

# Best's Rating Report



## Independence American Insurance Company A Member of The IHC Group

Wilmington, Delaware



A-

**Ultimate Parent:  
Geneve Holdings, Inc.**

### **INDEPENDENCE AMERICAN INSURANCE COMPANY**

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#### **BEST'S CREDIT RATING**

**Best's Financial Strength Rating: A-**

**Best's Financial Size Category: IX**

**Outlook: Stable**

#### **RATING RATIONALE**

**Rating Rationale:** The ratings of the Independence Holding Company (IHC) organization have been extended to Independence American

Insurance Company (Independence American), which reflects the strength it receives as part of the company and to its immediate parent, Madison National Life Insurance Company, Inc. Risk-adjusted capital has been at a more than adequate level for the last several years and operating earnings have been consistent and remain favorable over the last five years. Independence American adds diversification to the group by selling ancillary health products and pet insurance. Both are important parts to IHC's overall business strategy.

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

The ratings of the core operating affiliates of Independence Holding Company Group (The IHC Group) reflect the group's more than adequate level of risk-adjusted capital, continued profitability and focus on diversified premium growth. Partially offsetting these positive rating factors are a diminished business profile due to a significant

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premium and earnings decline in 2016 following an exit from one of the group's largest contributing lines of business and a challenge to grow supplemental health products given the intensified competition in that segment.

The IHC Group's consolidated risk-adjusted capital position, as measured by Best's Capital Adequacy Ratio (BCAR), has been more than adequate for the ratings of its members for the last five years and has been supported by the group's trend of favorable earnings. More recently, capitalization improved as a result of two transactions. In 2015, The IHC Group coinsured the last significant remaining annuity block of business, which substantially reduced the group's future liabilities and exposure to interest rate risk. Moreover, in 2016, the organization's premium base declined significantly due to the sale of the stop-loss business to Swiss Re that was completed on March 31, 2016. Prior to 2016, The IHC Group had generated profitable operating earnings primarily through stop-loss and disability segments with additional contribution from group life products as well as ancillary health products. Furthermore, earnings in 2015 were bolstered by the sale of administration infrastructure as part of the life and annuity coinsurance transaction at Madison National Life Insurance Company (Madison National). Over the last several years, The IHC Group has been transitioning from a primarily major medical and stop-writer to a specialty benefits writer with fully insured ancillary medical offerings, including limited medical, short-term medical, critical illness, non-subscriber occupational accident and pet insurance. This transition will also help the balance sheet as the products targeted for growth are less capital intensive in nature. While revenue from these new insurance products is expected to remain significantly lower compared to the major medical and medical stop-loss premium written prior, The IHC Group is focused on underwriting and pricing discipline for continued profitable growth.

Following the sale of the stop-loss block of business, the group's business profile has weakened, since the stop-loss represented over 40% of the organization's combined premiums in 2015. Although this has decreased revenue concentration in a single line of business, the remaining lines are not significant contributors to the group's earnings. This has negatively impacted results, evident by a 27% decline in net income year over year from third-quarter 2015 to third-quarter 2016. However, excluding the impact of the sale of the annuity block of business at Madison National in 2015, net income declined by 10%. The IHC Group has focused on growing supplemental fully insured lines; however, the competition in that segment has intensified as mid-size and large carriers are looking for additional sources of revenue diver-

sification. While The IHC Group is open to expanding through small targeted acquisitions of distribution channels and blocks of business, the company may be challenged to achieve material profitable growth. In addition, A.M. Best is concerned that near-term future earnings will continue to be pressured due to a lack of scale. However, the organization is more than sufficiently capitalized to support the existing risks and potential future growth as well as withstand possible earnings fluctuations.

Factors that could lead to a positive rating action include sustained diversified profitable premium growth while maintaining strong risk-adjusted capitalization. Factors that could lead to a negative rating action include a further decline in revenue and earnings and a substantial deterioration of risk-adjusted capitalization.

## KEY FINANCIAL INDICATORS (\$000)

Year	Total Capital					
	Assets	Capital Surplus Funds	Asset Valuation Reserve	Net Premiums Written	Net Invest Income	Net Income
2011	73,429	50,466	...	72,744	2,095	3,407
2012	84,697	54,427	...	85,787	2,000	3,271
2013	102,111	57,875	...	128,827	1,986	3,176
2014	102,872	60,168	...	133,593	2,077	3,127
2015	115,950	63,412	...	149,815	2,208	2,960

(\*) Data reflected within all tables of this report has been compiled from the company-filed statutory statement.

## BUSINESS PROFILE

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

Independence Holding Company (IHC), a Delaware corporation, is a publicly traded insurance holding company for a group of insurance companies operating throughout the United States trading on the NYSE under the symbol IHC. The company markets life and health insurance business directly through its insurance subsidiaries and marketing affiliates, and through independent brokers and agents, career advisors and direct to consumer.

The Independence Holding Company Group (The IHC Group), which consists of Standard Security Life Insurance Company of New York (Standard Security), Madison National Life Insurance Com-

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pany, Inc. (Madison National) and Independence American Insurance Company (Independence American), sells group life and long-term disability and New York short-term disability (DBL), as well as a variety of health insurance products including dental, vision, supplemental gap, limited and short-term medical, and most recently, pet insurance, international health and non-subscriber occupational accident insurance. Prior to 2016, the group's primary line of business was medical stop-loss for small and mid-size clients. However, on March 31, 2016, The IHC Group sold its medical stop-loss business to Swiss Re.

**Scope of Operations:** The IHC Group is comprised of three insurance subsidiaries that market insurance products. Standard Security markets short-term medical, limited medical, DBL, life, dental and vision products.

Standard Security has a sizeable share in the DBL market that was further enhanced following assumption of premium from a competitor that exited the market in 2013. Over the last several years, the company focused on profitable growth of the stop-loss segment and posted a substantial revenue expansion in that product. However, on March 31, 2016, The IHC Group sold its medical stop-loss business to Swiss Re. As a result, premium revenue at Standard Security has declined substantially through third quarter 2016. The company used to market major medical, but made a decision to exit/de-emphasize this product following the implementation of the Patient Protection and Affordable Care Act (ACA). Standard Security is domiciled in New York and is licensed in all 50 states, the District of Columbia, the Virgin Islands, and Puerto Rico.

Madison National is domiciled in Wisconsin and is licensed to sell insurance products in 49 states, the District of Columbia, American Samoa, Guam, and the Virgin Islands. Previously, the company's core operations involved acquiring life and annuity blocks of policies from other insurance companies and state insurance guaranty associations under assumption reinsurance and coinsurance agreements. Madison National also offers group term life and disability and specialty health products. Most of its ordinary life in-force business, prior to the reinsurance of all of its life and annuity business, had been acquired. Over the past several years, premium volume and reserves have been affected by the volume of reinsurance and acquisition activity conducted. In recent years, Madison National's business profile has changed considerably. Its medical stop-loss, which was once a core product for the company, was transferred to Standard Security. In addition, as a result of two separate transactions, first in 2013 and second in 2015, the company

entered into coinsurance agreements with unaffiliated reinsurers covering the entire block of its annuity business. As such, effective August 2015, Madison National has very minimal exposure to annuity and individual life products. Furthermore, similar to Standard Security, Madison National has exited/de-emphasized the major medical product following the implementation of the ACA. Today Madison National emphasizes the marketing of its group life and disability, and specialty health products, including dental, vision, and short-term medical through its distribution channels.

Independence American is domiciled in Delaware and is currently licensed in 50 states and the District of Columbia. Independence American is currently a 100% owned indirect subsidiary of IHC. Previously, it was owned by American Independence Corp. (AMIC), which was publicly traded prior to 2016. In 2011, Madison Investors Corporation, a subsidiary of Madison National, took over majority ownership of AMIC. Madison Investors Corporation, together with IHC, wholly own AMIC. Independence American focuses on selling various ancillary medical products, pet insurance and non-subscriber occupational accident insurance. Historically, Independence American generated most of its premium income as a reinsurer (over 20%) of employer medical stop-loss business produced by Standard Security. Independence American also wrote stop-loss business directly. Therefore, the revenue at Independence American has been substantially affected by the sale of the stop-loss business to Swiss Re.

**Territory:** The company is licensed in the District of Columbia and all states.

**Business Trends:** Through third quarter 2016, premium at The IHC Group decreased substantially following the sale of its stop-loss business to Swiss Re on March 31, 2016. However, the company plans to partially replace the lost revenue through growth of supplemental medical products, both organically and through small targeted acquisitions.

Over the last five years, The IHC Group has experienced premium fluctuations. During 2015, premium experienced slight decline, as growing stop-loss and ancillary medical products almost replaced all of the premium lost due to exit from major medical line of business. In 2014, premium declined primarily driven by the exit from the major medical line of business. The company made a strategic decision to discontinue its major medical product following the implementation of the ACA. Lower major medical revenue was partially

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offset by growth of stop-loss and expansion of multiple ancillary medical products.

The increased premium in 2013 was affected by several one-time events. This includes processing some of the 2014 renewals within major medical during the fourth quarter of 2013, taking on more risk within its major medical products as the result of terminating its reinsurance agreement with a third party company, and obtaining a sizeable portion of New York disability renewals from a carrier that had exited the marketplace.

## OPERATING PERFORMANCE

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

**Operating Results:** The IHC Group has diverse sources of revenue that have produced positive earnings on both a statutory and GAAP basis. Virtually all major lines of business, including medical stop-loss, fully insured medical insurance, and group life and disability, have contributed to the group's profitability in recent years. The earnings in the group health lines of business have been relatively consistent due to initiatives taken to improve the medical stop-loss product that has become the main engine of earnings for the group over the last several years. Following the sale of stop-loss business on March 31, 2016, earnings have declined by approximately 27% through third quarter 2016 when compared to the same time period the prior year, as that segment produced over 40% of net earnings in 2015. However, excluding the impact of the sale of the annuity block of business at Madison National in 2015, income declined by 10% and return on revenue remained strong through third quarter 2016 supported by profitable growth of supplemental health products.

Earnings improved substantially during 2015 primarily due to strong results in the stop-loss segment, as well as improved profitability on new ancillary medical products. In addition, financial performance was affected by several one-time items, including the coinsurance transaction at Madison National. Although profitable, statutory earnings within The IHC Group declined in 2013 and 2014 primarily due to higher loss ratios in the fully insured lines of business and a decrease in net investment income. Results in the major medical segment were affected, similar to other carriers, by increased utilization in advance of the implementation of the ACA. This was partially offset by higher premium within the company's medical stop-loss, short term medical

and disability lines of business. Underwriting results at Standard Security improved substantially in 2014 compared to 2013, as the major medical loss ratio moderated and profitability of stop-loss and ancillary medical lines continued to improve.

Madison National, which produced about forty percent of The IHC Group's statutory earnings in 2014, reported lower operating and net earnings in 2014 compared to 2013. The results were primarily affected by lower investment income that, in addition to lower net yield, resulted from over \$200 million decrease in invested assets following Madison National's annuity reinsurance transactions completed during 2013. Furthermore, 2013 operating earnings benefited from a reserve release and lower income taxes attributable to the treatment of the reinsurance transaction. Earnings at Madison National improved during 2015 in part due to the impact of a coinsurance transaction that occurred during the year. Through third quarter 2016, results moderated, as the invested assets experienced additional decline following the transfer of reserves related to the coinsurance transaction in 2015.

Independence American reported stable results over the last five years supported by growing revenue and improved loss ratios. Premium growth was attributable to pet insurance, medical stop-loss and other health and disability lines of business. Independence American results declined following the sale of the stop-loss business in 2016.

## BALANCE SHEET STRENGTH

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

**Capitalization:** The IHC Group maintains an appropriate level of risk-adjusted capitalization relative to its insurance and investment risks. The relative consistency of operating earnings within its diversified businesses has offset annual dividends paid to the ultimate holding company over the years. As a result, capital and surplus has grown considerably during that time. However, A.M. Best notes that premium growth has outpaced capital growth over the last five years. As such, the level of risk-adjusted capitalization declined; however, it remains more than adequate for the rating level. The level of risk-adjusted capitalization is expected to strengthen in 2016 following the sale of capital-intensive stop-loss segment. The company plans to focus on growth of supplemental health products where the capital requirements are lower compared to stop-loss.

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Like The IHC Group, Madison National has been able to increase statutory surplus over the last four years primarily due to several co-insurance agreements on existing blocks of ordinary annuity business, including the recent agreement the company executed in August 2015. Since 2011, the growth of capital and surplus at Madison National was supported by consistent statutory net income and favorable changes within its net unrealized gain position, which was partially offset by dividends paid. Due to the growth in capital and surplus, as well as changed product mix in recent years, Madison National maintains more than adequate level of capitalization to support its liabilities.

As a result of dividends Standard Security paid to the parent company over the last three years, its capital and surplus has remained relatively flat while premium experienced growth. However, the level of capitalization remains adequate to support the company's liabilities. Standard Security capitalization is expected to improve significantly in 2016, as the premium will drop following the sale of the stop-loss business.

Like Madison National and Standard Security, Independence American is adequately capitalized in support of its insurance and investment risks. A.M. Best expects Independence American to continue to grow its capital and surplus as the company's newer products, including pet insurance and non-subscriber occupational accident insurance lines of business, gain more traction.

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

**Liquidity:** The IHC Group maintains an adequate level of liquidity due to the majority of its holdings in publicly-traded securities in addition to its material amount of cash and short-term investments. Despite the fluctuating percentage of cash and short-term investments, the liquidity position within the group has remained relatively unchanged in recent years. A.M. Best believes The IHC Group's liquidity position is appropriate for the nature of its liabilities with an overall liquidity of 236.4% as of third quarter 2016.

The following text is derived from A.M. Best's Credit Report on Independence Holding Company Group (AMB# 069756).

**Investments:** The IHC Group's insurance subsidiaries investment portfolios are managed by the chief investment officer within IHC. The overall investment objective is to construct a conservative, diversified portfolio of multiple asset classes designed to match The IHC Group's

liability durations and cash flow requirements while maintaining a predominately investment-grade, diversified fixed income portfolio, with a high degree of liquidity.

In an effort to improve liquidity and the overall quality of its investments, IHC shortened the duration of its investment portfolio by moving new money away from municipal backed credit and into agency-backed municipal mortgage bonds, U.S. government backed bonds and municipals backed by corporate credits. Furthermore, The IHC Group generated higher yields, despite the continuing low interest rate environment, as the group moved away from lower-yielding municipals and into high-yield corporate bonds. The result of this change in investment strategy was an improvement in the group's liquidity while maintaining favorable yields. However, the group's net investment income has remained depressed in recent years due to lower portfolio yields and the significant decrease in invested assets that were attributable to the gradual transfer of the entire Standard Security's and Madison National's annuity reserves from 2012 to 2015. With all of The IHC Group's longer-term annuity liabilities being moved off of its books, A.M. Best expects the duration of the fixed maturity portfolio will be gradually modified to reflect the changes to its shorter-term liability structure.

Through third quarter 2016, The IHC Group's investment portfolio was comprised of the following: over half in fixed maturity securities, virtually all being of investment grade quality, and approximately 25% invested in equities. A.M. Best notes that most of the equity holdings are affiliated companies within the group. The remainder of The IHC Group's invested assets is allocated to cash and short-term securities, policy loans, alternative investments and other invested assets, all below 3% of the group's total investment portfolio.

The subsidiaries within The IHC Group follow the same investment objectives as their ultimate parent, IHC. However, due to the various products each company markets, the composition of their individual investment portfolio will be slightly different to match its liability obligations. Independence American invests in high-quality bonds which represent over 85% of the company's invested assets. Equities, cash and short-term investments comprise almost all of the remaining invested assets within the investment portfolios of Independence American. Madison National's and Standard Security's investment portfolio allocations are similar to Independence American since they market similar products. However, both companies have a much larger allocation to common stocks due to their ownership in other subsidiaries within IHC. Preferred and common stock make up over

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one-tenth of both Madison National's and Standard Security's invested assets. As a result of their higher equity holdings, investment grade bonds comprise the majority of both companies fixed maturity holding. The remainders of the investment portfolios for both companies are comprised of policy loans, cash and short-term investments in addition to Schedule BA assets.

## MANAGEMENT

**Officers:** President, David T. Kettig; Senior Vice President and Chief Financial Officer, Gary J. Balzofiore; Vice President and Secretary, Loan Nisser; Vice President and Controller, David B. Getz; Chief Compliance Officer and Vice President, Marla DiResta; Vice President, Jan M. Dubauskas.

**Directors:** Gary J. Balzofiore, Teresa A. Herbert, David T. Kettig.

### Balance Sheet

#### Assets (\$000)

	YE 2015
Total bonds .....	\$ 84,979
Total preferred stocks .....	2,966
Cash & short-term invest .....	5,156
Funds on deposit .....	4,771
Prem and consids due .....	11,546
Accrued invest income .....	725
Other assets .....	5,807
	<hr/>
Assets .....	\$115,950

#### Liabilities (\$000)

Unearned premiums .....	\$ 5,060
Policy claims .....	45,375
Comm taxes expenses .....	1,996
Other liabilities .....	107
	<hr/>
Total Liabilities .....	\$ 52,538
Common stock .....	3,000
Paid in & contrib surpl .....	26,902
Unassigned surplus .....	33,508
Other surplus .....	2
	<hr/>
Total .....	\$115,950

# Best's Rating Report

## Why is this *Best's*<sup>®</sup> Rating Report important to you?

The A.M. Best Company is the oldest, most experienced rating agency in the world and has been reporting on the financial condition of insurance companies since 1899.

A Best's Financial Strength Rating (FSR) is an **independent opinion** of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts and does not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. An FSR is **not a recommendation** to purchase, hold or terminate any insurance

policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser.

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