

INDEPENDENCE HOLDING CO
Form 10-K
March 15, 2013

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

COMMISSION FILE NUMBER 0-10306

INDEPENDENCE HOLDING COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

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

96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT
(Address of Principal Executive Offices)

06902
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, \$1.00 PAR VALUE PER SHARE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ___

No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ___ No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a 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 Act). Yes ___ No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of June 30, 2012 was \$77,470,000.

17,913,966 shares of common stock were outstanding as of March 6, 2013.

Documents Incorporated by Reference

Portions of the Registrant's definitive proxy statement to be delivered (or made available, pursuant to applicable regulations) to stockholders in connection with the 2012 annual meeting of stockholders to be held in June 2013 are incorporated by reference in response to Part III of this Report.

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Forward-Looking Statements

This report on Form 10–K 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 this report.

Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, 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. In light of these risks, uncertainties and assumptions, any forward-looking event discussed in this report may not occur. Our forward-looking statements speak only as of the date made, and we undertake no obligation to update or review any forward-looking statement, whether as a result of new information, future events or other developments, unless the securities laws require us to do so.

PART I

ITEM 1. BUSINESS

Business Overview

Independence Holding Company is a Delaware corporation (NYSE: IHC) that was formed in 1980. We are a holding company principally engaged in the life and health insurance business with principal executive offices located at 96 Cummings Point Road, Stamford, Connecticut 06902. At December 31, 2012, we owned a 78.6% controlling interest in American Independence Corp. (NASDAQ:AMIC), which owns Independence American Insurance Company ("Independence American"), IHC Risk Solutions LLC (Risk Solutions), IHC Specialty Benefits, Inc. (Specialty Benefits), and controlling interests in two agencies.

Our website is located at www.ihcgroup.com. Detailed information about IHC, its corporate affiliates and insurance products and services can be found on our website. In addition, we make our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to such reports available, free of charge, through our website, as soon as reasonably practicable after they are filed with or furnished to the SEC. The information on our website, however, is not incorporated by reference in, and does not form part of, this Annual Report on Form 10-K.

IHC provides specialized life and health coverage and related services to commercial customers and individuals. We focus on niche products and/or narrowly defined distribution channels primarily in the United States. Our wholly owned insurance company subsidiaries, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life") market their products through independent and affiliated brokers, producers and agents. Independence American also distributes through these sources as well as to consumers through a dedicated controlled distribution company and through company-owned web sites.

Madison National Life, Standard Security 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".

In 2013 IHC will retain the vast majority of the risk that it underwrites, and will focus on the following lines of business:

.
Medical excess (or "stop-loss")

.
Multiple fully insured health lines, including pet insurance

.
Group disability and life

.
Individual life, primarily through block acquisitions

Standard Security Life, Madison National Life and Independence American are each rated A- (Excellent) by A.M. Best Company, Inc. ("Best"). Standard Security Life is domiciled in New York and licensed as an insurance company in all 50 states, the District of Columbia, the Virgin Islands and Puerto Rico. Madison National Life is domiciled in Wisconsin, licensed to sell insurance products in 49 states, the District of Columbia, the Virgin Islands and Guam, and is an accredited reinsurer in New York. Independence American is domiciled in Delaware and licensed to sell insurance products in all 50 states and the District of Columbia. We have been informed by Best that a Best rating is assigned after an extensive quantitative and qualitative evaluation of a company's financial condition and operating performance and is also based upon factors relevant to policyholders, agents, and intermediaries, and is not directed toward protection of investors. Best ratings are not recommendations to buy, sell or hold any of our securities.

Our administrative companies underwrite market, administer and/or price life and health insurance business for our owned and affiliated carriers, and, to a lesser extent, for non-affiliated insurance companies. They receive fees for these services and do not bear any of the insurance risk of the companies to which they provide services, other than through profit commissions or profit slides. During 2012, our principal administrative companies were: (i) IHC Health Solutions Inc. (Health Solutions), a full-service marketing, management and administrative services company that operates in the individual and small employer markets; (ii) IHC Risk Solutions LLC (Risk Solutions), a full-service direct writer of medical stop-loss insurance for self-insured employer groups in the middle to larger employer markets; and (iii) Specialty Benefits, a program management and distribution company that focuses on individual and consumer products; (iv) Actuarial Management Corporation, an actuarial consulting firm providing product development and valuation services for IHC's fully insured health segment.

In addition, AMIC owns controlling interests in IPA Family, LLC ("IPA") and Healthinsurance.org LLC. IPA is a national, career agent marketing organization. Healthinsurance.org LLC is an online marketing company that owns www.healthinsurance.org, a lead generation site for individual health insurance, including in 2012 those over age 65. Our general agencies earn commissions for selling life and health insurance products underwritten by IHC's owned and affiliated insurance companies and also by unaffiliated carriers.

For information pertaining to the Company's business segments, reference is made to Note 21 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

Our Philosophy

Our business strategy consists of maximizing underwriting profits through a variety of niche life and health insurance products and through distribution channels that enable us to access specialized or underserved markets in which we believe we have a competitive advantage. Historically, our carriers have focused on establishing preferred relationships with producers who seek an alternative to larger, more bureaucratic health insurers, and on providing these producers with personalized service, competitive compensation and a broad array of products. A growing portion of our business comes from direct-to-consumer initiatives. While our 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. We seek relationships that will generate fee income and profit commissions for our administrative companies as well as risk income for our insurance carriers thereby permitting us to leverage IHC's vertically integrated organizational structure.

As a result of our increased control of distribution through corporate acquisitions, we have strengthened our ability to respond to market cycles in the health insurance sector by deploying our insurance underwriting activity across a larger number of business lines. In recent years, we have emphasized writing stop-loss business through Risk Solutions and only a few select managing general underwriters (MGUs) with whom we have done business for many years, including TRU Services, LLC (TRU), in which we have an equity interest. This has allowed us to be more selective in order to achieve better stop-loss underwriting results by terminating all under-performing non-owned programs. While a substantial portion of our book of business is with smaller self-funded groups, we have recently focused on developing stop-loss solutions for plans with 100 or fewer employees. These plans are increasingly

looking for affordable health-financing alternatives as a result of federal health care reform.

As a result of the reorganization of Risk Solutions and an expansion in the demand for stop-loss insurance generally, we have seen an increase in our gross written stop-loss premiums. Net premiums have benefitted from this growth and higher retention. Our gross written fully insured health premiums have increased, but our net premiums have remained relatively flat. We have experienced decreases in administrative costs as a percentage of premiums in both our Fully Insured Health and Stop-Loss segments resulting from the consolidation and efficiency initiatives implemented in the last several years.

DISTRIBUTION

Medical Stop-Loss

Standard Security Life, Madison National Life and Independence American write approximately 75% of their medical stop-loss business through Risk Solutions and TRU with the balance written through three independent MGUs. Standard Security Life is the primary carrier for our employer medical stop-loss products although, in 2012, we also write business for Madison National Life, Independence American and for unaffiliated carriers. During 2012, IHC owned two managing general underwriters, Majestic Underwriters LLC ("Majestic") and Alliance Underwriters, LLC, which transferred their stop-loss blocks and employees to Risk Solutions as of January 1, 2012 in exchange for fee income based on the business transferred. They are responsible for underwriting accounts in accordance with guidelines formulated and approved by us, billing and collecting premiums, paying commissions to agents, third party administrators and/or brokers, and processing claims. With respect to those select MGUs with which we do business, we establish underwriting guidelines, maintain approved policy forms and oversee claims for reimbursement, as well as appropriate accounting procedures and reserves. In order to accomplish this, we audit the MGUs' underwriting, claims and policy issuance practices to assure compliance with our guidelines, provide the MGUs with access to our medical management and cost containment expertise, and review cases that require referral based on our underwriting guidelines. MGUs are non-salaried contractors that receive fee income, generally a percentage of gross premiums produced by them on behalf of the insurance carriers they represent, and typically are entitled to additional income based on underwriting results.

The agents and brokers that produce this business are non-salaried contractors that receive commissions.

Fully Insured Health

The Fully Insured Health Segment includes the following lines of business (major medical health plans for small groups, individuals and families, dental/vision, short-term medical ("STM"), limited medical, pet insurance, and supplemental benefits, such as accident and critical illness plans) that are sold in the majority of states through multiple and varied distribution strategies. The largest line of business in this segment continues to be major medical for small employer groups (defined as employers with between two and fifty employees). The majority of our business in this segment is written (i) directly to agents through the Health Solutions telesales unit, (ii) through private-label arrangements managed by Health Solutions with non-affiliated third party administrators, (iii) through AMIC's captive agency relationships, and (iv) direct to consumers. We also market through general agents, agents and brokers.

The Fully Insured Health Segment is comprised of two major categories: (i) major medical essential health benefits (EHB) coverage (comprised of small-group major medical, major medical health plans for individuals and families

and small amount of large-group major medical) and (ii) non-EHB or supplemental benefits (including dental/vision, short-term medical, limited medical, pet insurance, critical illness, hospital indemnity, accident medical and non-subscriber occupational accident). Health Solutions performs marketing, sales, underwriting and administrative functions on the majority of our Fully Insured Health business. In addition, our carriers write a significant amount of Fully Insured Health business which is distributed and/or administered by independent third party administrators. In 2012 we formed Specialty Benefits to accelerate our growth into non-EHB or specialty lines of business by entering into several strategic relationships, most notably with a leading provider of pet insurance. We have also established a relationship with a leading provider of international health, life and disability plans for specialized niche markets, and invested in a joint venture to acquire third party administrators of non-subscriber occupational accident coverage in Texas.

The Fully Insured Health Segment has approximately 325 salaried employees performing all aspects of underwriting, risk selection and pricing, policy administration and management of fully insured

group and individual health insurance on behalf of IHC and other carriers, and management of approximately \$224 million of gross individual and group health premiums for multiple insurers.

The agents and brokers who produce the Fully Insured Health business are non-salaried contractors who receive commissions.

Other Products

Our other products are primarily distributed by general agents, agents and brokers. The short-term statutory disability benefit product in New York State ("DBL") is marketed primarily through independent general agents who are paid commissions based upon the amount of premiums produced. Madison National Life's disability and group life products are primarily sold in the Midwest to school districts, municipalities and hospital employer groups through a managing general agent that specializes in these target markets. Madison National Life also reinsures and will begin writing life, disability and health products serving the needs of expatriates, third-country nationals and local nationals.

Madison National Life sells a whole-life product with an annuity rider to military personnel and civil service employees. Its subsidiary, IHC Financial Group, Inc. (IHC Financial Group), recruits agents to sell life and annuity products to state and federal employees. Since these products are currently not available through IHC's carriers, IHC Financial Group has contracted with highly rated insurance companies to sell their life and annuity products to these individuals. The income for IHC Financial Group is derived completely from commissions on the sale of the products of these other companies. The agents and brokers who produce this business are non-salaried contractors who receive commissions. We earned approximately \$0.7 million of revenue in 2012 and we anticipate increased growth as we continue to recruit new agents. We wrote about \$6.5 million of annualized premiums from our whole-life and annuity products in 2012 and expect to write about \$8.0 million of annualized premium in 2013. Madison National Life expects to write about \$3.7 million of annualized final expense whole life premium in 2013.

PRINCIPAL PRODUCTS

Medical Stop-Loss

The Company is a leading writer nationally of excess or stop-loss insurance for self-insured employer groups that desire to manage the risk of large medical claims ("Medical Stop-Loss"). Standard Security Life was one of the first carriers to market Medical Stop-Loss insurance, starting in 1987, and the Insurance Group is now one of the largest writers of this product in the United States. Medical Stop-Loss insurance provides coverage to public and private entities that elect to self-insure their employees' medical coverage for losses within specified ranges, which permits such groups to manage the risk of excessive health insurance costs by limiting specific and aggregate losses to predetermined amounts. This coverage is available on either a specific or a specific and aggregate basis, although the

majority of the Insurance Group's policies cover both specific and aggregate claims. Plans are designed to fit the identified needs of the self-insured employer by offering a variety of deductibles (i.e., the level of claims after which the medical stop-loss benefits become payable).

IHC experienced an increase in premiums in the Medical Stop-Loss line of business in 2012 primarily from the marketing efforts of Risk Solutions. We expect this trend to continue throughout 2013.

Fully Insured Health Products

This line of business has two major categories: (i) Major Medical Essential Health Benefit (EHB) coverage, which had approximately \$131 million of gross premiums in 2012 and (ii) ancillary non-EHB plans, which had approximately \$93 million of gross premiums in 2012. Both categories are expected to grow in 2013, but the EHB category may shrink in 2014 and beyond as a result of the Patient Protection and Affordable Care Act, as amended (ACA).

Major Medical Essential Health Benefit Coverages

This category is primarily comprised of group major medical insurance and major medical plans for individuals and families. Both products include consumer driven health plan (CDHP) products and are approved and currently sold in the majority of states.

Group major medical is sold primarily to small employers (two to 50 covered lives) in the majority of states. It is fully insured major medical coverage that is principally designed to work with health reimbursement accounts and health savings accounts which are implemented by employers that wish to provide this benefit as part of an employee welfare benefit plan. These plans are offered primarily as preferred provider organizations ("PPO") plans, and provide a variety of cost-sharing options, including deductibles, coinsurance and co-payment. CDHPs are designed to provide participants with economic incentives to be informed consumers of healthcare. In addition to small group, the Company offers a unique group medical plan to employers (small and large) who are contractors working on government-funded projects under the Davis-Bacon and Service Contract Acts (the Acts"), much of which is associated with current and future U.S. infrastructure improvements. This plan helps contractors meet the provisions of a "bona fide" fringe benefit for their hourly workers as required in the Acts. The Company experienced a significant increase in gross premiums in 2012 due to an improvement in the underwriting process at Health Solutions, and certain competitors decreasing their product availability, or in some instances leaving the market altogether, in response to the ACA. The company is expecting to continue growth into 2013, primarily through the addition of new programs and distributors.

The Company markets major medical plans for individuals and families that include CDHP products which are approved in the majority of states. This line of business grew slightly in 2012, and it is anticipated that there will be some contraction in premium in 2013 due to the decrease in the number of states in which we market as a result of the ACA.

Supplemental or Non-EHB Products

This category is primarily comprised of dental/vision, STM, non-EHB supplemental plans for groups, individuals and families, and pet insurance. These are sold through multiple distribution strategies.

IHC sells group and individual dental products in all 50 states. We administer the majority of IHC's dental business and are also the primary distribution source of this line of business. The dental portfolio includes indemnity and PPO plans for employer groups of two or more lives and for individuals within affinity groups. Employer plans are offered on both employer paid and voluntary bases. As part of the distribution of our dental products, we also offer vision benefits. Vision plans will offer a flat reimbursement amount for exams and materials. Standard Security Life writes vision policies in the State of New York on behalf of national vision providers. IHC does not control the distribution or underwriting of the NY vision product, and therefore it does not retain its normal share of the risk and does not earn administrative fee income, other than the carrier fee. Gross dental premiums declined in 2012 due to pricing action taken to stabilize the underwriting results of the block. We expect the dental business to grow in 2013 as a result of new distribution relationships, new product offerings and possible block acquisitions. We anticipate a reduction in our vision business in New York.

IHC sells short-term medical products in the majority of states. STM is designed specifically for people with temporary needs for health coverage. Typically, STM products are written for a defined duration of twelve months or less. Among the typical purchasers of STM products are self-employed professionals, recent college graduates, persons between jobs, employed individuals not currently eligible for group insurance, and others who need insurance for a specified period of time less than 365 days. IHC's gross premium declined in this line of business in 2012 due to the termination of several non-owned distributors, however, during this period underwriting profits increased significantly. We anticipate modest growth in this line of business in 2013 in part due to increased demand for coverage that lasts until the guarantee issue provisions of the ACA begin in 2014, and new direct-to-consumer relationships.

The Company began to market supplemental products to individuals and families in 2010. These lines of business are generally used as either a supplement to a major medical plan or in lieu of major medical coverage for persons that do not qualify for or choose not to purchase such coverage. The main driver for growth in this line is that consumers are moving to higher-cost sharing on their individual major medical plans, and are looking for products to help them offset the additional risk of higher deductibles and out of pocket limits.

The product lines included in this supplemental grouping are hospital indemnity plans (HIP), limited benefit plans, critical illness and bundled packages of accident medical coverage, critical illness and life insurance. These products, which are available in most states, are not directly impacted by the ACA and are available through multiple distribution sources including Company owned direct-to-consumer websites and captive agents, general agents and on-line agencies.

IHC has medical benefit plans for employers who choose to offer non-EHB coverage to their employees. We offer a limited medical policy that offers affordable health coverage to hourly, part-time and/or seasonal employees, which is approved in a majority of states. Limited medical plans are a low cost alternative to major medical insurance that permit employees who do not otherwise have health insurance to begin to participate in the healthcare system. In 2012, the Company recorded an increase in gross premiums and projects continued growth in 2013 as employers use these products to create a benefit package to attract and retain part-time employees.

In 2012, the Company began marketing self-funded medical plans for employers between 10 and 50 employees. These plans, which are currently marketed in a limited number of states, appeal to employers that wish to participate in cost savings and wellness initiatives that will lower their claims costs. We expect that sales of the small group self-funded plans will grow in 2013 as we increase distribution and make the product available in additional states.

In 2012, the Company recorded about \$3.3 million of earned pet insurance premiums. In 2013, it is expected that we will record about \$17.0 million of earned pet insurance premiums through a national managing general underwriter with which the Company has a long-term agreement, and which is partially owned by the Company.

IHC entered into a reinsurance relationship with a leading producer of ex-patriot business, effective January 1, 2012, which provides employee benefit insurance, including medical, life, and disability, to ex-patriot employees of companies based in the United States. IHC, through its insurance subsidiaries, reinsures 15% of the risk on a quota share basis, or approximately \$4.9 million of earned premium in 2012. In addition, IHC has begun to file these policies in the United States on its carriers' paper for employers that wish to purchase a domestic policy to cover their employees. IHC expects growth in both insurance and reinsurance premiums in this line of business in 2013.

Group Disability: Life, Annuities and DBL

Group Long-Term and Short-Term Disability

The Company sells group long-term disability ("LTD") products to employers that wish to provide this benefit to their employees. Depending on an employer's requirements, LTD policies (i) cover between 40% and 90% of insurable salary; (ii) have elimination periods (i.e., the period between the commencement of the disability and the start of benefit payments) of between 30 and 730 days; and (iii) terminate after two, five or ten years, or extend to age 65 or the employee's Social Security normal retirement date. Benefit payments are reduced by social security, workers compensation, pension benefits and other income replacement payments. Optional benefits are available to employees, including coverage for partial or residual disabilities, survivor benefits and cost of living adjustments. The Company also markets short-term disability ("STD") policies that provide a weekly benefit to disabled employees until the earlier of: recovery from disability, eligibility for long-term disability benefits or the end of the STD benefit period. The Company experienced a decrease in sales to school districts and municipalities in 2012 as compared to 2011. We expect a slight increase in premiums in 2013.

New York Short-Term Disability (DBL)

Standard Security Life markets DBL. All companies with more than one employee in New York State are required to provide DBL insurance for their employees. DBL coverage provides temporary cash payments to replace wages lost as a result of disability due to non-occupational injury or illness. The DBL policy provides for (i) payment of 50% of salary to a maximum of \$170 per week; (ii) a maximum of 26 weeks in a consecutive 52 week period; and (iii) benefit commencement on the eighth consecutive day of disability. Policies covering fewer than 50 employees have fixed rates approved by the New York State Insurance Department. Policies covering 50 or more employees are individually underwritten. Standard Security Life's DBL premiums increased in 2012 due to increased marketing and expansion of sales through a new sales representative. The Company anticipates significant premium growth in 2013 due to continued marketing efforts and a major competitor exiting the market.

Group Term Life and Annuities

Madison National Life and Standard Security Life sell group term life products, including group term life, accidental death and dismemberment ("AD&D"), supplemental life and supplemental AD&D and dependent life. As with its group disability business, IHC anticipates modest growth in this line of business through expansion of its sales of these group term life products through existing distribution sources.

Individual Life, Annuities and Other

This category includes: (i) insurance products that are in runoff as a result of the Insurance Group's decision to discontinue writing such products; (ii) blocks of business that were acquired from other insurance companies; (iii) individual life and annuities written through Madison National Life's military and civilian government employee division and through its final expense distribution agency; (iv) blanket accident insurance sold through a specialized general agent; and (v) certain miscellaneous insurance products.

The Company markets a whole life product commonly referred to as a final expense life policy. This whole life product is sold to people in the 50 to 85 years old range. The face amounts can range from \$2,500 to \$50,000. We are currently averaging about \$13,500 per policy.

The following lines of Standard Security Life's in-force business are in runoff: individual accident and health, individual life, single premium immediate annuities, disability income, accidental medical, accidental death and AD&D insurance for athletes, executives and entertainers, and miscellaneous

insurance business. Madison National Life's runoff in this category consists of existing blocks of individual life, including pre-need (i.e., funeral expense) coverage, traditional and interest-sensitive life blocks which were acquired in prior years, individual accident and health products, annual and single premium deferred annuity contracts and individual annuity contracts.

ACQUISITIONS OF POLICY BLOCKS

In addition to its core life and health lines of business distributed as described above, IHC's acquisition group has acquired blocks of existing life insurance, annuity and disability policies from other insurance companies, guaranty associations and liquidators. Most of the acquired blocks have been primarily life, annuities or disability policies. Not only have these transactions yielded a healthy rate of return on the investment, but the overall long-term nature of the policies acquired serves as a counterbalance to the bulk of the policies currently being written which are short-term in nature.

Other than the following two blocks, the Company did not acquire any significant policy blocks in the last five years.

During 2010, Madison National Life acquired a block of life insurance policies with approximately \$1.6 million of life reserves.

During 2008, Madison National Life acquired a block of life insurance policies with approximately \$64.4 million of life reserves. The block consists of approximately \$32.2 million of older, traditional life reserves and \$32.2 million of annuity reserves.

The Company does not anticipate acquiring any significant blocks in 2013.

REINSURANCE AND POLICY RETENTION LIMITS

The Company's average retention of gross and assumed Medical Stop-Loss exposure was 83% in 2012, up from 78% in 2011, and 75% in 2010.

In 2012, IHC retained approximately 63% of gross and assumed Fully Insured Health exposure, compared to approximately 68% in 2011. Retentions on other lines of business remained relatively constant in 2011. The Company purchases quota share reinsurance and excess reinsurance in amounts deemed appropriate by its risk committee. The Company monitors its retention amounts by product line, and has the ability to adjust its retention as appropriate.

Reinsurance is used to reduce the potentially adverse financial impact of large individual or group risks, and to reduce the strain on statutory income and surplus related to new business. By using reinsurance, the Insurance Group is able to write policies in amounts larger than it could otherwise accept. The amount reinsured is the portion of each policy in excess of the retention limit on a particular policy.

Maximum net retention limits for Standard Security Life are: (i) \$210,000 per life on individual life and corresponding disability waiver of premium; (ii) no retention on accidental death benefits provided by rider to individual life policies; (iii) up to \$1,250,000 on any one medical stop-loss claim; (iv) \$5,000 of monthly benefits on disability income policies; and (v) up to \$1,250,000 for fully insured medical in a calendar year. Standard Security Life also maintains catastrophe reinsurance in order to protect against particularly adverse mortality which might occur with respect to its overall life business. Maximum net monthly retention limits on any one life for Madison National Life are: (i) \$8,600 per month on group long-term disability insurance; (ii) \$1,500 per week on group short-term disability insurance; (iii) \$150,000 per individual on group term life, accidental death benefits, including supplemental life and accidental death and dismemberment; (iv) \$125,000 on substandard ordinary life, group family life and individual ordinary life; (v) up to \$1,250,000 on any one medical stop-loss claim; (vi) individual monthly benefits from 1,000 to \$2,500 depending on recipient age and length of benefit

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period for individual accident and health insurance; and (vii) up to \$1,250,000 for fully insured medical in a calendar year. Maximum net retention limits for Independence American are: (i) up to \$1,250,000 on any one medical stop-loss claim; and (ii) up to \$1,250,000 for fully insured medical in a calendar year.

Effective April 1, 2009, Madison National Life entered into a reinsurance treaty with an unaffiliated reinsurer to cede \$48.8 million of life reserves.

Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer effective January 26, 2012 and transferred approximately \$143 million of group annuity reserves in the first quarter of 2012.

The following reinsurers represent approximately 84% of the total ceded premium for the year ended December 31, 2012:

Munich Reinsurance America, Inc.	31%
RGA Reinsurance Company	20%
Fidelity Security Life Insurance Company	18%
National Insurance Company of Wisconsin, Inc.	5%
American Fidelity Assurance Company	5%
Gerber Life Insurance Company	5%
	84%

The Insurance Group remains liable with respect to the insurance in-force which has been reinsured in the unlikely event that the assuming reinsurers are unable to satisfy their obligations. The Insurance Group cedes business (i) to individual reinsurance companies that are rated "A-" or better by Best or (ii) upon provision of adequate security. The ceding of reinsurance does not discharge the primary liability of the original insurer to the insured. Since the risks under the Insurance Group's business are primarily short-term, there would be limited exposure as a result of a change in a reinsurer's creditworthiness during the term of the reinsurance. At December 31, 2012 and 2011, the Insurance Group's ceded reinsurance in-force was \$6.0 billion and \$6.2 billion, respectively.

For further information pertaining to reinsurance, reference is made to Note 20 of Notes to Consolidated Financial Statements included in Item 8.

INVESTMENTS AND RESERVES

The Company's cash, cash equivalents and securities portfolio are managed by employees of IHC and its affiliates, and ultimate investment authority rests with IHC's in-house investment group. As a result of the nature of IHC's insurance liabilities, IHC endeavors to maintain a significant percentage of its assets in investment grade securities, cash and cash equivalents. At December 31, 2012, approximately 98.1% of the fixed maturities were investment grade and continue to be rated on average AA. The internal investment group provides a summary of the investment portfolio and the performance thereof at the meetings of the Company's board of directors.

As required by insurance laws and regulations, the Insurance Group establishes reserves to meet obligations on policies in-force. These reserves are amounts which, with additions from premiums expected to be received and with interest on such reserves at certain assumed rates, are calculated to be sufficient to meet anticipated future policy obligations. Premiums and reserves are based upon certain assumptions with respect to mortality, morbidity on health insurance, lapses and interest rates effective at the time the policies are issued. The Insurance Group also establishes appropriate reserves for substandard business, annuities and additional policy benefits, such as waiver of premium and accidental death. Standard Security Life and Madison National Life are also required by law to have an annual asset adequacy analysis, which, in general, projects the amount and timing of cash flows to the estimated

maturity date of liabilities, prepared by the certifying actuary for each insurance company. Standard Security Life, Madison National Life and Independence American invest their respective assets, which support the reserves and other funds in accordance with applicable insurance law, under the supervision of their respective board of directors. The Company manages interest rate risk seeking to maintain a portfolio with a duration and average life that falls within the band of the duration and average life of the applicable liabilities. The Company occasionally utilizes options to modify the duration and average life of the assets.

Under Wisconsin insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. With respect to the portion of an insurer's assets equal to its liabilities plus a statutorily-determined security surplus amount, a Wisconsin insurer cannot, for example, invest more than a certain percentage of its assets in non-amortizable evidences of indebtedness, securities of any one person (other than a subsidiary and the United States government), or common stock of any corporation and its affiliates (other than a subsidiary).

Under New York insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. For example, a New York life insurer cannot invest more than a certain percentage of its admitted assets in common or preferred shares of any one institution, obligations secured by any one property (other than those issued, guaranteed or insured by the United States or any state government or agency thereof), or medium and lower grade obligations. In addition, there are certain qualitative investment restrictions.

Under Delaware insurance law, there are restrictions relating to the percentage of an insurer's admitted assets that may be invested in a specific issuer or in the aggregate in a particular type of investment. In addition, there are qualitative investment restrictions.

The Company's total pre-tax investment performance for each of the last three years is summarized below, including amounts recognized in net income and unrealized gains and losses recognized in other comprehensive income or loss:

	2012	2011 (In thousands)	2010
Consolidated Statements of Operations			
Net investment income	\$ 33,356	\$ 39,788	\$ 41,801
Net realized investment gains	5,099	8,670	4,646
Other-than-temporary impairments in earnings	(704)	(1,523)	(3,819)
Consolidated Statements of Comprehensive Income			
Net unrealized gains on available-for-sale securities	10,827	11,345	12,309

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Total pre-tax investment performance	\$	48,578	\$	58,280	\$	54,937
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The above net unrealized gains on available-for-sale securities recognized through other comprehensive income, represent the net change in unrealized gains and losses on available-for-sale securities arising during the year, including any other-than-temporary impairments recognized in other comprehensive income, prior to deferred income taxes and noncontrolling interests. The Company does not have any non-performing fixed maturity investments at December 31, 2012.

COMPETITION AND REGULATION

We compete with many large insurance companies, small regional health insurers and managed care organizations. Although most life insurance companies are stock companies, mutual companies also write life insurance in the United States. Mutual companies may have certain competitive advantages since profits inure directly to the benefit of the policyholders.

The health insurance industry tends to be cyclical, and excess products, such as medical stop-loss, tend to be more volatile than fully insured health products. During a soft market cycle, a larger number of companies offer insurance on a certain line of business, which causes premiums in that line to trend downward. In a hard market cycle, insurance companies limit their writings in certain lines of business following periods of excessive losses and insurance and reinsurance companies redeploy their capital to lines that they believe will achieve higher margins.

IHC is an insurance holding company; and as such, IHC and its subsidiary carriers and administrative companies are subject to regulation and supervision by multiple state insurance regulators, including the New York State Insurance Department (Standard Security Life's domestic regulator), the Wisconsin Department of Insurance (Madison National Life's domestic regulator) and the Office of the Insurance Commissioner of the State of Delaware (Independence American's domestic regulator). Each of Standard Security Life, Madison National Life and Independence American is subject to regulation and supervision in every state in which it is licensed to transact business. These supervisory agencies have broad administrative powers with respect to the granting and revocation of licenses to transact business, the licensing of agents, the approval of policy forms, the approval of commission rates, the form and content of mandatory financial statements, reserve requirements and the types and maximum amounts of investments which may be made. Such regulation is primarily designed for the benefit of policyholders rather than the stockholders of an insurance company or insurance holding company.

Certain transactions within the IHC holding company system are also subject to regulation and supervision by such regulatory agencies. All such transactions must be fair and equitable. Notice to or prior approval by the applicable insurance department is required with respect to transactions affecting the ownership or control of an insurer and of certain material transactions, including dividend declarations, between an insurer and any person in its holding company system. Under New York, Wisconsin and Delaware insurance laws, "control" is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person. Under New York law, control is presumed to exist if any person, directly or indirectly, owns, controls or holds, with the power to vote ten percent or more of the voting securities of any other person. In Wisconsin, control is presumed if any person, directly or indirectly, owns, controls or holds with the power to vote more than ten percent of the voting securities of another person. In Delaware, control is presumed if any person, directly or indirectly, owns, controls or holds with the power to vote ten percent or more of the voting securities of any other person. In all three states, the acquisition of control of a domestic insurer needs to be approved in advance by the Commissioner of Insurance. See Note 22 of Notes to Consolidated Financial Statements included in Item 8 for information as to restrictions on the ability of the Company's insurance subsidiaries to pay dividends.

Risk-based capital requirements are imposed on life and property and casualty insurance companies. The risk-based capital ratio is determined by dividing an insurance company's total adjusted capital, as defined, by its authorized control level risk-based capital. Companies that do not meet certain minimum standards require specified corrective action. The risk-based capital ratios for each of Standard Security Life, Madison National Life and Independence American exceed such minimum ratios.

DISCONTINUED OPERATIONS

Effective December 31, 2007, the Company sold its credit life and disability segment by entering into a 100% coinsurance agreement with an unaffiliated insurer. The Company recorded a loss from discontinued operations of \$0.3 million for the year ended December 31, 2010, net of taxes, representing expenses and changes in claims and reserves related to the insurance liabilities for claims incurred prior to the aforementioned sale. No income (loss) from discontinued operations was recorded during the years ended December 31, 2012 or 2011.

EMPLOYEES

At December 31, 2012, the Company, including its direct and indirect majority or wholly owned subsidiaries, collectively had approximately 580 employees.

ITEM 1A.

RISK FACTORS

Many of the factors that affect our business and operations involve risk and uncertainty. The risks and uncertainties described below are not the only ones that we face, but are those that we have identified as being the most significant factors. Additional risks and uncertainties that we do not know about, or that we deem less significant than those identified below, may also materially and adversely affect our business, financial condition or results of operations and the trading price of our common stock.

Risks related to our Business

Our investment portfolio is subject to various risks that may result in realized investment losses. In particular, decreases in the fair value of fixed maturities may greatly reduce the value of our investments, and as a result, our financial condition may suffer.

We are subject to credit risk in our investment portfolio. Defaults by third parties in the payment or performance of their obligations under these securities could reduce our investment income and realized investment gains or result in the continued recognition of investment losses. The value of our investments may be materially adversely affected by increases in interest rates, downgrades in the preferred stocks and bonds included in our portfolio and by other factors that may result in the continued recognition of other-than-temporary impairments. Each of these events may cause us to reduce the carrying value of our investment portfolio.

In particular, at December 31, 2012, fixed maturities represented \$719.6 million or 88.7% of our total investments of \$811.4 million. The fair value of fixed maturities and the related investment income fluctuates depending on general economic and market conditions. The fair value of these investments generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us will generally increase or decrease in line with changes in market interest rates. In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations. An investment has prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. The impact of value fluctuations affects our Consolidated Financial Statements. Because all of our fixed maturities are classified as available for sale, changes in the fair value of our securities are reflected in our stockholders' equity (accumulated other comprehensive income or loss). No similar adjustment is made for liabilities to reflect a change in interest rates. Therefore, interest rate fluctuations and economic conditions could adversely affect our stockholders' equity, total comprehensive income and/or cash flows. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Although, at December 31, 2012, approximately 98.1% of the fixed

maturities were investment grade and continue to be rated on average AA, all of our fixed maturities are subject to credit risk. If any of the issuers of our fixed maturities suffer financial setbacks, the ratings on the fixed maturities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issuer defaults, we could have realized losses associated with the impairment of the securities.

We regularly monitor our investment portfolio to ensure that investments that are other-than-temporarily impaired are identified in a timely fashion, properly valued and any impairment is charged against earnings in the proper period. Assessment factors include, but are not limited to, the length of time and the extent to which the market value has been less than cost, the financial condition and rating of the issuer, whether any collateral is held and the Company's intent to sell, or be required to sell, debt securities before the anticipated recovery of its remaining amortized cost basis. However, the determination that a security has incurred an other-than-temporary decline in value requires the judgment of management. Inherently, there are risks and uncertainties involved in making these judgments. Therefore, changes in facts and circumstances and critical assumptions could result in management's decision that further impairments have occurred. This could lead to additional losses on investments, particularly those that management has the intent and ability to hold until recovery in value occurs.

Our earnings could be materially affected by an impairment of goodwill.

Goodwill represented \$50.3 million of our \$1.3 billion in total assets as of December 31, 2012. We review our goodwill annually for impairment or more frequently if indicators of impairment exist. We regularly assess whether any indicators of impairment exist, which requires a significant amount of judgment. Such indicators may include: a sustained significant decline in our share price and market capitalization; a decline in our expected future cash flows; a significant adverse change in the business climate; and/or slower growth rates, among others. Any adverse change in one of these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements. If we experience a sustained decline in our results of operations and cash flows, or other indicators of impairment exist, we may incur a material non-cash charge to earnings relating to impairment of our goodwill, which could have a material adverse effect on our results.

If rating agencies downgrade our insurance companies, our results of operations and competitive position in the industry may suffer.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Standard Security Life, Madison National Life and Independence American are all rated "A-" (Excellent) by A.M. Best Company, Inc. Best's ratings reflect its opinions of an insurance company's financial strength, operating performance, strategic position, and ability to meet its obligations to policyholders and are not evaluations directed to investors. The ratings of our carriers are subject to periodic review by Best. If Best reduces the ratings of any of our carriers from current levels, our business would be adversely affected.

Our loss reserves are based on an estimate of our future liability, and if actual claims prove to be greater than our reserves, our results of operations and financial condition may be adversely affected.

We maintain loss reserves to cover our estimated liability for unpaid losses and loss adjustment expenses, where material, including legal and other fees, and costs not associated with specific claims but related to the claims payment functions for reported and unreported claims incurred as of the end of each accounting period. Because setting reserves is inherently uncertain, we cannot be sure that current reserves will prove adequate. If our reserves are insufficient to cover our actual losses and loss adjustment expenses, we would have to augment our reserves and incur a charge to our earnings, and these charges could be material. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what we expect the ultimate settlement and administration of claims will cost. These

estimates, which generally involve actuarial projections, are based on our assessment of known facts and circumstances. Many factors could affect these reserves, including economic and social conditions, frequency and severity of claims, medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, and changes in doctrines of legal liability and damage awards in litigation. Many of these items are not directly quantifiable in advance. Additionally, there may be a significant reporting lag between the occurrence of the insured event and the time it is reported to us. The inherent uncertainties of estimating reserves are greater for certain types of liabilities, particularly those in which the various considerations affecting the type of claim are subject to change and in which long periods of time may elapse before a definitive determination of liability is made. Reserve estimates are continually refined in a regular and ongoing process as experience develops and further claims are reported and settled and are reflected in the results of the periods in which such estimates are changed.

Our inability to assess underwriting risk accurately could reduce our net income.

Our success is dependent on our ability to assess accurately the risks associated with the businesses on which we retain risk. If we fail to assess accurately the risks we retain, we may fail to establish the appropriate premium rates and our reserves may be inadequate to cover our losses, requiring augmentation of the reserves, which in turn would reduce our net income.

Our agreements with our producers that underwrite on our behalf require that each such producer follow underwriting guidelines published by us and amended from time to time. Failure to follow these guidelines may result in termination or modification of the agreement. We perform periodic audits to confirm adherence to the guidelines, but it is possible that we would not detect a breach in the guidelines for some time after the infraction, which could result in a material impact on the Net Loss Ratio (defined as insurance benefits, claims and reserves divided by the difference between premiums earned and underwriting expenses) for that producer and could have an adverse impact on our operating results.

We may be unsuccessful in competing against larger or better-established business rivals.

We compete with a large number of other companies in our selected lines of business. We face competition from specialty insurance companies and HMOs, and from diversified financial services companies and insurance companies that are much larger than we are and that have far greater financial, marketing and other resources. Some of these competitors also have longer experience and more market recognition than we do in certain lines of business. In addition to competition in the operation of our business, we face competition from a variety of sources in attracting and retaining qualified employees. We cannot assure you that we will maintain our current competitive position in the markets in which we operate, or that we will be able to expand operations into new markets. If we fail to do so, our results of operations and cash flows could be materially adversely affected.

We rely on reinsurance arrangements to help manage our business risks, and failure to perform by the counterparties to our reinsurance arrangements may expose us to risks we had sought to mitigate.

We utilize reinsurance to mitigate our risks in various circumstances. Reinsurance does not relieve us of our direct liability to our policyholders, even when the reinsurer is liable to us. Accordingly, we bear credit risk with respect to our reinsurers. Our reinsurers may be unable or unwilling to pay the reinsurance recoverable owed to us now or in the future or on a timely basis. A reinsurer's insolvency, inability or unwillingness to make payments under the terms of its reinsurance agreement with us could have an adverse effect on our financial condition, results of operations and cash flows.

We may be required to accelerate the amortization of deferred acquisition costs, which would increase our expenses and reduce profitability.

Deferred acquisition costs, or DAC, represent certain costs which vary with and are primarily related to the sale and issuance of our insurance policies and investment contracts and are deferred and amortized over the estimated life of the related insurance policies and contracts. These costs include commissions in excess of ultimate renewal commissions and certain other sales incentives, solicitation and printing costs, sales material and other costs, such as underwriting and contract and policy issuance expenses. Under U.S. generally accepted accounting principles ("GAAP"), DAC is amortized through operations over the lives of the underlying contracts in relation to the anticipated recognition of premiums or gross profits.

Our amortization of DAC generally depends upon anticipated profits from investments, surrender and other policy and contract charges, mortality, morbidity and maintenance and expense margins. Unfavorable experience with regard to expected expenses, investment returns, mortality, morbidity, withdrawals or lapses may cause us to increase the amortization of DAC, resulting in higher expenses and lower profitability.

We regularly review our DAC asset balance to determine if it is recoverable from future income. The portion of the DAC balance deemed to be unrecoverable, if any, is charged to expense in the period in which we make this determination. For example, if we determine that we are unable to recover DAC from profits over the life of a book of business of insurance policies or annuity contracts, or if withdrawals or surrender charges associated with early withdrawals do not fully offset the unamortized acquisition costs related to those policies or annuities, we would be required to recognize the additional DAC amortization as a current-period expense. In general, we limit our deferral of acquisition costs to costs assumed in our pricing assumptions.

The failure to maintain effective and efficient information systems could adversely affect our business.

Our business depends significantly on effective information systems, and we have different information systems for our various businesses. We have committed and will continue to commit significant resources to develop, maintain and enhance our existing information systems and develop new information systems in order to keep pace with continuing changes in information processing technology, evolving industry and regulatory standards, and changing customer preferences. Our failure to maintain effective and efficient information systems could have a material adverse effect on our financial condition and results of operations.

Failure to protect our policyholders' confidential information and privacy could adversely affect our business.

In the conduct of our business, we are subject to privacy regulations and to confidentiality obligations. For example, the collection and use of patient data in our health insurance operations is the subject of national and state legislation, including the Health Insurance Portability and Accountability Act of 1996, or HIPAA, and certain other activities we conduct are subject to the privacy regulations of the Gramm-Leach-Bliley Act. We also have contractual obligations to protect certain confidential information we obtain from our existing vendors, partners and policyholders. These obligations generally include protecting such confidential information in the same manner and to the same extent as we protect our own confidential information. If we do not properly comply with privacy regulations and protect

confidential information, we could experience adverse consequences, including regulatory sanctions, such as penalties, fines and loss of license, as well as loss of reputation and possible litigation.

Risks Related to our Industry

Our industry is highly regulated and changes in regulations affecting our businesses may reduce our profitability and limit our growth.

Our insurance subsidiaries are subject to state insurance laws and regulated by the insurance departments of the various states in which they are domiciled and licensed, which, among other things, conduct periodic examination of insurance companies. State laws grant insurance regulatory authorities broad administrative powers with respect to various aspects of our insurance businesses, including:

licensing companies and agents to transact business and regulating their respective conduct in the market;
approving policy forms and premium rates;

requiring certain methods of accounting and prescribing the form and content of records of financial condition required to be filed;

calculating the value of assets to determine compliance with statutory requirements;

establishing statutory capital and reserve requirements, such as for unearned premiums and losses;