stop-loss insurance for self-insured employer groups that desire to manage the risk of large medical claims ( Medical Stop-Loss ). 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 100% co-insured as of January 1, 2016. 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 represents a strategic shift that will have a major effect on the Company's operations and financial results. The disposal transaction qualifies for reporting as discontinued operations in the first quarter of 2016 as a result of the Board of Directors commitment to a plan for its disposal in January 2016. The assets, liabilities, and related income and expenses associated with the disposal group are presented as discontinued operations in the accompanying condensed consolidated financial statements and Notes thereto. The results of discontinued operations reflect the operations of the disposed MGUs. See Note 3 for more information. The run-off of IHC's remaining block of medical stop-loss business is in continuing operations.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and six months ended June 30, 2016 are not necessarily indicative of the results to be anticipated for the entire year.

(D)

### **Reclassifications**

Certain amounts in prior year's consolidated financial statements and Notes thereto have been reclassified to conform to the 2016 presentation, primarily for the effects of discontinued operations.

(E)

**Recent Accounting Pronouncements**

*Recently Adopted Accounting Standards*

In September 2015, the FASB issued guidance to simplify the accounting for adjustments made to provisional amounts recognized in a business combination and eliminate the requirement to retrospectively account for those adjustments. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

In February 2015, the FASB issued guidance that modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities for the purpose of consolidation. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

In June 2014, the FASB issued explicit guidance for entities that grant their employees share-based payments in which the terms of the award include a performance target that affects vesting and could be achieved after the requisite service period. 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 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 a write-down, 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 Update 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. The adoption of this guidance is not expected to 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. The amendments in this Update are effective for annual periods beginning after December 15, 2016, 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 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 amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016 and should be applied prospectively upon their effective date. The adoption of this guidance is not expected to have a material effect 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 Update 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 (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 requirements) should be applied prospectively to equity investments that exist as of the date of adoption of the Update. 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 2015, the FASB issued guidance requiring additional disclosures for short-duration contracts regarding the liability for unpaid claims and claim adjustment expenses. For public entities, the guidance is effective for annual reporting periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Early adoption is permitted. The adoption of this guidance is not expected to have a significant effect on the Company's consolidated financial statements.

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 was 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. Management has not yet determined the impact that the adoption of this guidance will have on the Company's consolidated financial statements.

**Note 2.**

**Income Per Common Share**

Diluted earnings 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 213,000 and 210,000 shares for the three months and six months ended June 30, 2016, respectively; and 163,000 and 165,000 shares for the three months and six months ended June 30, 2015, respectively.

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<br/>June 30</b> |             | <b>Six Months Ended<br/>June 30</b> |             |
|---|---------------------------------------|-------------|-------------------------------------|-------------|
|   | <b>2016</b>                           | <b>2015</b> | <b>2016</b>                         | <b>2015</b> |
| Income from continuing operations                       | \$ 4,495                              | \$ 5,222    | \$ 10,391                           | \$ 9,923    |
| Less: Income from continuing operations attributable to |                                       |             |                                     |             |

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|   |          |          |            |          |
|---|----------|----------|------------|----------|
| noncontrolling interests  | (199)    | (125)    | (305)      | (195)    |
| <b>Income from continuing operations attributable to IHC</b>      |          |          |            |          |
| <b>common shareholders</b>  | \$ 4,296 | \$ 5,097 | \$ 10,086  | \$ 9,728 |
| Income (loss) from discontinued operations                        | \$ 142   | \$ (66)  | \$ 109,912 | \$ 564   |
| Less: (Income) loss from discontinued operations attributable to  |          |          |            |          |
| noncontrolling interests  | (2)      | 1        | (9,552)    | (41)     |
| <b>Income (loss) from discontinued operations attributable to</b> |          |          |            |          |
| <b>IHC common shareholders</b>                                    | \$ 140   | \$ (65)  | \$ 100,360 | \$ 523   |

**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. The Company recorded a gain of \$99,934,000, 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 represents a strategic shift that will have a major effect on the Company 's operations and financial results. The disposal transaction qualifies for reporting as discontinued operations 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 will be no further involvement with the discontinued operation.

The following is a reconciliation of the major line items constituting the pretax profit of discontinued operations for the periods indicated (in thousands):

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2016</b>                          | <b>2015</b> |
| Revenue  | \$ -                                   | \$ 90       | \$ 6,406                             | \$ 1,250    |
| Selling, general and administrative expenses                       | -                                      | 172         | 5,689                                | 301         |
| Pretax profit (loss) of discontinued operations                    | -                                      | (82)        | 717                                  | 949         |
| Gain on disposal of discontinued operations, pretax                | -                                      | -           | 116,919                              | -           |
| Income (loss) from discontinued operations,<br>before income taxes | -                                      | (82)        | 117,636                              | 949         |
| Income taxes (benefits) on discontinued operations                 | (142)                                  | (16)        | 7,724                                | 385         |
| Income (loss) from discontinued operations                         | \$ 142                                 | \$ (66)     | \$ 109,912                           | \$ 564      |

The following is a reconciliation of the carrying amounts of major classes of assets and liabilities for discontinued operations for the periods indicated (in thousands):

|   | <b>June 30, 2016</b> | <b>December 31, 2015</b> |
|---|----------------------|--------------------------|
| <b>Major classes of assets included in discontinued operations:</b> |                      |                          |
| Cash  | \$ -                 | \$ 1,671                 |



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|  |    |         |        |
|--|----|---------|--------|
| Goodwill   |    | -       | 5,664  |
| Intangible assets  |    | -       | 919    |
| Other assets   |    | -       | 4,677  |
| Assets attributable to discontinued operations                           | \$ | -\$     | 12,931 |
| <b>Major classes of liabilities included in discontinued operations:</b> |    |         |        |
| Accounts payable and accrued liabilities                                 | \$ | 2,410\$ | (15)   |
| Liabilities attributable to discontinued operations                      | \$ | 2,410\$ | (15)   |

Total operating cash flows from discontinued operations for the three months and six months ended June 30, 2016 were \$0 and \$339,000, respectively, and were \$(1,178,000) and \$(1,062,000) for the three months and six months ended June 30, 2015, respectively. The Company elected to classify the proceeds received from the sale of discontinued operations in the investing activities section of the Condensed Consolidated Statement of Cash Flows.

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 (see Note 9). On a consolidated basis, the Company recorded income taxes on discontinued operations of \$7,724,000 for the six months ended June 30, 2016, consisting of \$5,777,000 of state taxes and \$1,947,000 of Federal taxes, net of a \$38,419,000 decrease in AMIC's valuation allowance.

#### 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):

|   | June 30, 2016     |                              |                               |               |  |
|---|-------------------|------------------------------|-------------------------------|---------------|--|
|   | AMORTIZED<br>COST | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES | FAIR<br>VALUE |  |
| <b>FIXED MATURITIES</b>                 |                   |                              |                               |               |  |
| <b>AVAILABLE-FOR-SALE:</b>              |                   |                              |                               |               |  |
| Corporate securities                    | \$ 238,318        | \$ 3,773                     | \$ (3,218)                    | \$ 238,873    |  |
| CMOs - residential <sup>(1)</sup>       | 2,820             | 78                           | -                             | 2,898         |  |
| U.S. Government obligations             | 76,216            | 538                          | (1)                           | 76,753        |  |
| Agency MBS - residential <sup>(2)</sup> | 29                | 1                            | -                             | 30            |  |
| GSEs <sup>(3)</sup>                     | 10,638            | 2                            | (162)                         | 10,478        |  |
| States and political subdivisions       | 208,894           | 6,310                        | (921)                         | 214,283       |  |
| Foreign government obligations          | 5,675             | 75                           | (42)                          | 5,708         |  |
| Redeemable preferred stocks             | 11,454            | 62                           | (404)                         | 11,112        |  |
| Total fixed maturities                  | \$ 554,044        | \$ 10,839                    | \$ (4,748)                    | \$ 560,135    |  |
| <b>EQUITY SECURITIES</b>                |                   |                              |                               |               |  |
| <b>AVAILABLE-FOR-SALE:</b>              |                   |                              |                               |               |  |
| Common stocks                           | \$ 4,926          | \$ 337                       | \$ (1)                        | \$ 5,262      |  |
| Nonredeemable preferred stocks          | 3,588             | 95                           | (4)                           | 3,679         |  |
| Total equity securities                 | \$ 8,514          | \$ 432                       | \$ (5)                        | \$ 8,941      |  |



|   | <b>December 31, 2015</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                    | \$ 172,621                |  | \$ 93                                 |  | \$ (5,868)                             | \$ 166,846            |
| CMOs - residential <sup>(1)</sup>       | 3,068                     |  | 2                                     |  | (14)                                   | 3,056                 |
| CMOs - commercial                       | 899                       |  | 296                                   |  | -                                      | 1,195                 |
| U.S. Government obligations             | 44,738                    |  | 120                                   |  | (64)                                   | 44,794                |
| Agency MBS - residential <sup>(2)</sup> | 34                        |  | 1                                     |  | -                                      | 35                    |
| GSEs <sup>(3)</sup>                     | 11,814                    |  | 2                                     |  | (254)                                  | 11,562                |
| States and political subdivisions       | 194,364                   |  | 2,159                                 |  | (1,857)                                | 194,666               |
| Foreign government obligations          | 2,318                     |  | 12                                    |  | (6)                                    | 2,324                 |
| Redeemable preferred stocks             | 4,036                     |  | 101                                   |  | (14)                                   | 4,123                 |
| <br>Total fixed maturities              | <br>\$ 433,892            |  | <br>\$ 2,786                          |  | <br>\$ (8,077)                         | <br>\$ 428,601        |
| <br><b>EQUITY SECURITIES</b>            |                           |  |                                       |  |  |                       |
| <b>AVAILABLE-FOR-SALE:</b>              |                           |  |                                       |  |  |                       |
| Common stocks                           | \$ 4,926                  |  | \$ -                                  |  | \$ (142)                               | \$ 4,784              |
| Nonredeemable preferred stocks          | 3,588                     |  | 56                                    |  | (2)                                    | 3,642                 |
| <br>Total equity securities             | <br>\$ 8,514              |  | <br>\$ 56                             |  | <br>\$ (144)                           | <br>\$ 8,426          |

(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 June 30, 2016, 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                   | \$ 12,176                 | \$ 12,085             |
| Due after one year through five<br>years  | 169,922                   | 170,784               |
| Due after five years through ten<br>years | 187,341                   | 190,815               |
| Due after ten years                       | 171,118                   | 173,045               |
| CMOs and MBSs                             | 13,487                    | 13,406                |
|   | \$ 554,044                | \$ 560,135            |

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

**June 30, 2016**

|  | Less than 12 Months |                   | 12 Months or Longer |                   | Total             |                   |
|--|---------------------|-------------------|---------------------|-------------------|-------------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses |
| Corporate securities                                       | \$ 20,570           | \$ 83             | \$ 54,794           | \$ 3,135          | \$ 75,364         | \$ 3,218          |
| U.S. Government obligations                                | 28,247              | 1                 | -                   | -                 | 28,247            | 1                 |
| GSEs   | -                   | -                 | 10,520              | 162               | 10,520            | 162               |
| States and political subdivisions                          | 31,983              | 256               | 24,447              | 665               | 56,430            | 921               |
| Foreign government obligations                             | 3,253               | 42                | -                   | -                 | 3,253             | 42                |
| Redeemable preferred stocks                                | 3,358               | 404               | -                   | -                 | 3,358             | 404               |
| <b>Total fixed maturities</b>                              | <b>87,411</b>       | <b>786</b>        | <b>89,761</b>       | <b>3,962</b>      | <b>177,172</b>    | <b>4,748</b>      |
| Common stocks  | 501                 | 1                 | -                   | -                 | 501               | 1                 |
| Nonredeemable preferred stocks                             | 1,323               | 4                 | -                   | -                 | 1,323             | 4                 |
| <b>Total equity securities</b>                             | <b>1,824</b>        | <b>5</b>          | <b>-</b>            | <b>-</b>          | <b>1,824</b>      | <b>5</b>          |
| <b>Total temporarily impaired securities</b>               | <b>\$ 89,235</b>    | <b>\$ 791</b>     | <b>\$ 89,761</b>    | <b>\$ 3,962</b>   | <b>\$ 178,996</b> | <b>\$ 4,753</b>   |
| <b>Number of securities in an unrealized loss position</b> | <b>27</b>           |                   | <b>29</b>           |                   | <b>56</b>         |                   |

**December 31, 2015**

|  | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |

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|  |                   |                 |                  |                 |                   |                 |
|--|-------------------|-----------------|------------------|-----------------|-------------------|-----------------|
| Corporate securities                                       | \$ 101,903        | \$ 2,559        | \$ 55,217        | \$ 3,309        | \$ 157,120        | \$ 5,868        |
| CMO s - residential  | 2,867             | 14              | -                | -               | 2,867             | 14              |
| U.S. Government obligations                                | 19,809            | 64              | -                | -               | 19,809            | 64              |
| GSEs   | 6,539             | 128             | 4,997            | 126             | 11,536            | 254             |
| States and political subdivisions                          | 68,898            | 780             | 31,351           | 1,077           | 100,249           | 1,857           |
| Foreign government obligations                             | 484               | 6               | -                | -               | 484               | 6               |
| Redeemable preferred stocks                                | 3,749             | 14              | -                | -               | 3,749             | 14              |
| <b>Total fixed maturities</b>                              | <b>204,249</b>    | <b>3,565</b>    | <b>91,565</b>    | <b>4,512</b>    | <b>295,814</b>    | <b>8,077</b>    |
| Common stocks  | 4,784             | 142             | -                | -               | 4,784             | 142             |
| Nonredeemable preferred stocks                             | 1,324             | 2               | -                | -               | 1,324             | 2               |
| <b>Total equity securities</b>                             | <b>6,108</b>      | <b>144</b>      | <b>-</b>         | <b>-</b>        | <b>6,108</b>      | <b>144</b>      |
| <b>Total temporarily impaired securities</b>               | <b>\$ 210,357</b> | <b>\$ 3,709</b> | <b>\$ 91,565</b> | <b>\$ 4,512</b> | <b>\$ 301,922</b> | <b>\$ 8,221</b> |
| <b>Number of securities in an unrealized loss position</b> | <b>99</b>         |                 | <b>31</b>        |                 | <b>130</b>        |                 |

Substantially all of the unrealized losses on fixed maturities available-for-sale at June 30, 2016 and December 31, 2015 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 June 30, 2016.

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

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2016                           | 2015     | 2016                         | 2015     |
| Available-for-sale securities:                            |                                |          |                              |          |
| Fixed maturities  | \$ 993                         | \$ 2,114 | \$ 1,621                     | \$ 3,414 |
| Common stocks   | -                              | -        | -                            | 1,465    |
| Total sales of available-for-sale securities              | 993                            | 2,114    | 1,621                        | 4,879    |
| Trading securities  | -                              | 86       | -                            | (421)    |
| Total realized gains                                      | 993                            | 2,200    | 1,621                        | 4,458    |
| Unrealized gains (losses) on trading securities:          |                                |          |                              |          |
| Change in unrealized gains (losses) on trading securities | 26                             | (101)    | (44)                         | (352)    |
| Total unrealized gains (losses) on trading securities     | 26                             | (101)    | (44)                         | (352)    |
| Gains (losses) on other investments                       | (1)                            | 1        | 1                            | (6)      |
| Net realized investment gains                             | \$ 1,018                       | \$ 2,100 | \$ 1,578                     | \$ 4,100 |

For the three months and six months ended June 30, 2016, proceeds from sales of available-for-sale securities were \$127,942,000 and \$159,436,000, respectively, and the Company realized gross gains of \$1,238,000 and \$1,853,000, respectively, and gross losses of \$164,000 and \$181,000, respectively, on those sales. For the three months and six months ended June 30, 2015, proceeds from sales of available-for-sale securities were \$279,598,000 and \$386,013,000, respectively, and the Company realized gross gains of \$2,659,000 and \$5,773,000, respectively, and gross losses of \$460,000 and \$642,000, 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 1H(iv) to the Consolidated Financial Statements in the 2015 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 six months of 2016 or 2015.

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

|                              | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|------------------------------|--------------------------------|--------|------------------------------|--------|
|                              | 2016                           | 2015   | 2016                         | 2015   |
| Balance at beginning of year | \$ -                           | \$ 473 | \$ 473                       | \$ 473 |
| Securities sold              | -                              | --     | (473)                        | --     |
| Balance at end of period     | \$ -                           | \$ 473 | \$ -                         | \$ 473 |

**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 primarily of CMO securities backed by commercial mortgages and municipal tax credit strips. For these securities, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management's assumptions and available market information. Significant unobservable inputs used in the fair value measurement of CMOs are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite change in the assumption used for prepayment rates. Further we retain independent pricing vendors to assist in valuing certain instruments.

**Trading securities:**

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

**Contingent liabilities:**

Contingent liabilities classified in Level 3 include; (i) a contingent liability assumed in connection with an acquisition related to an earn-out agreement whereby significant unobservable inputs are based on projected income; and (ii) a contingent liability recognized in connection with the deconsolidation of a former subsidiary and a newly formed joint venture transaction whereby significant unobservable inputs are based on projected cash flows.

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

|                                       | <b>June 30, 2016</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                  | \$ -                 | \$ 238,873        | \$ -            | \$ 238,873        |
| CMOs - residential                    | -                    | 2,898             | -               | 2,898             |
| US Government obligations             | -                    | 76,753            | -               | 76,753            |
| Agency MBS - residential              | -                    | 30                | -               | 30                |
| GSEs                                  | -                    | 10,478            | -               | 10,478            |
| States and political subdivisions     | -                    | 212,176           | 2,107           | 214,283           |
| Foreign government obligations        | -                    | 5,708             | -               | 5,708             |
| Redeemable preferred stocks           | 11,112               | -                 | -               | 11,112            |
| Total fixed maturities                | 11,112               | 546,916           | 2,107           | 560,135           |
| Equity securities available-for-sale: |                      |                   |                 |                   |
| Common stocks                         | 5,262                | -                 | -               | 5,262             |
| Nonredeemable preferred stocks        | 3,679                | -                 | -               | 3,679             |
| Total equity securities               | 8,941                | -                 | -               | 8,941             |
| Trading securities - equities         | 1,216                | -                 | -               | 1,216             |
| Total trading securities              | 1,216                | -                 | -               | 1,216             |
| <b>Total Financial Assets</b>         | <b>\$ 21,269</b>     | <b>\$ 546,916</b> | <b>\$ 2,107</b> | <b>\$ 570,292</b> |
| <b>FINANCIAL LIABILITIES:</b>         |                      |                   |                 |                   |
| Contingent liabilities                | \$ -                 | \$ -              | \$ 1,445        | \$ 1,445          |
| <b>Total Financial Liabilities</b>    | <b>\$ -</b>          | <b>\$ -</b>       | <b>\$ 1,445</b> | <b>\$ 1,445</b>   |



|                                       | December 31, 2015 |                   |                 | Total             |
|---------------------------------------|-------------------|-------------------|-----------------|-------------------|
|                                       | Level 1           | Level 2           | Level 3         |                   |
| <b>FINANCIAL ASSETS:</b>              |                   |                   |                 |                   |
| Fixed maturities available-for-sale:  |                   |                   |                 |                   |
| Corporate securities                  | \$ -              | \$ 166,846        | \$ -            | \$ 166,846        |
| CMOs - residential                    | -                 | 3,056             | -               | 3,056             |
| CMOs - commercial                     | -                 | -                 | 1,195           | 1,195             |
| US Government obligations             | -                 | 44,794            | -               | 44,794            |
| Agency MBS - residential              | -                 | 35                | -               | 35                |
| GSEs                                  | -                 | 11,562            | -               | 11,562            |
| States and political subdivisions     | -                 | 192,487           | 2,179           | 194,666           |
| Foreign government obligations        | -                 | 2,324             | -               | 2,324             |
| Redeemable preferred stocks           | 4,123             | -                 | -               | 4,123             |
| Total fixed maturities                | 4,123             | 421,104           | 3,374           | 428,601           |
| Equity securities available-for-sale: |                   |                   |                 |                   |
| Common stocks                         | 4,784             | -                 | -               | 4,784             |
| Nonredeemable preferred stocks        | 3,642             | -                 | -               | 3,642             |
| Total equity securities               | 8,426             | -                 | -               | 8,426             |
| Trading securities - equities         | 1,259             | -                 | -               | 1,259             |
| Total trading securities              | 1,259             | -                 | -               | 1,259             |
| <b>Total Financial Assets</b>         | <b>\$ 13,808</b>  | <b>\$ 421,104</b> | <b>\$ 3,374</b> | <b>\$ 438,286</b> |
| <b>FINANCIAL LIABILITIES:</b>         |                   |                   |                 |                   |
| Interest rate swap                    | \$ -              | \$ 11             | \$ -            | \$ 11             |
| Contingent liabilities                | -                 | -                 | 1,650           | 1,650             |
| <b>Total Financial Liabilities</b>    | <b>\$ -</b>       | <b>\$ 11</b>      | <b>\$ 1,650</b> | <b>\$ 1,661</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 2016 or 2015. The following tables present the changes in fair value of our Level 3 financial instruments for the periods indicated (in thousands):

| Three Months Ended June 30, 2016 |       |                       |  |
|----------------------------------|-------|-----------------------|--|
| Financial Assets:                |       | Financial Liabilities |  |
| States and                       | Total | Total                 |  |

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|   | <b>Political<br/>Subdivisions</b> | <b>Level 3<br/>Assets</b> | <b>Contingent<br/>Liabilities</b> | <b>Level 3<br/>Liabilities</b> |
|---|-----------------------------------|---------------------------|-----------------------------------|--------------------------------|
| <b>Beginning balance</b>                                      | \$ 2,143                          | \$ 2,143                  | \$ 1,555                          | \$ 1,555                       |
| Gains (losses) included in earnings:                          |                                   |                           |                                   |                                |
| Net investment income   | -                                 | -                         | (110)                             | (110)                          |
| Gains (losses) included in other comprehensive income (loss): |                                   |                           |                                   |                                |
| Net unrealized gains (losses)                                 | (10)                              | (10)                      | -                                 | -                              |
| Repayments and amortization of fixed maturities               | (26)                              | (26)                      | -                                 | -                              |
| Sales   | -                                 | -                         | -                                 | -                              |
| <b>Balance at end of period</b>                               | <b>\$ 2,107</b>                   | <b>\$ 2,107</b>           | <b>\$ 1,445</b>                   | <b>\$ 1,445</b>                |

## Six Months Ended June 30, 2016

|   | Financial Assets: |              |          | Financial Liabilities |             |
|---|-------------------|--------------|----------|-----------------------|-------------|
|   | CMOs              | States and   | Total    | Contingent            | Total       |
|   | Commercial        | Political    | Level 3  | Liabilities           | Level 3     |
|   |                   | Subdivisions | Assets   |                       | Liabilities |
| <b>Beginning balance</b>                                      | \$ 1,195          | \$ 2,179     | \$ 3,374 | \$ 1,650              | \$ 1,650    |
| Gains (losses) included in earnings:                          |                   |              |          |                       |             |
| Net investment income   | -                 | -            | -        | (743)                 | (743)       |
| Net realized investment gains                                 | 141               | -            | 141      | -                     | -           |
| Other income  | -                 | -            | -        | 538                   | 538         |
| Gains (losses) included in other comprehensive income (loss): |                   |              |          |                       |             |
| Net unrealized gains (losses)                                 | (296)             | (21)         | (317)    | -                     | -           |
| Repayments and amortization of fixed maturities               | (74)              | (51)         | (125)    | -                     | -           |
| Sales   | (966)             | -            | (966)    | -                     | -           |
| <b>Balance at end of period</b>                               | \$ -              | \$ 2,107     | \$ 2,107 | \$ 1,445              | \$ 1,445    |

## Three Months Ended June 30, 2015

|   | CMOs       | States and   | Total    |
|---|------------|--------------|----------|
|   | Commercial | Political    | Level 3  |
|   |            | Subdivisions | Assets   |
| <b>Beginning balance</b>                                      | \$ 1,016   | \$ 2,281     | \$ 3,297 |
| Gains (losses) included in other comprehensive income (loss): |            |              |          |
| Net unrealized gains (losses)                                 | 217        | (12)         | 205      |
| Repayments and amortization of fixed maturities               | -          | (21)         | (21)     |
| <b>Balance at end of period</b>                               | \$ 1,233   | \$ 2,248     | \$ 3,481 |

## Six Months Ended June 30, 2015

|  | States and   | Total  |
|--|--------------|--------|
|  | Subdivisions | Assets |



|   | <b>CMOs<br/>Commercial</b> | <b>Political<br/>Subdivisions</b> | <b>Level 3<br/>Assets</b> |
|---|----------------------------|-----------------------------------|---------------------------|
| <b>Beginning balance</b>                                      | \$ 953                     | \$ 2,314                          | \$ 3,267                  |
| Gains (losses) included in other comprehensive income (loss): |                            |                                   |                           |
| Net unrealized gains (losses)                                 | 280                        | (25)                              | 255                       |
| Repayments and amortization of fixed maturities               | -                          | (41)                              | (41)                      |
| <b>Balance at end of period</b>                               | \$ 1,233                   | \$ 2,248                          | \$ 3,481                  |

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):

|   | June 30, 2016            |                   | December 31, 2015        |                   |
|---|--------------------------|-------------------|--------------------------|-------------------|
|   | Level 2<br>Fair<br>Value | Carrying<br>Value | Level 2<br>Fair<br>Value | Carrying<br>Value |
| <b>FINANCIAL ASSETS:</b>                        |                          |                   |                          |                   |
| Policy loans                                    | \$ 38                    | \$ 38             | \$ 38                    | \$ 38             |
| <b>FINANCIAL LIABILITIES:</b>                   |                          |                   |                          |                   |
| Funds on deposit                                | \$ 150,286               | \$ 150,040        | \$ 173,625               | \$ 173,350        |
| Debt and junior subordinated<br>debt securities | \$ 42,125                | \$ 42,171         | \$ 43,283                | \$ 43,335         |

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

**(A)**

**Policy Loans**

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

**(B)**

**Funds on Deposit**

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

(C)

## **Debt**

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

## **Note 6.**

### **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 \$8,927,000 carrying value in these equity investments that are included in other investments in the Condensed Consolidated Balance Sheet as of June 30, 2016.

## **Note 7.**

### **Related Party Transactions**

Through a joint venture consummated in 2015, the Company has a significant equity interest in Ebix

Health Exchange. Ebix Health Exchange administers various lines of health insurance for IHC's insurance subsidiaries. The carrying value of the Company's equity investment in Ebix Health Exchange was \$8,771,000 and 9,838,000 at June 30, 2016 and December 31, 2015, respectively. Ebix Health Exchange reported a net loss of \$367,000 and \$1,188,000 for the three months and six months ended June 30, 2016, respectively. The Company recorded \$257,000 and \$445,000 of the losses in earnings for the three months and six months ended June 30, 2016, respectively; and reduced the contingent liability, previously recognized on the acquisition date, by \$110,000 and \$743,000, respectively, during the three months and six months ended June 30, 2016 representing cash operating losses.

The Company's Condensed Consolidated Balance Sheets at June 30, 2016 and December 31, 2015 include \$2,930,000 and \$1,397,000, respectively, of notes and other amounts receivable from Ebix Health Exchange, and include \$1,970,000 and \$405,000, respectively, of administrative fees and other expenses payable to Ebix Health Exchange, which are included in other assets and accounts payable, accruals and other liabilities, respectively. The Company's Condensed Consolidated Statements of Income for the three months and six months ended June 30, 2016 include \$89,000 and \$202,000, respectively, of fee income from Ebix Health Exchange, and include \$1,338,000 and \$2,585,000, respectively, of administrative fee expenses to Ebix Health Exchange, which are included in fee income and selling, general and administrative expenses. There are no comparable amounts for the three months and six months ended June 30, 2015.

#### **Note 8.**

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

Certain prior year balances of goodwill and intangible assets were reclassified to assets attributable to discontinued operations on the accompanying Condensed Consolidated Balance Sheet as of December 31, 2015 to conform to the 2016 presentation (see Notes 1 and 3).

The carrying amount of goodwill was \$47,276,000 at June 30, 2016 and December 31, 2015.

The Company has net other intangible assets of \$13,907,000 and \$14,598,000 at June 30, 2016 and December 31, 2015, 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):

**June 30, 2016**

**December 31, 2015**

|  | <b>Gross<br/>Carrying<br/>Amount</b> |  | <b>Accumulated<br/>Amortization</b> |  | <b>Gross<br/>Carrying<br/>Amount</b> |  | <b>Accumulated<br/>Amortization</b> |
|--|--------------------------------------|--|-------------------------------------|--|--------------------------------------|--|-------------------------------------|
| <b>Finite-lived Intangible Assets:</b> |                                      |  |                                     |  |                                      |  |                                     |
| Agent and broker relationships         | \$ 18,201                            |  | \$ 13,120                           |  | \$ 18,201                            |  | \$ 12,497                           |
| Trademarks                             | 1,000                                |  | 151                                 |  | 1,000                                |  | 83                                  |
| Total finite-lived                     | \$ 19,201                            |  | \$ 13,271                           |  | \$ 19,201                            |  | \$ 12,580                           |

|  | <b>June 30,<br/>2016</b> |  | <b>December 31,<br/>2015</b> |
|--|--------------------------|--|------------------------------|
| <b>Indefinite-lived Intangible Assets:</b> |                          |  |                              |
| Insurance licenses                         | \$ 7,977                 |  | \$ 7,977                     |
| Total indefinite-lived                     | \$ 7,977                 |  | \$ 7,977                     |

Amortization expense was \$351,000 and \$691,000 for the three months and six months ended June 30, 2016, respectively, and was \$382,000 and \$645,000 for the three months and six months ended June 30, 2015.

**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.

As a result of the Risk Solutions Sale and Coinsurance Transaction (see Note 3), AMIC utilized approximately \$109,770,000 of its operating loss carryforwards. At June 30, 2016, AMIC had remaining net operating loss carryforwards of approximately \$147,551,000 for federal income tax purposes, which expire in varying amounts through the year 2028, with a significant portion expiring in 2020.

**Note 10.**

**Reinsurance**

Effective January 1, 2016, all of the in-force stop-loss business of Standard Security Life and Independence American produced by Risk Solutions was co-insured in connection with the Risk Solutions Sale and Coinsurance Transaction (see Note 3). As a result of this transaction, the Company recorded \$56,055,000 of estimated amounts due from reinsurers.

The Company is contingently liable with respect to reinsurance in the unlikely event that the assuming reinsurers are unable to meet their obligations. The ceding of reinsurance does not discharge the primary liability of the original insurer to the insured.

**Note 11.**

**Stockholders Equity**

*Treasury Stock*

In 2016, IHC repurchased an aggregate 110,000 shares of its common stock in private transactions for \$1,792,000.

*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):

|   | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2016                           | 2015       | 2016                         | 2015       |
| Beginning balance   | \$ (479)                       | \$ 901     | \$ (3,440)                   | \$ 22      |
| Other comprehensive income (loss) before reclassifications                | 5,280                          | (2,783)    | 8,704                        | (89)       |
| Amounts reclassified from accumulated OCI                                 | (639)                          | (1,368)    | (1,045)                      | (3,145)    |
| Net other comprehensive income  | 4,641                          | (4,151)    | 7,659                        | (3,234)    |
| Less: Other comprehensive income attributable to noncontrolling interests | (108)                          | 33         | (165)                        | (10)       |
| Acquired from noncontrolling interests                                    | -                              | -          | -                            | 5          |
| Ending balance  | \$ 4,054                       | \$ (3,217) | \$ 4,054                     | \$ (3,217) |

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

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2016                           | 2015     | 2016                         | 2015     |
| Unrealized gains (losses) on available-for-sale securities reclassified during the period to the following income statement line items: |                                |          |                              |          |
| Net realized investment gains   | \$ 993                         | \$ 2,114 | \$ 1,621                     | \$ 4,879 |
| Income before income tax  | 993                            | 2,114    | 1,621                        | 4,879    |
| Tax effect  | 354                            | 746      | 576                          | 1,734    |
| Net income  | \$ 639                         | \$ 1,368 | \$ 1,045                     | \$ 3,145 |

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

expense in the period of the change until settlement.

At June 30, 2016, there were no shares available for future stock-based compensation grants under IHC's stock incentive plans. The following table summarizes share-based compensation expense, which is included in selling, general and administrative expenses on the Condensed Consolidated Statements of Income, applicable to the IHC plans, by award type for each of the periods indicated (in thousands):

|   | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |       |
|---|--------------------------------|--------|------------------------------|-------|
|   | 2016                           | 2015   | 2016                         | 2015  |
| <b>IHC's Share-based Compensation Plan:</b> |                                |        |                              |       |
| Stock options                               | \$ -                           | \$ -   | \$ 170                       | \$ 55 |
| Restricted stock units                      | 21                             | 23     | 44                           | 44    |
| SARs  | 209                            | (28)   | 467                          | (57)  |
| Share-based compensation expense, pre-tax   | 230                            | (5)    | 681                          | 42    |
| Tax benefits                                | 91                             | (2)    | 271                          | 17    |
| Share-based compensation expense, net       | \$ 139                         | \$ (3) | \$ 410                       | \$ 25 |

### Stock Options

The IHC's stock option activity during 2016 was as follows:

|                          | Shares<br>Under Option | Weighted- Average<br>Exercise Price |
|--------------------------|------------------------|-------------------------------------|
| <b>December 31, 2015</b> | 584,080                | \$ 9.35                             |
| Exercised                | (7,750)                | 9.09                                |
| <b>June 30, 2016</b>     | 576,330                | \$ 9.35                             |

In 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. In 2016, IHC received \$70,000 in cash from the exercise of stock options with an aggregate intrinsic value of \$56,000 and realized \$12,000 of tax benefits.

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

|  | <b>June 30, 2016</b> |                    |
|--|----------------------|--------------------|
|  | <b>Outstanding</b>   | <b>Exercisable</b> |
| Number of options  | 576,330              | 576,330            |
| Weighted average exercise price per share                | \$ 9.35              | \$ 9.35            |
| Aggregate intrinsic value for all options (in thousands) | \$ 4,969             | \$ 4,969           |
| Weighted average contractual term remaining              | 2.3 years            | 2.3 years          |

As of June 30, 2016, all of IHC's outstanding stock options are fully vested and all of the related compensation costs have been recognized.

**Restricted Stock**

The following table summarizes restricted stock activity for the six months ended June 30, 2016:

|                   | <b>No. of<br/>Non-vested<br/>Shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair Value</b> |
|-------------------|---|---|
| December 31, 2015 | 14,850                                  | \$ 12.26  |
| Vested            | (7,425)                                 | 12.24   |
| June 30, 2016     | 7,425                                   | \$ 12.28  |

The total fair value of restricted stock that vested during the first six months of 2016 and 2015 was \$120,000 and \$89,000, respectively. No restricted stock awards were granted in 2016. In 2015, IHC granted 7,425 restricted stock awards during the six months ended June 30 with weighted average grant-date fair values of \$11.78.

As of June 30, 2016, the total unrecognized compensation expense related to non-vested restricted stock unit awards was \$85,000 which is expected to be recognized over the remaining requisite weighted-average service period of 1.6 years.

**SARs**

IHC had 73,150 and 125,850 of SAR awards outstanding at June 30, 2016 and December 31, 2015, respectively. In 2016, 52,700 SARs were exercised with an aggregate intrinsic value of \$436,000. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at June 30, 2016 and December 31, 2015 are liabilities of \$775,000 and \$743,000, respectively, pertaining to SARs.

**B)****AMIC Share-Based Compensation Plans**

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

vesting periods.

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

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2016</b>               | <b>2015</b> | <b>2016</b>             | <b>2015</b> |
| <b>AMIC s Share-based Compensation Plans:</b> |                           |             |                         |             |
| Stock options                                 | \$ 11                     | \$ 11       | \$ 21                   | \$ 22       |
| Share-based compensation expense, pre-tax     | 11                        | 11          | 21                      | 22          |
| Tax benefits                                  | 4                         | 4           | 7                       | 8           |
| Share-based compensation expense, net         | \$ 7                      | \$ 7        | \$ 14                   | \$ 14       |

**Stock Options**

AMIC's stock option activity for the six months ended June 30, 2016 is as follows:

|                          | <b>Shares<br/>Under Option</b> | <b>Weighted- Average<br/>Exercise Price</b> |      |
|--------------------------|--------------------------------|---|------|
| <b>December 31, 2015</b> | 71,558                         | \$  | 8.88 |
| Exercised                | (30,446)                       |   | 8.62 |
| <b>June 30, 2016</b>     | 41,112                         | \$  | 9.07 |

The following table summarizes information regarding AMIC's outstanding and exercisable options as of June 30, 2016:

|  | <b>June 30, 2016</b> |                    |
|--|----------------------|--------------------|
|  | <b>Outstanding</b>   | <b>Exercisable</b> |
| Number of options  | 41,112               | 36,667             |
| Weighted average exercise price per share                | \$ 9.07              | \$ 8.86            |
| Aggregate intrinsic value for all options (in thousands) | \$ 636               | \$ 575             |
| Weighted average contractual term remaining              | 4.21 years           | 3.76 years         |

In 2016, AMIC received \$262,000 in cash from the exercise of stock options with an aggregate intrinsic value of \$212,000.

As of June 30, 2016, the total unrecognized compensation expense related to AMIC's non-vested options was \$19,000 which will be recognized over the remaining requisite service periods.

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

Net cash payments (receipts) for income taxes were \$5,694,000 and \$571,000 during the six months ended June 30, 2016 and 2015.

Cash payments for interest were \$957,000 and \$881,000 during the six months ended June 30, 2016 and 2015, respectively.

**Note 14.****Segment Reporting**

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

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2016                           | 2015       | 2016                         | 2015       |
| <b>Revenues:</b>                                       |                                |            |                              |            |
| Medical Stop-Loss <sup>(A)</sup>                       | \$ 8,114                       | \$ 52,139  | \$ 15,964                    | \$ 106,990 |
| Fully Insured Health                                   | 41,683                         | 49,631     | 81,770                       | 96,163     |
| Group disability, life and DBL                         | 25,677                         | 20,727     | 51,213                       | 41,475     |
| Individual life, annuities and other <sup>(A)</sup>    | 585                            | 8,375      | 1,336                        | 17,300     |
| Corporate  | 619                            | 43         | 1,730                        | 92         |
|  | 76,678                         | 130,915    | 152,013                      | 262,020    |
| Net realized investment gains                          | 1,018                          | 2,100      | 1,578                        | 4,100      |
| <b>Total revenues</b>                                  | \$ 77,696                      | \$ 133,015 | \$ 153,591                   | \$ 266,120 |
| <b>Income from continuing operations</b>               |                                |            |                              |            |
| <b>before income taxes:</b>                            |                                |            |                              |            |
| Medical Stop-Loss <sup>(A)</sup>                       | \$ 3,948                       | \$ 4,637   | \$ 11,750                    | \$ 8,958   |
| Fully Insured Health <sup>(B)</sup>                    | 1,990                          | 1,555      | 2,385                        | 2,832      |
| Group disability, life and DBL                         | 1,509                          | 3,159      | 8,210                        | 6,374      |
| Individual life, annuities and other <sup>(A)(C)</sup> | 315                            | (1,333)    | (1,478)                      | (2,385)    |
| Corporate  | (1,458)                        | (1,437)    | (5,198)                      | (3,197)    |
|  | 6,304                          | 6,581      | 15,669                       | 12,582     |
| Net realized investment gains                          | 1,018                          | 2,100      | 1,578                        | 4,100      |
| Interest expense                                       | (473)                          | (478)      | (926)                        | (910)      |
| <b>Income from continuing operations</b>               |                                |            |                              |            |
| <b>before income taxes</b>                             | \$ 6,849                       | \$ 8,203   | \$ 16,321                    | \$ 15,772  |

**(A)**

Substantially all of the business in the segment is coinsured. The current year's activity primarily reflects income or expenses related to the coinsurance and the run-off of any remaining blocks that were not coinsured.

**(B)**



The Fully Insured Health segment includes amortization of intangible assets. Total amortization expense was \$351,000 and \$382,000 for the three months ended June 30, 2016 and 2015, respectively, and was \$691,000 and \$645,000, respectively, for the six months ended June 30, 2016 and 2015. Amortization expense for the other segments is not material to their operating results.

(C)

The Individual life, annuities and other segment includes amortization of deferred charges in connection with the assumptions of certain ceded life and annuity policies amounting to \$283,000 and \$62,000 for the three months ended June 30, 2016 and 2015, respectively, and \$1,653,000 and \$416,000 for the six months ended June 30, 2016 and 2015, respectively.

**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, 2015, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

**Overview**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Specialty Benefits Inc. and IHC Carrier Solutions, Inc. IHC also owns a significant equity interest in: (i) Ebix Health Exchange Holdings, LLC ( Ebix Health Exchange ), an administration exchange for health insurance; and (ii) a managing general underwriter ( MGU ) that writes medical stop-loss. On March 31, 2016, the Company sold IHC Risk Solutions, LLC ( Risk Solutions ), its managing general underwriter of excess or stop-loss insurance. 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 100% co-insured as of January 1, 2016. IHC s block of Medical Stop-Loss business is in run-off. Standard Security Life, Madison National Life and Independence American are sometimes collectively referred to as the Insurance Group . IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company", or IHC , or are implicit in the terms we , us and our . At June 30, 2016, the Company also owned approximately a 91% interest in American Independence Corp. ("AMIC").

IHC intends to take AMIC private on or about August 31, 2016 by way of a statutory "short-form" merger. As a result, IHC will indirectly own all of the outstanding shares of AMIC s common stock.

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 health, disability and DBL; mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. IHC also seeks transactions that permit it to leverage its vertically integrated organizational structure by generating fee

income from production and administrative operating companies as well as risk income for its carriers and profit commissions. Management has always focused on managing the costs of its operations and providing its insureds with the best cost-containment tools available.

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

The results of operations for the three months and six months ended June 30, 2016 and 2015 are summarized as follows (in thousands):

|  | <b>Three Months Ended<br/>June 30,</b> |                 | <b>Six Months Ended<br/>June 30,</b> |                  |
|--|--|-----------------|--------------------------------------|------------------|
|  | <b>2016</b>                            | <b>2015</b>     | <b>2016</b>                          | <b>2015</b>      |
| Revenues   | \$ 77,696                              | \$ 133,015      | \$ 153,591                           | \$ 266,120       |
| Expenses   | 70,847                                 | 124,812         | 137,270                              | 250,348          |
| Income from continuing operations before income taxes      | 6,849                                  | 8,203           | 16,321                               | 15,772           |
| Income taxes   | 2,354                                  | 2,981           | 5,930                                | 5,849            |
| <b>Income from continuing operations</b>                   | <b>4,495</b>                           | <b>5,222</b>    | <b>10,391</b>                        | <b>9,923</b>     |
| Income (loss) from discontinued operations                 | 142                                    | (66)            | 109,912                              | 564              |
| <b>Net income</b>  | <b>4,637</b>                           | <b>5,156</b>    | <b>120,303</b>                       | <b>10,487</b>    |
| Less: Income from noncontrolling interests in subsidiaries | (201)                                  | (124)           | (9,857)                              | (236)            |
| <b>Net income attributable to IHC</b>                      | <b>\$ 4,436</b>                        | <b>\$ 5,032</b> | <b>\$ 110,446</b>                    | <b>\$ 10,251</b> |

o

Income from continuing operations of \$.25 per share, diluted, for the three months ended June 30, 2016 compared to \$.29 per share, diluted, for the same period in 2015. Income from continuing operations of \$.58 per share, diluted, for the six months ended June 30, 2016 compared to \$.56 per share, diluted, for the same period in 2015.

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Consolidated investment yields (on an annualized basis) of 2.8% for both the three months and six months ended June 30, 2016, compared to 2.5% and 2.8% for the comparable periods in 2015, respectively;

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Book value of \$25.58 per common share at June 30, 2016 compared to \$18.73 at December 31, 2015.

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

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The Medical Stop-Loss segment reported income before taxes of \$3.9 million and \$11.8 million for the second quarter and six months of 2016, respectively. Income from the Medical Stop-loss segment in 2016 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 during 2016 represent the activity of the remaining blocks of medical stop-loss business in run-off. In 2015, the Medical Stop-Loss segment reported income before taxes of \$4.6 million and \$9.0 million for second quarter and first six months, respectively.

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The Fully Insured Health segment reported \$2.0 million of income before taxes for the three months ended June 30, 2016 compared to \$1.6 million for the same period in 2015; and reported \$2.4 million of income before taxes for the six months ended June 30, 2016 compared to \$2.8 million for the same period in 2015.

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For the three months and six months ended June 30, 2016, premiums earned decreased \$6.6 million and \$14.8 million over the comparable periods in 2015. Major medical premiums

o

decreased \$9.6 million and \$19.5 million for the three months and six months ended June 30, 2016, respectively. As a result of the strategic decision to focus on ancillary products, this decrease was partially offset by increases from broader marketing of our short-term medical, scheduled benefit and gap plans and growth in the pet insurance line of business.

o

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

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2016                           | 2015      | 2016                         | 2015      |
| Premiums Earned                                   | \$ 37,539                      | \$ 44,159 | \$ 72,706                    | \$ 87,451 |
| Insurance Benefits, Claims & Reserves<br>Expenses | 20,479                         | 24,768    | 38,648                       | 48,925    |
|   | 15,953                         | 17,123    | 32,531                       | 33,854    |
| Loss Ratio <sup>(A)</sup>                         | 54.6%                          | 56.1%     | 53.2%                        | 55.9%     |
| Expense Ratio <sup>(B)</sup>                      | 42.5%                          | 38.8%     | 44.7%                        | 38.7%     |
| Combined Ratio <sup>(C)</sup>                     | 97.1%                          | 94.9%     | 97.9%                        | 94.6%     |

(A)

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

(B)

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

(C)

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

o

Although the loss ratio in 2016 was lower than 2015, the loss ratio would have been 46.1% for the six months ended June 30, 2016 excluding the occupational accident line of business. We are strategically evaluating this line of business and taking steps to improve the underwriting results. Expense ratios are higher in 2016 because of a change in the mix of business from major medical to specialty health products and as a result of the reallocation of certain fixed costs from the medical stop loss line to the specialty health line.

Income before taxes from the Group disability, life and DBL segment decreased \$1.7 million for the three months ended June 30, 2016, and increased \$1.8 million for the six months ended June 30, 2016 compared to the same periods in 2015. The decrease in second-quarter results is primarily the result of extremely favorable loss ratios in 2015 and more normalized loss ratios in the second quarter of 2016. The overall increase for the six months is primarily due to increased volume;

Losses before income taxes from the Individual life, annuities and other segment decreased \$1.6 million and \$0.9 million for the three months and six months ended June 30, 2016, respectively, primarily because substantially all of the life and annuity blocks were ceded in the third quarter of 2015. Current year activity primarily consists of the amortization of the related reinsurance costs.

Losses before tax from the Corporate segment for the second quarter of 2016 were comparable to the same quarter in 2015. Losses before tax from the Corporate segment for the six months ended June 30, 2016 increased \$2.0 million over the same period in 2015 primarily due to compensation costs that vary with changes in book value and increased audit and consulting fees; and

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

| <b>Gross Direct and Assumed<br/>Earned Premiums:</b> | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2016</b>                          | <b>2015</b> |
| Medical Stop-Loss                                    | \$ 75,581                              | \$ 73,090   | \$ 158,925                           | \$ 147,570  |
| Fully Insured Health                                 | 39,823                                 | 47,092      | 77,689                               | 95,085      |
| Group disability, life and DBL                       | 30,427                                 | 28,872      | 60,703                               | 57,568      |
| Individual, life, annuities and other                | 3,954                                  | 6,054       | 8,707                                | 12,412      |
|  | \$ 149,785                             | \$ 155,108  | \$ 306,024                           | \$ 312,635  |

| <b>Net Direct and Assumed<br/>Earned Premiums:</b> | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2016</b>                          | <b>2015</b> |
| Medical Stop-Loss                                  | \$ 4,250                               | \$ 51,231   | \$ 8,003                             | \$ 104,989  |
| Fully Insured Health                               | 37,539                                 | 44,159      | 72,706                               | 87,451      |
| Group disability, life and DBL                     | 23,842                                 | 20,064      | 47,469                               | 40,000      |
| Individual, life, annuities and other              | (4)                                    | 4,989       | 11                                   | 10,117      |
|  | \$ 65,627                              | \$ 120,443  | \$ 128,189                           | \$ 242,557  |

### **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, 2015. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges*, *Insurance Liabilities*, *Deferred Acquisition Costs*, *Investments*, *Goodwill and Other Intangible Assets*, and *Deferred Income Taxes* as those that, due to the judgments, estimates and assumptions inherent in those policies,



are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, Critical Accounting Policies in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2015. During the six months ended June 30, 2016, there were no additions to or changes in the critical accounting policies disclosed in the 2015 Form 10-K except for the recently adopted accounting standards discussed in Note 1(E) of the Notes to Condensed Consolidated Financial Statements.

**Results of Operations for the Three Months Ended June 30, 2016 Compared to the Three Months Ended June 30, 2015**

Information by business segment for the three months ended June 30, 2016 and 2015 is as follows:

| <b><u>June 30, 2016</u></b><br><b>(In thousands)</b> | <b><u>Premiums</u></b><br><b><u>Earned</u></b> | <b><u>Net</u></b><br><b><u>Investment</u></b><br><b><u>Income</u></b> | <b><u>Fee and</u></b><br><b><u>Other</u></b><br><b><u>Income</u></b> | <b><u>Benefits,</u></b><br><b><u>Claims</u></b><br><b><u>and</u></b><br><b><u>Reserves</u></b> | <b><u>Selling,</u></b><br><b><u>General</u></b><br><b><u>and</u></b><br><b><u>Administrative</u></b> | <b><u>Total</u></b> |
|--|--|---|--|--|--|---------------------|
| Medical Stop-Loss                                    | \$ 4,250                                       | 804   | 3,060  | 4,534  | (368)  | \$ 3,948            |
| Fully Insured Health                                 | 37,539   | 707   | 3,437  | 20,479   | 19,214   | 1,990               |
| Group disability,<br>life and DBL                    | 23,842   | 1,651   | 184  | 15,064   | 9,104  | 1,509               |
| Individual life,<br>annuities and<br>other           | (4)  | 479   | 110  | 400  | (130)  | 315                 |
| Corporate  | -  | 619   | -  | -  | 2,077  | (1,458)             |
| Sub total  | \$ 65,627                                      | \$ 4,260  | \$ 6,791   | \$ 40,477  | \$ 29,897  | 6,304               |

|   |  |  |  |  |  |          |
|---|--|--|--|--|--|----------|
| Net realized investment gains                         |  |  |  |  |  | 1,018    |
| Interest expense on debt                              |  |  |  |  |  | (473)    |
| Income from continuing operations before income taxes |  |  |  |  |  | 6,849    |
| Income taxes  |  |  |  |  |  | 2,354    |
| Income from continuing operations                     |  |  |  |  |  | \$ 4,495 |

| <b><u>June 30, 2015</u></b><br><b>(In thousands)</b> | <b><u>Premiums</u></b><br><b><u>Earned</u></b> | <b><u>Net</u></b><br><b><u>Investment</u></b><br><b><u>Income</u></b> | <b><u>Fee and</u></b><br><b><u>Other</u></b><br><b><u>Income</u></b> | <b><u>Benefits,</u></b><br><b><u>Claims</u></b><br><b><u>and</u></b><br><b><u>Reserves</u></b> | <b><u>Selling,</u></b><br><b><u>General</u></b><br><b><u>and</u></b><br><b><u>Administrative</u></b> | <b><u>Total</u></b> |
|--|--|---|--|--|--|---------------------|
| Medical Stop-Loss                                    | \$ 51,231                                      | 908   | -  | 38,242   | 9,260  | \$ 4,637            |
| Fully Insured Health                                 | 44,159   | 532   | 4,940  | 24,768   | 23,308   | 1,555               |
| Group disability,<br>life and DBL                    | 20,064   | 630   | 33   | 11,491   | 6,077  | 3,159               |
| Individual life,<br>annuities and<br>other           | 4,989  | 2,375   | 1,011  | 4,879  | 4,829  | (1,333)             |
| Corporate  | -  | 43  | -  | -  | 1,480  | (1,437)             |
| Sub total  | \$ 120,443                                     | \$ 4,488  | \$ 5,984   | \$ 79,380  | \$ 44,954  | 6,581               |

|   |  |  |  |  |  |          |
|---|--|--|--|--|--|----------|
| Net realized investment gains                         |  |  |  |  |  | 2,100    |
| Interest expense on debt                              |  |  |  |  |  | (478)    |
| Income from continuing operations before income taxes |  |  |  |  |  | 8,203    |
| Income taxes  |  |  |  |  |  | 2,981    |
| Income from continuing operations                     |  |  |  |  |  | \$ 5,222 |

**Premiums Earned**

In the second quarter of 2016, premiums earned decreased \$54.8 million over the comparable period of 2015. The decrease is primarily due to: (i) a decrease of \$47.0 million in the 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; (ii) a decrease of \$6.6 million in the Fully Insured Health segment principally as a result of a \$9.6 million decrease in premiums from exiting the Major Medical line, a \$2.3 million decrease in the fixed indemnity limited benefit line and a \$.7 million decrease in international medical business premiums, partially offset by premium increases in the short-term medical and pet lines of business of \$5.0 million and \$1.0 million, respectively, as a result of higher volume; and (iii) a decrease of \$5.0 million in the Individual life, annuities and other segment as a result of business in run-off; partially offset by (iv) a \$3.8 million increase in earned premiums from the Group disability, life, annuities and DBL segment primarily due to increased volume and retention in the LTD line and increased volume in the DBL line.

**Net Investment Income**

Total net investment income decreased \$0.2 million. The overall annualized investment yields were 2.8% and 2.5% in the second quarter of 2016 and 2015, respectively. The higher yield in the second quarter of 2016 was offset by a lower amount of invested assets due to cash transferred out in the third

quarter of 2015 in connection with a coinsurance and sale transaction, partially offset by cash received in connection with the sale of Risk Solutions in the first quarter of 2016. The overall decrease was primarily due to a decrease in income from partnerships and policy loans in 2016.

The annualized investment yields on bonds, equities and short-term investments were 2.8% and 2.5% in the second quarter of 2016 and 2015, respectively. IHC has approximately \$207.6 million in highly rated shorter duration securities earning on average 1.4%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

### **Net Realized Investment Gains**

The Company had net realized investment gains of \$1.0 million in 2016 compared to \$2.1 million in 2015. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

### **Fee Income and Other Income**

Fee income increased \$1.0 million for the three-month period ended June 30, 2016 compared to the three-month period ended June 30, 2015 primarily due to increased fee income related to the increased ownership in an agency holding company partially offset by decreased fees due to the partial sale and deconsolidation of a previously wholly owned Third Party Administrator in the Fully Insured Health segment.

Other income in the second quarter of 2016 increased \$1.8 million from the same period in 2015 primarily due to fees received in conjunction with the ceding of the Medical Stop Loss business.

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

In the second quarter of 2016, insurance benefits, claims and reserves decreased \$38.9 million over the comparable period in 2015. The decrease is primarily attributable to: (i) a decrease of \$33.7 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; (ii) a decrease of \$4.3 million in the Fully Insured Health segment, primarily due to a decrease of \$5.1 million in benefits, claims and reserves related to the run-off of the Major Medical business, a \$1.5 million decrease in fixed indemnity due to lower volume, and a \$1.1 million decrease in reserves in the international line due

to lower retention; partially offset by an increase of \$3.4 million in the short term medical line due to increased volume; and (iii) a decrease of \$4.5 million in the Individual life, annuity and other segment, primarily as a result of business in run-off; partially offset by (iv) an increase of \$3.6 million in benefits, claims and reserves in the group disability, life, annuities and DBL segment, primarily due to increased retentions and higher loss ratios on LTD lines and higher volume in DBL business.

**Selling, General and Administrative Expenses**

Total selling, general and administrative expenses decreased \$15.1 million over the comparable period in 2015. The decrease is primarily attributable to: (i) a decrease of \$9.7 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; (ii) a decrease of \$4.1 million in the Fully Insured Health segment primarily due to decreased expenses from the run-off of Major Medical, partially offset by an increase in expenses due to increased volume in the short term medical line; and (iii) a decrease of \$4.9 million in the Individual life, annuity and other segment largely due to business in run-off; partially offset by (iv) an increase of 3.0

million in the group disability, life, annuities and DBL segment primarily due to increased commission and other expenses in the LTD line as a result of higher volume and retentions; and (v) an increase of \$0.6 million in Corporate expenses due to compensation costs that vary with changes in book value.

### Income Taxes

The effective tax rate for the three months ended June 30, 2016 was 34.4% compared to 36.3% for the same period in 2015. The decrease is primarily the result of lower amounts of non-deductible expenses as a result of the Affordable Care Act and lower state taxes as a percentage of consolidated income, partially offset by an increase in benefits from tax-advantaged securities.

### **Results of Operations for the Six Months Ended June 30, 2016 Compared to the Six Months Ended June 30, 2015**

Information by business segment for the six months ended June 30, 2016 and 2015 is as follows:

| <b><u>June 30, 2016</u></b><br><b>(In thousands)</b>  | <b><u>Premiums</u></b><br><b><u>Earned</u></b> | <b><u>Net</u></b><br><b><u>Investment</u></b><br><b><u>Income</u></b> | <b><u>Fee and</u></b><br><b><u>Other</u></b><br><b><u>Income</u></b> | <b><u>Benefits,</u></b><br><b><u>Claims</u></b><br><b><u>and</u></b><br><b><u>Reserves</u></b> | <b><u>Selling,</u></b><br><b><u>General</u></b><br><b><u>and</u></b><br><b><u>Administrative</u></b> | <b><u>Total</u></b> |
|---|--|---|--|--|--|---------------------|
| Medical Stop-Loss                                     | \$ 8,003                                       | 1,840   | 6,121  | 6,367  | (2,153)  | \$ 11,750           |
| Fully Insured Health                                  | 72,706   | 1,063   | 8,001  | 38,648   | 40,737   | 2,385               |
| Group disability,<br>life and DBL                     | 47,469   | 3,246   | 498  | 25,551   | 17,452   | 8,210               |
| Individual life,<br>annuities and<br>other            | 11   | 867   | 458  | 654  | 2,160  | (1,478)             |
| Corporate   | -  | 1,680   | 50   | -  | 6,928  | (5,198)             |
| Sub total   | \$ 128,189                                     | \$ 8,696  | \$ 15,128  | \$ 71,220  | \$ 65,124  | 15,669              |
| Net realized investment gains                         |  |   |  |  |  | 1,578               |
| Interest expense on debt                              |  |   |  |  |  | (926)               |
| Income from continuing operations before income taxes |  |   |  |  |  | 16,321              |
| Income taxes  |  |   |  |  |  | 5,930               |
| Income from continuing operations                     |  |   |  |  |  | \$ 10,391           |

**Benefits, Selling,**

| <b><u>June 30, 2015</u></b><br><b>(In thousands)</b>  | <b><u>Premiums</u></b><br><b><u>Earned</u></b> | <b><u>Net</u></b><br><b><u>Investment</u></b><br><b><u>Income</u></b> | <b><u>Fee and</u></b><br><b><u>Other</u></b><br><b><u>Income</u></b> | <b><u>Claims</u></b><br><b><u>and</u></b><br><b><u>Reserves</u></b> | <b><u>General</u></b><br><b><u>and</u></b><br><b><u>Administrative</u></b> | <b><u>Total</u></b> |
|---|--|---|--|---|--|---------------------|
| Medical Stop-Loss                                     | \$ 104,989                                     | 2,001   | -  | 77,663  | 20,369   | \$ 8,958            |
| Fully Insured Health                                  | 87,451   | 1,137   | 7,575  | 48,925  | 44,406   | 2,832               |
| Group disability,<br>life and DBL                     | 40,000   | 1,401   | 74   | 22,836  | 12,265   | 6,374               |
| Individual life,<br>annuities and<br>other            | 10,117   | 5,279   | 1,904  | 9,576   | 10,109   | (2,385)             |
| Corporate   | -  | 92  | -  | -   | 3,289  | (3,197)             |
| Sub total   | \$ 242,557                                     | \$ 9,910  | \$ 9,553   | \$ 159,000  | \$ 90,438  | 12,582              |
| Net realized investment gains                         |  |   |  |   |  | 4,100               |
| Interest expense on debt                              |  |   |  |   |  | (910)               |
| Income from continuing operations before income taxes |  |   |  |   |  | 15,772              |
| Income taxes  |  |   |  |   |  | 5,849               |
| Income from continuing operations                     |  |   |  |   |  | \$ 9,923            |

**Premiums Earned**

In the first six months of 2016, premiums earned decreased \$114.4 million over the comparable period of 2015. The decrease is primarily due to: (i) a decrease of \$97.0 million in the 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; (ii) a decrease of \$14.8 million in the Fully Insured Health segment principally as a result of a \$19.5 million decrease in premiums from exiting the Major Medical line, a \$4.1 million decrease in the fixed

indemnity limited benefit line, and a \$1.3 million decrease in international medical business premiums due to lower retention, partially offset by premium increases in the short-term medical and pet lines of business of \$8.1 million and \$2.1 million, respectively, as a result of higher volume; and (iii) a decrease of \$10.1 million in the Individual life, annuities and other segment as a result of business in run-off; partially offset by (iv) a \$7.5 million increase in earned premiums from the Group disability, life, annuities and DBL segment primarily due to increased volume and retention in the LTD and group term life lines and increased volume in DBL business.

### **Net Investment Income**

Total net investment income decreased \$1.2 million. The overall annualized investment yields were 2.8% in the first six months of both 2016 and 2015. The overall decrease was primarily the result of a decrease in investment income on bonds, equities and short-term investments due to cash transferred out in the third quarter of 2015 in connection with a coinsurance and sale transaction, partially offset by cash received in connection with the sale of Risk Solutions in the first quarter of 2016. Additionally, income from partnerships and policy loans was lower in 2016.

The annualized investment yields on bonds, equities and short-term investments were 2.9% and 2.7% in the first six months of 2016 and 2015, respectively. IHC has approximately \$207.6 million in highly rated shorter duration securities earning on average 1.4%. A portfolio that is shorter in duration enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income.

### **Net Realized Investment Gains**

The Company had net realized investment gains of \$1.6 million in the first six months of 2016 compared to \$4.1 million in 2015. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

### **Fee Income and Other Income**

Fee income increased \$1.5 million for the six-month period ended June 30, 2016 compared to the six-month period ended June 30, 2015 primarily due to increased fee income related to the increased ownership in an agency holding company partially offset by decreased fees due to the partial sale and deconsolidation of a previously wholly owned Third Party Administrator in the Fully Insured Health segment.



Other income in the first six months of 2016 increased \$4.1 million from the same period in 2015 primarily due to fees received in conjunction with the ceding of the Medical Stop Loss business.

**Insurance Benefits, Claims and Reserves**

In the first six months of 2016, insurance benefits, claims and reserves decreased \$87.8 million over the comparable period in 2015. The decrease is primarily attributable to: (i) a decrease of \$71.3 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; (ii) a decrease of \$10.3 million in the Fully Insured Health segment, primarily due to a decrease of \$14.9 million in benefits, claims and reserves related to the run-off of the Major Medical business, a \$1.9 million decrease due to lower volume in the fixed indemnity business, and a \$2.3 million decrease due to lower retention in the international line; partially offset by increases of \$3.5 million in claims in the occupational accident lines due to higher claim activity and increases of \$4.1 million and \$1.0 million due to volume in the short term medical and pet lines; and (iii) a decrease of \$8.9

million in the Individual life, annuity and other segment, primarily as a result of business in run-off; partially offset by (iv) a, increase of \$2.7 million in benefits, claims and reserves in the group disability, life, annuities and DBL segment, primarily due to an increased retentions and higher loss ratios on LTD lines and increased volume in DBL business.

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

Total selling, general and administrative expenses decreased \$25.3 million over the comparable period in 2015. The decrease is primarily attributable to: (i) a decrease of \$22.5 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, (ii) a decrease of \$3.7 million in the Fully Insured Health segment primarily due to decreased expenses from the run-off of Major Medical, partially offset by an increase in expenses due to increased volume in the short term medical line; and (iii) a decrease of \$7.9 million in the Individual life, annuity and other segment largely due to lower general expenses from business in run-off; partially offset by (iv) an increase of 5.2 million in the group disability, life, annuities and DBL segment primarily due to increased commission and other expenses in the LTD line as a result of volume; and (v) an increase of \$3.6 million in Corporate principally from increased compensation costs that vary with changes in book value, in addition to higher audit and consulting fees in 2016.

### **Income Taxes**

The effective tax rate for the six months ended June 30, 2016 was 36.3% compared to 37.1% for the same period in 2015. The decrease is primarily the result of lower amounts of non-deductible expenses as a result of the Affordable Care Act.

## **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 six months ended June 30, 2016 or 2015.

### **Cash Flows**

The Company had \$26.6 million and \$17.5 million of cash and cash equivalents as of June 30, 2016 and December 31, 2015, respectively.

For the six months ended June 30, 2016, operating activities of the Company utilized \$11.8 million of cash, \$25.2 million was provided by investment activities and \$4.4 million of cash was utilized for financing activities. The increase in cash from investing is primarily related to the proceeds from the sale of Risk Solutions net of amounts subsequently invested in available-for-sale securities. Financing activities include \$1.2 million utilized for the repayment of debt, \$0.8 million for the payment of dividends and \$1.8

million for treasury share purchases.

The Company has \$481.2 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 six months ended June 30, 2016, cash received from the maturities and other repayments of fixed maturities was \$30.9 million.

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

### **BALANCE SHEET**

The Company had receivables due from reinsurers of \$488.3 million at June 30, 2016 compared to \$483.1 million at December 31, 2015. All of such reinsurance receivables are from highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at June 30, 2016.

Total investments increased \$118.7 million primarily as a result of the proceeds from the Risk Solutions Sale and Coinsurance Transaction.

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

|                          | <b>Policy Benefits and Claims</b> |                              |
|--------------------------|-----------------------------------|------------------------------|
|                          | <b>June 30,<br/>2016</b>          | <b>December 31,<br/>2015</b> |
| Medical Stop-Loss        | \$ 99,421                         | \$ 100,088                   |
| Fully Insured Health     | 45,378                            | 41,477                       |
| Group Disability         | 96,589                            | 97,986                       |
| Individual A&H and Other | 6,180                             | 5,892                        |
|                          | <b>\$ 247,568</b>                 | <b>\$ 245,443</b>            |

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

underlying factors are what determine the reasonably likely changes in the Projected Net Loss Ratio.

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

The \$115.9 million increase in IHC's stockholders' equity in the first six months of 2016 is primarily due to the \$110.4 million of net income attributable to IHC and \$7.5 million of other comprehensive income attributable to IHC, partially offset by \$1.8 million of treasury stock purchases and \$0.8 million of common

stock dividends.

### **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 \$4.8 million at June 30, 2016, 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. At June 30, 2016, no fixed maturities were invested in non-investment grade fixed maturities. The Company does not have any non-performing fixed maturities at June 30, 2016.

The Company reviews its investments regularly and monitors its investments continually for impairments. The Company did not record any other-than-temporary impairment losses in the six months ended June 30, 2016 or 2015. The following table summarizes the carrying value of securities with fair values less than 80% of their amortized cost at June 30, 2016 by the length of time the fair values of those securities were below 80% of their amortized cost (in thousands):

|                  | <b>Less than<br/>3 months</b> | <b>Greater than<br/>3 months,<br/>less than<br/>6 months</b> | <b>Greater than<br/>6 months,<br/>less than<br/>12 months</b> | <b>Greater than<br/>12 months</b> | <b>Total</b> |
|------------------|-------------------------------|--|---|-----------------------------------|--------------|
| Fixed maturities | \$ -                          | \$ 1,824   | \$ -  | \$ -                              | \$ 1,824     |

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 June 30, 2016. In 2016, the Company recorded \$13.5 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 June 30, 2016, is not materially different from that

reported in the schedule of such obligations at December 31, 2015 which was included in Item 7 of the Company's Annual Report on Form 10-K.

## **OUTLOOK**

For the balance of 2016, we anticipate:

.  
A continued decrease in premiums and earnings due to exiting the medical stop-loss business as a result of the closing of the Risk Solutions Sale and Coinsurance Transaction.

.  
Continued significant increase in specialty health premiums (including short-term and supplemental health products, such as dental, accidental medical, gap and critical illness products), and continued decrease in major medical premiums, which is in run-off. Increasing emphasis on direct-to-consumer and career advisor distribution initiatives as we believe this will be a growing means for selling health insurance in the coming years, and accompanying start-up costs of expanding our sales through our call center, career model (including our Aspira A Mas outreach to the Hispanic community) and transactional websites.

.  
If a rule proposed by certain departments of the federal government is enacted as published, the duration of short-term medical (STM) products may be regulated by the federal government. We do not anticipate any negative impact from this proposed rule in 2016, and we believe if it is adopted that we may see a shift in sales in 2017 from STM and to our hospital indemnity products, which may benefit IHC overall.

.  
Increasing retention in our group life and disability lines of business. We expect a continuation of the increase 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.

.  
Continued evaluation of strategic transactions. As a result of the sale of Risk Solutions, we have significant cash. We plan to redeploy some of this cash in making investments and acquisitions to bolster existing or new lines of business. Specialty Benefits has made two minority investments in call centers that have begun writing substantially all of their specialty health business with carriers affiliated with IHC. We are currently negotiating another similar transaction which we anticipate could close this year.



Continued focus on administrative efficiencies, including a reduced operating loss at Ebix Health Exchange.

We anticipate that we will take AMIC private on or about August 31, 2016.

On March 31, 2016, IHC and its subsidiary Independence American Holdings Corp. 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 is 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 \$99.9 million, 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.

The Company will remain highly liquid in 2016 as a result of the continuing shorter duration of the portfolio. IHC has approximately \$207.6 million in highly rated shorter maturity securities earning on average 1.4%; our portfolio as a whole is rated, on average, AA. The low duration of our portfolio enables us, if we deem prudent, the flexibility to reinvest in much higher yielding longer-term securities, which would significantly increase investment income 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.

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

### **ITEM 3.**

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

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

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

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

The expected change in fair value as a percentage of the Company's fixed income portfolio at June 30, 2016 given a 100 to 200 basis point rise or decline in interest rates is not materially different than the expected change at December 31, 2015 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, 2015, 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. Specifically, we did not have (i) sufficient tax accounting resources with adequate knowledge of the Company's process and controls over financial reporting related to income taxes to effectively design, operate, and document controls over accounting for income taxes, (ii) an adequate risk assessment process related to income tax accounting to identify and appropriately account for income taxes associated with significant, non-routine transactions and (iii) effective process level controls over completeness, existence, accuracy and disclosure of deferred tax balances.

#### ***Plan for Remediation of Material Weaknesses***

The Company is actively engaged in evaluating and determining implementation steps to remediate the material weaknesses in internal control over financial reporting identified related to accounting for income taxes. The Company has begun and will continue to (i) augment existing tax staff with additional skilled tax accounting resources and providing additional training to existing staff on the design and operation of tax related financial reporting and corresponding internal controls, (ii) enhance risk assessment processes that operate over accounting for income taxes, with a particular focus on the tax accounting and disclosure for unusual and complex transactions, and (iii) review the processes and controls in place to measure and record transactions related to tax accounting to enhance the effectiveness of the design and operation of those controls. Though the Company has begun to address the remediation efforts described above, until the remediation actions are fully implemented and the operational effectiveness of related internal controls validated through testing, the material weaknesses described above will continue to exist.

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

There has been no change in IHC's internal control over financial reporting during the quarter ended June 30, 2016 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1.**

**LEGAL PROCEEDINGS**

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

**ITEM 1A.**

**RISK FACTORS**

There were no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 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 2014, the Board of Directors authorized the repurchase of up to 500,000 shares of IHC's common stock, in addition to prior authorizations, under the 1991 plan. As of June 30, 2016, 214,911 shares were still authorized to be repurchased under the plan and, in August 2016, the Board of Directors increased the number of shares that can be repurchased up to 3,000,000.

Share repurchases during the second quarter of 2016 are summarized as follows:

|            | 2016        |                |       |  | Maximum Number  |
|------------|-------------|----------------|-------|--|-----------------|
| Month of   | Shares      | Average Price  |       |  | Of Shares Which |
| Repurchase | Repurchased | of Repurchased |       |  | Can be          |
|            |             | Shares         |       |  | Repurchased     |
| April      | -           | \$             | -     |  | 274,911         |
| May        | -           | \$             | -     |  | 274,911         |
| June       | 60,000      | \$             | 16.18 |  | 214,911         |

**ITEM 3.****DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4.****MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5.**

**OTHER INFORMATION**

Not applicable.

**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).

31.1

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

31.2

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

32.1

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

32.2

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

101.INS

XBRL Instance Document. \*

101.SCH

XBRL Taxonomy Extension Schema Document. \*

101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document. \*

101.LAB

XBRL Taxonomy Extension Label Linkbase Document. \*

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document. \*

101.DEF

XBRL Taxonomy Extension Definition Linkbase Document. \*

\* Filed herewith.

**SIGNATURES**

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

**INDEPENDENCE HOLDING COMPANY**

(REGISTRANT)

By:

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

Date:

August 15, 2016

Roy T.K. Thung

Chief Executive Officer, President

and Chairman

By:

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

Date:

August 15, 2016

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer