

REPORT ON EXAMINATION
OF
INDEPENDENCE AMERICAN
INSURANCE COMPANY
AS OF
DECEMBER 31, 2008

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

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The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the Company as reflected in the Report.

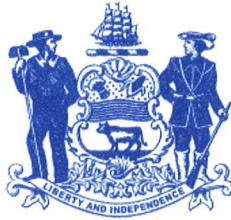
This Report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart", is written over a horizontal line.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 29th day of June, 2010

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

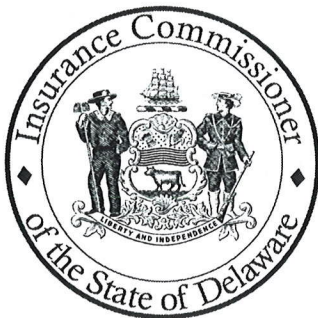
I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2008 of the

INDEPENDENCE AMERICAN INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

Attest By: *Sonia C. Harris*

Date: 29 June 2010



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 29th day of June 2010.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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SALUTATION

May 17, 2010

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Honorable Karen Weldin Stewart, CIR-ML
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Delaware Department of Insurance
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Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09-039, dated September 24, 2009, an examination has been made of the affairs, financial condition and management of the

INDEPENDENCE AMERICAN INSURANCE COMPANY

hereinafter referred to as "Company" or "IAIC", incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 1013 Centre Road, New Castle, Delaware 19805-1297. The examination was conducted at the principal offices of the Company located at 485 Madison Avenue, 14th Floor, New York, New York, 10022. The examination report thereon is respectfully submitted.

SCOPE OF THE EXAMINATION

We have performed our association examination of Independence American Insurance Company. The last examination was conducted as of December 31, 2005. This examination covers the three-year period from January 1, 2006, to December 31, 2008. We conducted our examination in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (the “NAIC Handbook”). The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information including; corporate governance, identifying and assessing current and prospective inherent risks to which the Company is exposed, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

During the course of this examination, consideration was given to work performed by the Company’s external accounting firm, KPMG, LLP (KPMG). Certain auditor workpapers have been incorporated into the workpapers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination.

The following areas were reviewed without material exception and have been included in the workpapers of the examination:

Corporate Records

Conflict of Interest
Fidelity Bond and Other Insurance
Pensions, Stock Ownership and Insurance Plans
Legal Actions
NAIC Ratios
Regulatory Agency Correspondence
All Asset and Liability Items Not Mentioned
Statutory Deposits

SUMMARY OF SIGNIFICANT FINDINGS

Compliance with Prior Examination Recommendations

Management and Control

Finding

It was recommended that the Company initiate procedures to comply with its Articles of Incorporation regarding the number of individuals serving on the Board of Directors and its Bylaws regarding the required appointed officers.

The Company has complied.

Affiliated Company Agreements

It is recommended that the Company initiate procedures to ensure that all affiliated company management and service agreements be submitted to the Commissioner of the Delaware Insurance Department for approval at least 30 days prior to the effective date of the agreements on the appropriate form required.

The Company has complied.

Reinsurance

It is recommended that the Company initiate procedures to ensure that all future reinsurance arrangements entered into are finalized within the time requirements of SSAP 62 or accordingly accounted for as retroactive reinsurance.

The Company has complied.

Compliance with Statutory Accounting Principles and Delaware Insurance Statutes

It is recommended that the Company initiate procedures to ensure future compliance with the Delaware Insurance Code and with statutory accounting principles as follows:

The Company has complied.

- Uncollected Premiums and Agents' Balances in Course of Collection are reflected in future financial statements net of commissions payable as defined in SSAP 6, paragraph 6.
- Any claims fund deposits ceded to reinsurers are to be reflected as the liability Funds Held by Companies Under Reinsurance Treaties as defined in SSAP 62, paragraph 20.
- To comply with the annual statement instructions and SSAP 62 guidelines, paid losses payable on assumed reinsurance should be included as part of the liability line item Reinsurance Payable on Paid Losses while paid losses recoverable and other such expenses relating to ceded reinsurance should be netted during the calculation of the asset Amounts Recoverable from Reinsurers.

Material Adverse Findings

As a result of this examination, no material adverse findings were noted.

Material Changes in Financial Statements

As a result of this examination, no financial adjustments were made.

SUBSEQUENT EVENTS

Affiliate Acquisition

On March 8, 2010, upstream holding company Independence Holding Co. (IHC) announced that it has acquired, via open-market transactions, additional publicly-traded common stock shares of their affiliate American Independence Corp. (AMIC), raising its aggregate holdings of AMIC to over 50% of total outstanding common shares, from approximately 13% at December 31, 2008. As a result of this transaction, AMIC becomes a majority-owned subsidiary of IHC. Beginning with the 2010 first quarter results, IHC will consolidate AMIC in its reported financial results.

U.S. Health Care Reform

The federal *Patient Protection and Affordable Care Act* (PPACA), a healthcare reform bill signed into law on March 23, 2010, includes a number of health-related provisions set to take effect between 2010 and 2014. These provisions, which will affect insurance companies offering accident and health insurance coverage, include (in-part); expanding Medicaid eligibility, subsidizing insurance premiums, requiring employee coverage and providing incentives for businesses to provide healthcare benefits, prohibiting discrimination based on pre-existing conditions, and establishing health insurance exchanges. Management has indicated that the PPACA may affect the Company's product mix and profitability, but to what degree, cannot be reasonably estimated at this time.

COMPANY HISTORY

General

The Company was incorporated February 26, 1973, under the laws of the State of Delaware as Pinnacle Insurance Company and commenced business on March 15, 1973. By agreement dated October 16, 1975, the Company was acquired from the Superintendent of Insurance of the State of New York by Geneve Holdings, Inc. (GHI) and has since remained within this holding company structure. On November 14, 2002, the Company's name was changed to Independence American Insurance Company.

Capitalization

The Company is authorized to issue 10,000 shares of common capital stock with a par value of \$600 per share. Currently, only 5,000 shares have been issued, all owned by Independence American Holding Corp. (IAHC). The following table reflects the Company's capitalization activity since the prior examination:

	<u>Capital Stock</u>	<u>Gross Paid-in & Contributed Surplus</u>
December 31, 2005	\$3,000,000	\$25,902,016
2006		1,000,000
December 31, 2008	<u>\$3,000,000</u>	<u>\$26,902,016</u>

Dividends

There were no dividends paid to the sole shareholder of the Company during the period under examination.

Mergers, Acquisitions and Disposals

The Company received \$2,830,615 in cash from parent IAHC on October 18, 2006, for the sale of its 14.06% interest in affiliate Voorhees Risk Management, LLC.

MANAGEMENT AND CONTROL

Directors

The Company's business affairs and corporate activities are vested in a Board of Directors that are elected annually by the sole shareholder and shall consist of not less than two members nor more than ten members. Members elected to the Company's Board also served as principal officers of the Company and interlocking Board members of other GHI companies. The Board of Directors, duly elected in accordance with Company bylaws and serving at December 31, 2008, is as follows:

<u>Individual</u>	<u>Principal Business Affiliation</u>
David T. Kettig	Standard Security Life Insurance Co. of New York
Gary J. Balzofiore	Standard Security Life Insurance Co. of New York
Bemon R. Erickson, Jr.	Standard Security Life Insurance Co. of New York
Jeffrey C. Smedsrud	Standard Security Life Insurance Co. of New York
Adam C. Vandervoort	Standard Security Life Insurance Co. of New York

Committees

There were no standing committees of the Board for the period under examination.

Senior Officers

The senior officers, duly appointed in accordance with Company bylaws and serving at December 31, 2008, are as follows:

<u>Individual</u>	<u>Office</u>
David T. Kettig	President
Gary J. Balzofiore	Senior Vice President, CFO & Treasurer
Adam C. Vandervoort	Senior Vice President, General Counsel and Secretary
Jeffrey C. Smedsrud	Senior Vice President and Chief Marketing Officer
David B. Getz	Vice President and Controller
Thomas A. Gibbons	Vice President and Chief Compliance Officer
Brian R. Schlier	Vice President – Tax
Alison Galante	1 st Vice President – Legal
Gregory L. Cohen	1 st Vice President – Litigation and Compliance
Lisa Virgona	1 st Vice President – Litigation and Compliance
John C. Morris	Assistant Secretary

CORPORATE GOVERNANCE

IAIC is not a public company and is not required to be compliant with requirements of Sarbanes-Oxley (SOX). However, the Company's upstream holding company, IHC, is publicly-traded and SOX-compliant. IAIC shares common management, systems, and similar controls and processes with its other insurance affiliates under IHC.

While the Company does not have its own corporate governance framework, the Company's upstream holding company IHC has adopted a structured Corporate Governance and Enterprise Risk Management framework which is applied to all insurance entities in the IHC Group for proactively addressing and mitigating risk (including prospective business risks).

The Company operates within a corporate governance environment that includes oversight and corporate direction of the upstream holding company IHC. The Board of Directors and management of both the Company and IHC have an overall positive effect on the control environment within the organization. Control consciousness is developed throughout the organization through an organizational structure that allows for ease of communication across legal entities, a conscious commitment to integrity, promoting ethical values and competence of employees, the assignment of clear authority and responsibility, an open management philosophy and operating style and, a commitment to the development of resources.

In its fiduciary role, the Board is responsible for overseeing internal controls over financial reporting established by management and the processes by which management satisfies itself that they are working effectively. The IHC Board of Directors is also responsible for assessing the risk of financial fraud by management and ensuring that controls are in place to prevent, deter, and detect such fraud. The oversight controls of the IHC Board extend to understanding management's strategic initiatives, risk management processes, and reviewing

significant estimates annually. Strategic business plans, budgets and all new products are approved by the Company's Board prior to implementation or introduction into the market.

HOLDING COMPANY

The Company is a member of an insurance holding company system as defined under Chapter 50, "Insurance Holding Companies" of the Delaware Insurance Code. Based upon our review of information provided, the Company's ownership structure at December 31, 2008, is as follows:

Geneve Holdings, Inc., (DE), 100% owner of
Geneve Corporation (DE), 100% owner of
GHC Corporation (DE), 100% owner of both SMH and SIC
SMH Associates Corp. (DE), 24.71% owner of IHC
SIC Securities Corp. (DE), 27.85% owner of IHC
Independence Holding Co. (IHC) (DE), 100% owner of
Independence Capital Corp. (DE), 100% owner of
Madison National Life Ins. Company (WI) (MNLIC), 100% owner of
Standard Security Life Ins. Company of New York (NY) (SSLICNY)
Madison Investors Corporation (DE), 34.42% owner of AMIC {1}
American Independence Corp. (AMIC) (DE), 100% owner of
Independence American Holdings Corp. (DE), 100% owner of
Independence American Insurance Company (DE)

{1} Publicly traded under the ticker "AMIC". According to publicly available documents filed with the SEC, there were 8,503,989 outstanding voting common shares of AMIC stock at December 31, 2008. Of these shares, Madison Investors Corporation owned 2,926,810 shares (34.42%), Independence Holding Company owned 1,104,433 shares (12.99%) and Madison National Life Insurance Company owned 196,053 shares (2.31%). Together, these three affiliates owned 4,227,296 shares (49.71%) of the AMIC outstanding shares. No other individual entity or group owned or controlled greater than 10% of AMIC at December 31, 2008.

AFFILIATED AGREEMENTS

Service Agreement

The Company was a party to an amended and restated intercompany service agreement with affiliate SSLICNY effective June 1, 2007. Under terms of the agreement, SSLICNY provides; legal, tax, financial statement preparation, accounting, policy issuance, and premium services to the Company and other participating affiliates. The agreement also requires the Company to provide audit and marketing services to SSLICNY. All services are provided at cost and the settlement of all expenses occurs quarterly. Pursuant to this agreement, the Company paid the following amounts to SSLICNY for the years under examination:

2006	\$357,153
2007	\$478,730
2008	\$458,193

Investment Services Agreement

The Company is party to an Investment Services Agreement with IHC effective December 1, 2006. IHC provides investment staffing services for the trading, sales, and maintenance of the Company's investment portfolio. This agreement replaced an earlier similar agreement with AMIC.

Tax Allocation Agreement

The Company was party to a Tax Allocation Agreement with affiliate AMIC effective May 1, 2008. The agreement allows the Company and AMIC to file federal income tax returns on a consolidated basis under Section 1504(c)(2) of the Internal Revenue Code of 1986. Amounts either payable or receivable under the agreement are calculated as if each participant

Independence American Insurance Company

filed a separate return with settlement amounts due within thirty days after the date the consolidated federal income tax return is filed.

Management Agreements

Marlton Risk Group (MRG)

The Company is party to a Management Agreement with affiliate Voorhees Risk Management, LLC d/b/a Marlton Risk Group (MRG) effective December 1, 2007. On behalf of the Company relating to aggregate and specific medical stop loss coverage, MRG will perform underwriting services, perform premium billing and collection services, reimburse claims, and perform in-force administration services.

Risk Assessment Strategies, Inc. (RAS)

The Company is party to a Management Agreement with affiliate Risk Assessment Strategies, Inc. (RAS) effective December 1, 2007. On behalf of the Company relating to aggregate and specific medical stop loss coverage, RAS will perform underwriting services, perform premium billing and collection services, reimburse claims, and perform in-force administration services.

IndependenceCare Underwriting Services

The Company is party to a Management Agreement with affiliate IndependenceCare Underwriting Services – Minneapolis LLC (ICUS-MN) effective December 1, 2007. On behalf of the Company relating to HMO reinsurance, out-of-area emergency excess of loss, employer stop loss, continuation of benefits coverage in the event of plan insolvency, and provider excess of loss coverage, ICUS-MN will perform underwriting services, perform premium billing and collection services, reimburse claims, and perform in-force administration services.

Administration Agreements

Health Plan Administrators, Inc. (HPA)

The Company is party to an Administration Agreement with affiliate Health Plan Administrators, Inc. (HPA) effective January 3, 2005. On behalf of the Company relating to short-term health insurance business, HPA will perform underwriting services, premium billing and collection services, claim review, processing and payment services, and in-force administration services. By year-end 2008, the short-term health insurance business was almost negligible.

GroupLink, Inc. (GroupLink)

The Company is party to an Administration Agreement with affiliate GroupLink, Inc. (GroupLink) effective July 1, 2005. On behalf of the Company, GroupLink will perform sales support services, underwriting services, premium billing and collection services, claim review, processing and payment services, and in-force administration services for voluntary dental plan business. There have been no premiums under this agreement since inception.

Independent Producers of America, LLC (IPA)

The Company is party to an Administration Agreement with affiliate Independent Producers of America, LLC (IPA) effective May 18, 2007. On an exclusive basis, IPA will market, sell and distribute the Company's accident and health plans covering individuals and their families. IPA has the authority to collect premiums and must submit premiums to the Company immediately. During the years under examination, direct premiums written under this agreement were \$0, \$455,864 and \$4,294,801 for 2006, 2007 and 2008, respectively.

UNAFFILIATED AGREEMENTS

Custodian Agreement

The Company was party to an amended and restated Custodian Agreement with JP Morgan Chase Bank N.A. (JP Morgan Chase) effective April 16, 2007. Review of the agreement terms show that it contains the minimum security standards suggested under the NAIC Financial Condition Examiners Handbook.

Management Agreement

Tactical Loss, LLC

The Company is party to a Management Agreement with Tactical Loss, LLC d/b/a Independence Insurance Group, Ltd. (Tactical Loss) effective September 1, 2008. Tactical Loss manages and supervises the writing of the Company's aggregate and specific stop-loss insurance policies. Policies are marketed to employer or other approved groups in connection with self-funded medical benefit programs. Policies may not be marketed to multiple employer groups (MEGs). Aggregate-only stop-loss insurance policies may not be issued unless approved in writing by the Company. Tactical Loss can receive applications from prospective insureds, and underwrite, quote and issue the policies or reject applications on the Company's behalf. Tactical Loss may also reimburse claims and collect and receive premiums for remittance to the Company or the Company's reinsurer.

Administrative Agreements

Employers Direct Health, Inc. (EDH)

On February 22, 2006, the Company entered into a letter of agreement with Employers Direct Health, Inc. (EDH, formerly known as First Integrated Health, Inc.), an unaffiliated MGA based in Dallas, Texas. Pursuant to this agreement, EDH began writing employer medical stop-loss business for the Company in 2006 and moved the majority of its existing block of employer-sponsored group major medical and medical stop-loss business to the Company beginning in early 2007. As part of compensation, the Company paid EDH \$2,500,000, which EDH simultaneously paid to IHC in consideration of IHC issuing 125,000 shares of its common stock at \$20 per share. As part of this agreement, an affiliate of EDH and the Company agreed to a profit/loss sharing arrangement whereby the Company will pay to, or receive from, such affiliate 35% of the underwriting profit or loss of the business written by the Company. Accordingly, the Company has recorded profit sharing commission expenses on the EDH business underwritten in 2008. The IHC stock is being held by the Company in escrow as collateral until such time as the aggregate annualized premiums for the health business and other risks written by EDH total \$30,000,000, thereby satisfying EDH obligations under the profit/loss sharing agreement. When this \$30,000,000 annual premium threshold is met, the Company will distribute the IHC stock to EDH less the number of shares of IHC stock necessary to maintain collateralization of ongoing risks. The EDH agreement terminates on December 31, 2011. Subject to satisfaction of certain conditions as to premium volume (\$50 million) and profitability of the block of business (6%), the agreement may be automatically extended until December 31, 2016. Assuming the aforementioned conditions are satisfied, EDH would be entitled to up to an additional \$2,500,000 depending on the value of the IHC publicly-traded stock as of December 31, 2011.

Independence American Insurance Company

As a result, the Company originally recorded a prepaid asset of \$2,500,000 for the initial payment (see Note 2 to the Financial Statements) and a derivative liability of \$743,000 (see Note 4 to the Financial Statements) for the potential additional \$2,500,000 payment in 2016 on its balance sheet to account for the fair value of such contingent payment at closing. If the EDH agreement is extended to December 31, 2016, subject to satisfaction of certain further conditions as to annual premium volume (\$80 million) and profitability on the block of business (6%), EDH would be entitled to up to an additional \$5,000,000 in cash depending on the value of the publicly-traded IHC stock on December 31, 2016. In addition, EDH could be entitled to a \$1,000,000 bonus on December 31, 2013, subject to satisfaction of certain conditions as to annual premium volume (\$100 million) and profitability of the block of business (6%). EDH is not required to own the IHC stock in order to receive any of the milestone/performance bonuses; however, EDH must retain ownership of the IHC stock for twelve months if it is issued to them. EDH has agreed to maintain collateralization in the form of a letter of credit from a bank in such form as reasonably accepted by the Company, or in cash or IHC stock, amounting to at least 3.5% of earned premium for the twelve months prior to the semi-annual evaluation date. EDH agrees to adjust the amount of collateral to maintain the 3.5% minimum. Any IHC stock to be used as collateral for EDH risks will be held in escrow. Upon termination of the agreement, EDH is allowed to keep possession of any IHC stock.

Insurers Administration Corporation (IAC)

The Company is a party to an Administrative Services agreement with Insurers Administration Corporation (IAC) and EDH effective September 22, 2006. IAC performs program management services for the A&H programs of the Company while EDH performs administrative and marketing services related to the A&H programs of the Company. EDH

underwrites the policies, collects premiums, and manages claims activity. As compensation for services provided, the Company pays 14% of premiums to EDH and 1% of premiums written to IAC. During the years under examination, direct premiums written pursuant to this agreement were \$0, \$26,552,741 and \$27,665,090 for 2006, 2007 and 2008, respectively. Direct written premiums for 2007 and 2008, as a percent of year-end 2006 and 2007 policyholder surplus, was 65.1% and 68.5%, respectively. Furthermore, EDH pays fully-insured claims on behalf of IAIC and has binding authority for fully insured and medical stop-loss policies. According to 18 Del. C. §1802(3) "Managing general agent" ("MGA") means any person, firm, association or corporation who negotiates and binds ceding reinsurance contracts on behalf of an insurer or manages all or part of the insurance business of an insurer (including the management of a separate division, department or underwriting office) and acts as an agent for such insurer whether known as a managing general agent, manager or other similar term, who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than 5 percent of the policyholder surplus as reported in the last annual statement of the insurer in any 1 quarter or year together with 1 or more of the following: a. Adjusts or pays claims in excess of an amount determined by the Commissioner, or b. Negotiates reinsurance on behalf of the insurer." Consequently, EDH, through its ability to bind policies and pay claims is, considered to be an MGA under 18 Del. C. §1802(3) and is in violation of 18 Del. C. §1803(b). Therefore;

It is recommended that the Company comply with the licensure requirements of 18 Del. C. §1803(b).

TERRITORY AND PLAN OF OPERATIONS

Territory

At December 31, 2008, the Company is licensed to write property and/or casualty insurance in the District of Columbia and all fifty U.S. states, except New Hampshire.

Plan of Operation

The majority of the Company's business is assumed from affiliates. On a direct basis, the Company provides specialized health coverage to commercial customers and individuals, focusing on niche health products and/or narrowly defined distribution channels in the United States. The Company writes employer medical stop-loss, medical provider excess loss insurance, group major medical coverage, short-term medical, and reinsures (on a quota share basis) employer medical stop-loss, provider excess of loss insurance, HMO reinsurance, short-term medical, group major medical, limited medical, vision, and short-term statutory disability benefit product in New York State (DBL) insurance.

2008 net written premiums by product segment are as follows:

<u>Major Product Line</u>	<u>Premiums</u>	<u>Percent of Total</u>
Medical Stop-Loss	\$54.57 million	56.3%
Fully Insured	38.98 million	40.2%
Disability	<u>3.40 million</u>	<u>3.5%</u>
Total	<u>\$96.95 million</u>	<u>100.0%</u>

Of the \$27.67 million direct premiums written by EDH in 2008, approximately 19.6% relates to medical stop-loss and 80.4% relates to fully insured coverages.

2008 net written premiums by source are as follows:

<u>Source</u>	<u>Premiums</u>	<u>Percent of Total</u>
Assumed from affiliate SSLICNY	\$53.96 million	55.7%
Direct from non-affiliate EDH	27.67 million	28.5%
Assumed from affiliate MNLIC	12.92 million	13.3%
Direct from affiliate IPA	4.29 million	4.4%
All Other Net	<u>(1.89) million</u>	<u>(1.9)%</u>
Total	<u>\$96.95 million</u>	<u>100.0%</u>

2008 direct written premiums by state (top 5) are as follows:

<u>State</u>	<u>Premiums</u>	<u>Percent of Total</u>
Texas	\$21.02 million	65.0%
North Carolina	6.83 million	21.1%
Arizona	0.86 million	2.7%
South Carolina	0.51 million	1.6%
Georgia	0.50 million	1.5%
All Others (21 states)	<u>2.62 million</u>	<u>8.1%</u>
Total	<u>\$32.34 million</u>	<u>100.0%</u>

GROWTH OF THE COMPANY

The following information was obtained from the Company's filed Annual Statements and covers the three preceding years since its last examination (2005):

<u>Year</u>	<u>Admitted Assets</u>	<u>Capital & Surplus</u>	<u>Premiums Earned</u>	<u>Net Income</u>
2008	\$70,839,501	\$40,365,337	\$96,983,600	\$2,323,334
2007	\$73,776,346	\$40,408,832	\$106,099,925	\$170,537
2006	\$62,840,390	\$40,777,760	\$67,776,870	\$1,896,689
2005	\$60,056,161	\$39,335,291	\$66,117,528	\$2,667,265

Since December 31, 2005, the Company's financial results were as follows:

- 17.96% increase in admitted assets
- 2.62% increase in capital and surplus
- 46.68% increase in premiums earned
- 12.89% decrease in net income

The increase in premiums earned is due to the direct business from EDH beginning in 2007. Despite poor general economic conditions from 2007 to date, the Company has remained profitable over the examination period.

REINSURANCE

General

The Company's premiums for 2008 are as follows:

	<u>Non-Affiliated</u>	<u>Affiliated</u>	<u>Total</u>
Direct	\$28,046,785	\$4,294,801	\$32,341,586
Assumed	(4,986)	66,878,810	66,873,824
Gross	\$28,041,799	\$71,173,611	\$99,215,410
Ceded	<u>\$2,154,531</u>	<u>\$114,379</u>	<u>\$2,268,910</u>
Net (Gross less Ceded)	<u>\$25,887,268</u>	<u>\$71,059,232</u>	<u>\$96,946,500</u>

The Company retained 97.7% of its gross business in 2008.

Assumed

The Company assumes the majority of its business through reinsurance agreements with affiliates SSLICNY and MNLIC effective January 1, 2002 (signed November 7, 2007), and April 1, 2002 (signed March 3, 2008), respectively. Under the terms of these agreements, through December 31, 2014, the Company assumes on a quota share basis up to 30% of aggregate and specific stop loss insurance, provider excess insurance and any other such insurance risks issued to managed care organizations. During the period under review, the Company assumed the following premium amounts from these two affiliates:

2008	\$66,878,810
2007	\$79,411,183
2006	\$66,625,610

Independence American Insurance Company

All outside assumption reinsurance agreements were terminated in 2004. Consequently, the premiums received during the examination period under those reinsurance agreements in run-off are negligible.

Ceded

Under the terms of a reinsurance agreement with affiliate MNLIC effective January 1, 2004, the Company cedes up to 55% of aggregate and specific stop loss insurance, provider excess insurance and any other such insurance risks issued to managed care organizations. During the period under review, the Company ceded the following premium amounts to MNLIC:

2008	\$114,379
2007	\$136,490
2006	\$1,056,526

The Company cedes HPA-produced short-term medical insurance business under a quota share reinsurance agreement effective March 1, 2005, with participation from Everest Reinsurance Company (40%) and Transatlantic Reinsurance Company (10%). Premiums under this agreement, which is in run-off, for 2008 were approximately \$8,000. The counterparties signed the participation interests and liabilities portion of the reinsurance agreement on June 19, 2006.

The Company cedes IPA-produced business under a quota share reinsurance agreement effective June 1, 2007, with participation from Munich Reinsurance America, Inc. (50%). Premiums under this reinsurance agreement for the years under examination were \$2,147,000 and \$115,000 for 2008 and 2007, respectively. The counterparty signed the participation interests and liabilities portion of the reinsurance agreement on October 5, 2007.

ACCOUNTS AND RECORDS

Accounting System and Information

During the examination period, all necessary accounting records of the Company were maintained on electronic data processing equipment (“EDP”). The general ledger is maintained on a statutory basis with additional accounts used to convert to the accrual basis suitable for Generally Accepted Accounting Principles. Investment transactions are administered through IHC’s investment department which is located in Stamford, Connecticut, and processed using CAMRA software.

Independent Accountants

The Company’s financial statements are audited each year by KPMG of New York, New York, which issues a statutory audit opinion and report. For all of the years under review, KPMG issued an unqualified opinion.

Actuarial Opinion

The Company’s loss and loss adjustment expense (LAE) reserves and related actuarial items were reviewed by Richard J. Nelson, FSA, MAAA, of Towers Perrin, who issued a statement of actuarial opinion, based on the financial information presented by the Company. The opinion stated that the reserves and related actuarial values carried on the balance sheet were fairly stated and met the requirements of the insurance laws of the State of Delaware.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2008.

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Reconciliation of Change in Policyholder Surplus

	<u>Assets</u>			
	<u>Gross Assets</u>	Non-admitted <u>Assets</u>	Net Admitted <u>Assets</u>	<u>Note</u>
Bonds	\$49,721,561		\$49,721,561	1
Preferred Stocks	3,075,118		3,075,118	
Cash, Cash Equivalents and Short-term Investments	4,524,205		4,524,205	
Investment Income Due and Accrued	509,485		509,485	
Uncollected Premiums and Agents' Balances in Course of Collection	9,956,334	\$3,015,344	6,940,990	
Amounts Recoverable from Reinsurers	41,047		41,047	
Funds Held by Reinsured Companies	5,213,248		5,213,248	
Other Amounts Recoverable Under Reinsurance Contracts	230,565		230,565	
Federal Income Taxes Recoverable	338,788		338,788	
Net Deferred Tax Asset	1,891,114	1,736,318	154,796	
Aggregate Write-ins for Other Than Invested Assets	<u>2,035,262</u>	<u>1,945,564</u>	<u>89,698</u>	2
Total Assets	<u>\$77,536,727</u>	<u>\$6,697,226</u>	<u>\$70,839,501</u>	

Liabilities, Surplus and Other Funds

Losses		\$28,817,250	3
Commissions Payable		834,314	
Other Expenses		94,517	
Taxes, Licenses and Fees		297,220	
Unearned Premiums		200,000	
Funds Held By Company Under Reinsurance Treaties		25,409	
Aggregate Write-ins for Liabilities		<u>205,454</u>	4
Total Liabilities		<u>\$30,474,164</u>	
Common Capital Stock		\$3,000,000	
Gross Paid In and Contributed Surplus		26,902,015	
Unassigned Funds (Surplus)		<u>10,463,322</u>	
Surplus as Regards Policyholders		<u>\$40,365,337</u>	
Total Liabilities, Surplus and Other Funds		<u>\$70,839,501</u>	

Statement of Income

UNDERWRITING INCOME

Premiums Earned \$96,983,600

DEDUCTIONS:

Losses Incurred \$69,890,035

Loss Adjustment Expenses Incurred 224,070

Other Underwriting Expenses Incurred 27,077,275

Total Underwriting Deductions \$97,191,380

Net Underwriting Gain (Loss) \$(207,780)

INVESTMENT INCOME

Net Investment Income Earned \$3,245,742

Net Realized Capital Gains (Losses) (404,706)

Net Investment Gain (Loss) \$2,841,036

OTHER INCOME

Aggregate Write-ins for Miscellaneous Income \$394,209

Total Other Income \$394,209

Net Income After Dividends to Policyholders, After Capital Gains \$3,027,465

Tax and Before All Other Federal and Foreign Income Taxes

Federal and Foreign Income Taxes Incurred 704,131

Net Income \$2,323,334

Reconciliation of Change in Policyholder Surplus

CAPITAL AND SURPLUS ACCOUNT

Surplus as Regards Policyholders, December 31, 2005 \$39,335,291

Net Income \$4,390,560

Change in Net Unrealized Capital Gains or (Losses) 313,582

Change in Net Deferred Income Tax 2,023,130

Change in Non-admitted Assets (6,697,226)

Surplus Adjustments Paid In 1,000,000

Change in Surplus as Regards Policyholders for the Exam Period \$1,030,046

Surplus as Regards Policyholders, December 31, 2008 \$40,365,337

NOTES TO THE FINANCIAL STATEMENTS

1. Bonds \$49,721,561

100% of the Company's bonds and mortgage-backed securities (MBS) are rated as Class 1 or Class 2 by the NAIC. The Company has no investments in private placement securities, has no exposure through direct investments in sub-prime mortgage loans, and has not taken any impairment on assets due to credit deterioration. The Company has eight positions in non-agency whole-loan "Alt-A" mortgages, which may have indirect exposure due to the sub-prime market, with the following aggregate values at December 31, 2008: actual cost \$2,734,769, book value \$2,600,920, market value \$1,852,413, impairment losses \$0. The Company also has two positions in corporate securities, which also may have indirect exposure to the sub-prime market, with the following aggregate values at December 31, 2008: actual cost \$789,760, book value \$750,096, market value \$575,903, impairment losses \$0.

2. Aggregate Write-ins for Other Than Invested Assets \$89,698

This balance consists of the following components: \$89,698 in admitted claims funds and \$1,945,564 as "other assets", for a gross balance of \$2,035,262, of which \$1,945,564 was non-admitted as described below.

Relating to the EDH agreement dated February 22, 2006, described earlier in this report, the Company classified those transactions as follows:

<u>Description</u>	<u>Amortization Period</u>	<u>Original Balance</u>	<u>Cumulative Amortization</u>	<u>Net Balance</u>
Original \$2,500,000 Payment in 2007	1/1/2007- 12/31/2011	\$2,500,000	\$648,914	\$1,851,086
Potential \$2,500,000 Bonus in 2011	1/1/2007-	<u>743,392</u>	<u>\$648,914</u>	<u>94,478</u>
Total		<u>\$3,243,392</u>	<u>\$1,297,828</u>	<u>\$1,945,564</u>

18 Del. C. §1102(3) specifically requires that the stock of the insurer, owned by it or any equity therein or loans secured thereby, or any proportionate interest in such stock acquired or held through the ownership by such insurer of an interest in another firm, corporation or business unit must be treated as a non-admitted asset on the financial statement of the insurer. Since the loan to EDH is for the purpose of acquiring the stock of the Company's upstream parent, IHC, it must be reflected on all statutory financial statements as a non-admitted asset. Consequently, the Company non-admitted the entire \$1,945,564 balance at December 31, 2008.

If the EDH agreement is extended past December 31, 2011, an additional amortizable prepaid asset may be required to be established for the fair value of any future bonuses through December 31, 2016.

3. Losses

\$28,817,250

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a review of the Company's reserve methodologies and adequacy. INS evaluated the Company's book of business by line of business for losses and LAE. The conclusions reached by INS are largely based upon information supplied by the Company's staff, which included an in-depth actuarial analysis. The INS reserve analysis was performed on both a gross and net of reinsurance basis and did not address the collectability of reinsurance recoverable. The INS reserve review found the Company's combined net loss and LAE reserves were adequate to support the business underwritten.

Loss and LAE reserves are subject to errors of estimation arising from the fact that the ultimate liability for claims evaluated as of the valuation date are dependent on future contingent events which cannot always be anticipated. The possible occurrence of such events, as well as the inherent uncertainty associated with statistical estimates, allows no guarantee that the actual

ultimate liabilities will be the same as the reserve levels described in this examination report. The review was conducted in conjunction with the current financial examination. Based on the review, INS has accepted the conclusion that additional actuarial reserves were not required as of December 31, 2008.

4. Aggregate Write-ins for Liabilities \$205,454

Relating to the EDH agreement dated February 22, 2006, described earlier in this report, in conjunction with the recording of the fair value of the potential 2011 bonus of \$2,500,000 as a \$743,392 prepaid asset, the Company also recorded an off-setting derivative liability of \$743,392. The value of this EDH derivative liability is evaluated each quarter by the Company and the corresponding change in fair value is reflected in the “Other Income” section [aggregate write-ins for miscellaneous income” line] of the Statement of Income. The value of the EDH derivative decreased \$1,042,734 from \$1,248,188 at year-end 2007 to \$205,454 at year-end 2008.

If the EDH agreement is extended beyond December 31, 2011, an additional amortizable derivative liability may be required to be established for the fair value of any future bonuses through December 31, 2016.

SUMMARY OF RECOMMENDATIONS

1. EDH, through its ability to bind policies and pay claims, is considered to be an MGA under 18 Del. C. §1802(3) and is in violation of 18 Del. C. §1803(b). Therefore it is recommended that the Company comply with the licensure requirements of 18 Del. C. §1803(b). [Unaffiliated Agreements page 16]


CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 2008</u>	<u>December 31, 2005</u>	<u>Difference</u>
Assets	\$70,839,501	\$60,056,161	\$10,783,340
Liabilities	\$30,474,164	\$20,720,870	\$9,753,294
Capital and Surplus	\$40,365,337	\$39,335,291	\$1,030,046

In addition to the undersigned, actuarial consulting services were provided by the actuarial firm of INS Consultants, Inc. and the Information Technology audit was performed by INS Services, Inc.

Respectfully submitted,



Andrew Chiodini, CFE
Examiner In-Charge
State of Delaware