INDEPENDENCE HOLDING COMPANY

ANNUAL REPORT 2004

To Our Shareholders

As we celebrate Independence Holding Company's 25th year of business, we look back on 2004 as not only the year in which we were listed on the New York Stock Exchange (NYSE:IHC) and another record year of operations, but as the year in which we laid the foundation of a much larger and more diversified insurance company. As evidenced by the transactions completed in the 2005 first quarter, we have already begun to build on this foundation, and are quite optimistic that the future holds great promise for your Company.

What causes our optimism? First, we have already demonstrated our ability to deliver on our promise to diversify our operations and product lines, gain greater control over the distribution of our business, and generate cross-selling opportunities. Second, we produced record results in 2004 despite a generally "soft" employer medical stop-loss market. Finally, we continue to develop our relationship with our 42% owned affiliate, American Independence Corp. (NASDAQ: AMIC), which owns managing general underwriters (MGUs) that control the majority of our core line of business and one of our principal reinsurers. At December 31, 2004, AMIC had $280 million of net operating loss carry forwards (NOLs) for Federal income tax purposes, which arose from its former Internet-related operations.

In January 2005, Strategic Health Associates ("SHA"), of which we own 80%, acquired Health Plan Administrators ("HPA"). HPA is a leading administrator of short-term medical plans for people with temporary health needs, such as graduating college students, persons who are self-employed or who have started new jobs and whose benefits have not yet begun, divorcees, and people seeking an alternative to COBRA. Standard Security Life will become the issuing carrier for much of this business upon receiving policy approvals, which is expected to be substantially completed soon. HPA fulfills approximately 70% of policy applications directly through its interactive website, which receives an average of 20 million "clicks" per month. HPA has historically sold dental insurance and an Rx benefit through its website, and we believe that there is an opportunity to expand on these sales and provide other insurance benefits to those visiting its site. SHA has also invested in a telemarketing operation that will sell IHC's medical, dental, life, vision and other ancillary products to small employer groups in 14 states. Through Insurers Administrative Corp., our partner in SHA, Standard Security Life will begin writing $50 million of major medical insurance serving primarily small companies in 26 states. In order to benefit from this block immediately, we 100% co-insured the business as of January 1, 2005, with the expectation of assuming the policies later this year, subject to regulatory approvals. In addition, Madison Life has begun to write small group major medical in selected states. These products are part of the trend toward "consumer-driven" health plans. Such plans are becoming more popular among employers because they give members financial incentives to take a more active role in their health and health care, use doctors more prudently, and choose competitively-priced drugs and medical procedures. By 2008, it has been estimated that such plans will cover 10% to 15% of all privately insured Americans. What's next for SHA? We are actively looking at opportunities to enhance the distribution of our dental and vision products through acquisitions or strategic alliances, and we are in discussions to expand into other niche health businesses, including limited medical benefit plans. By the end of 2005, we expect that our Strategic Health segment will be generating $100 million of annualized premiums from our new lines of business, which tend to be less volatile than medical stop-loss business.

Employer medical stop-loss continues to be our largest product line (constituting approximately $280 million of annualized premiums), and we are one of the largest writers of this business in the United States. Despite a “softer” market for this product in 2004, this block remained profitable. We have taken steps to improve the overall performance of this block, which could slow its growth in 2005. However, we believe that we will be well-positioned if the market improves. While we consider a wide range of factors in our strategic planning and policy making, we consistently emphasize underwriting profit as our primary goal in all decisions as to whether or not to increase retention in a core line, expand into new products, or acquire an insurance operation or a block of business.

AMIC, which is managed by IHC through a service agreement, has become an increasingly important part of your Company. The MGUs owned by AMIC have a block of $143 million of annualized medical stop-loss premiums, the majority of which is written by Standard Security Life and Madison Life, and AMIC’s insurance company subsidiary, Independence American, is IHC’s largest reinsurer.

Financial Results

IHC continues to produce meaningful growth in the following key measures of financial performance:

- Net income for the year ended December 31, 2004 increased to $22.9 million ($1.60 per share, diluted) as compared to $18.6 million ($1.30 per share, diluted) for 2003. This represents a 13.6% return on beginning stockholders’ equity for 2004.
- Revenues for 2004 were $226 million as compared to $188 million in 2003, a 20% increase. Gross premiums increased to $409 million for 2004 from $368 million for 2003.
- Stockholders’ equity per share increased 10% to $13.39 per share at December 31, 2004 from $12.14 per share at December 31, 2003.
- Assets increased to $968 million at December 31, 2004 from $898 million at year-end 2003, and we expect that they will soon exceed $1 billion. Total investments increased to $722 million in 2004 from $593 million in 2003, and annual investment yield approximated 6.2% in 2004 compared to 6.5% in 2003. At December 31, 2004, approximately 96.6% of your Company’s investable assets were represented by investment grade fixed-income securities, cash and cash equivalents, resale agreements, and policy loans; less than 1% were held directly in non-investment grade bonds.

Insurance Operations

In 2004, we were successful in increasing our gross medical stop-loss premiums and our net retained premiums (through greater retention), while maintaining an underwriting profit. Medical stop-loss is a “short tail” business, so we can say with a high degree of confidence that our 2000 through 2002 treaty year results were very profitable. While we expect the 2003 and 2004 treaty years to still be quite profitable, they will be somewhat less so than the preceding years due to "softening" of the market. These favorable results benefit the bottom lines of our carriers, reinsurers, and (through profit sharing) our MGUs, and such results have permitted us to increase our retained premium. MGUs in which IHC and AMIC own significant equity interests are expected to produce approximately 65% of IHC's annualized medical stop-loss premiums in 2005. We audit each of our MGUs, and, together with our reinsurance partners, provide them with access to a broad array of underwriting, medical management, claims and actuarial expertise. We are very selective in appointing new MGUs, and any newly-appointed MGUs must submit all quotes to our underwriters for review prior to release. With respect to business written in 2005, both Standard Security Life and Madison Life have increased their average retention of medical stop-loss exposure.

The 2004 year was also a successful one for Madison Life's group life and disability, credit and government personnel lines and Standard Security Life's DBL, which increased premiums and produced profitable underwriting results. We are currently bidding on several blocks and, given the current pressures on the insurance industry, we expect that additional blocks should continue to become available for acquisition this year, and we are poised to bid on attractive opportunities.

As we look forward to our next 25 years, we believe your Company is very well positioned to continue producing the exceptional returns we have generated for our shareholders since we started rebuilding IHC in September 1991 after divesting certain non-strategic assets. At that point, our stock traded at a low of $.70 per share after adjustment for stock splits and stock dividends. On July 20, 2004, the day we rang the opening bell to celebrate listing on the New York Stock Exchange, our stock closed at $22.15, which is a 30% CAGR since that low. IHC has been consistently profitable, posting net income in 48 consecutive quarters. We have significantly outperformed our peers in the last five years, and we are now included in the Russell 2000 Index. Assuming dividend reinvestment, a $100 investment in IHC on December 31, 1999 would have been worth $324 as of December 31, 2004, which is a CAGR of approximately 26%. Given the continued profitability of our core businesses, strong capital position, and enhanced strategic affiliations that allow us to expand and control the distribution of our products, we are quite optimistic as to our prospects.

We could not have produced these results without our dedicated staff, management team, and Board of Directors, and without the continuing support of our shareholders.

Very truly yours,

Roy T.K. Thung
Chief Executive Officer and President

Dated: May 10, 2005
www.independenceholding.com

PRODUCT LINES

MEDICAL STOP-LOSS

- **Employer Medical Stop-Loss**
  Insurance products that allow self-insured employers to manage the risk of excessive health insurance exposures by limiting aggregate and specific losses to a predetermined amount.
- **Provider Excess Loss/ HMO Reinsurance**
  Insurance and reinsurance products that allow providers, HMO's and managed care organizations to reduce their risk assumption and/or are otherwise required to purchase coverage by contract or state regulation.

STRATEGIC HEALTH PRODUCTS

- **Employer-Sponsored Group Major Medical**
  Fully-insured major medical coverage designed to work with health reimbursement accounts ("HRA") and health savings accounts ("HSA").
- **Short-Term Medical**
  Fully-insured major medical coverage with a defined duration, which is normally twelve months or less.
- **Dental/Vision**
  Dental indemnity and PPO coverage for small and large employer and affinity groups. Vision benefits for a specified amount toward eye exams and the purchase of eye glasses and contact lenses.

GROUP DISABILITY, LIFE, ANNUITIES AND DBL

- **New York Short-Term DBL/Other Disability**
  New York State mandated temporary cash payments to replace wages loss as a result of disability due to non-occupational injury or illness; other miscellaneous disability products.
- **Group Long-Term and Short-Term Disability and Group Term Life**
  An employee benefit under a master employer policy that provides disability income and life insurance protection.

INDIVIDUAL LIFE, ANNUITIES AND OTHER

- **Volunteer Firefighters Group Annuity and Term Life**
  A length of service award program for volunteer firefighters that can be structured as either a defined benefit or contribution plan and group term life.
- **Military and Government Personnel Individual Life**
  Individual life insurance with annuity and accumulation fund riders structured to meet the needs of military and civilian government personnel.
- **Acquired Blocks/Other Business**
  Acquired blocks of policies, including individual life and annuities, pre-need and burial, disability income; insurance products in runoff status; miscellaneous business.

CREDIT LIFE AND DISABILITY

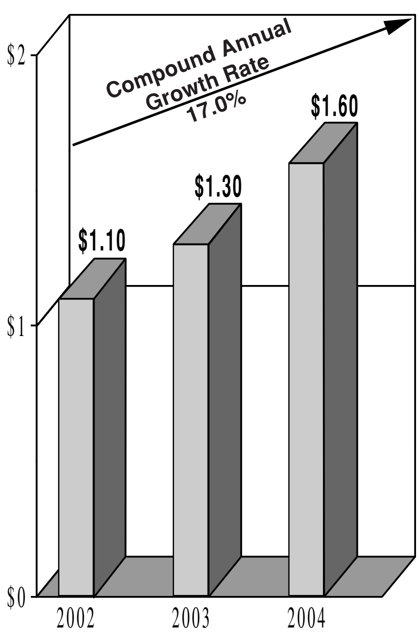
- Disability income and life insurance protection for the debtor offered by entities that extend or arrange for the extension of credit.

Financial Highlights

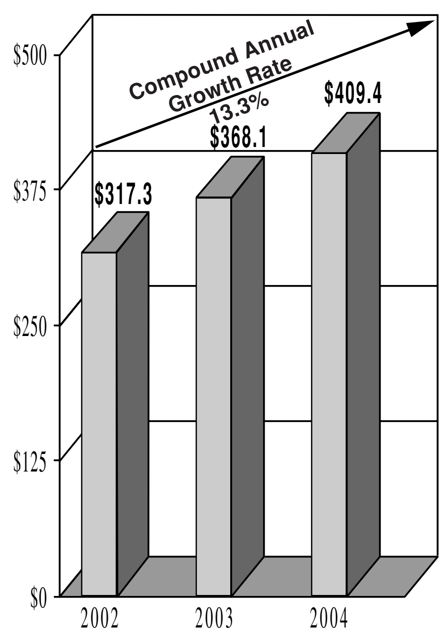
(dollars in thousands, except per share amounts)

	Year Ended December 31		
	2004	2003	2002
Income Statement Data:			
Total revenues	**$225,669**	$187,878	$174,353
Net investment income	**42,915**	35,796	35,733
Net income	**22,939**	18,593	15,813
Per Share:			
Diluted net income	**1.60**	1.30	1.10
Cash dividend	**0.05**	0.0278	0.0278
Book value	**13.39**	12.14	11.02
Return on beginning book value from diluted net income	**13.58%**	12.10%	11.50%
Balance Sheet Data:			
Total investments	**722,176**	593,403	533,581
Total assets	**968,493**	898,302	744,128
Debt and subordinated debt securities	**50,646**	35,182	8,438
Common stockholders' equity	**188,853**	168,896	153,718

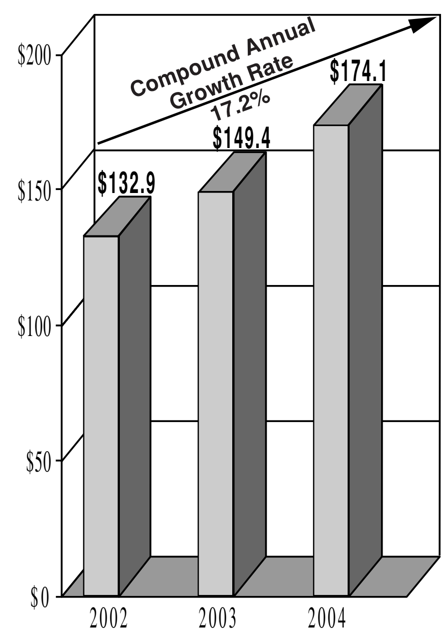
Diluted Net Income
(per share)



Gross Premiums
($ millions)



Net Premiums
($ millions)



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, 2004
COMMISSION FILE NUMBER 0-10306

INDEPENDENCE HOLDING COMPANY
(Exact name of Registrant as specified in its charter)

Delaware	**58-1407235**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
96 Cummings Point Road Stamford, Connecticut	**06902**
(Address of Principal Executive Offices)	**(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
(Title of Class)

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 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 an accelerated filer (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, 2004 was $97,780,000.

14,002,766 shares of common stock were outstanding as of March 15, 2005.

Documents Incorporated by Reference

Portions of the Proxy Statement for the 2005 Annual Meeting of Stockholders.

FORM 10-K CROSS REFERENCE INDEX

PART I

Item 1. *Business*

Independence Holding Company, a Delaware corporation (NYSE: IHC), is a holding company principally engaged in the life and health insurance business through (i) its wholly-owned subsidiaries, Standard Security Life Insurance Company of New York ("Standard Life"), Madison National Life Insurance Company, Inc. ("Madison Life") and their subsidiaries, (ii) its 80% owned subsidiary, Strategic Health Associates Inc. ("SHA") (collectively, the "Insurance Group"), and (iii) its affiliate, American Independence Corp. (NASDAQ:AMIC). IHC and its subsidiaries (including the Insurance Group) are collectively referred to as the "Company."

Standard Life, which has an A (Excellent) rating from A.M. Best Company, Inc. ("Best"), 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 Life, which is domiciled in Wisconsin and licensed to sell insurance products in 46 states, the District of Columbia and the Virgin Islands and is an accredited reinsurer in New York, has an A– (Excellent) rating from Best. The Company has 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 securities of IHC.

The Company owns 40% of the common stock of AMIC. By virtue of its acquisition of the stock of First Standard Holdings Corp. from the Company in November 2002, AMIC is engaged in the insurance and reinsurance business through its operating subsidiaries: Independence American Insurance Company ("Independence American") and its managing general underwriter ("MGU") subsidiaries: IndependenceCare Holdings LLC, Risk Assessment Strategies Inc. and Voorhees Risk Management LLC, d.b.a. Marlton Risk Management (the "AMIC MGUs"). The AMIC MGUs write medical stop-loss business for Standard Life and Madison Life, as well as other carriers. In addition, Independence American has entered into reinsurance treaties with Standard Life and Madison Life under which they also cede to Independence American at least 15% of the medical stop-loss business written by Standard Life and Madison Life. Such treaties terminate December 31, 2014, unless sooner terminated by Independence American. In 2004, Independence American received an average of 19.3% of the medical stop-loss premiums written by Standard Life and Madison Life and 20% of Standard Life's DBL business. In 2005, Standard Life and Madison Life expect to also cede premiums from short-term medical, employer-sponsored group major medical and dental to Independence American. Two representatives of IHC are directors of AMIC and AMIC's operations are substantially being directed by the management of IHC.

In addition to the AMIC MGUs, the Company also has significant ownership positions in three other medical stop-loss MGUs ("IHC MGUs"). One of the IHC MGUs, Majestic Underwriters LLC ("Majestic"), which was acquired July 13, 2004, is owned 52% by the Company, 23% by AMIC and 25% by management of Majestic. The Company owns 50% and 42%, respectively, of the other IHC MGUs. The Company also owns 80% of SHA, with the balance being owned by Insurers Administrative Corporation ("IAC"). IAC is a leading third party administrator of individually underwritten and group health plans, which is unaffiliated with the Company. On January 5, 2005, SHA purchased all of the stock of HPA Holdings Corp. (which is the holding company for Health Plan Administrators, Inc. and HPA Marketing Inc. (individually and collectively "HPA") for $12 million cash. HPA specializes in marketing and administering short-term and temporary medical insurance products. In March 2005, SHA invested $291,000 in consideration of a 30% interest in a newly-formed telemarketing firm, CA Insurance Services, LLC ("CA Services"), which will market major medical and other insurance products to small and medium size employers.

For information pertaining to the Company's business segments, reference is made to Note 19 of the Notes to Consolidated Financial Statements included in Item 8.

PRINCIPAL PRODUCTS

Medical Stop-Loss

The Company is a leading writer nationally of excess or stop-loss insurance for (i) self-insured employer groups that desire to manage the risk of large medical claims ("Employer Medical Stop-Loss"); (ii) providers, managed care organizations, including provider hospital organizations, hospital groups, physician groups and individual practice associations (collectively, "MCOs") that have assumed risk and desire to reduce their claim volatility ("Provider Excess Loss"); and (iii) health maintenance organizations ("HMOs") that desire to reduce their claim volatility ("HMO Reinsurance"). Employer Medical Stop-Loss, Provider Excess Loss and HMO Reinsurance are collectively referred to as "Medical Stop-Loss."

Standard Life was one of the first carriers to market Employer 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. Employer Medical Stop-Loss insurance allows self-insured employers to manage the risk of large medical claims after a deductible, while permitting them flexibility in designing employee health coverages at a cost that may be lower than that available through traditional indemnity plans. 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).

Standard Life is also a leading writer nationally of excess products for the managed health care market. Provider Excess Loss is marketed to MCOs that have assumed risk (through capitation by an HMO or otherwise) and desire to reduce their claims volatility and/or are required to purchase coverage by contract or regulation. HMO Reinsurance is excess coverage for HMOs that desire to reduce their claims volatility and/or are required to purchase coverage by regulation. Many state regulatory authorities responsible for HMO oversight require such coverage. This coverage allows HMOs to manage the risk of random high-cost medical events by limiting specific losses to a pre-determined amount.

The Company markets Employer Medical Stop-Loss, Provider Excess Loss and HMO Reinsurance primarily through MGUs who are non-salaried contractors that receive administrative fees. MGUs are responsible for underwriting accounts in accordance with guidelines formulated and approved by the Company, billing and collecting premiums, paying commissions to third party administrator ("TPAs") and/or brokers, adjudicating claims, and overseeing the medical management process. The Company is responsible for selecting MGUs, establishing underwriting guidelines, maintaining approved policy forms and overseeing medical management of large claims for reimbursement, as well as establishing appropriate accounting procedures and reserves. In order to accomplish this, the Company audits the MGUs' underwriting, claims and policy issuance practices to assure compliance with the Company's guidelines, provides the MGUs with access to its medical management and cost containment expertise, and reviews cases that require referral based on the Company's underwriting guidelines. During 2004, the Company marketed its Medical Stop-Loss products through 16 MGUs. The Company, together with its affiliates, owns significant equity interests in MGUs, including the AMIC MGUs and IHC MGUs, that produced approximately 73% of the Company's Medical Stop-Loss business in 2004. See "MGU Equity Investments".

As a result of higher retention and favorable projected underwriting results, the Company anticipates continued positive financial results from its Medical Stop-Loss business for the coming year. See "Outlook" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7.

Strategic Health Products

Employer-Sponsored Group Major Medical

The Company began selling high deductible employer-sponsored group major medical ("Major Medical") products to small and medium size employers in one state in the first quarter of 2005. This is fully insured major medical coverage designed to work with health reimbursement accounts ("HRA") and health savings accounts ("HSA") 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-payments.

Standard Life and Madison Life are preparing to market this product in 36 states, and anticipate initial sales in many of these states by mid-2005. As more fully described in "Transfer of Policy Blocks," Standard Life has entered into an agreement with an unaffiliated carrier to 100% co-insure as of January 1, 2005, and subsequently assume, a block of major medical policies which had approximately $50 million of collected premiums in 2004. This block is marketed and administered by IAC In addition, CA Services will market Madison Life's Major Medical, dental, vision and other insurance products. CA Services and IAC and non-salaried contractors that receive commissions.

IHC anticipates significant growth in this line of business in future years, although growth in 2005 may be dependent on how quickly the Company receives approvals of its policies.

Short-Term Medical

As a result of the acquisition of HPA, the Company will begin selling individual short-term major medical products ("Short-Term") by mid-2005. Short-Term is designed specifically for people with transient needs for health coverage. Typically, Short-Term products are written as major medical coverage with a defined duration, which is normally twelve months or less. Among the typical purchasers of Short-Term products would be self-employed professionals, recent college graduates, individuals between jobs, employed individuals not currently eligible for group insurance, and others who need insurance for a specified period of time. Standard Life and Madison Life anticipate distributing this product in 46 states through HPA, which was founded in 1939. HPA markets nationally through 39,000 insurance agents and brokers. HPA is a non-salaried contractor that receives fees and commissions. IAC will oversee the management of HPA on behalf of SHA.

IHC anticipates growth in this line of business in future years, although in 2005 this may be dependent on how quickly it receives approvals of its policies and completes the transition process for the acquisition of HPA. The Company also believes that it will be able to cross-sell other products through HPA's distribution channels.

Dental/Vision

Standard Life and Madison Life will begin selling dental and vision products along with their Major Medical products in 2005. In addition, the Company is evaluating other opportunities to market dental and/or vision through other distribution sources, including HPA and CA Services. The dental would provide indemnity and PPO coverage to both small and large employer and affinity groups. These plans would be available in a variety of deductibles and co-insurance percentages in three coverage categories: Diagnostic/Preventative, Simple Restorative and Prosthodontics. Vision benefits would pay a specified amount toward eye exams and the purchase of eye glasses and contact lenses.

IHC's growth in dental and vision in 2005 will depend on how quickly it develops and receives approvals for stand alone policies, and whether it is successful in acquiring a dental TPA, blocks of business, and/or distribution networks.

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.

Madison Life's disability products are primarily sold in the Midwest to school districts, municipalities and hospital employer groups through a managing general agent ("MGA") that specializes in these target markets. The Company also sells through independent general agents and agents. These general agents are paid commissions based upon the amount of premiums produced.

The Company intends to increase sales by targeting its existing relationships, and maximizing its traditionally strong sales to school districts, municipalities and hospital employer groups.

New York Short-Term Disability

Standard Life markets a short-term statutory disability benefit product in New York State ("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. The DBL business is marketed primarily through independent general agents who are paid commissions based upon the amount of premiums produced. Standard Life anticipates expanding its DBL business through the addition of general agents, strategic marketing alliances and the acquisition of blocks of business. Effective July 1, 2004, Standard Life began reinsuring 20% of DBL to AMIC.

Group Term Life and Annuities

Madison Life sells group term life products which are marketed primarily to the same customers that purchase its group LTD and STD products. These products include group term life, accidental death and dismemberment ("AD&D"), supplemental life and supplemental AD&D and dependent life. Madison Life's group term life products are distributed by the same MGA and independent general agents and agents that distribute its group disability products, with compensation based upon the amount of premiums produced. As with its group disability business, the Company intends to expand its sales of these group term life products through these distribution sources.

Standard Life distributes group term life insurance products through MGUs (including its Medical Stop-Loss MGUs), HMOs, general agents and brokers. The independent general agents and agents or brokers who market these products are paid commissions, and the MGUs and HMOs that market these products receive administrative fees. Standard Life markets in 45 states specialized defined benefit and defined contribution service award programs, together with separate group life coverage, to Volunteer Emergency Services personnel. These products are distributed through independent general agents who are paid commissions.

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 Life's military and civilian government employee division; (iv) blanket accident insurance sold through a specialized general agent; and (v) certain miscellaneous insurance products.

The following lines of Standard 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 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 from 1998 to 2003, individual accident and health products, annual and single premium deferred annuity contracts and individual annuity contracts.

In 2000, Madison Life began marketing an individual life product (with annuity and accumulation fund riders) to military and civilian government employees, primarily through payroll deduction, as a result of Madison Life's acquisition in 1999 of a block of this business with $78.0 million in reserves. This business, which is distributed through independent general agents and brokers who receive commissions, generated premiums of $5.1 million and $3.6 million in 2004 and 2003, respectively, which represented a 42% increase year over year.

Credit Life and Disability

Madison Life sells credit life and disability products that insure a debtor for a value and duration not to exceed the amount and repayment term of the indebtedness. Credit insurance is composed of two basic types of coverage: (i) credit life insurance provides for a lump sum benefit paid to the creditor upon the death of the insured debtor to extinguish or reduce the balance of indebtedness; and (ii) credit disability insurance provides a monthly benefit/indemnity (usually a sum equal to the scheduled monthly loan payment) paid to the creditor in the event of the insured debtor's total disability until the debtor recovers or is able to return to gainful employment or until the scheduled expiration of the insurance coverage, whichever first occurs. Generally, Madison Life's credit insurance coverage parameters are: (i) at inception of coverage, insureds must be under age 70 for life and under age 66 for disability; (ii) life coverage until the insured attains the age of 71 and disability coverage until the insured attains the age of 66; (iii) maximum life benefit of $110,000 and maximum aggregate disability benefit of $84,000; (iv) maximum monthly disability indemnity/benefit of $1,200; and (v) maximum term of coverage of 120 months. Over 70% of Madison Life's credit insurance net written premium is derived from financial institutions (banks, thrifts, credit unions and finance companies). Madison Life also markets through entities that arrange for the extension of credit (e.g., automobile, marine and motorcycle dealerships). Its credit insurance products are marketed and distributed by non-salaried general agents and brokers who receive commissions or service fees. Madison Life anticipates nominal expansion in its credit line in 2005.

The following table sets forth gross direct and assumed earned premiums and premiums earned of the Insurance Group by principal product for the years indicated (in thousands):

GROSS DIRECT AND ASSUMED EARNED PREMIUMS

	2004	2003	2002
Medical stop-loss	$291,204	$257,128	$204,575
Group disability; life, annuities and DBL	69,424	64,256	64,323
Individual life, annuities and other	28,451	26,630	32,595
Credit life and disability	20,321	20,126	15,829
	$409,400	$368,140	$317,322

PREMIUMS EARNED

	2004	2003	2002
Medical stop-loss	$ 96,512	$ 76,122	$ 59,380
Group disability; life, annuities and DBL	37,041	36,173	37,523
Individual life, annuities and other	21,079	17,957	21,885
Credit life and disability	19,435	19,155	14,102
	$174,067	$149,407	$132,890

The following table summarizes the aggregate life insurance in-force of the Insurance Group (in thousands):

	2004	2003	2002
Life Insurance in-force:			
Group	$6,055,260	$5,489,162	$5,402,402
Individual term	277,087	279,411	274,273
Individual permanent	1,250,440	1,170,459	1,102,668
Credit	941,566	860,221	762,202
Total Life Insurance in-force(1),(2)	$8,524,353	$7,799,253	$7,541,545
New Life Insurance:			
Group	$ 752,043	$ 845,064	$ 658,106
Individual term	21	318	961
Individual permanent	220,342	149,253	140,483
Credit	299,774	395,250	321,607
Total New Life Insurance	$1,272,180	$1,389,885	$1,121,157
Notes:			
(1) Includes participating insurance	$ 135,523	$ 134,018	$ 134,191
(2) Before ceded reinsurance of:			
Group	$3,027,135	$3,004,856	$2,941,806
Individual	200,593	147,871	167,075
Credit	27,967	19,230	33,162
Total ceded reinsurance	$3,255,695	$3,171,957	$3,142,043

STRATEGIC DISTRIBUTION RELATIONSHIPS

MGUs are the principal distribution source for the Company's Medical Stop-Loss line of business. MGUs receive fee income, generally 8% to 12% of gross premium produced by them on behalf of the insurance carriers they represent, and typically are entitled to additional income based on underwriting results. In order to assure itself of a captive distribution network and to further participate in fee income as well as underwriting profit, the Company has made equity investments in Medical Stop-Loss MGUs through which it writes business. The Company and its affiliates currently have significant equity investments in nine MGUs, including the AMIC MGUs and IHC MGUs. The Company anticipates that these MGUs will continue to contribute a high percentage of the Insurance Group's premiums in this line of business in 2005.

HPA is currently the sole administrator for the Company's Short-Term products. IAC receives a management fee for providing senior management to HPA and certain IAC employees provide services to HPA pursuant to an Administrative Outsourcing Arrangement. Standard Life and Madison Life market their Major Medical products exclusively either through IAC and CA Services.

TRANSFER OF POLICY BLOCKS

Effective as of January 1, 2005, Standard Life entered into a Reinsurance and Assumption Agreement with an unaffiliated insurer pursuant to which Standard Security agreed to assume approximately $50 million of employer-sponsored group major medical premium, subject to receiving regulatory approvals. Prior to receiving such approvals, such insurer will cede, on a 100% quota share basis, this premium to Standard Life. New business will continue to be written on such other company's paper, and reinsured 100% by Standard Life, until such time as Standard Life has approved policies in the applicable states.

In June 2004, the Company acquired a block of individual annuity and supplementary contracts and life policies through an assumption reinsurance transaction. The block had reserves of $26.6 million. Madison Life assumed responsibility for administration of the block on September 1, 2004.

In December 2003, the Company acquired three blocks of annuity and life policies with reserves in excess of $92 million. Madison Life acquired two of these blocks of business from active companies. One block consisted of individual annuity contracts with reserves of $56.5 million. The other block primarily consisted of individual annuity contracts plus some supplementary contracts with a total reserve transfer of $15.1 million. Standard Life acquired the third block, which primarily consisted of individual life insurance and some annuities. The reserves transferred to Standard Life in this acquisition were $21 million. The business is being administered through Madison Life's systems and is partially reinsured to Madison Life.

Madison Life acquired two blocks of business with effective dates in 2000. One was a small credit insurance block purchased from a company that was voluntarily liquidating. The other was a block of universal life polices with reserves of $14.7 million purchased from a company that was exiting this line of business.

REINSURANCE AND POLICY RETENTION LIMITS

The Company increased its average retention of the first $1 million of Medical Stop-Loss exposure to approximately 34% in 2004 from 30% in 2003. In 2004, Standard Life and Madison Life also ceded, on average, 19.3% of their Medical Stop-Loss business to their affiliate, Independence American. Standard Life retained 80% of DBL premium with the balance ceded, as of July 1, 2004, to Independence American. Retentions on other lines of business remained relatively constant in 2004. The Company has sufficient capital to retain even greater risk, but it 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 Life at December 31, 2004 were: (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) $500,000 on any one medical stop-loss claim; (iv) $2,500 of monthly benefits on disability income policies; and (v) $25,000 on its special disability business. For certain treaty years, Standard Life also maintains stop-loss and catastrophe reinsurance in order to protect against particularly adverse mortality which might occur with respect to its overall life business.

At December 31, 2004, maximum net monthly retention limits on any one life for Madison Life were: (i) $5,000 per month on group long-term disability insurance; (ii) $1,400 per week on group short-term disability insurance; (iii) $87,500 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 credit life, group family life and individual ordinary life; (v) $500,000 on any one medical stop-loss claim; (vi) $1,200 per month on credit disability insurance; and (vii) $1,000 monthly benefit on individual accident and health insurance.

The following reinsurers represent 79.4% of the total ceded premium for the year ended December 31, 2004:

Everest Reinsurance Co.	26.2%
Independence American Insurance Co.	20.1%
American Re-Insurance Co.	12.1%
ReliaStar Life Insurance Company	12.1%
General Reinsurance Corp.	8.9%
	79.4%

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 its affiliate, Independence American, (ii) to individual reinsurance companies that are rated "A" or better by Best or (iii) 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, 2004 and 2003, the Insurance Group's ceded reinsurance in-force was $3.3 billion and $3.2 billion, respectively.

For further information pertaining to reinsurance, reference is made to Note 18 of Notes to Consolidated Financial Statements.

INVESTMENTS AND RESERVES

More than 98.4% of the Company's securities portfolio is 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, 2004, approximately 99.1% of the fixed maturities were investment grade. The internal investment group provides a summary of the investment portfolio and the performance thereof at the meetings of the 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 polices 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 Life and Madison 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 Life and Madison Life invest their respective assets, which support the reserves and other funds in accordance with applicable insurance law, under the supervision of their respective Boards 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 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 amount 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.

The following table reflects the asset value in dollars (in thousands) and as a percentage of total investments of the Company as of December 31, 2004:

INVESTMENTS BY TYPE

	Carrying Value	% of Total Investments
Fixed maturities:		
United States Government and authorities	$ 88,658	12.3%
Government-sponsored enterprise mortgage backed securities	72,938	10.1%
States, municipalities and political subdivisions	17,704	2.5%
All other corporate securities	367,084	50.8%
Total fixed maturities	546,384	75.7%
Equity securities:		
Industrial, miscellaneous and all other common stocks	4,435	.6%
Non-redeemable preferred stocks	7,664	1.1%
Total equity securities	12,099	1.7%
Short-term investments	21,470	2.9%
Securities purchased under agreements to resell	93,544	13.0%
Investment partnership interests	24,118	3.3%
Operating partnership interests	6,220	.8%
Policy loans	16,756	2.3%
Investment in trust subsidiaries	1,146	.2%
Other	439	.1%
Total investments	$722,176	100.0%

At December 31, 2004, 99.1% of the Company's fixed maturities were investment grade. The composition of the Company's fixed maturities at December 31, 2004, utilizing Standard and Poor's rating categories, was as follows:

Grade	% Invested
AAA	52.4%
AA	2.6%
A	14.0%
BBB	30.1%
BB or lower	0.9%
	100.0%

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 stockholders' equity as accumulated other comprehensive income or loss:

	2004	2003	2002
		(In thousands)	
Consolidated Statements of Operations			
Net investment income	$42,915	$35,796	$35,733
Net realized and unrealized gains (losses)	2,394	313	(7,558)
Consolidated Balance Sheets			
Net unrealized (losses) gains	(4,713)	(2,366)	3,610
Total pre-tax investment performance	$40,596	$33,743	$31,785

The net unrealized (losses) gains recognized in the Consolidated Balance Sheets represent the net change occurring during the year, prior to adjustments for deferred acquisition costs and deferred income taxes.

COMPETITION AND REGULATION

The Company competes with many larger insurance companies, HMOs and other 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. HMOs may also have certain competitive advantages since they are subject to different regulations than insurance companies.

IHC is an insurance holding company; as such, IHC and the Insurance Group are subject to regulation and supervision by the insurance supervisory agencies of New York in the case of Standard Life and Wisconsin in the case of Madison Life. Each of Standard Life and Madison Life is also subject to regulation and supervision in all jurisdictions 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 holding company.

Certain transactions within the holding company system are also subject to regulation and supervision by such regulatory agencies. Terms of all such transactions must be fair and reasonable. Notice to or prior approval by the home state insurance department is required with respect to transactions affecting the ownership or control of a domestic insurer and of certain material transactions, including extraordinary dividend declarations, between an insurer and any person in its holding company system. Under New York and Wisconsin 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, the presumption is defined as to more than ten percent of the voting securities of another person. In both states, the acquisition of control of a domestic insurer needs to be approved in advance by the Commissioner of Insurance. See Note 20 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 Life and Madison Life exceed such minimum ratios.

EMPLOYEES

The Company has 264 employees.

Item 2. *Properties*

IHC

IHC has entered into a renewable short-term arrangement with Geneve Corporation for the use of 6,750 square feet of office space as its corporate headquarters in Stamford, Connecticut.

Standard Life

Standard Life leases 13,000 square feet of office space in New York, New York as its corporate headquarters, 3,000 square feet of office space in Farmington, New York for its DBL claims processing center and 800 square feet of office space in Heathrow, Florida for a marketing office.

Madison Life

Madison Life leases 17,500 square feet of office space in Middleton, Wisconsin as its corporate headquarters, 3,900 square feet in Birmingham, Alabama for its military and government individual life and annuity division, 1,300 square feet in Austin, Texas for executive office space, and 2,400 square feet in Wilkesboro, North Carolina for its credit agency.

Majestic Underwriters LLC

Majestic leases 7,050 square feet of office space in Troy, Michigan as its corporate headquarters and 984 square feet in Hinsdale, Illinois.

Strategic Health Associates

SHA leases 8,002 square feet of office space in Rockford, Illinois as its corporate headquarters, 4,083 square feet in Tampa, Florida and 210 square feet in Pewaukee, Wisconsin.

Item 3. *Legal Proceedings*

The Company knows of no material pending legal proceedings to which it is a party or of which any of its property is the subject.

Item 4. *Submission of Matters to a Vote of Security Holders*

None.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Stockholder Matters***

On July 15, 2004, the Company moved the listing of IHC common stock to the New York Stock Exchange. The Company's common stock now trades under the symbol IHC. Prior to that the common stock traded on the NASDAQ National Market tier at the NASDAQ Stock Market under the symbol INHO. The following tabulation shows the high and low sales prices for IHC's common stock.

	High	Low
Quarter Ended:		
December 31, 2004	$19.05	$17.95
September 30, 2004	22.75	16.71
June 30, 2004	21.25	16.18
March 31, 2004	18.88	13.33
Quarter Ended:		
December 31, 2003	$13.83	$11.67
September 30, 2003	14.40	11.29
June 30, 2003	12.51	10.51
March 31, 2003	12.15	9.49

IHC's stock price closed at $18.45 on December 31, 2004.

At February 28, 2005, the number of record holders of IHC's common stock was 1,119.

IHC declared a special 80% stock dividend on June 8, 2004, which was distributed on July 2, 2004. The transaction was accounted for as a stock split effected in the form of a dividend. All share and per share disclosures in this Form 10-K have been retroactively restated to reflect such dividend.

IHC declared a cash dividend of $.025 per share on its common stock on each of June 9, 2004 and November 23, 2004 for a total annual dividend of $.05 per share.

IHC declared a cash dividend of $.0278 per share on its common stock on November 18, 2003.

The Company's website is www.independenceholding.com.

Item 6. ***Selected Financial Data***

The following is a summary of selected consolidated financial data of the Company for each of the last five years.

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(In thousands, except per share data)				
Income Data:					
Total revenues	$225,669	$187,878	$174,353	$151,590	$127,037
Net income applicable to common shares	22,939	18,593	15,813	14,383	11,352
Balance Sheet Data:					
Total investments	722,176	593,403	533,581	537,090	490,507
Total assets	968,493	898,302	744,128	725,796	714,628
Insurance liabilities	681,329	646,969	528,839	513,224	526,192
Debt and junior subordinated debt securities	50,646	35,182	8,438	12,188	15,000
Common stockholders' equity	188,853	168,896	153,718	137,548	126,533
Per Share Data:					
Cash dividends declared per common share	.05	.0278	.0278	.0278	.0278
Basic income per common share	1.63	1.33	1.13	1.02	.80
Diluted income per common share	1.60	1.30	1.10	1.00	.79
Book value per common share	13.39	12.14	11.02	9.81	8.92

The Selected Financial Data should be read in conjunction with the accompanying Consolidated Financial Statements and Notes thereto.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

OVERVIEW

The Company is a holding company principally engaged in health insurance throughout the United States, and is a leader in the medical stop-loss industry nationally. The Company operates through its two insurance carriers (Standard Life and Madison Life), Strategic Health Associates Inc ("SHA") and its 40% ownership interest in American Independence Corp. ("AMIC"), which owns medical stop-loss managing general underwriters (MGUs). Through its ownership of AMIC and other MGUs, IHC controls approximately 73% of the production sources for this core product, while maintaining profitability through disciplined underwriting. Through its ownership of Health Plan Administrators Inc. ("HPA"), IHC controls the distribution of its short-term medical products. Through its ownership interest in CA Insurance Services ("CA Services") and its contractual relationship with Insurers Administrative Corporation ("IAC"), the Company controls the distribution of its group major medical products. IHC also writes group disability/DBL, group life and annuities, individual life and annuities, and credit life and disability. These lines of business are targeted to niche markets. The majority of group life and disability business is focused in the upper Midwest school and public entity markets. The DBL business is written in New York State and administered through Standard Life's web-based back office. Individual life and annuities are written under a nation-wide program for volunteer emergency service personnel. The credit life and disability business is marketed through a select group of producers.

While management considers a wide range of factors in its strategic planning and decision-making, underwriting profit is consistently emphasized as the primary goal in all decisions as to whether or not to increase our retention in a core line, expand into new products, acquire an entity or a block of business, or otherwise change our business model. Management's assessment of trends in healthcare and morbidity, with respect to medical stop-loss, major medical, short-term medical, dental, 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. In addition, the Company's acquisition group assesses opportunities to acquire blocks of business based on the amount of reserves transferred and current interest rates. Finally, management focuses on managing the costs of our operations, which contributes to the Company's consistent profitability.

The following is a summary of key events:

- Net income of $22.9 million ($1.60 per share, diluted); 23.4% increase from 2003;
- Revenues of $225.7 million; 20.1% increase from 2003;
- Assets of $968.5 million; 7.8% increase from 2003;
- Book value of $13.39 per share; 10.3% increase from 2003;
- On July 15, 2004, moved the listing of IHC common stock to the New York Stock Exchange. The Company's stock now trades under the symbol "IHC";
- Increased the cash dividend 80% and began paying this dividend semi-annually;
- Declared an 80% stock dividend resulting in shareholders as of the record date June 18, 2004, receiving eight additional shares for every 10 shares owned;
- Effective July 1, 2004, together with AMIC, acquired a 75% interest in a medical stop-loss MGU with approximately $41 million of annualized premium;
- As of January 1, 2005, reinsured, on a 100% quota share basis, a block of $50 million of major medical policies administered by IAC which will be assumed upon receiving regulatory approval;
- On January 5, 2005, acquired HPA, a TPA that specializes in short-term and temporary medical insurance products which had a block of $23 million in 2004;
- On March 1, 2005, SHA acquired a 30% interest in CA Services, which will telemarket major medical and other products for Madison Life;

- IHC will begin writing group major medical in 36 states and short-term medical in 46 states in 2005;
- Increased retention of medical stop-loss premium at Standard Life and Madison Life to an average of 34% in 2004 from 30% in 2003 and 28% in 2002;
- Generated consolidated investment yield of 6.2% in 2004, as compared to 6.5% in 2003;
- Investment portfolio continues to have an average AA rating and remains highly liquid; and
- 96.6% of the Insurance Group's invested assets in investment grade fixed-income securities, cash and cash equivalents, resale agreements and policy loans; only .9% held directly in non-investment grade bonds and a negligible amount in mortgage loans.

Prior to November 2002, the Insurance Group included equity interests in two managing general underwriters: IndependenceCare Holdings LLC ("IndependenceCare") and Risk Assessment Strategies, Inc. ("RAS") and a Delaware property and casualty insurer, Independence American Insurance Company ("Independence American", formerly known as First Standard Security Insurance Company). On June 30, 2002, the Company acquired the remaining shares of common stock and preferred stock held by minority shareholders to increase its ownership of RAS to 100%. On November 14, 2002, the Company sold the stock of First Standard Holdings Corp., which owned 100% of the stock of IndependenceCare, RAS and Independence American, to AMIC for $31.9 million in cash. At such time, IHC owned 19.9% of the stock of AMIC. The sale of FSHC resulted in a $4.6 million gain, net of tax ($8.1 million pre-tax) to the Company. On April 22, 2003, IHC completed a cash tender offer and acquired an additional one million shares of AMIC. Following the tender offer, IHC owned 31.7% of the stock of AMIC. On December 22, 2003, IHC purchased an additional 613,401 shares (or 7.3% of the outstanding shares in AMIC) in open market and private transactions, and on June 15, 2004, IHC purchased an additional 94,488 shares which brought IHC's percentage of ownership in AMIC to 40%. Two representatives of IHC are directors of AMIC and AMIC's operations are substantially being directed by the management of IHC.

Information pertaining to the Company's business segments is provided in Note 19 of Notes to Consolidated Financial Statements included in Item 8.

CRITICAL ACCOUNTING POLICIES

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP") and to general practices within the insurance industry. The preparation of the financial statements in conformity with GAAP requires 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 is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8. Management has identified the accounting policies described below 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 management's discussion and analysis.

Insurance Reserves

The Company maintains loss reserves to cover its estimated liability for unpaid losses and loss adjustment expenses, including legal and other fees as well as a portion of the Company's general expenses, for reported and unreported claims incurred as of the end of each accounting period.

The Company computes insurance reserves primarily using the net premium method based on anticipated investment yield, mortality (morbidity on health insurance) and withdrawals. Liabilities for insurance reserves on certain short-term medical coverages were computed using completion factors and expected loss ratios derived from actual historical premium and claim data. These methods are widely used in the life and health insurance industry to estimate the liabilities for insurance reserves. Inherent in these calculations are management and actuarial judgments and estimates which could significantly impact the ending reserve liabilities and, consequently, operating results. Actual results may differ, and these estimates are subject to interpretation and change. Management believes that the

Company's method of estimating the liabilities for insurance reserves provided appropriate levels of reserves at December 31, 2004 and 2003. Changes in the Company's reserves estimates are recorded through a charge or credit to its earnings.

Premium Revenue Recognition

Premiums from short-duration contracts are recognized as revenue over the period of the contracts in proportion to the amount of insurance protection provided. Premiums from long duration contracts are recognized as revenue when due from policyholders.

Investments

The Company accounts for its investments in debt and equity securities under Statement of Financial Accounting Standards No. 115 ("SFAS 115"), *Accounting for Certain Investments in Debt and Equity Securities*. The Company has classified all of its investments as available-for-sale or trading securities. These investments are carried at fair value based on quoted market prices with unrealized gains and losses reported in either accumulated other comprehensive income (loss) in the accompanying Consolidated Balance Sheets for available-for-sale securities or as unrealized gains or losses in the accompanying Consolidated Statements of Operations for trading securities. Net realized gains and losses on investments are computed using the specific identification method and are reported in the accompanying Consolidated Statements of Operations. Declines in value judged to be other-than-temporary are determined based on the specific identification method and are reported in the accompanying Consolidated Statements of Operations as net realized losses. The factors considered by management in determining when a decline is other than temporary include but are not limited to: the length of time and extent to which the fair value has been less than cost; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; whether the issuer of a debt security has remained current on principal and interest payments; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions; and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. For securities within the scope of Emerging Issues Task Force Issue 99-20, such as purchased interest-only securities, an impairment loss is recognized when there has been a decrease in expected cash flows combined with a decline in the security's fair value below cost.

2004 COMPARED TO 2003

Net income was $22.9 million, or $1.60 per share, diluted, for the year ended December 31, 2004 compared to $18.6 million, or $1.30 per share, diluted, for the year ended December 31, 2003. The Company's income before taxes increased $4.9 million to $33.6 million for the year ended December 31, 2004 from $28.7 million for 2003. The Company had net realized and unrealized gains of $2.4 million in the year ended 2004 compared to $.3 million in 2003. Income tax expense increased $.6 million to $10.7 million in the year ended December 31, 2004 from $10.1 million in 2003, primarily reflecting the increase in income before taxes, partially offset by a 2004 tax benefit related to the policyholders' surplus account. Under provisions of the Life Insurance Company Tax Act of 1959, life insurance companies were allowed certain special deductions for Federal income tax purposes that were accumulated in a memorandum tax account designated as "policyholders' surplus." Distributions of the untaxed amounts in this account would result in the Company incurring an additional tax. The Company provided tax expense of $1.1 million in 1992 and prior years for taxes related to the policyholders' surplus account. As a result of the October 2004 enactment of the American Jobs Creation Act of 2004, the Company reduced 2004 income tax expense by $1.1 million for the reversal of the prior years' income tax provisions. The Company intends to implement the distribution requirements of this tax law which will eliminate any future policyholders' surplus account tax.

Insurance Group

The Insurance Group's pre-tax income increased $5.2 million to $36.0 million in 2004 from $30.8 million in 2003. These results include net realized and unrealized gains of $2.2 million in 2004 compared to $.2 million in 2003.

Premium revenues grew $24.7 million to $174.1 million in 2004 from $149.4 million in 2003; premium revenues increased $7.1 million at Madison Life and $17.6 million at Standard Life. The change at Madison Life is comprised of increases of: $4.2 million in the medical stop-loss line of business due to higher volume; $1.0 million from the ordinary life lines; $.8 million from the LTD line; $.6 million from the Group A&H lines from business assumed in 2004; $.3 million from the credit lines due to increased writings; and $.2 million from the GTL line. The change at Standard Life is comprised of the following increases: $16.9 million in medical stop-loss premiums due to higher volume in 2004; $1.0 million in the VFD line due to increased production; $.9 million in the ordinary life line; and $.5 million from blanket due to increased retention; partially offset by decreases of $.9 million in provider excess due to the termination of a reinsurance contract; and $.8 million from DBL due to the 20% coinsurance agreement with Independence American.

Total net investment income of the Insurance Group increased $6.1 million, primarily due to an increase in investable assets. The annualized return on investments of the Insurance Group was 6.0% for the year 2004 and 6.4% for the year 2003.

Equity income from AMIC increased $.1 million primarily due to the increase in ownership, partially offset by a decrease in AMIC's net income.

Other income increased $3.5 million primarily due to MGU fee income generated from the acquisition of Majestic.

Insurance benefits, claims and reserves increased $23.8 million, reflecting increases of $7.9 million at Madison Life and $15.9 million at Standard Life. Madison Life's increase resulted from: a $2.8 million increase from interest credited on universal life and annuity policies; a $1.6 million increase in the stop-loss line from growth in the business; a $1.4 million increase in LTD due to higher claims; a $.8 million increase in the ordinary life due to the fourth quarter of 2003 acquisitions; a $1.0 million increase in GTL due to higher losses; and a $.4 million increase from Group A&H due to higher claims; partially offset by a $.1 million decrease from all other lines. The change at Standard Life is comprised of: higher claims and reserves of $14.5 million from the medical stop-loss line due to greater volume and an increase in claims experience; an increase in reserves of $1.5 million attributable to the ordinary life line of business that the Company assumed in November 2003; an increase of $1.1 million in VFD from greater volume and a $.9 million increase from interest credited on annuities; partially offset by a $1.1 million decrease from a provider excess due to the decrease in premiums; a $.5 million decrease from DBL due to the coinsurance agreement with Independence American; and a $.5 million decrease from HMO reinsurance due to improved experience.

Amortization of deferred acquisition costs and general and administrative expenses for the Insurance Group increased $7.4 million due to increases at Madison Life of $1.0 million, at Standard Life of $6.2 million and $.2 million from other subsidiaries. The increase at Madison Life is due to increased general expenses of $1.4 million due to increased salaries, administrative fees and costs associated with implementation of the internal control reporting requirements and other provisions of the Sarbanes-Oxley Act, partially offset by a $.2 million decrease in net commissions and a $.2 million decrease in deferred acquisition costs. The increase at Standard Life is due to increases in: commissions of $3.4 million due to the increase in premiums, general expenses of $.3 million, taxes licenses and fees of $1.2 million, amortization of deferred acquisition costs of $.9 million and minority interest in earnings of acquired companies of $.4 million.

Corporate

The pre-tax loss for corporate increased $.3 million to $2.4 million for the year ended December 31, 2004 from $2.1 million for the year ended December 31, 2003. The higher pre-tax loss is primarily attributable to increases in interest expense of $1.4 million due to the increase in debt and general expense of $.3 million primarily from costs related to Sarbanes-Oxley Act compliance, partially offset by increases in net investment income of $1.0 million due to an increase in invested assets and other income of $.4 million.

2003 COMPARED TO 2002

Net income was $18.6 million, or $1.30 per share, diluted, for the year ended December 31, 2003 compared to $15.8 million, or $1.10 per share, diluted, for the year ended December 31, 2002. The Company's income before taxes increased $3.2 million to $28.7 million for the year ended December 31, 2003 from $25.5 million for 2002. The Company had net realized and unrealized gains of $.3 million in 2003 compared to net losses of $7.6 million in 2002. The net loss in 2002 was primarily attributable to other than temporary impairments on certain investment securities (see Liquidity). Decisions to sell securities are based on cash flow needs, investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from year to year. The $3.2 million increase in income before taxes primarily consisted of: an increase in realized gains of $7.9 million and increases from the stop-loss line and individual annuity and life lines in 2003, partially offset by 2002 gains of $8.1 million on a sale of a subsidiary and $1.3 million on the sale of real estate. Income tax expense increased $.5 million to $10.1 million in 2003 from $9.6 million 2002 reflecting the increase in income before taxes.

Insurance Group

The Insurance Group's income before taxes increased $10.8 million to $30.8 million from $20.0 million in 2002. These results include net realized and unrealized gains of $.2 million in 2003 compared to net realized and unrealized losses of $7.6 million in 2002.

Premium revenues increased $16.5 million to $149.4 million in 2003 from $132.9 million in 2002; premium revenues increased $11.3 million at Madison Life and $5.2 million at Standard Life. The increase at Madison Life is comprised of: a $6.1 million increase in stop-loss premiums due to the introduction of this business at Madison Life in the third quarter of 2002 and the growth each quarter of the line; a $5.1 million increase in the credit line of business primarily due to increased writings; and a $.3 million increase in the long-term disability ("LTD") line; such increases were partially offset by a $.2 million decrease in all other lines. The increase at Standard Life is comprised of: a $12.2 million increase in the medical stop-loss line due to an increase in premiums written; and a $.9 million increase in its HMO reinsurance line due to increased premiums written; partially offset by a $3.7 million decrease in the individual annuity line due to a reinsurance assumption transaction which positively impacted 2002; a $2.2 million decrease in provider excess due to the sale of Independence American Insurance Company ("IAIC") to AMIC; a $.9 million decrease in the DBL line due to decreased production; a $.7 million decrease in group life due to lower retention; a $.3 million decrease in the point-of-service line due to the cancellation of one large group in the prior year; and a $.1 million decrease from all other lines.

As a result of the Company's decision to reduce its exposure to investment partnerships and decreased income from operating partnerships, total net investment income decreased $1.8 million. The annualized return on investments of the Insurance Group was 6.4% for 2003 and 7.1% in 2002.

Equity income from AMIC increased $4.2 million to $2.3 million in 2003, compared to a $1.9 million loss for 2002. The Company purchased a 19.9% equity interest in AMIC on July 30, 2002. On April 22, 2003, IHC completed a cash tender offer and acquired 1 million shares of AMIC. On December 22, 2003, IHC acquired an additional 613,401 shares of AMIC, bringing IHC's total ownership percentage to 39%. IHC accordingly recorded its percentage of AMIC's net income under the equity method of accounting. The loss of $1.9 million in 2002 relates to the wind-down of AMIC's previous Internet operations. The 2003 income is due to positive results from AMIC's insurance operations.

Other income decreased $5.4 million primarily due to the loss of fee income resulting from the sale of IndependenceCare and RAS to AMIC in the fourth quarter of 2002.

Insurance benefits, claims and reserves increased $3.3 million, reflecting an increase of $4.5 million at Madison Life and a decrease of $1.2 million at Standard Life. Madison Life's increase resulted from: a $4.1 million increase in stop-loss reserves due to the growth of this line since its introduction in the third quarter of 2002; a $2.4 million increase in credit life and accident and health reserves due to the increase in premiums; and a $.2 million increase in all other lines of business; partially offset by a $1.3 million decrease in the ordinary life and annuity line due to a decrease from surrenders and interest credited; and a $.9 million decrease in LTD claims and reserves. The change at Standard Life is comprised of: a $3.6 million decrease in the annuity line due to the previously mentioned assumption reinsurance transaction which negatively impacted 2002; a $1.9 million decrease in provider excess reserves resulting from improved experience; a $1.0 million decrease in ordinary life due to the continued runoff of this line; a $.9 million decrease in point of service claims due to the cancellation of one large group as previously mentioned; a $.6 million decrease in DBL claims and reserves due to slightly lower loss ratios; a $.5 million decrease in the behavioral health line due to a reduction in retention; and a $.4 million decrease in group life due to lower retention; partially offset by a $7.6 million increase in medical stop-loss reserves due to the increase in premiums; and a $.1 million increase in all other lines.

Amortization of deferred acquisition costs and general and administrative expenses for the Insurance Group increased $7.1 million due to an increase of $4.8 million from Madison Life; a $2.9 million increase from Standard Life; and a decrease of $.6 million from the sale of IndependenceCare to AMIC. Madison Life's expenses increased due to an increase in commission expense of $2.0 million; a $.9 million increase in amortization of deferred acquisition costs from acquisitions; and an increase in general expenses of $3.0 million due to higher administrative fees, salaries and taxes associated with the increase in premium volume; partially offset by a $1.1 million decrease from the sale of RAS to AMIC. Standard Life's increase is due to an increase of $1.4 million in commissions and general expenses due to higher compensation costs and a $1.5 million increase in taxes, licenses and fees.

Corporate

Pre-tax income for the year ended December 31, 2003 decreased by $7.6 million, representing a loss of $2.1 million in 2003 compared to income of $5.5 million in 2002. This decrease in income is primarily attributable to the gain of $8.1 million in 2002 on the sale of First Standard Holdings Corp. to AMIC; a $1.3 million gain in 2002 on the sale of real estate; and a $.5 million increase in interest expense in 2003 due to the refinancing of existing debt and the issuance of trust preferred securities; partially offset by an increase of $1.8 million in net investment income in 2003 due to a greater amount of invested assets; a $.2 million increase in realized gains; and a $.3 million decrease in all other expenses.

LIQUIDITY

Insurance Group

The Insurance Group normally provides cash flow from (i) operations; (ii) the receipt of scheduled principal payments on its portfolio of fixed income securities; and (iii) earnings on investments. Such cash flow is used partially to finance liabilities for insurance reserves. These liabilities represent long-term and short-term obligations which are calculated using certain assumed interest rates.

Asset Quality

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. Of the aggregate carrying value of the Insurance Group's investment assets, approximately 96.6% was invested in investment grade fixed income securities, cash and cash equivalents, resale agreements and policy loans and at December 31, 2004. Also at such date, approximately 99.1% of the Company's fixed maturities were investment grade. These investments carry less default risk and, therefore, lower interest rates than other types of fixed maturity investments. At December 31, 2004 approximately .9% of the carrying value of fixed maturities was invested in a non-investment grade fixed income security (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any mortgage loans or non-performing fixed maturities.

Investment Impairments

The Company reviews its investments regularly and monitors its investments continually for impairments. For the years ended December 31, 2004, 2003 and 2002, the Company recorded a realized loss for other than temporary impairments on securities not yet sold of $.6 million, $5.2 million and $7.2 million, respectively. In 2004, 2003 and 2002, $.4 million, $5.0 million and $6.4 million, respectively, of the loss relates to an interest related impairment recognized on certain interest only securities ("IO Securities") resulting from unexpected prepayments of the mortgage obligations underlying the IO Securities due to falling interest rates. The Company has invested in IO Securities to help actively manage its interest rate exposure. Typically these securities account for less than 2% of IHC's total portfolio assets and are rated AAA or better. In a rising interest rate environment, IO Securities will increase in value which acts to mitigate the unrealized loss on the balance of the bond portfolio. In a decreasing interest rate environment, IO Securities will decline in value, but there will be an unrealized gain in the rest of the bond portfolio. Although these securities performed as expected, the Company applies the methodology of Emerging Issues Task Force 99-20, "Recognition of Interest Income and Impairment of Purchased and Retained Beneficial Interests in Securitized Financial Assets" ("EITF 99-20") in determining when an IO Security is considered other than temporarily impaired. The Company records realized losses under EITF 99-20 when there is a decrease in expected cash flows combined with a decline in the IO Securities' fair value below cost.

The Company's gross unrealized losses on fixed maturities totaled $9.3 million at December 31, 2004. Substantially all of these securities were investment grade. The unrealized losses, primarily within the corporate securities portfolio, have been evaluated in accordance with the Company's policy and were determined to be temporary in nature at December 31, 2004. The Company holds all fixed maturities as available-for-sale and accordingly marks all of its securities to fair value through accumulated other comprehensive income or loss.

Share Repurchase Program

In June 2004, the Board of Directors authorized an additional 450,000 share repurchase. As of December 31, 2004, 420,037 shares were still authorized to be repurchased under the plan. This repurchase plan, like the 450,000 share repurchase authorized in 2002, is a continuation of a program initiated in 1991 as described in Note 13 of Notes to Consolidated Financial Statements.

The following table summarizes information with respect to the share repurchase program:

2004			
Month of Repurchase	**Number of Shares Repurchased**	**Average Price of Repurchased Shares**	**Maximum Number of Shares Which Can be Repurchased**
January	—	$ —	270,817
February	—	—	270,817
March	—	—	270,817
April	—	—	270,817
May	168,480	20.89	102,337
June	3,600	16.64	548,737
July	—	—	548,737
August	—	—	548,737
September	27,700	17.69	521,037
October	61,900	18.09	459,137
November	39,100	18.07	420,037
December	—	—	420,037

2003 Month of Repurchase	Number of Shares Repurchased	Average Price of Repurchased Shares	Maximum Number of Shares Which Can be Repurchased
January	162,751	$11.08	495,529
February	11,952	10.64	483,577
March	67,500	10.87	416,077
April	18,000	10.97	398,077
May	89,280	10.97	308,797
June	2,340	11.17	306,457
July	27,000	11.58	279,457
August	—	—	279,457
September	—	—	279,457
October	5,940	12.10	273,517
November	2,700	13.02	270,817
December	—	—	270,817

Risk Management

The Company manages interest rate risk by 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. Options may be utilized to modify the duration and average life of such assets; see Note 1(F)(iv) of Notes to Consolidated Financial Statements.

The following summarizes the estimated pre-tax change in fair value (based upon hypothetical parallel shifts in the U.S. Treasury yield curve) of the fixed income portfolio assuming immediate changes in interest rates at specified levels at December 31, 2004:

Change in Interest Rates	Estimated Fair Value	Estimated Change In Fair Value
	(in millions)	
200 basis point rise	$487.7	$(58.7)
100 basis point rise	519.5	(26.9)
Base scenario	546.4	—
100 basis point decline	571.3	24.9
200 basis point decline	598.4	52.0

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.

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 come 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 gains in its 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.

Balance Sheet

Total investments and cash and cash equivalents increased $81.4 million at December 31, 2004 largely due to the net cash of $22.0 million provided by operating activities; cash of $25.8 million received in the purchase of policy blocks; and net proceeds of $14.5 million from the issuance of debt. The decrease in insurance reserves-health of $7.8 million is due to the timing of claims payments. The $36.8 million increase in funds on deposit is primarily a result of the purchase of individual annuity policies in the second quarter of 2004. The Company issued $15.5 million in junior subordinated debt securities to a wholly-owned unconsolidated trust during 2004. The $20.0 million increase in total stockholders' equity is due to net income generated in the year ended December 31, 2004, partially offset by a decrease in unrealized gains on investments and by the net purchases of the Company's common stock.

The Company had net receivables from reinsurers of $115.0 million at December 31, 2004. Substantially all of the business ceded to such reinsurers is of short duration. All of such receivables are either due from the Company's affiliate, Independence American, highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at December 31, 2004. As of December 31, 2004, the balance due from Independence American is $10.9 million.

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.

Total Corporate liquidity (cash, cash equivalents, resale agreements, fixed maturities, equity securities and partnership interests) amounted to $37.6 million at December 31, 2004. During 2004, IHC repurchased 300,780 shares of common stock for $5.9 million under its common stock repurchase program.

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. In November 2004, March 2004 and December 2003, the Company borrowed $15 million, $10 million and $12 million, respectively, through pooled trust preferred issuances by subsidiary trusts. In September 2003, the Company entered into a $12.5 million line of credit, all of which was drawn down. The cash proceeds of the line of credit and the trust preferred securities issued in 2003 were used to repay existing debt and for general corporate purposes. See Note 11 of the Notes to Consolidated Financial Statements in Item 8.

IHC enters into a variety of contractual obligations with third-parties in the ordinary course of its operations. These obligations, as of December 31, 2004, are set forth in the table below. However, we do not believe that our cash flow requirements can be fully assessed based upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon our future needs. Although some outflows are fixed, others depend on future events. The Company had the following expected contractual obligations relating to debt, trust preferred securities (junior subordinated debt), non-cancelable leases, insurance reserves and funds on deposit at December 31, 2004:

	Debt	Junior Subordinated Debt	Leases	Insurance Reserves	Funds on Deposit	Total
2005	$ —	$ —	$1,047	$121,556	$ 36,469	$159,072
2006	12,500	—	998	34,192	33,859	81,549
2007	—	—	806	24,822	31,608	57,236
2008	—	—	737	21,670	29,702	52,109
2009	—	—	736	20,100	28,051	48,887
2010 and thereafter	—	38,146	1,473	115,112	148,776	303,507
Totals	$12,500	$38,146	$5,797	$337,452	$308,465	$702,360

In accordance with SFAS No. 115, the Company may carry its portfolio of fixed income securities either as held to maturity (carried at amortized cost), as trading securities (carried at fair market value) or as available-for-sale (carried at fair market value). The Company has chosen to carry all of its debt securities as available-for-sale. In 2004, the Company experienced a decrease in unrealized gains (losses) of $2.6 million, net of deferred tax benefits of $1.5 million and net of deferred policy acquisition costs of $.6 million in total stockholders' equity, reflecting net unrealized losses of $2.0 million at December 31, 2004 compared to net unrealized gains of $.6 million at December 31, 2003. From time to time, as warranted, the Company employs investment strategies to mitigate interest rate and other market exposures.

Under certain circumstances set forth in the Limited Liability Company Agreement of Majestic, the Company has the right and/or obligation to purchase some or all of the minority interests in Majestic.

OUTLOOK

The Company anticipates continued favorable operating performance in 2005 as a result of (i) marketing of its new strategic health products including the rollover of the $50 million block of employer-sponsored group major medical administered by Insurers Administrator Corporation ("IAC"), a market leader in sales of consumer driven medical plans to the small and medium size employer group maket; (ii) cross-selling of products through controlled distribution sources, including its affiliates, Health Plan Administrators, Inc. ("HPA") and CA Insurance Services ("CA Services"); (iii) improved profitability of its Medical Stop-Loss business through stricter underwriting and anticipation of a somewhat "harder" market; (iv) the appointment of new stop-loss MGUs; and (v) acquisition of blocks of business.

IHC began marketing employer-sponsored group major medical in one state in the first quarter of 2005. Beginning in 2005, the Company is preparing to market this product in 36 states. Standard Life will also 100% reinsure, with the intent of assuming, a $50 million block of this business as of January 1, 2005. In addition, during 2005, IHC will begin distributing short-term medical, dental and vision products. The major medical, dental and vision products, will be marketed through IAC and CA Services. The short-term medical and other products will be written through HPA, a market leader in these products. These products, taken together, provide IHC with a full array of health products. In addition, the Company should generate cross-selling opportunities for IHC's current life and health products and others currently under development. IHC will continue to seek other strategic acquisitions of TPAs and other distribution sources.

The Company increased its average retention on Medical Stop-Loss written by Standard Life and Madison Life from 30% in 2003 to 34% in 2004. In 2004, approximately 73% of the Company's Medical Stop-Loss business was underwritten by MGUs in which the Company or its affiliates have significant equity interests. The Company anticipates that these MGUs will continue to contribute a high percentage of the Insurance Group's premiums in the Medical Stop-Loss line of business in 2005. In addition, the Company exerts influence over its other MGUs through its high retention of risk and by working with only a selected group of reinsurers that share IHC's commitment to underwriting discipline. For all of its MGUs, Standard Life and Madison Life regularly audit the MGUs' compliance with the Company's underwriting, claims and policy issuance guidelines.

The Medical Stop-Loss market is generally cyclical in nature. When a product experiences several consecutive years of underwriting profitability, it is not unusual for there to be more competitors entering that line which can increase pressure on pricing and create a "softer" market. The Medical Stop-Loss market began to "soften" in 2003, and less favorable conditions continued through 2004. Despite these market conditions, the Company produced profitable results in 2003 and 2004, and expects continued profitability in 2005. As a result of these market conditions, the rate IHC is able to charge for Medical Stop-Loss increased at a lesser rate in recent years, however, increases in medical trend have also been held in check to a greater extent and deductibles and attachment points have increased. This reduces IHC's overall risk exposure. The Company remains optimistic that it will continue to produce profitable results, however, its ability to grow the Medical Stop-Loss line in 2005 may be somewhat limited, although the Company intends to appoint new MGUs which would generate additional premiums. IHC's new lines of business (major medical, short-term medical, dental and vision) are less volatile than Medical Stop-Loss. The Company is optimistic that these lines will yield profitable results while producing significant growth.

Madison Life anticipates moderate growth in its group LTD, credit and term life lines as a result of increased production and improved loss ratios. In 2000, as a result of Madison Life's 1999 acquisition of a block with $78.0 million in reserves, Madison Life began marketing an individual life product (with annuity riders) to military and civilian government employees, primarily through payroll deduction. The Company will continue to review acquisitions, and believes that it is well positioned to consummate additional acquisitions should the opportunity arise.

The Company entered into an Aggregate Excess of Loss Retrocessional Reinsurance Agreement with a reinsurer for its 2004 Medical Stop-Loss business, effective as of January 1, 2005, pursuant to which the Company will provide such reinsurer with a loss ratio cover to cap the reinsurer's losses, excluding certain losses, at a 90% net loss ratio. Approximately $43 million of net premium was ceded to such reinsurer during such period and the Company charged 8% of the premium ceded to the reinsurer for such coverage. In addition, the Company entered into a Commutation Agreement with this same reinsurer, pursuant to which, effective as of January 1, 2005, the reinsurer will return 94% of the net premium collected to date with respect to the 2003 Medical Stop-Loss business ceded to such reinsurer, and the Company will release most future liabilities of such reinsurer with respect to such business. To date, approximately $27 million of net premium was ceded to such reinsurer for such year.

Madison National and Independence American entered into a reinsurance agreement to protect Independence American against certain losses occurring during the period from January 1, 2005 to December 31, 2005. In the event that Independence American's claims, loss adjustment expenses, and incurred but not reported reserves ("Net Losses") exceeds 95% of the net premiums earned by Independence American, then Madison National will pay Independence American an amount equal to the excess over the Net Losses. In no event shall Madison National pay Independence American more than $5,000,000. Independence American will pay Madison National, quarterly, a premium of 0.175% of net retained premium subject to a minimum premium of $50,000 and a maximum premium of $100,000.

NEW ACCOUNTING PRONOUNCEMENTS

On September 30, 2004, the Financial Accounting Standards Board ("FASB") issued Staff Position No. EITF Issue 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which delays the effective date for the measurement and recognition guidance contained in Emerging Issues Task Force ("EITF") Issue No. 03-1. EITF Issue No. 03-1 provides guidance for evaluating whether an investment is other-than-temporarily impaired and was originally to be effective for other-than-temporary impairment evaluations made in reporting periods beginning after June 15, 2004 (July 1, 2004 for the Company). The delay in the effective date for the measurement and recognition guidance contained in EITF Issue No. 03-1 does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. Subsequent to the issuance of Staff Position No. EITF Issue 03-1-1, the FASB announced plans for a full reconsideration of existing authoritative literature concerning other-than-temporary impairment of securities. The outcome of this reconsideration and the impact, if any, on the Company's impairment recognition cannot be predicted at this time.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004) ("FASB 123(R)"), "Share-Based Payment", which supercedes SFAS No. 123, "Accounting for Stock-Based Compensation," and APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123(R) addresses the accounting for share-based payment transactions with employees and other third parties; eliminates the ability account for share-based compensation transactions using APB 25; and requires that the compensation costs relating to such transactions be recognized in the statement of operations. The revised statement is effective as of the first interim period beginning after June 15, 2005 and, therefore, the Company will adopt the statement on July 1, 2005 as required. SFAS 123(R) applies to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. Additionally, beginning on the required effective date, compensation expense will be recognized for the portion of outstanding awards for which the requisite service (vesting) has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosures. The impact of adoption cannot be predicted at this time because it will depend, in part, on levels of share-based payments granted in the future. However, had the Company adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the pro forma disclosure included in Note 1(R) of the Notes to Consolidated Financial Statements in Item 8.

SAFE HARBOR STATEMENT

From time to time, information provided by the Company, including but not limited to statements in this report, or other statements made by or on behalf of the Company, may contain "forward-looking" information within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements involve a number of risks, uncertainties and contingencies, many of which are beyond the Company's control, which may cause actual results, performance or achievements to differ materially from those anticipated. Set forth below are important factors that could cause the Company's results, performance or achievements to differ materially from those in any forward-looking statements made by or on behalf of the Company.

RISK FACTORS AFFECTING THE COMPANY'S OPERATING RESULTS AND FINANCIAL CONDITION

The risks and uncertainties described below are not the only ones that the Company faces. Additional risks and uncertainties not presently known to the Company or that the company currently deems immaterial may also impair the Company's business operations. If any of the following risks actually occur, the Company's business, financial condition or results of operations could be materially adversely affected. In such case, the trading price of the Company's common stock could decline.

The Company's Results May Fluctuate as a Result of Factors Generally Affecting the Insurance and Reinsurance Industry

The results of companies in the insurance and reinsurance industry historically have been subject to significant fluctuations and uncertainties. Factors that affect the industry in general could also cause the Company's results to fluctuate. The industries and the Company's financial condition and results of operations may be affected significantly by:

- Fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested capital and may impact the ultimate payout of loss amounts;
- Rising levels of actual costs that are not known by companies at the time they price their products;

- Losses related to terrorist activities, random acts of violence or declared or undeclared war;
- Changes in reserves resulting from different types of claims that may arise and the development of judicial interpretations relating to the scope of insurers' liability; and
- The overall level of economic activity and the competitive environment in the industry.

If the Rating Agencies Downgrade the Company's Insurance Companies, the Company's 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 Life is rated "A" (Excellent) and Madison Life is rated "A–" (Excellent) by A.M. Best Company, Inc. ("Best"). 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 Standard Life and Madison Life are subject to periodic review by Best. If Best reduces either or both Madison Life's or Standard Life's ratings from its current levels, the Company's business could be adversely affected.

The Company's Loss Reserves are Based on an Estimate of Its Future Liability, and if Actual Claims Prove to be Greater Than The Company's Reserves, Its Results of Operations and Financial Condition May Be Adversely Affected

The Company maintains loss reserves to cover its estimated liability for unpaid losses and loss adjustment expenses, including legal and other fees as well as a portion of the Company's general expenses, for reported and unreported claims incurred as of the end of each accounting period. Because setting reserves is inherently uncertain, the Company cannot be sure that current reserves will prove adequate in light of subsequent events. If the Company's reserves are insufficient to cover its actual losses and loss adjustment expenses, the Company would have to augment its reserves and incur a change to its earnings, and these charges could be material. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what the Company expects the ultimate settlement and administration of claims will cost. These estimates, which generally involve actuarial projections, are based on the Company's assessment of facts and circumstances then known, as well as estimates of future trends in claims severity, frequency, judicial theories of liability and other factors. These variables are affected by both internal and external events, such as changes in claims handling procedures, inflation, judicial trends and legislative changes. 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 the Company. 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. Adjustments to reserves are reflected in the results of the periods in which such estimates are changed.

Certain Proposed Federal and State Legislation May, if Adopted, Adversely Affect the Company's Employer Medical Stop-Loss Business

Individuals who obtain health coverage through self-insured plans cannot currently sue their employer in state court for punitive or compensatory damages, but can seek legal recourse in federal court where an employer can be ordered to cover a wrongfully-denied benefit. In the continuing debate over health care reform, certain federal and state legislation has been proposed which could have the effect of making plan sponsors, administrators, or certain other parties liable for punitive damages in state court. While the Company cannot predict whether any of these proposals will be adopted or what, if any, impact enactment of any of these would have on its employer medical stop-loss business, the number of employers offering health benefits or choosing self-insured plans could be reduced, plans could increase the portion paid by employees (thereby reducing participation), pricing and coverage options could be affected, and the Insurance Group could be faced with greater liability exposures.

The Company's Inability to Assess Underwriting Risk Accurately Could Reduce Its Net Income

The Company's success is dependent on its ability to assess accurately the risks associated with the businesses on which the risk is retained. If the Company fails to assess accurately the risks it retains, the Company may fail to establish the appropriate premium rates and the Company reserves may be inadequate to cover its losses, requiring augmentation of the Company's reserves, which in turn could reduce the Company's net income.

Decreases in the Fair Market Value of Fixed Income Securities May Greatly Reduce the Value of the Company's Investment Portfolio, and as a Result, the Company's Financial Condition May Suffer

At December 31, 2004, $546.4 million of the Company's $722.2 million investment portfolio was invested in fixed income securities. The fair market value of these fixed income securities and the investment income from these fixed income securities fluctuate depending on general economic and market conditions. With respect to the Company's investments in fixed income securities, the fair market value of these investments generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by the Company from future investments in fixed income securities will generally increase or decrease with 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. Historically, the impact of market fluctuations has affected the Company's financial statements. Because all of the Company's fixed income securities are classified as available for sale, changes in the fair market value of the Company's securities are reflected in the Company's accumulated other comprehensive income. No adjustment is made for liabilities to reflect a change in interest rates. Therefore, interest rate fluctuations and economic conditions could adversely affect the Company's stockholders' equity, total comprehensive income and/or cash flows.

If the Company Fails to Comply With Extensive State and Federal Regulations, the Company Will Be Subject to Penalties, Which May Include Fines and Suspension and Which May Adversely Affect the Company's Results of Operations and Financial Condition

The Company is subject to extensive governmental regulation and supervision. Most insurance regulations are designed to protect the interests of policyholders rather than stockholders and other investors. This regulation, generally administered by a department of insurance in each state in which the Company does business, relates to, among other things

- Approval of policy forms and premium rates;
- Standards of solvency, including risk-based capital measurements, which are a measure developed by the National Association of Insurance Commissioners and used by state insurance regulators to identify insurance companies that potentially are inadequately capitalized;
- Licensing of insurers and their agents;
- Restrictions on the nature, quality and concentration of investments;
- Restrictions on transactions between insurance companies and their affiliates;
- Restrictions on the size of risks insurable under a single policy;
- Requiring deposits for the benefit of policyholders;
- Requiring certain methods of accounting;
- Prescribing the form and content of records of financial condition required to be filed; and
- Requiring reserves for unearned premium, losses and other purposes.

State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies, holding company issues and other matters.

The Insurance Group's business depends on compliance with applicable laws and regulations and its ability to maintain valid licenses and approvals for its operations. Regulatory authorities have broad discretion to grant, renew, or revoke licenses and approvals. Regulatory authorities may deny or revoke licenses for various reasons, including the violation or regulations. In some instances, the Insurance Group follows practices based on its interpretations of regulations, or those that it believes to be generally followed by the industry, which may be different from the requirements or interpretations of regulatory authorities. If the Insurance Group does not have the requisite licenses and approvals and does not comply with applicable regulatory requirements, the insurance regulatory authorities could preclude or temporarily suspend the Insurance Group from carrying on some or all of its activities or otherwise penalize it. That type of action could have a material adverse effect on the Insurance Group's business. Also, changes in the level of regulation of the insurance industry (whether federal, state or foreign), or changes in laws or regulations themselves or interpretations by regulatory authorities, could have a material adverse effect on the Insurance Group's business.

Item 7A. *Quantitative and Qualitative Disclosures about Market Risk*

See the discussion of interest rate risk under "Risk Management" in Item 7.

Item 8. *Financial Statements and Supplementary Data*

See Index to Consolidated Financial Statements and Schedules on page 32.

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

Item 9A. *Controls and Procedures*

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

There has been no change in IHC's internal control over financial reporting during the fourth quarter of 2004 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

The Report of Management on Internal Control Over Financial Reporting and the related Report of Independent Registered Public Accounting Firm are included in Item 8 of this Form 10-K.

PART III

Item 10. *Directors and Executive Officers of the Registrant*

Information required by this Item is incorporated by reference to "Election of Directors" and "Executive Officers" in the Company's Proxy Statement for its 2005 Annual Meeting of Stockholders.

Item 11. *Executive Compensation*

Information required by this Item is incorporated by reference to "Executive Compensation" in the Company's Proxy Statement for its 2005 Annual Meeting of Stockholders, except that the information required by paragraphs (i), (k) and (l) of Item 402 Regulation S-K (§229.402) and set forth in such Proxy Statement is specifically not incorporated by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management*

Information required by this Item is incorporated by reference to "Principal Stockholders" in the Company's Proxy Statement for its 2005 Annual Meeting of Stockholders.

Item 13. *Certain Relationships and Related Transactions*

Information required by this Item is incorporated by reference to "Principal Stockholders" in the Company's Proxy Statement for its 2005 Annual Meeting of Stockholders.

Item 14. *Principal Accountant Fees and Services*

Information concerning principal accountant fees and services is included under the caption "Ratification of Appointment of Independent Registered Public Accounting Firm" in the Company's Proxy Statement for its 2005 Annual Meeting of Stockholders.

PART IV

Item 15. *Exhibits, Financial Statement Schedules and Reports on Form 8-K*

(a) (1) and (2) See Index to Consolidated Financial Statements and Schedules on page 32.

(a) (3) EXHIBITS See Index to Exhibits on page 72.

(b) The Company filed the following reports on Form 8-K during the fourth quarter of 2004:

A report on Form 8-K was filed October 6, 2004 to announce the formation of Special Health Products Division.

A report on Form 8-K was filed on November 8, 2004 to announce financial results of the quarter and nine months ended September 30, 2004.

A report on Form 8-K was filed on December 9, 2004 to announce the declaration of semi-annual dividend.

SIGNATURES

Pursuant to the requirements of Section 13 or Section 15(d) 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, on March 15, 2005.

INDEPENDENCE HOLDING COMPANY
(Registrant)

By: /s/ ROY T.K. THUNG
Roy T.K. Thung
President, and Chief Executive Officer
(Principal Executive Officer)

/s/ TERESA A. HERBERT
Teresa A. Herbert
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated as of the 15th day of March, 2005.

/s/ LARRY R. GRABER **Larry R. Graber**	Director
/s/ ALLAN C. KIRKMAN **Allan C. Kirkman**	Director
/s/ STEVEN B. LAPIN **Steven B. Lapin**	Director and Vice Chairman
/s/ EDWARD NETTER **Edward Netter**	Director and Chairman
/s/ ROBERT P. ROSS, JR. **Robert P. Ross, Jr.**	Director
/s/ JAMES G. TATUM **James G. Tatum**	Director
/s/ ROY T.K. THUNG **Roy T.K. Thung**	Director, President, and Chief Executive Officer (Principal Executive Officer)
/s/ TERESA A. HERBERT **Teresa A. Herbert**	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES

* All other schedules have been omitted as they are not applicable or not required, or the information is included in the Consolidated Financial Statements or Notes thereto.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders
INDEPENDENCE HOLDING COMPANY:

The management of Independence Holding Company ("IHC") is responsible for establishing and maintaining adequate internal control over financial reporting. IHC's internal control system is a process designed to provide reasonable assurance to the company's management and board of directors regarding the reliability of financial reporting and fair presentation of published financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

IHC acquired Majestic Underwriters LLC ("Majestic") during 2004. Management excluded from its assessment of the effectiveness of IHC's internal control over financial reporting as of December 31, 2004, Majestic's internal control over financial reporting associated with total assets of $8,607,000 and total revenues of $2,121,000 as of and for the year ended December 31, 2004.

Management assessed the effectiveness of IHC's internal control over financial reporting as of December 31, 2004. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*. Based on our assessment we concluded that, as of December 31, 2004, IHC's internal control over financial reporting is effective.

KPMG LLP, the independent registered public accounting firm that audited the consolidated financial statements in this Annual Report, has issued an audit report on management's assessment of, and the effective operation of, IHC's internal control over financial reporting as of December 31, 2004, which is included herein on page 34.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
INDEPENDENCE HOLDING COMPANY:

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that Independence Holding Company and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control-Integrated Framework* issued by COSO. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by COSO.

The Company acquired Majestic Underwriters LLC ("Majestic") during 2004, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, Majestic's internal control over financial reporting associated with total assets of $8,607,000 and total revenues of $2,121,000 included in the consolidated financial statements of the Company as of and for the year ended December 31, 2004. Our audit of internal control over financial reporting of the Company also excluded an evaluation of internal control over financial reporting of Majestic.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Independence Holding Company and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2004, and our report dated March 15, 2005 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

New York, New York
March 15, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
INDEPENDENCE HOLDING COMPANY:

We have audited the accompanying consolidated financial statements of Independence Holding Company and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Independence Holding Company and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 15, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

New York, New York
March 15, 2005

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
	(In thousands)	
ASSETS:		
Investments:		
Short-term investments	$ 21,470	$ 8,640
Securities purchased under agreements to resell	93,544	26,549
Fixed maturities	546,384	490,311
Equity securities	12,099	21,403
Other investments	48,679	46,500
Total investments	722,176	593,403
Cash and cash equivalents	13,196	60,547
Due from securities brokers	4,795	17,542
Investment in American Independence Corp. (“AMIC”)	30,626	27,345
Deferred acquisition costs	37,386	33,113
Due and unpaid premiums	7,100	6,210
Due from reinsurers	121,987	128,418
Notes and other receivables	7,172	13,882
Other assets	24,055	17,842
Total assets	$968,493	$898,302
LIABILITIES AND STOCKHOLDERS’ EQUITY:		
Liabilities:		
Insurance reserves-health	$166,087	$173,838
Insurance reserves-life and annuity	171,365	170,799
Funds on deposit	308,465	271,668
Unearned premiums	17,468	16,491
Policy claims-life	6,590	5,780
Policy claims-health	2,495	1,854
Other policyholders’ funds	8,859	6,539
Due to securities brokers	14,760	20,773
Due to reinsurers	6,957	5,889
Accounts payable, accruals and other liabilities	25,948	20,593
Debt	12,500	12,500
Junior subordinated debt securities	38,146	22,682
Total Liabilities	779,640	729,406
Stockholders’ Equity:		
Preferred stock (none issued)	—	—
Common stock, 14,102,766 and 13,904,259 shares issued and outstanding, respectively, net of 132,300 and 3,708,123 shares in treasury, respectively	14,103	13,904
Paid-in capital	75,789	75,579
Accumulated other comprehensive (loss) income	(1,976)	647
Retained earnings	100,937	78,766
Total Stockholders’ Equity	188,853	168,896
Total Liabilities and Stockholders’ Equity	$968,493	$898,302

See accompanying Notes to Consolidated Financial Statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2004	2003	2002
	(In thousands, except per share data)		
Revenues:			
Health premiums earned	$141,078	$119,929	$101,033
Life and annuity premiums earned	32,989	29,478	31,857
Net investment income	42,915	35,796	35,733
Net realized and unrealized gains (losses)	2,394	313	(7,558)
Equity income (loss) on AMIC	2,334	2,292	(1,931)
Gain on sale of a subsidiary	—	—	8,106
Other income	3,959	70	7,113
	225,669	187,878	174,353
Expenses:			
Insurance benefits, claims and reserves—health	88,134	72,231	55,342
Insurance benefits, claims and reserves—life and annuity	37,808	29,944	43,492
Amortization of deferred acquisition costs	8,542	7,025	6,083
Interest expense on debt	2,338	898	435
Selling, general and administrative expenses	55,217	49,038	43,538
	192,039	159,136	148,890
Income before income taxes	33,630	28,742	25,463
Income tax expense	10,691	10,149	9,650
Net income	$ 22,939	$ 18,593	$ 15,813
Basic income per common share	$ 1.63	$ 1.33	$ 1.13
Weighted average shares outstanding	14,058	13,963	14,002
Diluted income per common share	$ 1.60	$ 1.30	$ 1.10
Weighted average diluted shares outstanding	14,372	14,249	14,407

See accompanying Notes to Consolidated Financial Statements.

INDEPENDENCE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
			(In thousands, except shares)			
Balance at December 31, 2001	14,021,401	$14,022	$78,352	$ 94	$ 45,080	$137,548
Net income					15,813	15,813
Net change in unrealized gains (losses)				1,601		1,601
Total comprehensive income						17,414
Purchase of common stock	(165,700)	(166)	(1,714)		74	(1,806)
Exercise of common stock options	3,690	3	16		(1)	18
Exercise of common stock warrants	83,880	84	885		(38)	931
Common stock dividend ($.0278 per share)					(387)	(387)
Balance at December 31, 2002	13,943,271	13,943	77,539	1,695	60,541	153,718
Net income					18,593	18,593
Net change in unrealized gains (losses)				(1,048)		(1,048)
Total comprehensive income						17,545
Purchase of common stock	(387,461)	(387)	(4,072)		172	(4,287)
Exercise of common stock options	348,449	348	1,929		(154)	2,123
Common stock dividend ($.0278 per share)					(386)	(386)
Other capital transactions			183			183
Balance at December 31, 2003	13,904,259	13,904	75,579	647	78,766	168,896
Net income					22,939	22,939
Net change in unrealized gains (losses)				(2,623)		(2,623)
Total comprehensive income						20,316
Purchase of common stock	(300,780)	(301)	(5,669)		75	(5,895)
Exercise of common stock options	369,919	370	3,791		(139)	4,022
Common stock dividend ($.05 per share)					(704)	(704)
Purchase of Majestic	129,808	130	1,970			2,100
Other capital transactions	(440)		118			118
Balance at December 31, 2004	14,102,766	$14,103	$75,789	$(1,976)	$100,937	$188,853

See accompanying Notes to Consolidated Financial Statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2004	2003	2002
	(In thousands)		
Cash Flows from Operating Activities:			
Net income	$ 22,939	$ 18,593	$ 15,813
Adjustments to reconcile net income to Net cash provided by operating activities:			
Amortization of deferred acquisition costs	8,542	7,025	6,083
Net realized and unrealized (gains) losses	(2,394)	(313)	7,558
Equity (income) loss on AMIC and other equity investments	(3,285)	(2,482)	1,049
Gain on sale of subsidiary	—	—	(8,106)
Depreciation and amortization	898	769	877
Deferred tax expense (benefit)	4,494	4,765	(2,195)
Other	1,247	(89)	(168)
Changes in assets and liabilities:			
Net sales of trading securities	551	33	9
Change in insurance liabilities	(7,998)	29,124	33,838
Additions to deferred acquisition costs	(12,177)	(13,008)	(7,793)
Change in net amounts due from and to reinsurers	7,499	(2,887)	(6,420)
Change in income tax liability	173	(5,980)	1,044
Change in due and unpaid premiums	(890)	1,093	198
Other	2,418	4,855	(12,474)
Net cash from operating activities	22,017	41,498	29,313
Cash Flows from Investing Activities:			
Change in net amount due from and to securities brokers	6,734	(22,379)	(13,201)
Net (purchase) sale of short-term investments	(12,857)	(7,526)	2,284
Net purchases of securities under resale and repurchase agreements	(66,995)	(744)	(18,649)
Sales of equity securities	30,623	23,386	28,166
Purchases of equity securities	(20,916)	(28,152)	(19,978)
Sales of fixed maturities	1,171,384	1,315,853	1,535,307
Maturities of fixed maturities	4,000	4,245	—
Purchases of fixed maturities	(1,235,879)	(1,385,168)	(1,549,938)
Proceeds of sales of other investments	2,182	38,610	37,536
Additional investments in other investments, net of distributions	(3,280)	(22,207)	(22,926)
Acquisitions of Managing General Underwriters	(1,540)	—	(3,357)
Investment in AMIC	(1,464)	(15,830)	(15,000)
Cash received in purchases of policy blocks	25,785	81,166	—
Sale of a subsidiary	—	—	26,646
Change in notes receivable	7,835	(5,032)	(3,811)
Other	(1,726)	(1,261)	(414)
Net cash from investing activities	(96,114)	(25,039)	(17,335)
Cash Flows from Financing Activities:			
Repurchase of common stock	(5,667)	(4,287)	(1,807)
Exercise of common stock options	2,054	2,123	18
Proceeds (payments) of investment-type insurance contracts	16,572	7,841	(3,153)
Proceeds of debt and junior subordinated debt securities, net	14,533	33,944	—
Repayment of debt	—	(8,438)	(3,750)
Dividends paid	(746)	(387)	(389)
Net cash from financing activities	26,746	30,796	(9,081)
(Decrease) increase in cash and cash equivalents	(47,351)	47,255	2,897
Cash and cash equivalents, beginning of year	60,547	13,292	10,395
Cash and cash equivalents, end of year	$ 13,196	$ 60,547	$ 13,292

See accompanying Notes to Consolidated Financial Statements.

Note 1. Significant Accounting Policies and Practices

(A) ***Business and Organization***

Independence Holding Company ("IHC") is a holding company principally engaged in the life and health insurance business through its wholly-owned subsidiaries, Standard Security Life Insurance Company of New York ("Standard Life") and Madison National Life Insurance Company, Inc. ("Madison Life") and their subsidiaries (collectively, the "Insurance Group") and a 40% equity interest in the common stock of American Independence Corp. ("AMIC"). IHC and its subsidiaries (including the Insurance Group) are collectively referred to as the "Company."

Geneve Corporation, a diversified financial holding company, and its affiliated entities held 58% of IHC's outstanding common stock at December 31, 2004.

(B) ***Basis of Presentation***

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and 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. generally accepted accounting principles requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

On June 8, 2004, IHC declared a special 80% stock dividend, payable to shareholders of record on June 18, 2004 with a distribution date of July 2, 2004. A total of 6,243,787 common shares (issued out of both treasury and authorized and unissued shares) were distributed and fractional shares were paid in cash in lieu of stock. The stock distribution has been accounted for as a stock split effected in the form of a dividend. Accordingly, the par value of the additional shares issued ($6,244,000) was charged to retained earnings and a corresponding amount was credited to common stock, on a retroactive basis, with no change in total stockholders' equity. In addition, all share and per share data for all periods presented herein has been adjusted to reflect the additional shares.

(C) ***Reclassifications***

Certain amounts in prior years' consolidated financial statements and Notes thereto have been reclassified to conform to the 2004 presentation.

(D) ***Cash Equivalents and Short-Term Investments***

Cash equivalents are carried at cost which approximates fair value and include principally interest-bearing deposits at brokers, money market instruments and U.S. Treasury securities with original maturities of less than 91-days. Investments with original maturities of 91-days to 1 year are considered short-term investments and are carried at cost which approximates fair value.

(E) ***Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase***

Securities purchased under agreements to resell ("resale agreements") and securities sold under agreements to repurchase ("repurchase agreements") are treated as financing transactions and are carried at the amounts at which the securities will be subsequently resold or repurchased as specified in the agreements.

(F) ***Investment Securities***

(i) Investments in fixed income securities, redeemable preferred securities, equity securities and derivatives (options and options on future contracts) are accounted for as follows:

(a) Securities which are held for trading purposes are carried at estimated fair value ("fair value"). Net unrealized gains or losses are credited or charged, as appropriate, to the Consolidated Statements of Operations.

(b) Securities which may or may not be held to maturity ("available-for-sale securities") are carried at fair value. Unrealized gains or losses, net of deferred income taxes and adjustments to deferred policy acquisition costs, are credited or charged, as appropriate, directly to accumulated other comprehensive income or loss (a component of stockholders' equity). Net realized gains and losses on sales of available-for-sale securities, and unrealized losses considered to be other than temporary, are credited or charged to the Consolidated Statements of Operations.

(ii) Financial instruments sold, but not yet purchased, represent obligations to replace borrowed securities that have been sold. Such transactions occur in anticipation of declines in the fair value of the securities. The Company's risk is an increase in the fair value of the securities sold in excess of the consideration received, but that risk is mitigated as a result of relationships to certain securities owned. Unrealized gains or losses on open transactions are credited or charged, as appropriate, to the Consolidated Statements of Operations (hedge accounting is not applied to these derivates). While the transaction is open, the Company will also incur an expense for any accrued dividends or interest payable to the lender of the securities. When the transaction is closed, the Company realizes a gain or loss in an amount equal to the difference between the price at which the securities were sold and the cost of replacing the borrowed securities.

(iii) Gains or losses on sales of securities are determined on the basis of specific identification.

(iv) The Company enters into derivative financial instruments, such as put and call option contracts and options on interest rate futures contracts, to minimize losses on portions of the Company's fixed income portfolio in a rapidly changing interest rate environment. Equity index options are entered into to offset price fluctuations in the equity markets. These derivative financial instruments are all readily marketable and are carried on the Consolidated Balance Sheets at their current fair value with changes in unrealized gains or losses, credited or charged, as appropriate, directly to the Consolidated Statements of Operations (hedge accounting is not applied to these derivatives). All realized gains and losses are reflected currently in the Consolidated Statements of Operations. There were no such derivatives outstanding at December 31, 2004 and 2003. Gains and losses on these instruments were insignificant during 2004, 2003 and 2002.

(v) Fair value is determined by quoted market prices, where available, or by independent pricing services.

(vi) The Company reviews its investment securities regularly and determines whether other than temporary impairments have occurred. If a decline in fair value is judged by management to be other than temporary, a loss is recognized by a charge to the Consolidated Statements of Operations, establishing a new cost basis for the security. The factors considered by management in its regular review include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; whether the issuer of a debt security has remained current on principal and interest payments; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions; and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. For securities within the scope of Emerging Issues Task Force Issue 99-20, such as purchased interest-only securities, an impairment loss is recognized when there has been a decrease in expected cash flows combined with a decline in the security's fair value below cost.

(G) ***Investment in American Independence Corp.***

The Company's investment in AMIC is carried on the equity method, with the Company's share of equity income or loss credited or charged, as appropriate, to the Consolidated Statements of Operations with a corresponding change to the investment in AMIC.

(H) ***Other Investments***

Partnership interests primarily consist of investments in partnerships that have relatively "market neutral" arbitrage strategies, or strategies that are relatively insensitive to interest rates. All securities held by these partnerships are carried at fair value. The Company's partnership interests are carried on the equity method, which approximates the Company's equity in their underlying net book value. Equity income or loss is credited or charged, as appropriate, to the Consolidated Statements of Operations. Policy loans are stated at their aggregate unpaid balances.

(I) ***Deferred Acquisition Costs ("DAC")***

The costs of acquiring new insurance business (principally commissions, certain variable underwriting, agency and policy issuance expenses, and the direct costs of acquiring blocks of business) are deferred and are being amortized. For investment products (principally annuities) and universal life insurance products, DAC is being amortized with interest over the lives of the policies in relation to the present value of estimated gross profits. DAC is adjusted each quarter to reflect revised best estimate assumptions. Any resulting DAC unlocking adjustments are reflected currently in the Consolidated Statements of Operations. DAC for all other products is amortized proportionally over the period during which the premium is earned. All DAC is periodically reviewed to determine recoverability from future income, including investment income, and, if not recoverable, is charged to expense. Deferred acquisition costs have been increased (decreased) by $637,000, $703,000 and ($1,034,000) in 2004, 2003 and 2002, respectively, representing the portion of unrealized losses (gains) on investment securities available for sale that have been allocated to deferred acquisition costs on interest sensitive products rather than to stockholders' equity as a component of other comprehensive income.

(J) ***Property and Equipment***

Property and equipment of $2,415,000 and $2,105,000 are included in other assets at December 31, 2004 and 2003, respectively, net of accumulated depreciation and amortization of $4,994,000 and $3,948,000, respectively. Improvements are capitalized while repair and maintenance costs are charged to operations as incurred. Depreciation of property and equipment has been provided on the straight-line method over the estimated useful lives of the respective assets. Amortization of leasehold improvements has been provided on the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

(K) ***Insurance Reserves***

The Company maintains loss reserves to cover its estimated liability for unpaid losses and loss adjustment expenses, including legal and other fees as well as a portion of the Company's general expenses, for reported and unreported claims incurred as of the end of each accounting period. The Company computes insurance reserves primarily using the net premium method based on anticipated investment yield, mortality (morbidity on health insurance) and withdrawals. Liabilities for insurance reserves on certain short-term medical coverages were computed using completion factors and expected loss ratios derived from actual historical premium and claim data. The reserves for annuities in payout status are computed at the present value of remaining benefits discounted at statutory interest rates and statutory mortality rates if life contingent. These methods are widely used in the life and health insurance industry to estimate the liabilities for insurance reserves. Inherent in these calculations are management and actuarial judgments and estimates which could significantly impact the ending reserve liabilities and, consequently, operating results. Life reserve interest rates are generally graded and range from 2.0% to 11.3% per annum. Withdrawals are based on experience.

(L) ***Funds on Deposit***

Funds received for certain long-duration contracts (principally deferred annuities and universal life policies) are credited directly to a policyholder liability account, funds on deposit. Withdrawals are recorded directly as a reduction of respective policyholders' funds on deposit. Amounts on deposit were credited at annual rates ranging from 2.0% to 11.3% in 2004, 2.5% to 8.1% in 2003 and 2.5% to 12.0% in 2002. The average credited rate was 4.5% in 2004 and 2003, and 4.8% in 2002.

(M) ***Insurance Premium Revenue Recognition***

Premiums from short-duration contracts ordinarily will be recognized as revenue over the period of the contracts in proportion to the amount of insurance protection provided. Premiums from long-duration contracts are recognized as revenue when due from policyholders.

(N) ***Participating Policies***

Participating policies represent 10.2%, 11.0% and 11.1% of the individual life insurance in-force and 0.5%, 0.7% and 0.9% of the net premiums earned, as of and for the years ended December 31, 2004, 2003 and 2002, respectively, and provide for the payment of dividends. Dividends to policyholders are determined annually and are payable only upon declaration by the Board of Directors of the insurance companies. At December 31, 2004 and 2003, none of the insurance companies' stockholders' equity was restricted because of participating policyholders' surplus.

(O) ***Deferred Income Taxes***

The provision for deferred income taxes is based on the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized by applying enacted statutory tax rates to temporary differences between amounts reported in the Consolidated Financial Statements and the tax bases of existing assets and liabilities. A valuation allowance is recognized for the portion of deferred tax assets that, in management's judgment, is not likely to be realized. The effect on deferred income taxes of a change in tax rates or laws is recognized in income tax expense in the period that includes the enactment date.

(P) ***Income Per Common Share***

Included in the diluted earnings per share calculation for 2004, 2003 and 2002, respectively, are 314,000, 286,000 and 405,000 incremental shares from the assumed exercise of stock options using the treasury stock method. Net income does not change as a result of the assumed dilution of options.

(Q) ***Reinsurance***

Amounts paid for or recoverable under reinsurance contracts are included in total assets or total liabilities as due from reinsurers or due to reinsurers. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies using assumptions consistent with those used to account for the underlying policies.

(R) ***Stock-Based Compensation***

The Company applies Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations in accounting for its stock option plans. Since stock options under the plans are issued with an exercise price equal to the stock's fair value on date of grant, no compensation cost has been recognized in the Consolidated Statements of Operations. The Company follows the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation."

SFAS No. 123 establishes a fair value based method of accounting for stock-based compensation plans as an alternative to APB Opinion No. 25. Under SFAS No. 123, the compensation cost for options is measured at the grant date based on the value of the award, and such cost is recognized as an expense over the vesting period of the options. Compensation cost for stock appreciation rights ("SARs") is recognized over the service period of the award under both APB Opinion No. 25 and SFAS No. 123. Had the Company applied SFAS No. 123 in accounting for stock-based compensation awards, net income and net income per share for the years ended December 31, 2004, 2003 and 2002 would have been as follows:

	2004	2003	2002
	(In thousands, except per share data)		
Net income, as reported	$22,939	$18,593	$15,813
Add SAR expense included in reported net income, net of tax	90	60	130
Deduct SAR and stock option expense under SFAS No. 123, net of tax	(791)	(625)	(620)
Pro forma net income	$22,238	$18,028	$15,323
Basic income per common share			
As reported	$ 1.63	$ 1.33	$ 1.13
Pro forma	$ 1.58	$ 1.29	$ 1.09
Diluted income per common share			
As reported	$ 1.60	$ 1.30	$ 1.10
Pro forma	$ 1.55	$ 1.27	$ 1.06

A tax benefit of $525,000, $415,000 and $334,000 was reflected in the pro forma expense under SFAS No. 123 for the years ended December 31, 2004, 2003 and 2002, respectively.

The pro forma adjustments relate to (i) SARs granted during 2000 and 2003 for which compensation cost was recognized as the increase, if any, of the Company's current stock price over the base price specified in the award, and (ii) options granted for which a fair value on the date of the grant was determined using the Black-Scholes model of theoretical options pricing. The fair values of options were based on the following assumptions: (i) expected volatility based on historical market prices; (ii) risk-free rate of return based on the 5-year U.S. Treasury Note yields at the date of grant; (iii) dividend yield based on the current dividend rate paid on the common stock; and (iv) a three year phased-in vesting period that averages two years.

The weighted average fair value of options granted during 2004, 2003 and 2002 was $5.16, $5.30 and $3.55 per share, respectively. Valuation assumptions are presented below:

	Weighted Averages for Options Issued During		
	2004	2003	2002
Expected life, in years	5	5	5
Expected volatility	45.6%	44.9%	31.7%
Risk free interest rate	3.9%	2.5%	4.7%
Expected annual dividends per share	$.05	$.0278	$.0278

As discussed in Note 1(U), the Company is required to adopt a fair-value-based method of accounting for stock options, beginning in 2005, which will result in the recognition of compensation expense.

(S) ***Goodwill and Other Intangible Assets***

Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Under SFAS 142, goodwill is no longer subject to amortization over its estimated useful life. Instead, SFAS 142 requires that goodwill be evaluated at least annually for impairment by applying a fair value based test and, if impairment occurs, the amount of impaired goodwill must be written off immediately. At December 31, 2004 and 2003, the Company had goodwill of $5,901,000 and $2,365,000, respectively. At December 31, 2004 and 2003, the Company had other intangible assets of $1,278,000 and $477,000, respectively, net of accumulated amortization of $135,000 in 2004. Goodwill and other intangible assets are included in other assets in the Consolidated Balance Sheets. In both 2004 and 2003, $477,000 of the intangible assets had an indefinite life and are not subject to amortization. The Company evaluates goodwill and other intangible assets for impairment at least annually. An impairment charge was not required in 2004, 2003 or 2002.

The changes in the carrying amount of goodwill are as follows for the years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
		(In thousands)	
Balance at beginning of year	$2,365	$ 392	$ 3,985
Acquisition of Majestic	2,800	—	—
Acquisition of AMIC shares	736	3,421	3,197
Sale of subsidiary	—	—	(6,790)
Equity share of acquired deferred tax benefits (AMIC)	—	(1,448)	—
Balance at end of year	$5,901	$ 2,365	$ 392

Amortization expense on intangible assets was $135,000 for the year ended December 31, 2004 (none in 2003 and 2002). Estimated amortization expense on intangible assets held at December 31, 2004 for the next five years is as follows:

Year Ended	Amortization Expense (In thousands)
2005	$297
2006	173
2007	118
2008	80
2009	53

The remaining amortization period is 9 years for this asset.

(T) ***Derivative Instruments***

The Company accounts for derivative instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded in the balance sheet as assets or liabilities at fair value. Hedge accounting is permitted only if certain criteria are met, including a requirement that a highly effective relationship exist between the derivative instrument and the hedged item, both at inception of the hedge and on an ongoing basis. Results of effective hedges are recognized in other comprehensive income for cash flow hedges and in current earnings for fair value hedges. The ineffective portions of hedge results are recognized in current earnings.

At December 31, 2004, the Company was a party to an interest rate swap agreement that was designated and effective as a cash flow hedge in accordance with SFAS No. 133. The objective of the swap is to reduce the variability in cash flows associated with the repricing of interest rates on certain variable rate debt. Changes in fair value of the swap are recorded in accumulated other comprehensive income or loss and are reclassified to net income as earnings are affected by the variability in the interest payments on the hedged debt.

(U) *New Accounting Pronouncements*

On September 30, 2004, the Financial Accounting Standards Board ("FASB") issued Staff Position No. EITF Issue 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which delays the effective date for the measurement and recognition guidance contained in Emerging Issues Task Force ("EITF") Issue No. 03-1. EITF Issue No. 03-1 provides guidance for evaluating whether an investment is other-than-temporarily impaired and was originally to be effective for other-than-temporary impairment evaluations made in reporting periods beginning after June 15, 2004 (July 1, 2004 for the Company). The delay in the effective date for the measurement and recognition guidance contained in EITF Issue No. 03-1 does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. Subsequent to the issuance of Staff Position No. EITF Issue 03-1-1, the FASB announced plans for a full reconsideration of existing authoritative literature concerning other-than-temporary impairment of securities. The outcome of this reconsideration and the impact, if any, on the Company's impairment recognition cannot be predicted at this time.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123(R)"), "Share-Based Payment", which supercedes SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123(R) addresses the accounting for share-based payment transactions with employees and other third parties; eliminates the ability to account for share-based compensation transactions using APB 25; and requires that the compensation costs relating to such transactions be recognized in the statement of operations. The revised statement is effective as of the first interim period beginning after June 15, 2005 and, therefore, the Company will adopt SFAS 123(R) on July 1, 2005 as required. SFAS 123(R) applies to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. Additionally, beginning on the required effective date, compensation expense will be recognized for the portion of outstanding awards for which the requisite service (vesting) has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosures. The revised statement is effective as of the first interim period beginning after June 15, 2005. The Company will adopt the statement on July 1, 2005 as required. The impact of adoption cannot be predicted at this time because it will depend, in part, on levels of share-based payments granted in the future. However, had the Company adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the pro forma disclosure included in Note 1(R).

Note 2. American Independence Corp.

AMIC is an insurance holding company engaged in the insurance and reinsurance business as a result of its acquisition of First Standard Holdings Corp. ("FSHC") from the Company in November 2002. AMIC does business with the Insurance Group, including reinsurance treaties under which in 2004, Standard Life and Madison Life ceded an average of 19.3% of their medical stop-loss business and 20% of their New York Statutory Disability Business. IHC owns 40% of AMIC's outstanding common stock at December 31, 2004 which, as described below, was purchased in four separate transactions in 2002, 2003 and 2004. IHC accounts for its investment in AMIC under the equity method; including goodwill, the investment in AMIC had a carrying value of $33,334,000 and $29,318,000 at December 31, 2004 and 2003, respectively.

For the years ended December 31, 2004 and 2003, IHC recorded $2,334,000 and $2,292,000, respectively, of equity income from its investment in AMIC representing IHC's proportionate share of income based on its varied ownership interest during both years. For the year ended December 31, 2002, IHC recorded a loss of $1,931,000 from its 19.9% equity investment in AMIC from July 30, 2002 to December 31, 2002.

In the fourth quarter of 2003, AMIC recognized income of $4,466,000 for a further reduction in the valuation allowance on its deferred tax asset which relates primarily to federal net operating loss carryforwards. This reduction had no effect on IHC's net income since it represented previously unrecognized tax benefits that existed when IHC acquired its ownership in AMIC. IHC recognizes its share of such benefits first as a reduction of its AMIC goodwill (until reduced to zero), and then as a component of its equity in AMIC's income or loss. IHC's equity share of AMIC's 2003 fourth quarter adjustment amounted to $1,448,000, which was recorded as a reduction of goodwill. IHC's remaining balance of AMIC goodwill was $2,708,000 and $1,973,000 at December 31, 2004 and 2003, respectively.

On July 30, 2002, the Company purchased a 19.9% interest in AMIC for $15,000,000. On November 14, 2002, the Company sold all of the stock of its subsidiary, FSHC, for $31,920,000 cash to AMIC. The sale of FSHC resulted in a gain to the Company of $10,120,000. Due to the Company's investment in AMIC, the Company reduced its investment by 19.9% of this gain and recognized in income a pre-tax gain of $8,106,000 ($4,564,000, net of tax). In April 2003, the Company completed a cash tender offer at $9.00 per share and purchased an additional 1,000,000 shares (or approximately 12%) of AMIC's outstanding common stock. In December 2003, the Company purchased an additional 613,401 shares of AMIC common stock and, in June 2004, purchased an additional 94,488 shares, bringing IHC's ownership of AMIC to 3,374,555 shares or 40% of the total shares outstanding at December 31, 2004.

The condensed balance sheets of AMIC at December 31, 2004 and 2003 are as follows:

	2004	2003
	(In thousands)	
Investments, at fair value	$ 44,469	$ 38,258
Cash and restricted cash	19,838	18,148
Goodwill	24,154	23,668
Deferred tax asset, net	13,491	15,990
Other assets	22,443	16,027
Total assets	$124,395	$112,091
Insurance liabilities	$ 38,042	$ 32,846
Other liabilities	5,860	5,091
Total liabilities	43,902	37,937
Minority interest	4,026	4,026
Total stockholders' equity	76,467	70,128
Total liabilities and stockholders' equity	$124,395	$112,091

In the fourth quarter of 2002, AMIC changed its fiscal year from September 30 to December 31. Accordingly, AMIC reported operating results for the twelve months ended December 31, 2004 and 2003, a transition period of three months ended December 31, 2002, and the twelve months ended September 30, 2002. AMIC's condensed operating results are as follows:

	Twelve Months Ended December 31, 2004	Twelve Months Ended December 31, 2003	Three Months Ended December 31, 2002	Twelve Months Ended September 30, 2002
	(In thousands)			
Revenues	$80,378	$55,553	$ 2,688	$ 1,730
Expenses	71,145	45,985	8,264	10,560
Income (loss) from continuing operations before income taxes	9,233	9,568	(5,576)	(8,830)
(Provision) benefit for income taxes	(3,569)	2,993	(1)	—
Income (loss) from continuing operations	5,664	12,561	(5,577)	(8,830)
Income (loss) from discontinued operations	240	110	(1,475)	(5,926)
Net income (loss)	$ 5,904	$12,671	$(7,052)	$(14,756)

The Company earned $327,000, $175,000 and $19,000 in 2004, 2003 and 2002, respectively, from its services agreement with AMIC dated November 15, 2002, and amended April 21, 2004.

Standard Life earned $223,000 and $26,000 in 2004 and 2003, respectively, from its service agreement with Independence American Insurance Corp. ("Independence American") dated June 1, 1988. No amounts were charged during 2002.

Note 3. Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell are utilized to invest excess funds on a short-term basis. At December 31, 2004, the Company had $93,544,000 in resale agreements outstanding, all of which settled on January 3, 2005 and were subsequently reinvested. The Company maintains control of securities purchased under resale agreements, values the collateral on a daily basis and obtains additional collateral, if necessary, to protect the Company in the event of default by the counterparties.

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:

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities available-for-sale:				
Corporate securities	$248,423	$2,614	$(5,275)	$245,762
Collateralized mortgage obligations ("CMOs") and asset backed securities ("ABS")	122,963	1,123	(2,764)	121,322
U.S. Government and agencies obligations	54,874	349	(691)	54,532
Agency mortgage backed pass through securities ("MBS")	34,167	30	(71)	34,126
Government-sponsored enterprise ("GSE") MBS	73,380	80	(522)	72,938
States and political subdivisions	17,110	594	—	17,704
Total fixed maturities	$550,917	$4,790	$(9,323)	$546,384
Equity securities available-for-sale:				
Common stock	$ 3,801	$ 690	$ (56)	$ 4,435
Preferred stock	7,404	262	(2)	7,664
Total equity securities	$ 11,205	$ 952	$ (58)	$ 12,099

Government-sponsored enterprise mortgage-backed securities consist of Federal Home Loan Mortgage Corporation and Federal National Mortgage Association securities.

	December 31, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities available-for-sale:				
Corporate securities	$206,665	$3,418	$(3,400)	$206,683
CMOs and ABS	187,189	3,940	(3,583)	187,546
U.S. Government and agencies obligations	43,645	199	(673)	43,171
Agency MBS	20,898	65	(38)	20,925
GSE MBS	14,881	—	(195)	14,686
States and political subdivisions	17,033	278	(11)	17,300
Total fixed maturities	$490,311	$7,900	$(7,900)	$490,311
Equity securities available-for-sale:				
Common stock	$ 3,577	$ 694	$ (12)	$ 4,259
Preferred stock	16,806	570	(232)	17,144
Total equity securities	$ 20,383	$1,264	$ (244)	$ 21,403

The amortized cost and fair value of fixed maturities at December 31, 2004, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

	Amortized Cost	Fair Value	% of Fair Value
	(Dollars in thousands)		
Due in one year or less	$ 5,215	$ 5,223	1.0%
Due after one year through five years	29,297	28,732	5.3%
Due after five years through ten years	99,831	98,795	18.0%
Due after ten years	186,064	185,248	33.9%
	320,407	317,998	58.2%
CMO, ABS, and MBS			
15 year	140,762	139,010	25.4%
30 year	89,748	89,376	16.4%
	$550,917	$546,384	100.0%

Gross gains of $9,335,000 and gross losses of $7,109,000 were realized on sales of available-for-sale securities for the year ended December 31, 2004. During 2004, the Company also recorded $622,000 of losses on securities not yet sold with declines in fair value that the Company considered to be other than temporary, including $430,000 for impairment of interest only securities due to decreases in expected cash flows attributable to declines in market interest rates. The Company realized net gains of $554,000 from trading securities in 2004.

Gross gains of $13,579,000 and gross losses of $8,301,000 were realized on sales of available-for-sale securities for the year ended December 31, 2003. During 2003, the Company also recorded $5,154,000 of losses on securities not yet sold with declines in fair value that the Company considered to be other than temporary, including $4,984,000 for impairment of interest only securities due to decreases in expected cash flows attributable to declines in market interest rates. The Company realized net gains of $189,000 from trading securities in 2003.

Gross gains of $23,119,000 and gross losses of $23,095,000 were realized on sales of available-for-sale securities for the year ended December 31, 2002. During 2002, the Company also recorded $7,170,000 of losses on securities not yet sold with declines in fair value that the Company considered to be other than temporary, including $6,402,000 for impairment of interest only securities due to decreases in expected cash flows attributable to declines in market interest rates. The Company realized net losses of $412,000 from trading securities in 2002.

The following table summarizes, for all securities in an unrealized loss position at December 31, 2004 and 2003, respectively, the aggregate fair value and gross unrealized loss by length of time those securities which had continuously been in an unrealized loss position:

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2004	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Corporate securities	$163,517	$5,060	$ 2,608	$ 215	$166,125	$5,275
CMOs and ABS	74,076	2,046	30,664	718	104,740	2,764
US Government and agencies	40,630	691	—	—	40,630	691
Agency MBS	15,568	71	2	—	15,570	71
GSE MBS	44,584	522	—	—	44,584	522
Total fixed maturities	338,375	8,390	33,274	933	371,649	9,323
Common stock	726	56	—	—	726	56
Preferred stock	1,143	2	—	—	1,143	2
Total temporarily impaired securities	$340,244	$8,448	$33,274	$ 933	$373,518	$9,381

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2003	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Corporate securities	$110,055	$2,655	$ 6,655	$ 745	$116,710	$3,400
CMOs and ABS	109,277	2,870	2,938	713	112,215	3,583
US Government and agencies	31,457	673	—	—	31,457	673
Agency MBS	17,339	38	4	—	17,343	38
GSE MBS	14,686	195	—	—	14,686	195
States and political subdivisions	1,494	11	—	—	1,494	11
Total fixed maturities	284,308	6,442	9,597	1,458	293,905	7,900
Common stock	397	12	—	—	397	12
Preferred stock	7,656	232	—	—	7,656	232
Total temporarily impaired securities	$292,361	$6,686	$ 9,597	$1,458	$301,958	$8,144

Substantially all of the unrealized losses at December 31, 2004 and 2003 relate to investment grade securities and are attributable to changes in market interest rates subsequent to purchase. There were no securities with unrealized losses that were individually significant dollar amounts at December 31, 2004 or 2003. At December 31, 2004 and 2003, a total of 63 and 54 securities, respectively, were in a continuous unrealized loss position for less than 12 months and 6 and 10 securities, respectively, had continuous unrealized losses for 12 months or longer. For fixed maturities, there are no securities past due or securities for which the Company currently believes it is not probable that it will collect all amounts due according to the contractual terms of the investment. Because the Company has the ability to hold securities with unrealized losses until a market price recovery (which, for fixed maturities, may be until maturity) the Company did not consider these investments to be other-than-temporarily impaired at December 31, 2004 and 2003.

Note 5. Fair Value Disclosure of Financial Instruments

The following methods and assumptions were used to estimate the fair value of financial instruments not disclosed elsewhere in the Notes:

(A) ***Policy Loans***

The fair value of policy loans is calculated by projecting the current policy loans in the aggregate 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 policy loan 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 carrying value which approximates fair value. The second type carries fixed interest rates which are higher than current market interest rates. The fair value of these deposits was determined 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 carrying value which approximates fair value.

(C) ***Debt***

The Company has two types of debt. The first type is at variable interest rates which approximate market interest rates. The Company's carrying value of this debt approximates fair value. The second type of debt is fixed interest rate debt. The fair value of this debt is determined by discounting the debt using current market interest rates.

The estimated fair values of financial instruments are as follows:

	December 31, 2004		December 31, 2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities	$546,384	$546,384	$490,311	$490,311
Equity securities	12,099	12,099	21,403	21,403
Policy loans	16,756	18,912	18,088	20,253
Other	166	166	—	—
Financial liabilities:				
Funds on deposit	308,465	309,180	271,668	272,248
Debt and junior subordinated debt securities	50,646	50,293	35,182	35,182

Note 6. Net Investment Income

Major categories of net investment income for the years ended December 31, 2004, 2003 and 2002 are summarized as follows:

	2004	2003	2002
		(In thousands)	
Fixed maturities	$35,795	$28,802	$27,811
Equity securities	1,164	1,118	1,307
Short-term investments	1,038	591	1,192
Policy loans	1,090	1,075	1,231
Equity income:			
Investment partnerships	2,900	4,067	3,882
Operating partnerships	924	230	882
Other	606	269	261
Interest expense	(383)	(181)	(643)
Investment expenses	(219)	(175)	(190)
	$42,915	$35,796	$35,733

Note 7. Net Realized and Unrealized Gains (Losses)

Net realized and unrealized gains (losses) on investments for the years ended December 31, 2004, 2003 and 2002 are as follows:

	2004	2003	2002
		(In thousands)	
Fixed maturities	$1,075	$(751)	$(5,744)
Equity securities	1,136	990	(1,305)
Other	(53)	74	(509)
Net realized gains (losses)	2,158	313	(7,558)
Unrealized gain on Majestic put/call	236	—	—
Net realized and unrealized gain (loss)	$2,394	$ 313	$(7,558)

Note 8. Other Investments

Other investments consist of the following at December 31, 2004 and 2003:

	2004	2003
	(In thousands)	
Investment partnership interests	$24,118	$21,218
Policy loans	16,756	18,088
Operating partnership interests	6,220	6,075
Investment in trust subsidiaries	1,146	682
Other	439	437
	$48,679	$46,500

The Company had invested $10,086,000 and $10,878,000 at December 31, 2004 and 2003, respectively, in Dolphin Limited Partnership-A ("DLP-A"), a limited partnership which has focused on relatively "market neutral" investment strategies, such as merger arbitrage, convertible arbitrage and distressed situations. These strategies generally may be less affected by movements in the equity and fixed income markets than traditional investments. "Merger arbitrage" is an investment strategy primarily designed to profit from the successful completion of proposed mergers, takeovers, tender offers, leveraged buy-outs, recapitalizations and spin-offs. "Convertible arbitrage" is a strategy principally designed to capitalize on discrepancies in the pricing of convertible securities and their underlying common stock or equivalents. "Distressed situations" principally means entities which are in bankruptcy proceedings or are otherwise financially distressed. While these strategies are considered relatively "market neutral," there are also risks associated with the underlying transactions. The Company's net investment income for 2004, 2003 and 2002 includes $958,000, $1,331,000 and $326,000, respectively, for its proportionate share of the net income of DLP-A.

On July 2, 2003, IHC became a limited partner in Dolphin Domestic Fund II, L.P. ("Dolphin II") by making a commitment to invest $7,000,000 in the fund, of which $3,500,000 and $1,750,000 was funded at December 31, 2004 and 2003, respectively. The remaining $3,500,000 at December 31, 2004 is subject to capital call by the general partner of Dolphin II with 7 days prior written notice. Dolphin II is generally expected to make investments in companies where it can employ an "active investor" approach to investing. It will primarily seek to acquire significant positions in the debt and/or equity of publicly traded securities of North American companies. At December 31, 2004 and 2003, the carrying value of the Company's investment in Dolphin II was $4,563,000 and $1,962,000, respectively. During 2004, the general partner determined to liquidate the net assets of the partnership which is expected to occur in 2005. The Company's net investment income for 2004 and 2003 includes $852,000 and $212,000, respectively, for its proportionate share of the net income of Dolphin II.

Note 9. Acquisition

Effective July 1, 2004, IHC acquired a 52% controlling interest in Majestic Underwriters LLC ("Majestic"), a medical stop-loss Managing General Underwriter ("MGU"), which had a block of approximately $41 million of annualized premium. AMIC acquired a 23% interest and the current senior management of Majestic owns 25% of the MGU. The purchase of IHC's share was paid for with both net cash of $1,540,000 and the issuance of 129,808 shares of IHC common stock (the "Shares") with a fair value of $2,100,000 (See Note 13). IHC recorded goodwill of $2,800,000 and intangible assets of $936,000 in connection with the acquisition of its 52% controlling interest.

IHC issued a stock put on all IHC shares issued in the acquisition that vests on July 1, 2005 and expires on July 1, 2006, at a price of $17.15 per share ("Put"). IHC was granted a corresponding stock call on the same IHC shares that vests on July 1, 2005 and expires on July 1, 2006, at a price of $20.00 per share ("Call"). The put and call were recorded at fair value at the acquisition date. For the year ended December 31, 2004, IHC recorded an unrealized gain of $236,000 in the Consolidated Statement of Operations representing the net change in fair value of the put and call. Under certain circumstances set forth in the Limited Liability Agreement of Majestic, the Company has the right and/or obligation to purchase some or all of the minority interest in Majestic.

Note 10. Insurance Policy Claims and Reserves

The liabilities for unpaid claims and claim adjustment expenses and insurance reserves-health represent amounts necessary to provide for the estimated cost of settling claims relating to insured events that have been incurred prior to the balance sheet date which have not yet been settled.

The change in the liability for reserves, unpaid claims and claim adjustment expenses for the Insurance Group's health and disability coverages for December 31, 2004, 2003 and 2002 is as follows:

	2004	2003	2002
		(In thousands)	
Balance at beginning of year	$175,692	$156,380	$141,075
Less: reinsurance recoverables	113,181	105,932	98,361
Net balance at beginning of year	62,511	50,448	42,714
Amount incurred:			
Current year	82,563	70,652	61,160
Prior years	5,570	1,578	(403)
Total	88,133	72,230	60,757
Amount paid, related to:			
Current year	44,146	28,232	29,263
Prior years	42,480	31,935	23,760
Total	86,626	60,167	53,023
Net balance at end of year	64,018	62,511	50,448
Plus: reinsurance recoverables	104,564	113,181	105,932
Balance at end of year	$168,582	$175,692	$156,380

The preceding schedule reflects (i) the due and unpaid, (ii) claims in the course of settlement, (iii) estimated incurred but not reported reserves and (iv) the present value of amounts not yet due on claims. The incurred and paid data above reflects all activity for the year. The amount incurred in 2004 for prior years of $5,570,000 primarily relates to an increase in Medical Stop-Loss and LTD reserves.

Note 11. Debt and Junior Subordinated Debt Securities

(A) ***Debt***

A subsidiary of IHC entered into a $12,500,000 line of credit in September 2003. As to such subsidiary, the line of credit (i) contains restrictions with respect to, among other things, the creation of additional indebtedness, the consolidation or merger with or into certain corporations, the payment of dividends and the retirement of capital stock; (ii) requires the maintenance of minimum amounts of net worth, as defined, certain financial ratios, and certain investment restrictions; and (iii) is secured by the stock of Madison Life and the assets of such subsidiary of IHC. At both December 31, 2004 and 2003, there was $12,500,000 outstanding under the line of credit. The debt matures in full on September 1, 2006. The line of credit bears interest at a variable interest rate equal to LIBOR plus 1.25%. The Company has entered into an interest rate swap, with terms that mirror those of the debt, under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate of 3.96%. There was no hedge ineffectiveness on this swap which is accounted for as a cash flow hedge. The fair value of the swap and the related after tax adjustment in accumulated other comprehensive income (loss) were insignificant at December 31, 2004 and 2003.

(B) *Junior Subordinated Debt Issued to Trust Preferred Subsidiaries*

Junior subordinated debt consisted of the following at December 31, 2004 and 2003:

	2004	2003
	(In thousands)	
Independence Preferred Trust I—Trust Preferred	$10,000	$10,000
Independence Preferred Trust I—Common Stock	310	310
Junior subordinated debt security—Trust I	10,310	10,310
Independence Preferred Trust II—Trust Preferred	12,000	12,000
Independence Preferred Trust II—Common Stock	372	372
Junior subordinated debt security—Trust II	12,372	12,372
Independence Preferred Trust III—Trust Preferred	15,000	—
Independence Preferred Trust III—Common Stock	464	—
Junior subordinated debt security—Trust III	15,464	—
Total junior subordinated debt securities	$38,146	$22,682

The Company has three statutory business trusts that were formed in 2004 and 2003 for the purpose of issuing trust preferred securities, totaling $37,000,000 at December 31, 2004 and $22,000,000 at December 31, 2003, to institutional investors in pooled issuances. Although the Company owns all of the trusts' common securities, it is not the primary beneficiary for purposes of FIN 46R, "Consolidation of Variable Interest Entities," and, accordingly, the trusts are unconsolidated subsidiaries for financial reporting purposes. This resulted in the recognition of liabilities of $38,146,000 and $22,682,000 at December 31, 2004 and 2003, respectively, for junior subordinated debt and an asset of $1,146,000 and $682,000, respectively, for the investment in trust subsidiaries. The Company's subordinated debt securities, which are the sole assets of the subsidiary trusts, are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has provided a full and unconditional guarantee of amounts due on the trust preferred securities. The terms of the junior subordinated debt securities, including interest rates and maturities, are the same as the related trust preferred securities.

Independence Preferred Trust I. The distributions payable on the capital securities are cumulative and payable quarterly in arrears. The Company has the right, subject to events of default, to defer payments of interest for a period not to exceed 20 consecutive quarters, provided that no extension period may extend beyond the maturity date of April 7, 2033. The Company has no current intention to exercise its right to defer interest payments. The rate on the capital securities is fixed at 7.4% for the first five years and set at approximately 400 basis points over the three month LIBOR thereafter.

The capital securities are mandatorily redeemable upon maturity on April 7, 2033. The Company has the right to redeem the capital securities, in whole or in part, on certain dates prior to April 7, 2008 with certain prepayment penalties. If the capital securities were redeemed on or after April 7, 2008, the redemption price would be 100% (without penalty) of the principal amount plus accrued and unpaid interest.

Independence Preferred Trust II. The distributions payable on the capital securities are cumulative and payable quarterly in arrears. The Company has the right, subject to events of default, to defer payments of interest for a period not to exceed 20 consecutive quarters, provided that no extension period may extend beyond the maturity date of January 8, 2034. The Company has no current intention to exercise its right to defer interest payments. The rate on the capital securities is set at 390 basis points over the three month LIBOR and was 5.97% and 5.10% at December 31, 2004 and 2003, respectively.

The capital securities are mandatorily redeemable upon maturity on January 8, 2034. The Company has the right to redeem the capital securities, in whole or in part, on certain dates prior to January 8, 2009 with certain prepayment penalties. If the capital securities were redeemed on or after January 8, 2009, the redemption price would be 100% (without penalty) at the principal amount plus accrued and unpaid interest.

Independence Preferred Trust III. The distributions payable on the capital securities are cumulative and payable quarterly in arrears. The Company has the right, subject to events of default, to defer payments of interest for a period not to exceed 20 consecutive quarters, provided that no extension period may extend beyond the maturity date of December 15, 2034. The Company has no current intention to exercise its right to defer interest payments. The rate on the capital securities is fixed at 7.2% for the first five years and is 350 basis points over the three month LIBOR thereafter.

The capital securities are mandatorily redeemable upon maturity on December 15, 2034. The Company has the right to redeem the capital securities, in whole or in part, on certain dates prior to December 15, 2009 with certain prepayment penalties. If the capital securities are redeemed on or after December 15, 2009, the redemption price would be 100% (without penalty) at the principal amount plus accrued and unpaid interest.

Cash payments for interest on debt and junior subordinated debt securities were $1,796,000, $673,000 and $434,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

Note 12. Preferred Stock

IHC has 100,000 authorized shares of preferred stock, par value $1.00 per share.

Note 13. Common Stock

On July 29, 2004, IHC filed an amendment to its Restated Certificate of Incorporation with the Secretary of State of the State of Delaware to reflect an increase in the number of shares of common stock, $1.00 par value per share, which IHC has authority to issue by 5,000,000 from 15,000,000 to 20,000,000, and consequently, to increase the total number of shares of all classes of stock which IHC shall have authority to issue by 5,000,000, from 15,100,000 to 20,100,000. The amendment was approved by the written consent of stockholders pursuant to a consent solicitation commenced on July 12, 2004. IHC has reserved 1,318,872 shares of common stock for issuance under its stock option plans at December 31, 2004.

In 1991, IHC initiated a program of repurchasing shares of its common stock. From January 1, 1991 through December 31, 2004, IHC repurchased 5,572,652 adjusted common shares, or 34.0% of the amount outstanding on January 1, 1991, at a cost of $30,632,000. This total includes repurchases of 300,780 shares, 387,463 shares, and 165,699 shares in 2004, 2003 and 2002, respectively. All of such repurchased shares have either been retired, reissued, or become treasury shares.

During the third quarter of 2004, the Company issued 129,808 shares of its common stock in connection with the acquisition of Majestic. The shares were issued at a fair value of $16.18 per share in reliance upon the exemption from the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”), as a private placement of unregistered securities under Section 4(2) thereof. Accordingly, the shares will be “restricted securities”, subject to a legend and will not be freely tradable in the United States until the shares are registered for resale under the Securities Act, or to the extent they are tradable under Rule 144 promulgated under the Securities Act or any other available exemption. Any resale or other disposition of the securities in the United States must be made either under a registration statement filed by IHC with the Securities and Exchange Commission or under an exemption from the registration requirements of the Securities Act.

During the second quarter of 2002, the Company purchased the remaining minority interest in a majority owned MGU of Madison Life. The purchase was paid for with both cash and the issuance of 83,880 shares of common stock. The shares were issued at a fair value of $11.11 per share in reliance upon the exemption from the registration requirements of the Securities Act, as a private placement of unregistered securities under Section 4(2) thereof. Accordingly, the shares will be “restricted securities”, subject to a legend and will not be freely tradable in the United States until the shares are registered for resale under the Securities Act, or to the extent they are Tradable under Rule 144 promulgated under the Securities Act or any other available exemption. Any resale or other disposition of the securities in the United States must be made either under a registration statement filed by IHC with the Securities and Exchange Commission or under an exemption from the registration requirements of the Securities Act.

Note 14. Sale of Remaining Real Estate

In 2002, a subsidiary of the Company sold the Company's only remaining real estate holdings for cash of $1,340,000. As the carrying value of such property was zero, the sale resulted in a pre-tax gain in the fourth quarter of 2002 of $1,340,000, which is included in other income in the Consolidated Statements of Operations.

Note 15. Stock-Based Compensation

On May 25, 1988, the stockholders approved the amended and restated Stock Option and Incentive Stock Option Plan (the "1988 Plan") under which 1,584,000 shares of common stock were reserved for options and other common stock awards. Under the terms of the 1988 Plan, option exercise prices are equal to the quoted market price of the shares at the date of grant. Further, the options have expiration dates ranging from five to ten years from the date of grant. With regard to IHC employees, options vest ratably over a three year period beginning on the first or second anniversary of the date of grant, and with regard to directors, options vest six months from the date of grant. The final option grants under the 1988 Plan were made during 2003.

On June 20, 2003, the stockholders approved the Independence Holding Company 2003 Stock Incentive Plan ("2003 Plan") under which 630,000 shares of common stock were reserved for options and other common stock awards. Under the terms of the 2003 Plan, option exercise prices will not be less than the fair market value of a share of stock on the date of grant. At December 31, 2004 and 2003, options to purchase 134,640 and 392,580 shares, respectively, were available for future grants under the both the Plans.

During 1999, the Company granted 44,550 Stock Appreciation Rights ("Rights") with a base price of $6.39. At the date of grant, the base price equaled the quoted market price of the shares. During 2004, all of the Rights were exercised and the difference between the base price of the Rights and then-current market price was paid in cash.

In the first quarter of 2003, the Company granted 238,410 Rights with a base price of $11.08. At the date of grant, the base price equaled the quoted market price of the shares. In the second quarter of 2003, these Rights were immediately vested and terminated; a like number of non-qualified stock options were issued under the 2003 Plan at the then-current market price to the employees whose Rights were terminated; and the difference between the base price of the Rights and the then-current market price was paid to such employees in cash.

The following table summarizes information with respect to stock options granted under the 1988 Plan and the 2003 Plan for the years ended December 31, 2004, 2003, and 2002:

	2004		2003		2002	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,296,211	$ 7.88	1,334,790	$ 5.99	1,150,560	$ 5.31
Granted	257,940	20.73	315,810	11.30	200,070	9.87
Exercised	(369,919)	5.86	(348,449)	3.76	(3,690)	4.83
Forfeited	—	—	(4,950)	6.00	(12,150)	6.00
Expired	—	—	(990)	13.19	—	—
Outstanding at end of year	1,184,232	$11.31	1,296,211	$ 7.88	1,334,790	$ 5.99
Exercisable at end of year	645,672	$ 7.75	720,475	$ 6.08	932,220	$ 4.91

The following table is a summary of stock options outstanding and exercisable at December 31, 2004:

Range of Exercise Price		Options Outstanding			Options Exercisable	
From	To	Number Outstanding	Remaining Weighted Average Contractual Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 2.89	$ 5.18	137,470	1.7	$ 3.95	137,470	$ 3.95
6.00	8.32	280,831	1.2	7.26	280,831	7.26
9.39	11.52	507,991	3.0	10.74	221,431	10.54
13.19	20.89	257,940	4.4	20.75	5,940	14.71
$ 2.89	$20.89	1,184,232	2.7	$11.31	645,672	$ 7.75

Note 16. Income Taxes

The Company and its subsidiaries file a consolidated Federal income tax return on a June 30 fiscal year. The provision for income tax expense (benefit) for the years ended December 31, 2004, 2003 and 2002 is as follows:

	2004	2003	2002
	(In thousands)		
Current:			
U.S. Federal	$ 5,907	$ 5,198	$11,029
State and Local	290	186	816
	6,197	5,384	11,845
Deferred:			
U.S. Federal	4,226	4,659	(1,795)
State and Local	268	106	(400)
	4,494	4,765	(2,195)
	$10,691	$10,149	$ 9,650

Taxes computed at the Federal statutory rate of 35% in 2004, 2003 and 2002, are reconciled to the Company's actual income tax expense as follows:

	2004	2003	2002
		(In thousands)	
Tax computed at the statutory rate	$11,771	$10,060	$ 8,912
Dividends received deduction and tax exempt interest	(252)	(274)	(219)
State and local income taxes, net of Federal effect	363	444	270
Valuation allowance	—	(254)	69
Gain on sale of a subsidiary	—	—	705
Policyholders' surplus account tax	(1,122)	—	—
Other, net	(69)	173	(87)
Income tax expense	$10,691	$10,149	$ 9,650

The income tax benefit for the year ended December 31, 2004 allocated to stockholders' equity (principally for net unrealized losses on investment securities) was $1,453,000, representing the change to a net deferred tax asset of $1,111,000 at December 31, 2004 from a net deferred tax liability of $342,000 at December 31, 2003.

Temporary differences between the Consolidated Financial Statement carrying amounts and tax bases of assets and liabilities that give rise to the deferred tax assets and liabilities at December 31, 2004 and 2003 relate to the following:

	2004	2003
	(In thousands)	
Deferred Tax Assets:		
Deferred insurance policy acquisition costs	$ 6,302	$ 9,786
Investment write-downs	257	784
Unrealized losses on investment securities	1,316	963
Insurance reserves	309	684
Other	2,824	4,522
Total gross deferred tax assets	11,008	16,739
Deferred Tax Liabilities:		
Deferred insurance policy acquisition costs	(10,469)	(11,560)
Insurance reserves	(3,149)	(5,662)
Unrealized gains on investment securities	(39)	(1,316)
Investment in AMIC	(1,170)	(130)
Other	(2,284)	(1,012)
Total gross deferred tax liabilities	(17,111)	(19,680)
Net deferred tax liability	$ (6,103)	$ (2,941)

The $254,000 decrease and the $69,000 increase in the valuation allowance for the year ended December 31, 2003 and 2002, respectively, were allocated to the state and local income taxes on operations. The net deferred tax liability is included in other liabilities in the Consolidated Balance Sheets.

Under provisions of the Life Insurance Company Tax Act of 1959, life insurance companies were allowed certain special deductions for Federal income tax purposes that were accumulated in a memorandum tax account designated as "policyholders' surplus." Distributions of the untaxed amounts in this account would result in the Company incurring an additional tax. The Company provided tax expense of $1,122,000 in 1992 and prior years for taxes related to the policyholders' surplus account. As a result of the October 2004 enactment of the American Jobs Creation Act of 2004, the Company reduced 2004 income tax expense by $1,122,000 for the reversal of the prior years' income tax provisions. The Company intends to implement the distribution requirements of this tax law which will eliminate any future policyholders' surplus account tax.

Net cash payments for income taxes were $6,004,000, $8,181,000 and $11,086,000 in 2004, 2003 and 2002, respectively.

Note 17. Commitments and Concentration of Credit Risk

Certain subsidiaries of the Company are obligated under non-cancelable operating lease agreements for office space. Total rental expense for the years 2004, 2003 and 2002 for operating leases was $1,218,000, $1,287,000 and $1,382,000, respectively.

The approximate minimum annual rental expense for operating leases that have remaining non-cancelable lease terms in excess of one year at December 31, 2004 are as follows (in thousands):

2005	$1,047
2006	998
2007	806
2008	737
2009	736
2010 and thereafter	1,473
Total	$5,797

As described in Note 8, the Company also has an unfunded commitment of $3,500,000 related to an investment partnership at December 31, 2004.

At December 31, 2004, the Company had no investment securities of any one issuer or in any one industry which exceeded 10% of stockholders' equity, except for investments in obligations of the U.S. Government and its agencies, and mortgage-backed securities issued by GSEs.

Fixed maturities with a carrying value of $5,947,000 and $5,187,000 were on deposit with various state insurance departments at December 31, 2004 and 2003, respectively.

At December 31, 2004, the Company had total net receivables of $59,802,000 from two reinsurers which are both rated A+ by A.M. Best. These are the only reinsurers with net receivables that individually exceed 10% of the equity of the Company. The Company believes that these receivables are fully collectible.

The Company knows of no material pending legal proceedings to which the Company is a party or of which any of its property is the subject.

Note 18. Reinsurance

(a) *Purchase of Policy Blocks*

In the second quarter of 2004, IHC acquired a block of individual annuity policies through an assumption reinsurance transaction.

In the fourth quarter of 2003, Madison Life and Standard Life closed three coinsurance transactions consisting of purchases of blocks of annuity and life policies.

A summary of the amounts recorded by the Company as of the effective dates is as follows (in thousands):

	2004	2003
Liabilities:		
Insurance reserves (life)	$ —	$12,485
Funds on deposit	26,585	78,969
Other policyholders' funds	—	1,518
	26,585	92,972
Non-cash assets:		
Due from ceding company	—	5,110
Deferred acquisition costs	800	4,939
Due and unpaid premiums	—	650
Policy loans	—	1,107
	800	11,806
Cash received	$25,785	$81,166

(b) *Effect of Reinsurance*

Standard Life and Madison Life reinsure portions of certain business in order to limit the assumption of disproportionate risks. Standard Life and Madison Life retain varying amounts of individual life or group life insurance. Amounts not retained are ceded to other companies on an automatic or facultative basis. In addition, Standard Life and Madison Life participate in various coinsurance treaties on a quota share basis. Standard Life and Madison Life are 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.

The effect of reinsurance on life insurance in-force, benefits to policyholders and premiums earned is as follows:

	Direct Amount	Assumed From Other Companies	Ceded to Other Companies	Net Amount	Assumed to Net
			(In thousands)		
Life Insurance In Force:					
December 31, 2004	$8,140,817	$383,536	$3,255,695	$5,268,658	7.3%
December 31, 2003	7,447,989	351,264	3,171,957	4,627,296	7.6%
December 31, 2002	7,232,845	308,700	3,142,043	4,399,502	7.0%
Benefits to Policyholders:					
December 31, 2004	$ 233,325	$ 36,264	$ 158,958	$ 110,631	32.8%
December 31, 2003	170,401	32,278	119,428	83,251	38.8%
December 31, 2002	183,033	15,131	118,119	80,045	18.9%
Premiums Earned:					
December 31, 2004					
Life and annuity	$ 39,890	$ 6,187	$ 13,088	$ 32,989	18.7%
Health	315,929	47,394	222,245	141,078	33.6%
	$ 355,819	$ 53,581	$ 235,333	$ 174,067	30.8%
December 31, 2003					
Life and annuity	$ 38,403	$ 2,293	$ 11,218	$ 29,478	7.8%
Health	289,501	37,943	207,515	119,929	31.6%
	$ 327,904	$ 40,236	$ 218,733	$ 149,407	26.9%
December 31, 2002					
Life and annuity	$ 40,101	$ 2,523	$ 10,767	$ 31,857	7.9%
Health	238,701	35,997	173,665	101,033	35.6%
	$ 278,802	$ 38,520	$ 184,432	$ 132,890	29.0%

The Company ceded $49,082,000, $28,146,000, and $1,636,000 of premiums to a subsidiary of AMIC in the years ended December 31, 2004 and 2003 and the three months ended December 31, 2002, respectively.

Note 19. Segment Reporting

The Insurance Group principally engages in the life and health insurance business. Interest expense, taxes, and general expenses associated with parent company activities are included in Corporate. Identifiable assets by segment are those assets that are utilized in each segment and are allocated based upon the mean reserves of each such segment. Corporate assets are composed principally of cash equivalents, resale agreements, fixed maturities, equity securities, partnership interests and certain other investments. Information by business segment for the years ended December 31, 2004, 2003 and 2002 is presented below.

	2004	2003	2002
		(In thousands)	
Revenues:			
Medical Stop-Loss (A)	$101,027	$ 78,893	$ 67,061
Group disability; life, annuities and DBL	47,330	44,802	45,818
Individual life, annuities and other	50,833	41,437	43,977
Credit life and disability	20,508	20,307	15,030
Corporate (B)	3,577	2,126	10,025
	223,275	187,565	181,911
Net realized and unrealized gains (losses)	2,394	313	(7,558)
	$225,669	$187,878	174,353
Income Before Income Taxes:			
Medical Stop-Loss (A)	$ 17,347	$ 14,503	$ 13,250
Group disability; life, annuities and DBL	6,073	7,855	7,612
Individual life, annuities and other	9,634	7,739	6,440
Credit life and disability	698	563	125
Corporate (B)	(178)	(1,333)	6,029
	33,574	29,327	33,456
Interest expense	(2,338)	(898)	(435)
Net realized and unrealized gains (losses)	2,394	313	(7,558)
	$ 33,630	$ 28,742	$ 25,463

(A) The amount includes income (loss) from AMIC of $2,334,000, $2,292,000 and $(1,931,000) for the years 2004, 2003 and 2002, respectively.

(B) The amount in 2002 includes an $8,106,000 gain on sale of a subsidiary and a $1,340,000 gain on the sale of real estate.

	2004	2003
	(In thousands)	
Identifiable Assets at Year End		
Medical Stop-Loss (A)	$ 91,597	$ 68,788
Group disability; life, annuities and DBL	226,833	207,669
Individual life, annuities and other	592,360	559,881
Credit life and disability	22,122	23,946
Corporate	35,581	38,018
	$968,493	$898,302

(A) The amount includes the investment in AMIC (including goodwill) of $33,334,000 and $29,318,000 at December 31, 2004 and 2003, respectively.

Note 20. Dividend Restrictions on Insurance Subsidiaries and Statutory Accounting Policies

Dividends from Madison Life are subject to the prior notification to the Commissioner of Insurance of the State of Wisconsin if such dividend distribution exceeds 115% of the distribution for the corresponding period of the previous year. In addition, if such dividends, together with the fair market value of other dividends paid or credited and distributions made within the preceding twelve months, exceed the lesser of (i) total net gain from operations for the preceding calendar year minus realized capital gains for that calendar year and (ii) 10% of surplus with regard to policyholders as of December 31 of the preceding year, such dividends may be paid so long as such dividends have not been disapproved by the Wisconsin Insurance Commissioner within 30 days of its receipt of notice thereof. Subject to the above procedure, the maximum amount of dividends that Madison Life may pay in 2005, in accordance with such calculation, is $5,400,000. No dividends were declared or paid by Madison Life in 2004, 2003 or 2002.

The payment of dividends by Standard Life to its parent, Madison Life, is subject to the prior notification to the New York State Insurance Department if such dividends, together with other dividends, in such calendar year exceed the lesser of (i) 10% of surplus as regards policyholders as of the immediately preceding calendar year and (ii) net gain from operations for the immediately preceding calendar year, not including realized capital gains. Such dividends may be paid so long as they have not been disapproved by the New York State Department of Insurance within 30 days of its receipt of notice thereof. Subject to the above procedure, the maximum amount of dividends that Standard Life may pay in 2005, in accordance with such calculation, is $10,549,000. Standard Life declared and paid a dividend of $6,000,000 to Madison Life in 2003. No dividends were declared or paid by Standard Life in 2004 or 2002.

Under Delaware law, IHC is permitted to pay dividends from surplus or net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. IHC declared cash dividends of $704,000, $386,000 and $387,000 in 2004, 2003 and 2002, respectively.

Note 21. Subsequent Events

On January 5, 2005, Strategic Health Associates, Inc. ("SHA") acquired a 100% interest in Health Plan Administrators, Inc. ("HPA"), an administrator of short-term and temporary medical insurance products based in Rockford, Illinois and Tampa, Florida, for $12 million cash. IHC owns 80% of SHA with the remainder owned by Insurers Administrative Corporation ("IAC"), a leading individual and group health insurance administrator. Beginning in the first quarter of 2005, HPA offers short-term medical insurance in certain jurisdictions through Standard Security Life.

As of January 1, 2005, IHC has agreed to reinsure, on a 100% basis and subsequently assume, subject to regulatory approval, a block in excess of $50 million of employer-sponsored group major medical insurance. This block is currently, and will continue to be, administered by IAC. The current carrier will continue issuing new business until the Standard Life policy forms are approved. Standard Life will begin issuing new business as its policy forms are approved, and will begin assuming the existing policies as approvals are received. It is anticipated that this process will be substantially completed during 2005.

Note 22. Comprehensive Income

The components of total comprehensive income include net income and certain amounts reported directly in equity, principally the after-tax unrealized gains and losses on investment securities available-for-sale.

Amounts reported in equity and included in total comprehensive income for the years ended December 31, 2004, 2003 and 2002 are as follows:

	Before Tax	Tax Effect	Net of Tax
		(In thousands)	
2004			
Unrealized losses, arising during the year	$(2,319)	$ 690	$(1,629)
Reclassification of realized and unrealized gains in net income	(2,394)	763	(1,631)
Allocation to deferred acquisition costs	637	—	637
Unrealized losses on securities, net	$(4,076)	$ 1,453	$(2,623)
2003			
Unrealized losses, arising during the year	$(2,053)	$ 508	$(1,545)
Reclassification of realized gains included in net income	(313)	107	(206)
Allocation to deferred acquisition costs	703	—	703
Unrealized losses on securities, net	$(1,663)	$ 615	$(1,048)
2002			
Unrealized losses, arising during the year	$(3,948)	$ 1,826	$(2,122)
Reclassification of realized losses included in net income	7,558	(2,801)	4,757
Allocation to deferred acquisition costs	(1,034)	—	(1,034)
Unrealized gains on securities, net	$ 2,576	$ (975)	$ 1,601

Note 23. Quarterly Data (Unaudited)

The quarterly results of operations for the years ended December 31, 2004 and 2003 are summarized below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
2004				
Total revenues	$52,432	$58,113	$58,673	$56,451
Net income	$ 5,500	$ 5,550	$ 5,546	$ 6,343
Net income per common share—basic	$ .39	$ .40	$ .39	$ .45
Net income per common share—diluted	$ .39	$ .39	$ .38	$ .44

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
2003				
Total revenues	$42,490	$48,086	$47,595	$49,707
Net income	$ 4,437	$ 4,958	$ 4,493	$ 4,705
Net income per common share—basic	$ .32	$ .35	$ .32	$ .34
Net income per common share—diluted	$ .31	$ .34	$ .32	$ .33

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

SUMMARY OF INVESTMENTS—OTHER THAN INVESTMENTS IN AFFILIATES

December 31, 2004

Column A	Column B	Column C	Column D
Type of Investment	Cost	Value	Amount Shown on Balance Sheet
		(In thousands)	
Fixed Maturities:			
United States Government and authorities	$ 89,041	$ 88,658	$ 88,658
GSE MBS	73,380	72,938	72,938
States, municipalities and political subdivisions	17,110	17,704	17,704
All other corporate securities	371,386	367,084	367,084
Total Fixed Maturities	550,917	546,384	546,384
Equity Securities:			
Industrial, miscellaneous and all other common stocks	3,801	4,435	4,435
Non-redeemable preferred stocks	7,404	7,664	7,664
Total Equity Securities	11,205	12,099	12,099
Short-term investments	21,470	21,470	21,470
Securities purchased under agreements to resell	93,544	93,544	93,544
Investment partnership interests	24,118	24,118	24,118
Operating partnership interests	6,220	6,220	6,220
Policy loans	16,756	16,756	16,756
Investment in trust subsidiaries	1,146	1,146	1,146
Other	439	439	439
Total Investments	$725,815	$722,176	$722,176

SCHEDULE II

INDEPENDENCE HOLDING COMPANY

BALANCE SHEETS
(PARENT COMPANY ONLY)

	December 31, 2004	December 31, 2003
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 589	$ 5,345
Other investments	12,377	8,503
Investments in consolidated subsidiaries	198,795	176,102
Investment in AMIC	3,575	3,102
Amounts due from consolidated subsidiaries, net	12,772	3,622
Taxes receivable	1,666	8,271
Other assets	2,750	2,682
Total Assets	$232,524	$207,627
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable and other liabilities	$ 4,722	$ 5,061
Amounts due to consolidated subsidiaries, net	—	10,135
Income taxes payable	450	467
Junior subordinated debt securities	38,146	22,682
Dividends payable	353	386
Total Liabilities	43,671	38,731
Stockholders' Equity:		
Preferred stock (none issued)	—	—
Common stock, 14,102,766 and 13,904,259 shares issued and outstanding, respectively, net of 132,300 and 3,708,123 shares in treasury, respectively	14,103	13,904
Paid-in capital	75,789	75,579
Accumulated other comprehensive (loss) income	(1,976)	647
Retained earnings	100,937	78,766
Total stockholders' equity	188,853	168,896
Total liabilities and stockholders' equity	$232,524	$207,627

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

INDEPENDENCE HOLDING COMPANY

STATEMENTS OF OPERATIONS
(PARENT COMPANY ONLY)

	Year Ended December 31,		
	2004	2003	2002
	(In thousands)		
Revenues:			
Net investment income	$ 1,735	$ 1,116	$ 2,666
Net realized gains	—	42	1
Other income	2,870	1,863	1,731
	4,605	3,021	4,398
Expenses:			
General and administrative expenses	4,669	2,426	2,895
(Loss) income before income tax (benefit) expense	(64)	595	1,503
Income tax (benefit) expense	(298)	35	487
Income before equity in net income of subsidiaries	234	560	1,016
Equity in net income of subsidiaries	22,705	18,033	14,797
Net income	$22,939	$18,593	$15,813

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

INDEPENDENCE HOLDING COMPANY

STATEMENTS OF CASH FLOWS
(PARENT COMPANY ONLY)

	Year Ended December 31, 2004	2003	2002
	(In thousands)		
Cash Flows from Operating Activities:			
Net income	$ 22,939	$ 18,593	$ 15,813
Adjustments to reconcile net income to net cash (used by) provided by operating activities:			
Equity in net income of subsidiaries	(22,705)	(18,033)	(14,797)
Net realized gains	—	(42)	(1)
Change in other assets and liabilities	560	(9,000)	156
Net cash provided (used) by operating activities	794	(8,482)	1,171
Cash Flows from Investing Activities:			
(Increase) decrease in investments in and advances to consolidated subsidiaries	(12,314)	5,688	3,981
Sale of equity securities	—	260	—
Acquisition of MGU	—	—	(3,357)
Additional investments in other investments, net of distributions	(3,410)	(10,318)	5,724
Investment in AMIC	—	(6,823)	—
Net cash (used) provided by investing activities	(15,724)	(11,193)	6,348
Cash Flows from Financing Activities:			
Repurchase of common stock	(5,667)	(4,287)	(1,807)
Exercise of common stock options	2,054	2,123	18
Proceeds of junior subordinated debt securities	14,533	21,444	—
Dividends paid	(746)	(387)	(389)
Net cash provided (used) by financing activities	10,174	18,893	(2,178)
(Decrease) increase in cash and cash equivalents	(4,756)	(782)	5,341
Cash and cash equivalents, beginning of year	5,345	6,127	786
Cash and cash equivalents, end of year	$ 589	$ 5,345	$ 6,127

The financial information of Independence Holding Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
SUPPLEMENTARY INSURANCE INFORMATION
(In thousands)

	Deferred Insurance Acquisition Costs	Policy Liabilities, Claims & Other Policy Holders' Funds	Unearned Premiums	Premiums Earned	Net Investment Income Gains, and Other Income(1)	Benefits and Claims	Amortization of Deferred Insurance Acquisition Costs	Other Operating Expenses(2)	Premiums Written
December 31, 2004:									
Life and Annuity	$32,758	495,279	7,827	32,989	46,944	24,022	6,458	24,708	$ 32,540
Health	4,628	168,582	9,641	141,078	7,187	86,609	2,084	36,114	142,635
	$37,386	663,861	17,468	174,067	54,131	110,631	8,542	60,822	$175,175
December 31, 2003:									
Life and Annuity	$29,088	454,786	7,337	29,478	39,222	22,759	5,146	20,497	$ 40,147
Health	4,025	175,692	9,154	119,929	6,849	60,493	1,879	31,466	121,110
	$33,113	630,478	16,491	149,407	46,071	83,252	7,025	51,963	$161,257
December 31, 2002:									
Life and Annuity	$22,762	355,957	7,481	31,857	31,943	35,265	4,423	20,032	$ 33,094
Health	3,625	156,380	9,021	101,033	7,485	63,569	1,660	27,396	102,968
	$26,387	512,337	16,502	132,890	39,428	98,834	6,083	47,428	$136,062

(1) Net investment income is allocated between product lines based on the mean reserve method.

(2) Direct operating expenses are specifically identified and charged to product lines. Indirect expenses are allocated based on time studies, however, other acceptable methods of allocation might produce different results.

EXHIBIT INDEX

Exhibit Number			
3(i)	Restated Certificate of Incorporation of Independence Holding Company. (b)		
3(i)(a)	Amendment to Restated Certificate of Incorporation of Independence Holding Company, filed with the Secretary of State of the State of Delaware on July 29, 2004. (i)		
3(ii)	By-laws of Independence Holding Company. (a)		
4(i)	Form of Warrant Certificate to purchase shares of Common Stock of Independence Holding Company, expiring June 30, 2001. (a)		
10(i)	Assumption Reinsurance Agreements		
(iii)	(A)	Executive Compensation Plans and Agreements	
		(1)	Independence Holding Company 1988 Stock Incentive Plan (c)
		(2)	Form of Independence Holding Company Stock Option Agreement (d)
		(3)	Deferred Compensation Agreement (e)
		(4)	Retirement Benefit Agreements (e)
		(4)(a)	Amendment No. 1 to Retirement Benefit Agreement
		(5)	Amendment No. 1 to 1988 Stock Incentive Plan (f)
		(6)	Form of Stock Appreciation Rights Agreement (g)
		(7)	Independence Holding Company 2003 Stock Incentive Plan (h)
21	Principal subsidiaries of Independence Holding Company, as of March 15, 2005.		
23	Consent of KPMG LLP.		
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		

(a) Such exhibit is incorporated by reference to the Report on Form 10-K for the fiscal year ended December 31, 1987, as amended, of Independence Holding Company.

(b) Such exhibit is incorporated by reference to the Report on Form 10-Q for the quarter ended June 30, 1996 of Independence Holding Company.

(c) Such exhibit is incorporated by reference to the Proxy Statement for the Annual Meeting of Stockholders held on May 25, 1989 of Independence Holding Company.

(d) Such exhibit is incorporated by reference to the Report on Form 10-K for the fiscal year ended December 31, 1988 of Independence Holding Company.

(e) Such exhibit is incorporated by reference to the Report on Form 10-K for the fiscal year ended December 31, 1993 of Independence Holding Company.

(f) Such exhibit is incorporated by reference to the Report on Form 10-K for the fiscal year ended December 31, 1997 of Independence Holding Company.

(g) Such exhibit is incorporated by reference to the Report on Form 10-Q for the quarter ended June 30, 1999 of Independence Holding Company.

(h) Such exhibit is incorporated by reference to the Proxy Statement for the Annual Meeting of Stockholders held on June 20, 2003 of Independence Holding Company.

(i) Such exhibit is incorporated by reference to the Report on Form 8-K dated July 29, 2004.

Exhibits will be furnished upon request for a reasonable fee.

Directors:

Larry R. Graber
President,
Madison National Life
Insurance Company, Inc.

Allan C. Kirkman
Executive Vice President,
Mellon Bank, N.A.

Steven B. Lapin
President and Chief Operating Officer,
The Aristotle Corporation

Edward Netter
Chairman,
Geneve Corporation

Robert P. Ross, Jr.
President,
The Starboard Capital
Management Corporation

James G. Tatum, C.F.A.
Investment Advisor

Roy T.K. Thung
Chief Executive Officer and President,
Independence Holding Company

Executive Offices:

96 Cummings Point Road
Stamford, CT 06902
(203) 358-8000
www.independenceholding.com

Transfer Agent:

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016

Shareholder Inquiries:

(800) 368-5948
www.rtco.com

Code of Ethics and Conduct:

The Company's Code of Business Ethics and Corporate Code of Conduct can be found on the Company's website at www.independenceholding.com

Executive Officers:

Edward Netter
Chairman

Roy T.K. Thung
Chief Executive Officer
and President

Steven B. Lapin
Vice Chairman

Teresa A. Herbert
Senior Vice President and
Chief Financial Officer

David T. Kettig
Senior Vice President, Chief Legal
Officer and Secretary

Alex Giordano
Vice President and
Chief Marketing Officer

Mark A. Musser
Vice President—Strategic Business
Development

Paul R. Janerico
Vice President—Internal Audit

Brian R. Schlier
Vice President—Taxation

Henry B. Spencer
Vice President—Investments

C. Winfield Swarr
Vice President and
Chief Underwriting Officer

Independent Auditors:

KPMG LLP
757 Third Avenue
New York, NY 10017

Form 10-K:

Additional copies of this report, which includes the Company's annual report as filed with the Securities and Exchange Commission on Form 10-K, may be obtained without charge by writing:
Investor Relations
Independence Holding Company
96 Cummings Point Road
Stamford, CT 06902

INDEPENDENCE HOLDING COMPANY

Ninety Six Cummings Point Road • Stamford, Connecticut 06902