



POSITIVE PHYSICIANS HOLDINGS, INC.

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Federal EIN: 83-0824448
SIC Code: 6331

QUARTERLY REPORT

For the Period Ending September 30, 2020 (the "Reporting Period")

The number of shares outstanding of our common stock is 3,615,500 as of September 30, 2020 (the end of reporting period).

The number of shares outstanding of our common stock is 3,615,500 as of June 30, 2020 (the end of previous reporting period).

Indicate by check mark whether the company is a shell company (as defined in Rule 405 of the Securities Act of 1933 and Rule 12b-2 of the Exchange Act of 1934):

Yes: No:

Indicate by check mark whether the company's shell status has changed since the previous reporting period:

Yes: No:

Indicate by check mark whether a change in control of the company has occurred over this reporting period:

Yes: No:

POSITIVE PHYSICIANS HOLDINGS, INC.

TABLE OF CONTENTS

<u>Statement on Forward-Looking Information</u>	1
Item 1. <u>The Exact Name of the Issuer and Address and Telephone Number of Issuer’s Principal Office</u>	3
Item 2. <u>Shares Outstanding</u>	4
Item 3. <u>Interim Consolidated Financial Statements</u>	4
Item 4. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	5
Item 5. <u>Legal Proceedings</u>	15
Item 6. <u>Defaults Upon Senior Securities</u>	15
Item 7. <u>Other Information</u>	15
Item 8. <u>Exhibits</u>	15
Item 9. <u>Issuer’s Certification</u>	16
Exhibit 3.1 <u>Interim Consolidated Financial Statements</u>	17
<u>Consolidated Balance Sheets</u>	17
<u>Consolidated Statements of Operations</u>	18
<u>Consolidated Statements of Comprehensive Income</u>	19
<u>Consolidated Statements of Stockholders’ Equity</u>	20
<u>Consolidated Statements of Cash Flows</u>	21
<u>Notes to Consolidated Financial Statements</u>	22

Statement on Forward-Looking Information

This report may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995 with respect to the Company's business, financial condition and results of operations and the plans and objectives of its management. Forward-looking statements can generally be identified by use of forward-looking terminology such as "may," "will," "plan," "expect," "intend," "anticipate," and "believe." These forward-looking statements may include estimates, assumptions or projections and are based on currently available financial, industry, competitive and economic data and our current operating plans. All forward-looking statements are subject to risks and uncertainties, including risks regarding the effects and duration of the COVID-19 pandemic, that could cause actual results to differ materially from those expressed or implied by the forward-looking statements.

The effect of the COVID-19 pandemic on our operations could have a material adverse effect on our business, financial condition, results of operations, or cash flows. The World Health Organization has declared the outbreak of COVID-19, which began in December 2019, a pandemic and the U.S. federal government has declared it a national emergency. Our business and operations could be materially and adversely affected by the effects of COVID-19. The global spread of COVID-19 has already created significant volatility, uncertainty and economic disruption in the markets in which we operate. Governments, public institutions, and other organizations in countries and localities where cases of COVID-19 have been detected are taking certain emergency measures to mitigate its spread, including implementing travel restrictions and closing factories, schools, public buildings, and businesses. While the full impact of this outbreak is not yet known, we are closely monitoring the spread of COVID-19 and continually assessing its potential effects on our business.

As a result of the restrictions put in place to address COVID-19 and the related economic downturn, the Company has experienced business disruptions including, but not limited to, office closures and difficulties in maintaining operational continuance during remote operations required by illness, social quarantining, and work from home orders that were in force. The extent to which our results continue to be affected by COVID-19 will largely depend on future developments which cannot be accurately predicted, including the duration and scope of the pandemic, governmental and business responses to the pandemic and the impact on the global economy. While these factors are uncertain, the COVID-19 pandemic or the perception of its effects could continue to have a material adverse effect on our business, financial condition, results of operations, or cash flows.

Diversus Management, LLC ("Diversus Management"), a subsidiary of Diversus, Inc. ("Diversus"), manages and administers essentially all of the operations of Positive Insurance Company under the terms of a management agreement. Positive Insurance Company also has a contract with Gateway Risk Services, LLC ("Gateway"), another subsidiary of Diversus, under which Gateway provides claims processing and risk management services. If the ability of Diversus Management and Gateway to fulfill their obligations to us under these agreements is adversely impacted, then this may have a material adverse effect on our business and operations.

Other factors that could cause actual results to differ materially from those in the forward-looking statements, include, but are not limited to:

- the potential impact of fraud, operational errors, system malfunctions, or cybersecurity incidents;
- financial market conditions, including, but not limited to, changes in interest rates and the stock markets causing a reduction of investment income or investment gains and reduction in the value of our investment portfolio;
- future economic conditions in the market in which we compete that are less favorable than expected;
- the effect of legislative, judicial, economic, demographic, and regulatory events in the jurisdictions where we do business;
- our ability to successfully implement steps to optimize the business portfolio, ensure capital efficiency, and enhance investment returns;
- the risks associated with the management of capital on behalf of investors;
- our ability to enter new markets successfully and capitalize on growth opportunities either through acquisitions or the expansion of our producer network;
- the success with which our brokers sell our products and our ability to collect payments from our insureds;
- heightened competition, including specifically the intensification of price competition, the entry of new competitors and the development of new products by new or existing competitors, resulting in a reduction in the demand for our products;
- our concentration in medical professional liability insurance, which makes us particularly susceptible to adverse changes in that industry segment;
- changes in general economic conditions, including inflation, unemployment, interest rates and other factors;

- estimates and adequacy of loss reserves and trends in loss and loss adjustment expenses;
- changes in the coverage terms required by state laws, including higher limits;
- our inability to obtain regulatory approval of, or to implement, premium rate increases;
- inadequacy of premiums we charge to compensate us for our losses incurred;
- the effectiveness of our risk management loss limitation methods;
- our ability to obtain reinsurance coverage at reasonable prices or on terms that adequately protect us and to collect amounts that we believe we are entitled to under such reinsurance;
- our ability to attract and retain qualified management personnel;
- the potential impact on our reported net income (loss) that could result from the adoption of future accounting standards issued by the Financial Accounting Standards Board or other standard-setting bodies;
- unanticipated changes in industry trends and ratings assigned by nationally recognized rating organizations;
- statutory requirements that limit our ability to receive dividends from our insurance subsidiary;
- the impact of future results on the recoverability of our deferred tax asset;
- adverse litigation or arbitration results; and
- adverse changes in applicable laws, regulations or rules governing insurance holding companies and insurance companies, including tax or accounting matters, limitations on premium levels, increases in minimum capital and reserves, other financial viability requirements, and changes that affect the cost of, or demand for, our products.

We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We undertake no obligation to update any forward-looking statement, whether as a result of new information, future events, or otherwise.

Item 1. The Exact Name of The Issuer and Address and Telephone Number of Issuer's Principal Office

Company Description

Positive Physicians Holdings, Inc. (OTCQX: PPHI) is a Pennsylvania domiciled holding company, which was incorporated on May 1, 2018 for the purpose of acquiring three Pennsylvania based reciprocal insurance exchanges: Positive Physicians Insurance Exchange ("PPIX"), Professional Casualty Association ("PCA"), and Physicians' Insurance Program Exchange ("PIPE"). In connection with the completion of PPHI's initial public offering, PPIX, PCA, and PIPE converted from reciprocal insurance exchanges into stock insurance companies and were merged together to form Positive Physicians Insurance Company ("Positive Insurance Company"), a wholly owned subsidiary of the Company. PPHI's initial public offering and its acquisition of Positive Insurance Company were completed on March 27, 2019. Prior to that time, PPHI had minimal assets and liabilities and had not engaged in any operations.

Positive Insurance Company underwrites medical professional liability coverage for physicians, their corporations, medical groups, clinics and allied healthcare providers. Medical professional liability insurance protects physicians and other health care providers against liabilities arising from the rendering of, or failure to render, professional medical services. We offer claims-made coverage, claims-made plus, and occurrence-based policies as well as tail coverage in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, and Michigan. Our policies include coverage for the cost of defending claims. Claims-made policies provide coverage to the policyholder for claims reported during the period of coverage. We offer extended reporting endorsements, or tails, to cover claims reported after the policy expires. Occurrence-based policies provide coverage to the policyholders for all losses incurred during the policy coverage year regardless of when the claims are reported.

Issuer's Exact Name: Positive Physicians Holdings, Inc.

Issuer's Address: 100 Berwyn Park, Suite 220
850 Cassatt Road, Berwyn, PA 19312

Issuer's Telephone: Telephone: 888-335-5335
Fax: 610-644-5265

Issuer's Website: www.positivephysicians.com

Investor Relations: Donovan C. Augustin
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Positive Physicians Holdings, Inc.
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Item 2. Shares Outstanding

The following table shows our common stock share ownership as of September 30, 2020:

	<u>September 30, 2020</u>
Number of shares authorized	10,000,000
Number of shares outstanding ⁽¹⁾	3,646,490
Freely tradable shares (public float)	311,567
Total number of shareholders on record	~ 100

(1) Shares outstanding include vested stock options of 30,990 that are exercisable as of September 30, 2020, as additional shares would need to be issued by the Company, if exercised.

As of September 30, 2020, we have more than 50 beneficial shareholders each owning at least 100 shares of our common stock.

Beneficial owners owning 5% or more of the outstanding shares of our common stock as of September 30, 2020 were as follows:

	<u>Number of Shares Beneficially Owned</u>	<u>Percent of Outstanding Common Stock</u>
Insurance Capital Group, LLC 767 Fifth Avenue, 16th Floor, New York, New York 10153	2,277,753	63.0%
Enstar Holdings (US) LLC 150 2nd Avenue N 3rd Floor, St. Petersburg, Florida 33701	976,180	27.0%

Item 3. Interim Consolidated Financial Statements

The interim consolidated financial statements of Positive Physicians Holdings, Inc. as of and for the periods ended September 30, 2020 are attached hereto as Exhibit 3.1 and are hereby incorporated by reference into this Quarterly Report, including:

- Consolidated Balance Sheets
- Consolidated Statements of Operations
- Consolidated Statements of Comprehensive Income
- Consolidated Statements of Stockholders' Equity
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements

The interim consolidated financial statements and the accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The interim consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results. As permitted under GAAP, certain footnotes or other financial disclosures are condensed or omitted in the interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2019.

The interim consolidated financial statements and the accompanying notes for the three and nine months ended September 30, 2020 and 2019 are unaudited. Operating results for the interim period are not necessarily indicative of the results that may be expected or achieved for the year ending December 31, 2020.

Item 4. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to provide a more comprehensive review of Positive Physicians Holdings, Inc. (“PPHI”) and its wholly owned subsidiary’s (collectively referred to as the “Company,” which also may be referred to as “we” or “us”) operating results and financial condition than can be obtained from reading the Financial Statements alone. The discussion should be read in conjunction with the Unaudited Consolidated Financial Statements and the notes thereto included as “Exhibit 3.1 Interim Consolidated Financial Statements” of the Company. We also recommend you read Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2019.

OVERVIEW

Positive Physicians Holdings, Inc. is a Pennsylvania domiciled holding company, which was incorporated on May 1, 2018 for the purpose of acquiring three Pennsylvania based reciprocal insurance exchanges: Positive Physicians Insurance Exchange (“PPIX”), Professional Casualty Association (“PCA”), and Physicians’ Insurance Program Exchange (“PIPE”). In connection with the completion of PPHI’s initial public offering, PPIX, PCA, and PIPE converted from reciprocal insurance exchanges into stock insurance companies.

As part of the conversions, on March 27, 2019, PPIX merged with and into PPIX Conversion Corp., PCA merged with and into PCA Conversion Corp., and PIPE merged with and into PIPE Conversion Corp. Accordingly, PPIX, PCA, and PIPE no longer exist. Immediately thereafter, PCA Conversion Corp. and PIPE Conversion Corp. merged with and into PPIX Conversion Corp., which then changed its name to Positive Physicians Insurance Company (“Positive Insurance Company”) and became our single insurance company subsidiary and successor to PPIX, PCA, and PIPE. PPHI had minimal assets and liabilities and had not engaged in any operations prior to March 27, 2019.

Positive Insurance Company writes medical malpractice insurance for healthcare providers practicing in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, and Michigan. Diversus Management, LLC (“Diversus Management”) manages and administers essentially all of the operations of Positive Insurance Company under the terms of a management agreement. Diversus Management is a wholly owned subsidiary of Diversus, Inc. (“Diversus”). Pursuant to the terms of the agreement, effective March 27, 2019, Diversus Management provides such administrative services to Positive Insurance Company in exchange for fees based upon a percentage of Positive Insurance Company’s gross written premiums, less return premiums. Diversus Management may also earn quarterly performance management fees based on Positive Insurance Company’s combined ratio and net earned premiums. Positive Insurance Company remains responsible for all underwriting decisions and the payment of all claims and claims related expenses incurred under policies issued by Positive Insurance Company and for all sales commissions paid to producers.

Positive Insurance Company underwrites medical professional liability coverage for physicians, their corporations, medical groups, clinics and allied healthcare providers. Medical professional liability insurance (“MPLI”) protects physicians and other health care providers against liabilities arising from the rendering of, or failure to render, professional medical services. We offer claims-made coverage, claims-made plus, and occurrence-based policies as well as tail coverage in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, and Michigan. Our policies include coverage for the cost of defending claims. Claims-made policies provide coverage to the policyholder for claims reported during the period of coverage. We offer extended reporting endorsements, or tails, to cover claims reported after the policy expires. Occurrence-based policies provide coverage to the policyholders for all losses incurred during the policy coverage year regardless of when the claims are reported. Although we generate a majority of our premiums from individual and small group practices, we also insure several major physician groups.

Marketplace Conditions and Trends

The MPLI industry is affected by recurring industry cycles known as “hard” and “soft” markets. A soft market is characterized by intense competition, resulting in lower pricing in order to compete for business. A hard market, generally considered a beneficial industry trend, is characterized by reduced competition that results in higher pricing. From approximately 2001 until approximately 2007, the Pennsylvania MPLI market experienced a hard market cycle. This resulted in the creation of several alternative MPLI providers, such as PPIX, PCA, and PIPE.

The MPLI market began to experience a soft market cycle around the second quarter of 2008, due primarily to the large rate increases taken over the previous six years. The soft market continued and was facilitated by the restructuring of the healthcare industry, partially as a result of the Affordable Care Act. This resulted in significant price competition, as the number of medical professionals practicing independent of hospitals or large professional groups began to decline. According to a study prepared by the National Association of Insurance Commissioners, MPLI direct premiums written declined by 24.0% on a national basis from 2006 to 2018 and declined by 14.6% in Pennsylvania and 33.0% in New Jersey during this same time period. This resulted in lower direct premiums written and lower operating profits for many MPLI carriers.

The soft market cycle troughed in 2012, and since then, national loss payouts, on average, have steadily increased through 2019. As a result, underwriting criteria in the MPLI industry has started to become more stringent, with opportunities for improved pricing, and we believe the market cycle has transitioned to a hard market. At Positive Insurance Company, our renewal book of business has been experiencing price increases of 2.5% through reduced credits, a development which we expect to continue and extend through our remaining policy renewals in 2020. We are also seeing rate increases take place by other carriers in many of the states in which we write business.

In addition to pricing increases, we intend to achieve further premium growth with our expansion into new states. Positive Insurance Company was admitted into Texas in November 2019 and is currently in the process of obtaining approval on premium rates before we can begin writing business there. We are also currently in the process of obtaining licenses to write business in the states of California, Florida and Georgia.

Effects of COVID-19

Our operations and business have experienced disruptions due to the conditions surrounding the COVID-19 pandemic spreading throughout the United States. These disruptions include, but are not limited to, office closures and difficulties in maintaining operational continuance during remote operations required by illness, social quarantining, and work from home orders that were in force. Our management has devoted substantial time and attention to assessing the potential impact of COVID-19 and those events on our operations and financial position and developing operational and financial plans to address those matters.

As a result of the COVID-19 pandemic, we have seen premium decreases due to policy endorsements associated with doctors electing to work part time, take a leave of absence or retire. In addition, some of our insureds have elected to temporarily change their areas of practice and/or specialties. For example, a doctor may choose to drop from orthopedic surgery to office-only status due to the lack of elective surgeries. We have received notification for such requests from our policyholders which went into effect on June 30, 2020 and necessary reimbursements or credits against future payments have been applied. During the first nine months of 2020, we recorded approximately \$300,000 in return premium adjustments, or reductions in direct premiums written, associated with these policy endorsements.

In terms of collections, prior to the pandemic, our policy was to cancel any insurance policies for which premiums had not been received within 60 days subsequent to policy effective date, with notice of intent to cancel sent to the insured after 30 days post-inception date, or post-payment due date. As a result of COVID-19, we updated this policy and suspended cancellations of insurance contracts resulting from non-payment of premium and deferred payments until June 30, 2020 for invoices due after April 1, 2020. The amount of premium payment deferrals was approximately \$950,000. Also, due to this change in policy, we recorded an allowance for uncollectible premium of approximately \$170,000 at September 30, 2020 based on the aging of outstanding premiums receivable. Dependent upon the extent to which our policyholders' own businesses have been impacted by the pandemic, our collection of premiums against current in-force policies could be significantly impacted.

With respect to claims, our policyholder base mainly consists of physicians, their corporations and medical groups. During the COVID-19 pandemic, on-site visits to doctors have declined and been replaced by an increase in telehealth/virtual office visits. Since the COVID-19 pandemic resulted in government-issued work from home orders, although we have seen the number of new claims reported since then decline, it is unclear if this is from the closure of courts during this period of time or due to other factors. In general, our expectation is that the frequency of new claims reported regarding medical rendered during this time period will decrease. As to actual claims relating to COVID-19 exposures, we anticipate that the number of claims will be minimal. Unless some unforeseen fact pattern is established, we expect that the difficulty of establishing the source of a COVID-19 exposure, as well as the heroic efforts of healthcare providers, will serve to make such claims unattractive to both patients and their counsel. We do not anticipate our loss and LAE ratios to be impacted. However, this view could change in the future depending on the duration of the pandemic and if the lower frequency of new claims reported becomes a trend.

Principal Revenue and Expense Items

Positive Insurance Company derives its revenue primarily from net premiums earned, net investment income, and net realized and unrealized gains (losses) from investments.

Net premiums earned

Gross premiums written is equal to direct and assumed premiums before the effect of ceded reinsurance. Net premiums written is the difference between gross premiums written and premiums ceded or paid to reinsurers (ceded premiums written).

Premiums earned are the earned portion of net premiums written. Gross premiums written include all premiums recorded by an insurance company during a specified policy period. Insurance premiums on MPLI policies are recognized in proportion to the

underlying risk insured and are earned ratably over the duration of the policies. At the end of each accounting period, the portion of the premiums that is not yet earned is included in unearned premiums and recognized as revenue in subsequent periods over the remaining term of the policy. The policies written by Positive Insurance Company typically have a term of twelve months. Thus, for example, for a policy that is written on July 1, 2020, one-half of the premiums would be earned in 2020 and the other half would be earned in 2021.

Net investment income and net realized and unrealized gains (losses) from investments

We invest our surplus and the funds supporting our insurance liabilities (including unearned premiums and unpaid loss and loss adjustment expenses) in cash, cash equivalents, short-term investments, and equity and debt securities. Investment income includes interest and dividends earned. We recognize realized gains when invested assets are sold for an amount greater than their cost or amortized cost (in the case of fixed maturity securities) and recognize realized losses when investment securities are written down as a result of other-than-temporary-impairment or sold for an amount less than their cost or amortized cost, as applicable. Realized gains and losses on sales of fixed maturity and equity securities and other investments and unrealized holding gains and losses on equity securities and other investments are included in realized investment gains (losses), net. Our portfolio of investment securities is managed by our outside investment manager, who has discretion to buy and sell securities in accordance with the investment policy approved by Positive Insurance Company's Board of Directors.

Losses and loss adjustment expenses

Losses and loss adjustment expenses ("LAE") represent the largest expense item and include: (1) claim payments made, (2) estimates for future claim payments and changes in those estimates for prior periods, and (3) costs associated with investigating, defending and adjusting claims, including legal fees.

Other underwriting expenses

Expenses incurred to underwrite risks include policy acquisition costs and underwriting and administrative expenses. Policy acquisition costs consist of commission expenses, premium taxes, and certain other underwriting expenses that vary with and are primarily related to the writing and acquisition of new and renewal business. These policy acquisition costs are deferred and amortized over the effective period of the related insurance policies. Underwriting and administrative expenses consist of salaries, rent, office supplies, depreciation, and all other operating expenses not otherwise classified separately, and payments to bureaus and assessments of statistical agencies for policy service and administration items such as rating manuals, rating plans and experience data.

Income taxes

We use the asset and liability method of accounting for income taxes. Deferred income taxes arise from the recognition of temporary differences between financial statement carrying amounts and the tax bases of our assets and liabilities. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The effect of a change in tax rates is recognized in the period of the enactment date.

Key Financial Measures

We evaluate our insurance operations by monitoring certain key measures of growth and profitability. Some of these measurements are "non-GAAP" financial measurements under Securities and Exchange Commission rules and regulations. We utilize certain non-GAAP financial performance measures that are widely used in the property and casualty insurance industry and that we believe are valuable in managing our business and for comparison to our peers. These financial performance measures are the loss and LAE ratio, expense ratio, combined ratio, underwriting income (loss), and operating income (loss).

We measure growth by monitoring changes in gross premiums written and net premiums written, and measure underwriting profitability by examining losses and LAE, underwriting expenses and combined ratios. We also measure profitability by examining underwriting income (loss) and operating income (loss).

Loss and LAE ratio

The loss and LAE ratio is the ratio (expressed as a percentage) of losses and loss adjustment expenses incurred to premiums earned. Positive Insurance Company measures the loss and LAE ratio on a policy year and calendar year loss basis to measure underwriting profitability. A policy year loss and LAE ratio measures losses and loss adjustment expenses for insured events occurring in a particular year, regardless of when they are reported, as a percentage of premiums earned during that year. A calendar year loss and LAE ratio measures losses and loss adjustment expenses for insured events occurring during a particular year and the change in loss reserves from prior policy years as a percentage of premiums earned during that year.

Expense ratio

The expense ratio is the ratio (expressed as a percentage) of other underwriting expenses (attributable to insurance operations) to premiums earned, and measures our operational efficiency in producing, underwriting and administering the Company's insurance business.

Combined ratio

The combined ratio is a measure of property and casualty underwriting performance. The combined ratio computed on a GAAP basis is equal to the sum of losses and loss adjustment expenses and other underwriting expenses, all divided by net premiums earned. If the combined ratio is below 100%, we are making an underwriting profit. If our combined ratio is at or above 100%, we are not profitable without investment income and may not be profitable if investment income is insufficient.

Underwriting income (loss)

Underwriting income (loss) measures the pre-tax profitability of insurance operations. It is derived by subtracting losses and loss adjustment expenses and other underwriting expenses from earned premiums.

Operating income (loss)

Operating income (loss) measures the profitability of business operations. We define it as GAAP net income (loss) excluding net realized investment gains and losses, net of tax. Net realized investment activity is excluded because net realized investment gains and losses are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business operations. Operating income is a non-GAAP measure which is important for an understanding of our overall results of operations. However, it does not replace net income (loss) as the GAAP measure of our consolidated results of operations, nor should it be viewed as a substitute for measures determined in accordance with GAAP.

RESULTS OF OPERATIONS

Our results of operations are influenced by factors affecting the MPLI industry, in general. The operating results of the United States MPLI industry are subject to significant variations due to competition, changes in regulation, rising medical expenses, judicial trends, fluctuations in interest rates, and other changes in the investment environment.

Our premium levels and underwriting results have been, and continue to be, influenced by market conditions. Pricing in the MPLI industry historically has been cyclical. During a soft market cycle, price competition is more significant than during a hard market cycle which makes it difficult to attract and retain properly priced MPLI business. As previously discussed, the markets in which we operate, and the national MPLI markets, were in a prolonged period of a soft market cycle. However, we are seeing price increases with our policy renewals in 2020 and we believe the market is hardening. Therefore, it is generally likely that insurers will be able to increase their rates or profit margins, as market conditions continue to improve. A hard market typically has a positive effect on premium growth, which can include absolute increases in premiums written.

We reported a net loss of \$65,541 for the third quarter of 2020, compared to a net loss of \$5,038 for the third quarter of 2019. The modest decline for the third quarter in 2020 is primarily due to slightly lower underwriting results during the current quarter. For the first nine months, we had net losses of \$830,181 in the current year, compared to \$474,196 in prior year. The year-to-date results reflect realized investment losses in 2020, compared to gains in 2019, mainly due to fluctuations in the unrealized position on our equity securities, which was largely offset by improved underwriting results in 2020.

For the third quarter, we had an operating loss of \$64,076 in 2020, compared to operating income of \$86,517 in 2019. The decrease for the third quarter in 2020 is primarily due to slightly lower underwriting results during the current quarter. For the first nine months, we had operating income of \$334,544 in the current year, compared to an operating loss of \$1,192,603 last year. The year-to-date increase in our operating results, compared to prior year, largely reflects improvement in our underwriting profitability for the year.

Total revenues were \$5,614,210 in the third quarter of 2020, compared to \$7,644,024 for the same period last year. Total revenues were \$14,941,004 for the first nine months of 2020, compared to \$20,882,997 for the first nine months of 2019. The decline in revenues during the first nine months of 2020, compared to the first nine months in 2019, primarily reflects unrealized losses on equity securities recognized in current year in contrast to unrealized gains recorded in prior year. The decreases for both the third quarter and first nine months of 2020, compared to the same periods in 2019, also reflect lower net premiums earned.

The major components of consolidated revenues and pre-tax income (loss) for the three and nine months ended September 30, 2020 and 2019 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenues:				
Net premiums earned	\$ 5,022,962	\$ 6,989,910	\$14,407,394	\$17,809,111
Net investment income	593,102	770,007	2,007,945	2,164,510
Realized investment gains (losses), net	(1,854)	(115,893)	(1,474,335)	909,376
Total revenues	<u>5,614,210</u>	<u>7,644,024</u>	<u>14,941,004</u>	<u>20,882,997</u>
Expenses:				
Losses and loss adjustment expenses	3,415,871	4,121,056	9,797,285	11,710,172
Other underwriting expenses	2,302,778	3,466,905	6,994,629	9,752,342
Interest expense	273	912	2,128	2,691
Total expenses	<u>5,718,922</u>	<u>7,588,873</u>	<u>16,794,042</u>	<u>21,465,205</u>
Income (loss) before income taxes	(104,712)	55,151	(1,853,038)	(582,208)
Income tax expense (benefit)	(39,171)	60,189	(1,022,857)	(108,012)
Net loss	<u>\$ (65,541)</u>	<u>\$ (5,038)</u>	<u>\$ (830,181)</u>	<u>\$ (474,196)</u>
Underwriting loss (1)	<u>\$ (133,558)</u>	<u>\$ (61,910)</u>	<u>\$ (636,156)</u>	<u>\$ (2,352,124)</u>
Operating income (loss)	<u>\$ (64,076)</u>	<u>\$ 86,517</u>	<u>\$ 334,544</u>	<u>\$ (1,192,603)</u>

(1) Underwriting loss excludes holding company expenses of \$562,129 and \$536,141 for the three months ended September 30, 2020 and 2019, and \$1,748,364 and \$1,301,279 for the nine months ended September 30, 2020 and 2019, respectively.

Premiums Written and Premiums Earned

The comparative changes in premiums written and premiums earned for the three months ended September 30, 2020 and 2019 are reflected in the table below.

	Three Months Ended September 30,		
	2020	2019	% Change
Premiums written:			
Direct	\$ 5,731,073	\$ 7,307,405	-21.6%
Ceded	552,290	742,219	-25.6%
Premiums written, net of reinsurance	<u>\$ 5,178,783</u>	<u>\$ 6,565,186</u>	-21.1%
Premiums earned:			
Direct	\$ 5,988,571	\$ 7,969,537	-24.9%
Ceded	965,609	979,627	-1.4%
Premiums earned, net of reinsurance	<u>\$ 5,022,962</u>	<u>\$ 6,989,910</u>	-28.1%

The comparative changes in premiums written and premiums earned for the nine months ended September 30, 2020 and 2019 are reflected in the table below.

	Nine Months Ended September 30,		
	2020	2019	% Change
Premiums written:			
Direct	\$16,964,925	\$19,288,247	-12.0%
Ceded	2,975,735	3,342,950	-11.0%
Premiums written, net of reinsurance	<u>\$13,989,190</u>	<u>\$15,945,297</u>	-12.3%
Premiums earned:			
Direct	\$17,054,642	\$20,398,452	-16.4%
Ceded	2,647,248	2,589,341	2.2%
Premiums earned, net of reinsurance	<u>\$14,407,394</u>	<u>\$17,809,111</u>	-19.1%

The declines in direct premiums written and direct premiums earned during the third quarter and first nine months of 2020, compared to the same periods in 2019, primarily reflect new business written and earned in the third quarter last year which did not renew in the current period. In addition, the decreases in direct premiums written for both the third quarter and first nine months of 2020 were impacted by return premium adjustments associated with policy endorsements related to the COVID-19 pandemic. The year-to-date decline in direct premiums written also reflects the non-renewal of prior year policies which did not satisfy our underwriting criteria.

The decreases in ceded premiums written during the third quarter and first nine months of 2020, compared to the same periods in 2019, correlate with the respective declines in direct premiums written for those periods.

Net Investment Income

The following table sets forth our average cash and invested assets and investment income for the reported periods:

	Nine Months Ended September 30,	
	2020	2019
Average cash and invested assets	\$ 124,211,838	\$ 112,558,968
Net investment income	2,007,945	2,164,510
Annualized return on average cash and invested assets	2.16%	2.56%

Net investment income for the first nine months of 2020 was \$2,007,945, compared to \$2,164,510 for the first nine months of 2019. The average monthly net investment income decreased from \$241,000 during the first nine months last year to \$223,000 during the same period this year.

The decrease in net investment income primarily reflects lower investment yields in the current year, partially offset by the increase in our cash and invested asset positions, due to proceeds from the initial public offering stock issuance on March 27, 2019.

Realized Investment Gains (Losses), Net

Net realized investment gains (losses) for the three and nine months ended September 30, 2020 and 2019 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Total gain (loss) on sales of investments	\$ 32,232	\$ (736)	\$ 81,596	\$ (180,680)
Unrealized gain (loss) on equity securities and other investments	(34,086)	(115,157)	(1,555,931)	1,090,056
Total net realized investment gains (losses)	<u>\$ (1,854)</u>	<u>\$ (115,893)</u>	<u>\$ (1,474,335)</u>	<u>\$ 909,376</u>

The unrealized loss on equity securities during the first nine months of 2020 primarily reflects the market volatility associated with the COVID-19 pandemic. During the second quarter, we sold the majority of these equity holdings for a modest net realized gain following a partial recovery in corresponding fair values. Our fixed maturity investments are available-for-sale because we may, from time to time, make sales of securities that are not impaired, consistent with our investment goals and policies.

Losses and Loss Adjustment Expenses

The components of the GAAP combined ratios were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Loss and LAE ratio	68.0%	59.0%	68.0%	65.8%
Expense ratio (1)	34.7%	41.9%	36.4%	47.4%
Combined ratio	102.7%	100.9%	104.4%	113.2%

(1) Expense ratio excludes holding company expenses of \$562,129 and \$536,141 for the three months ended September 30, 2020 and 2019, and \$1,748,364 and \$1,301,279 for the nine months ended September 30, 2020 and 2019, respectively.

The increase in the loss and LAE ratios for the third quarter and first nine months of 2020, compared to the same periods in 2019, primarily reflects a higher loss and LAE estimate for the current policy year.

The MPLI line of business is prone to variability in the loss reserving process due to the extended period of time during which claims can be made and the subsequent time required to settle those claims. Adjustments to our original estimates resulting from claims are not made until the period in which there is reasonable evidence that an adjustment to the reserve is appropriate.

Other Underwriting Expenses

Other underwriting expenses, including changes in deferred acquisition costs, decreased to \$2,302,778 for the third quarter of 2020, compared to \$3,466,905 for the third quarter of 2019, and decreased to \$6,994,629 during the first nine months of 2020, compared to \$9,752,342 for the same period in 2019. Positive Insurance Company pays a management fee to Diversus Management which is equal to a percentage of premiums written. This percentage was reduced from 25% to 12%, effective March 27, 2019. Positive Insurance Company also incurred \$371,000 in initial public offering and conversion costs during the first nine months of 2019, mainly in the first quarter, which are included in other underwriting expenses. The year-to-date decline also includes a lower amortization of deferred acquisition costs in the current year, which reflects the prior year reduction in the management fee percentage. These expense reductions during the first nine months of 2020 were partially offset by the amortization of the prepaid management fee which was not incurred in the first quarter last year.

The decrease in other underwriting expenses on a quarter-to-date basis is primarily due to a lower amortization of deferred acquisition costs in the current year, which reflects the prior year reduction in the management fee percentage noted above.

Income Tax Expense (Benefit)

The provision for income taxes for the three and nine months ended September 30, 2020 resulted in income tax benefits of \$39,171 and \$1,022,857, respectively, compared to income tax expense of \$60,189 and income tax benefit of \$108,012, respectively, for the same periods in 2019. The Company's effective tax rate for both years was 21%.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") into law. The CARES Act includes certain income tax-related law changes that have a material effect on our deferred income taxes. The most significant effect on our deferred income taxes is due to changes in the federal net operating loss ("NOL") carryback provisions which allow us to carryback NOLs originating in 2018 and 2019 to prior tax years with corporate income tax rates of 34% (as opposed to forward to future tax years with corporate income tax rates of 21%). As a result of this legislation, during the first nine months of 2020, we significantly reduced our NOL balance by \$2,969,550, or \$623,606 tax-effected, and recorded additional federal income tax refunds of \$1,205,964, which resulted in an income tax benefit of \$582,358.

Loss Reserves

The following tables provide case and incurred-but-not-reported reserves of Positive Insurance Company's losses and loss adjustment expenses as of September 30, 2020 and December 31, 2019.

As of September 30, 2020

	<u>Case Reserves</u>	<u>IBNR Reserves</u>	<u>Total Reserves</u>
Medical professional liability	\$ 32,953,660	\$ 21,466,300	\$ 54,419,960
Total net reserves	32,953,660	21,466,300	54,419,960
Reinsurance recoverables on unpaid claims	3,598,668	5,096,900	8,695,568
Gross reserves	<u>\$ 36,552,328</u>	<u>\$ 26,563,200</u>	<u>\$ 63,115,528</u>

As of December 31, 2019

	<u>Case Reserves</u>	<u>IBNR Reserves</u>	<u>Total Reserves</u>
Medical professional liability	\$ 30,126,567	\$ 25,966,273	\$ 56,092,840
Total net reserves	30,126,567	25,966,273	56,092,840
Reinsurance recoverables on unpaid claims	1,894,670	5,620,465	7,515,135
Gross reserves	<u>\$ 32,021,237</u>	<u>\$ 31,586,738</u>	<u>\$ 63,607,975</u>

The estimation of Positive Insurance Company's reserves is based on several actuarial methods, each of which incorporates many quantitative assumptions. The judgment of the independent actuary plays an important role in selecting among various loss development factors and selecting the appropriate method, or combination of methods, to use for a given policy year.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of an entity's ability to secure sufficient cash to meet its contractual obligations and operating needs. Our insurance operations generate cash by writing policies and collecting premiums. The cash generated is used to pay losses and LAE as well as other underwriting expenses. Any excess cash is invested and earns investment income.

We maintain investment and reinsurance programs that are intended to provide sufficient funds to meet our obligations without forced sales of investments. As such, our investment portfolio contains a high degree of liquidity, with relatively short-term and highly liquid assets, to ensure the availability of funds and to meet the demands of claim settlements and operating expenses. We also have an Investment Committee which meets regularly to discuss cash flow projections and our short-term cash needs as well as asset allocation within our investment portfolio.

Furthermore, liquidity requirements are met primarily through operating cash flows and by maintaining a portfolio with maturities that reflect our estimates of future cash flow requirements. Our investment strategy includes setting guidelines for asset quality standards, allocating assets among investment types and issuers, and other relevant criteria for our portfolio. In addition, invested asset cash flows, which include both current interest income received and investment maturities, are structured to consider projected liability cash flows of loss reserve payouts that are based on actuarial models. Property and casualty claim demands are somewhat unpredictable in nature and require liquidity from the underlying invested assets. Our invested assets are structured to emphasize current investment income while maintaining appropriate portfolio quality and diversity.

Cash flows for the nine months ended September 30, 2020 and 2019 were as follows:

	<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>
Cash flows used in operating activities	\$ (3,500,412)	\$ (14,236,706)
Cash flows provided by (used in) investing activities	53,057	(4,507,732)
Cash flows (used in) provided by financing activities	(48,495)	33,527,777
Net (decrease) increase in cash and cash equivalents	<u>\$ (3,495,850)</u>	<u>\$ 14,783,339</u>

Cash flows from operating activities improved during the first nine months of 2020, compared to prior year, primarily attributable to the payment of the \$10,000,000 prepaid management fee to Diversus in 2019. Cash flows from investing activities increased in the first nine months of 2020, compared to prior year, mainly due to additional sales of equity securities in the current year. The decrease in cash flows from financing activities in 2020 reflects proceeds of \$33,574,401 received from the initial public offering stock issuance in March 2019.

At the holding company level, our primary sources of liquidity are dividends and tax payments received from Positive Insurance Company and capital raising activities. We utilize cash to pay debt obligations, taxes to the federal government, and corporate expenses. At September 30, 2020, we had \$15,345,474 of cash and short-term investments at our holding company which we believe, combined with our other capital sources, will continue to provide us with sufficient funds to meet our foreseeable ongoing expenses and other obligations.

Our insurance subsidiary, Positive Insurance Company, is restricted by the insurance laws and regulations of the Commonwealth of Pennsylvania as to the amount of dividends or other distributions it may pay to the holding company. In considering future dividend policy, Positive Insurance Company will consider, among other things, applicable regulatory constraints. At September 30, 2020, Positive Insurance Company had statutory surplus of \$39,488,725.

An order by the Pennsylvania Insurance Department approving the conversions of PPIX, PCA, and PIPE prohibits the declaration or payment of any dividend, return of capital, or other distribution by PPHI to Insurance Capital Group, LLC and Enstar Holdings (US) LLC, the two principal stockholders of PPHI, or any other shareholder without the prior approval of the Pennsylvania Insurance Department, for a period of three years following the effective date of the conversions. Additionally, by the order of the Pennsylvania Insurance Department, Positive Insurance Company cannot pay a dividend to PPHI for a period of three years following the effective date of the conversions without the approval of the Pennsylvania Insurance Department.

Prior to its payment of any dividend, Positive Insurance Company will be required to provide notice of the dividend to the Pennsylvania Insurance Department. This notice must be provided to the Pennsylvania Insurance Department 30 days prior to the payment of an extraordinary dividend and 10 days prior to the payment of an ordinary dividend. The Pennsylvania Insurance Department has the power to limit or prohibit dividends if Positive Insurance Company is in violation of any law or regulation. These restrictions or any subsequently imposed restrictions may affect our future liquidity.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures, or capital reserves.

INVESTMENTS

Our investment portfolio is invested primarily in publicly traded, investment grade, fixed maturity securities with an average credit quality of A as rated by nationally recognized credit rating agencies. The portfolio is externally managed by independent, professional investment managers and is broadly diversified across sectors and issuers. Exposures are aggregated, monitored, and actively managed by our Investment Committee. We also have an investment policy statement which requires managers to maintain highly diversified exposures to individual issuers and closely monitor compliance with portfolio guidelines.

We have structured our investment portfolio to provide an appropriate matching of maturities with anticipated claims payments. The fair values of these investments are subject to fluctuation in interest rates. If we decide or are required in the future to sell securities in a rising interest rate environment, then we would expect to incur losses from such sales. As of September 30, 2020, the average duration of our fixed maturity security investments that support the insurance reserves was approximately 3.2 years, while the duration of our insurance reserves was slightly lower, reflecting our decision to maintain longer asset duration in order to enhance overall yield, while maintaining a high overall credit quality. We estimate that a 100 basis points (bps) increase in interest rates would reduce the valuation of our fixed maturity portfolio by \$3,739,503 at September 30, 2020.

The following table shows the fair value and amortized cost/cost of our available-for-sale fixed maturity and equity securities:

	September 30, 2020		December 31, 2019	
	Fair Value	Amortized Cost/Cost	Fair Value	Amortized Cost/Cost
U.S. government	\$ 12,981,070	\$ 12,816,595	\$ 10,751,562	\$ 10,689,829
States, territories, and possessions	1,145,192	1,085,009	1,143,023	1,096,638
Subdivisions of states, territories, and possessions	12,751,679	12,249,644	12,822,865	12,440,863
Industrial and miscellaneous	77,914,112	74,202,690	71,030,592	69,445,114
Total fixed maturity securities	104,792,053	100,353,938	95,748,042	93,672,444
Equity securities	226,829	628,256	7,756,966	6,602,462
	<u>\$105,018,882</u>	<u>\$100,982,194</u>	<u>\$103,505,008</u>	<u>\$100,274,906</u>

The fair value of our investment portfolio increased during the first nine months of 2020, primarily due to unrealized appreciation in our fixed maturity securities, mainly corporate bonds, which resulted from declining interest rates. We also sold the majority of our equity securities during the second quarter for a modest net realized gain in order to de-risk our consolidated balance sheet. The total net unrealized gain on our investment portfolio at September 30, 2020 was \$4,036,688, or 4% of the amortized cost or cost basis, compared to an overall net unrealized gain of \$3,230,102 at December 31, 2019.

Year-to-date movements in the unrealized gain (loss) position of our fixed maturity and equity securities are as follows:

	September 30, 2020	December 31, 2019	YTD Change
Fixed maturity securities:			
Unrealized gains	\$ 4,646,946	\$ 2,127,857	\$ 2,519,089
Unrealized losses	(208,831)	(52,259)	(156,572)
Net fixed maturity securities unrealized gains	<u>4,438,115</u>	<u>2,075,598</u>	<u>2,362,517</u>
Equity securities:			
Unrealized gains	—	1,493,581	(1,493,581)
Unrealized losses	(401,427)	(339,077)	(62,350)
Net equity securities unrealized (losses) gains	<u>(401,427)</u>	<u>1,154,504</u>	<u>(1,555,931)</u>
Net unrealized gain	<u>\$ 4,036,688</u>	<u>\$ 3,230,102</u>	<u>\$ 806,586</u>

For our fixed maturity securities that were temporarily impaired at September 30, 2020 and December 31, 2019, the length of time that such securities were in an unrealized loss position, as measured by their month-end fair value, are as follows:

Description of securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2020:						
U.S. government	\$2,720,677	\$ 3,222	\$ 443,076	\$ 17,144	\$3,163,753	\$ 20,366
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	70,735	4,576	70,735	4,576
Industrial and miscellaneous	3,675,310	183,613	126,128	276	3,801,438	183,889
Total fixed maturity securities	<u>\$6,395,987</u>	<u>\$ 186,835</u>	<u>\$ 639,939</u>	<u>\$ 21,996</u>	<u>\$7,035,926</u>	<u>\$ 208,831</u>

Description of securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2019:						
U.S. government	\$2,628,516	\$ 8,227	\$4,061,077	\$ 30,263	\$ 6,689,593	\$ 38,490
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	93,000	7,470	93,000	7,470
Industrial and miscellaneous	4,773,607	5,934	350,922	365	5,124,529	6,299
Total fixed maturity securities	<u>\$7,402,123</u>	<u>\$ 14,161</u>	<u>\$4,504,999</u>	<u>\$ 38,098</u>	<u>\$11,907,122</u>	<u>\$ 52,259</u>

At September 30, 2020, we had gross unrealized losses on fixed maturity securities of \$208,831, compared to gross unrealized losses on fixed maturity securities of \$52,259 at December 31, 2019. The increase in gross unrealized losses during the first nine months of 2020 was attributable to increases in interest rates, mainly associated with our holdings in certain corporate bonds. We have not observed any evidence which would lead us to believe that the entire amortized cost basis will not be recovered.

OTHER MATTERS

Comparison of SAP and GAAP Results

Results presented in accordance with GAAP vary in certain respects from results presented in accordance with statutory accounting practices prescribed or permitted by the Pennsylvania Insurance Department (collectively “SAP”). Prescribed SAP includes state laws, regulations and general administrative rules, as well as a variety of National Association of Insurance Commissioners publications. Permitted SAP encompasses all accounting practices that are not prescribed. Our domestic insurance subsidiary uses SAP to prepare various financial reports for use by insurance regulators.

Critical Accounting Policies

As of September 30, 2020, there were no material changes to our critical accounting estimates. For a full discussion of our critical accounting estimates, refer to Item 7 in our 2019 Form 10-K.

Item 5. Legal Proceedings

Positive Physicians Holdings, Inc. and its wholly owned subsidiary (collectively referred to as the “Company”) are periodically subject to litigation in the normal course of its business. Based upon information presently available to us, we do not consider any litigation to be material. However, given the uncertainties attendant to litigation, we cannot assure you that our results of operations and financial condition will not be materially adversely affected by any litigation.

Item 6. Defaults Upon Senior Securities

None

Item 7. Other Information

None

Item 8. Exhibits

3.1 Interim Consolidated Financial Statements

Item 9. Issuer's Certifications

I, Lewis S. Sharps, M.D., certify that:

1. I have reviewed this quarterly disclosure statement of Positive Physicians Holdings, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: November 13, 2020

/s/ Lewis S. Sharps, M.D.

Lewis S. Sharps, M.D.
Chief Executive Officer

I, Donovan C. Augustin., certify that:

1. I have reviewed this quarterly disclosure statement of Positive Physicians Holdings, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: November 13, 2020

/s/ Donovan C. Augustin

Donovan C. Augustin
Chief Financial Officer

Exhibit 3.1 Interim Consolidated Financial Statements.

**Positive Physicians Holdings, Inc.
Consolidated Balance Sheets**

	<u>September 30, 2020</u> (Unaudited)	<u>December 31, 2019</u>
Assets		
Available-for-sale fixed maturity securities, at fair value	\$ 104,792,053	\$ 95,748,042
Equity securities, at fair value	226,829	7,756,966
Short-term investments, at fair value	250,002	1,169,472
Total investments	<u>105,268,884</u>	<u>104,674,480</u>
Cash and cash equivalents	17,492,231	20,988,081
Accrued investment income	685,831	699,087
Premiums receivable	6,872,505	7,383,876
Reinsurance recoverable	9,366,524	7,850,409
Income taxes recoverable	2,161,575	1,313,935
Unearned ceded premiums	1,509,831	1,181,345
Deferred acquisition costs	2,508,265	2,584,486
Deferred income taxes	200,337	891,584
Prepaid management fee	7,857,143	8,928,571
Other assets	192,175	124,507
Total assets	<u>\$ 154,115,301</u>	<u>\$ 156,620,361</u>
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss adjustment expenses	\$ 63,115,528	\$ 63,607,975
Unearned premiums	12,693,407	12,783,124
Reinsurance payable	2,083,377	1,961,653
Accounts payable, accrued expenses, and other liabilities	1,882,182	5,009,346
Note payable	16,363	64,858
Total liabilities	<u>79,790,857</u>	<u>83,426,956</u>
Stockholders' Equity		
Common stock, \$0.01 par value, 10,000,000 shares authorized; 3,615,500 shares issued and outstanding	36,155	36,155
Additional paid-in capital	49,515,910	49,421,081
Retained earnings	21,266,266	22,096,447
Accumulated other comprehensive income	3,506,113	1,639,722
Total stockholders' equity	<u>74,324,444</u>	<u>73,193,405</u>
Total liabilities and stockholders' equity	<u>\$ 154,115,301</u>	<u>\$ 156,620,361</u>

The accompanying notes are an integral part of these consolidated financial statements.

Positive Physicians Holdings, Inc.
Consolidated Statements of Operations

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues				
Net premiums earned	\$ 5,022,962	\$ 6,989,910	\$ 14,407,394	\$ 17,809,111
Net investment income	593,102	770,007	2,007,945	2,164,510
Realized investment gains (losses), net	(1,854)	(115,893)	(1,474,335)	909,376
Total revenues	<u>5,614,210</u>	<u>7,644,024</u>	<u>14,941,004</u>	<u>20,882,997</u>
Expenses				
Losses and loss adjustment expenses, net	3,415,871	4,121,056	9,797,285	11,710,172
Other underwriting expenses	2,302,778	3,466,905	6,994,629	9,752,342
Interest expense	273	912	2,128	2,691
Total expenses	<u>5,718,922</u>	<u>7,588,873</u>	<u>16,794,042</u>	<u>21,465,205</u>
Income (loss) before provision for income taxes	(104,712)	55,151	(1,853,038)	(582,208)
Provision for income taxes	(39,171)	60,189	(1,022,857)	(108,012)
Net loss	<u>\$ (65,541)</u>	<u>\$ (5,038)</u>	<u>\$ (830,181)</u>	<u>\$ (474,196)</u>
Loss per common share				
Common stock - basic	<u>\$ (0.02)</u>	<u>\$ (0.00)</u>	<u>\$ (0.23)</u>	<u>\$ (0.13)</u>
Common stock - diluted	<u>\$ (0.02)</u>	<u>\$ (0.00)</u>	<u>\$ (0.23)</u>	<u>\$ (0.13)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Positive Physicians Holdings, Inc.
Consolidated Statements of Comprehensive Income

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net loss	\$ (65,541)	\$ (5,038)	\$ (830,181)	\$ (474,196)
Other comprehensive income, net of tax:				
Unrealized gain on available-for-sale fixed maturity securities:				
Unrealized holding gain during the period, net of income tax expense of \$45,845 and \$111,475 for the three months ended September 30, 2020 and 2019 and \$496,129 and \$732,859 for the nine months ended September 30, 2020 and 2019, respectively	204,696	429,346	1,941,554	2,738,677
Reclassification adjustments for (gains) losses included in net loss, net of income tax (expense) benefit of \$(8,568) and \$(2,653) for the three months ended September 30, 2020 and 2019 and \$(19,980) and \$4,856 for the nine months ended September 30, 2020 and 2019, respectively	(32,233)	(9,984)	(75,163)	18,264
Other comprehensive income	172,463	419,362	1,866,391	2,756,941
Comprehensive income	<u>\$ 106,922</u>	<u>\$ 414,324</u>	<u>\$ 1,036,210</u>	<u>\$ 2,282,745</u>

The accompanying notes are an integral part of these consolidated financial statements.

Positive Physicians Holdings, Inc.
Consolidated Statements of Stockholders' Equity

	Three Months Ended September 30, 2020 (Unaudited)				
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, July 1, 2020	\$ 36,155	\$49,492,203	\$21,331,807	\$ 3,333,650	\$74,193,815
Stock based compensation expense	—	23,707	—	—	23,707
Net loss	—	—	(65,541)	—	(65,541)
Other comprehensive income	—	—	—	172,463	172,463
Balance, September 30, 2020	<u>\$ 36,155</u>	<u>\$49,515,910</u>	<u>\$21,266,266</u>	<u>\$ 3,506,113</u>	<u>\$74,324,444</u>

	Nine Months Ended September 30, 2020 (Unaudited)				
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, January 1, 2020	\$ 36,155	\$49,421,081	\$22,096,447	\$ 1,639,722	\$73,193,405
Stock based compensation expense	—	94,829	—	—	94,829
Net loss	—	—	(830,181)	—	(830,181)
Other comprehensive income	—	—	—	1,866,391	1,866,391
Balance, September 30, 2020	<u>\$ 36,155</u>	<u>\$49,515,910</u>	<u>\$21,266,266</u>	<u>\$ 3,506,113</u>	<u>\$74,324,444</u>

	Three Months Ended September 30, 2019 (Unaudited)				
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, July 1, 2019	\$ 36,155	\$49,421,081	\$21,866,240	\$ 1,107,563	\$72,431,039
Issuance of common stock	—	—	—	—	—
Net loss	—	—	(5,038)	—	(5,038)
Other comprehensive income	—	—	—	419,362	419,362
Balance, September 30, 2019	<u>\$ 36,155</u>	<u>\$49,421,081</u>	<u>\$21,861,202</u>	<u>\$ 1,526,925</u>	<u>\$72,845,363</u>

	Nine Months Ended September 30, 2019 (Unaudited)				
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, January 1, 2019	\$ —	\$15,882,835	\$22,335,398	\$ (1,230,016)	\$36,988,217
Issuance of common stock	36,155	33,538,246	—	—	33,574,401
Net loss	—	—	(474,196)	—	(474,196)
Other comprehensive income	—	—	—	2,756,941	2,756,941
Balance, September 30, 2019	<u>\$ 36,155</u>	<u>\$49,421,081</u>	<u>\$21,861,202</u>	<u>\$ 1,526,925</u>	<u>\$72,845,363</u>

The accompanying notes are an integral part of these consolidated financial statements.

Positive Physicians Holdings, Inc.
Consolidated Statements of Cash Flows

	<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net loss	\$ (830,181)	\$ (474,196)
Adjustments to reconcile net loss to net cash flows used in operating activities:		
Deferred income taxes	195,120	(109,058)
Net realized (gain) loss on sales of investments	(81,596)	180,680
Unrealized loss (gain) on equity securities and other investments	1,555,931	(1,090,056)
Amortization of fixed maturity premiums	240,723	177,776
Depreciation and amortization expense	1,111,129	753,987
Stock based compensation expense	94,829	—
Changes in operating assets and liabilities:		
Accrued investment income	13,256	(23,355)
Premiums receivable	511,371	1,884,701
Reinsurance recoverable	(1,516,115)	(974,823)
Income taxes recoverable	(847,640)	(367)
Unearned ceded premiums	(328,486)	(753,608)
Deferred acquisition costs	76,221	1,240,853
Prepaid management fee	—	(10,000,000)
Other assets	(107,370)	208,822
Losses and loss adjustment expenses	(492,447)	(2,438,399)
Unearned premiums	(89,717)	(1,110,204)
Reinsurance payable	121,724	662,906
Accounts payable, accrued expenses, and other liabilities	(3,127,164)	(2,372,365)
Net cash flows used in operating activities	<u>(3,500,412)</u>	<u>(14,236,706)</u>
Cash flows from investing activities:		
Proceeds from sales of fixed maturity securities	15,931,214	9,178,609
Proceeds from sales of equity securities and other investments	6,026,885	2,175,620
Purchases of fixed maturity securities	(22,491,888)	(13,919,951)
Purchases of equity securities	(332,624)	(599,091)
Net sales (purchases) of short-term investments	919,470	(1,342,919)
Net cash flows provided by (used in) investing activities	<u>53,057</u>	<u>(4,507,732)</u>
Cash flows from financing activities		
Proceeds from issuance of common stock	—	33,574,401
Payments of notes payable	(48,495)	(46,624)
Net cash flows (used in) provided by financing activities	<u>(48,495)</u>	<u>33,527,777</u>
Net change in cash and cash equivalents	(3,495,850)	14,783,339
Cash and cash equivalents, at beginning of period	20,988,081	3,903,620
Cash and cash equivalents, at end of period	<u>\$ 17,492,231</u>	<u>\$ 18,686,959</u>
Cash paid during the period for interest	<u>\$ 2,128</u>	<u>\$ 3,173</u>

The accompanying notes are an integral part of these consolidated financial statements.

Positive Physicians Holdings, Inc.
Notes to Unaudited Consolidated Financial Statements

1. Organization

The accompanying unaudited consolidated financial statements include the accounts of Positive Physicians Holdings, Inc. and its wholly owned subsidiary (collectively referred to as the “Company”). Positive Physicians Holdings, Inc. is a Pennsylvania domiciled holding company, which was incorporated on May 1, 2018 for the purpose of acquiring three Pennsylvania based reciprocal insurance exchanges: Positive Physicians Insurance Exchange (“PPIX”), Professional Casualty Association (“PCA”), and Physicians’ Insurance Program Exchange (“PIPE”). In connection with the completion of the Company’s initial public offering, PPIX, PCA, and PIPE converted from reciprocal insurance exchanges into stock insurance companies and were merged together to form Positive Physicians Insurance Company (“Positive Insurance Company”), a wholly owned subsidiary of the Company. The Company’s initial public offering and its acquisition of Positive Insurance Company were completed on March 27, 2019. Prior to that time, the Company had minimal assets and liabilities and had not engaged in any operations. References to the Company or Positive Insurance Company financial information in this Quarterly Report prior to the conversion and merger date is to the financial information of PPIX, PCA, and PIPE on a combined basis. When used in this Quarterly Report, “we” and “our” mean PPIX, PCA, and PIPE prior to March 27, 2019, and Positive Insurance Company thereafter.

On May 18, 2020, the Company received a written notice from the Listing Qualifications Department of Nasdaq indicating that the Company is not in compliance with Listing Rule 5550(a)(4), due to the Company’s failure to meet the minimum 500,000 publicly held shares requirement for continued listing on the Nasdaq Capital Market. On August 5, 2020, the Company filed with the Securities and Exchange Commission (“SEC”) a Form 25, notification to voluntarily delist from the Nasdaq Capital Market. On August 14, 2020, the Company filed a Form 15 with the SEC to suspend its reporting obligations under Section 15(d) of the Securities Exchange Act of 1934. The delisting was effective on August 17, 2020 and the deregistration was effective on November 12, 2020. The Company’s stock is currently trading on the OTCQX Best Market under the symbol, PPHI.

Positive Insurance Company

Positive Insurance Company writes medical malpractice insurance for healthcare providers practicing in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, and Michigan. Diversus Management, LLC (“Diversus Management”) manages and administers essentially all of the operations of Positive Insurance Company under the terms of a management agreement. Diversus Management is a wholly owned subsidiary of Diversus, Inc. (“Diversus”). Pursuant to the terms of the agreement, effective March 27, 2019, Diversus Management provides such administrative services to Positive Insurance Company in exchange for fees based upon a percentage of Positive Insurance Company’s gross written premiums, less return premiums. Diversus Management may also earn quarterly performance management fees based on Positive Insurance Company’s combined ratio and net earned premiums. Positive Insurance Company remains responsible for all underwriting decisions and the payment of all claims and claims related expenses incurred under policies issued by Positive Insurance Company and for all sales commissions paid to producers.

Products and Services

Positive Insurance Company underwrites medical professional liability coverage for physicians, their corporations, medical groups, clinics and allied healthcare providers. Medical professional liability insurance (“MPLI”) protects physicians and other health care providers against liabilities arising from the rendering of, or failure to render, professional medical services. We offer claims-made coverage, claims-made plus, and occurrence-based policies as well as tail coverage in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, and Michigan. Our policies include coverage for the cost of defending claims. Claims-made policies provide coverage to the policyholder for claims reported during the period of coverage. We offer extended reporting endorsements, or tails, to cover claims reported after the policy expires. Occurrence-based policies provide coverage to the policyholders for all losses incurred during the policy coverage year regardless of when the claims are reported. Although we generate a majority of our premiums from individual and small group practices, we also insure several major physician groups.

The Company accounts for its medical professional liability insurance business as a single reporting segment line of business.

Option Agreement

Upon completion of the conversions of PPIX, PCA, and PIPE and the securities offering on March 27, 2019, the Company and Diversus entered into an option agreement whereby either party has the option to cause Diversus, subject to shareholder approval, to merge with and become a wholly owned subsidiary of the Company. Under the terms of the agreement, the option may be exercised by either the Company or Diversus at any time (1) during the period beginning 2 years after completion of the conversions of the exchanges and ending 54 months after the completion of the conversions, or (2) if earlier than 2 years after the completion of the

conversions, then such date that the majority stockholder of the Company no longer has the right to appoint a majority of the board of directors of the Company. In connection with any merger, the common stock shareholders of Diversus will receive either cash, common stock shares of the Company, or some combination thereof for their shares of Diversus' common stock. With respect to the preferred stock shares of Diversus, they will either be paid out in cash or converted into common stock shares of Diversus as if such preferred stock shares were converted into Diversus' common stock shares immediately prior to the effective date of the merger.

2. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2020 are not necessarily indicative of the results that may be expected for the year ending December 31, 2020.

Our consolidated financial statements include our accounts and those of our wholly owned subsidiary. We have eliminated all inter-company accounts and transactions in consolidation.

Positive Physicians Holdings, Inc. was formed on May 1, 2018. Prior to the completion of the initial public offering, the Company, PPIX, PCA, and PIPE were under the common control of Diversus. Additionally, prior to March 27, 2019, the Company did not engage in substantive pre-combination activities, and accordingly, is not considered the acquirer of the net assets of Positive Insurance Company. The acquirer of these net assets is the majority stockholder of the Company. Accordingly, the accompanying unaudited financial statements do not reflect any adjustments to fair value as might have been determined had the Company accounted for the acquisition of Positive Insurance Company's net assets as a business combination.

We recommend you read the interim consolidated financial statements we include in this Quarterly Report in conjunction with the financial statements and the notes to our financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2019.

3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and notes. Actual results could differ from these estimates and such differences could be material. The Company's principal estimates include the liability for losses and loss adjustment expenses, deferred acquisition costs, other-than-temporary impairments of investments, and valuation of deferred tax assets.

Cash and Cash Equivalents

The Company considers cash and cash equivalents to be cash on hand and depository bank accounts with original maturities of three months or less, are readily convertible to known amounts of cash, and present insignificant risk of changes in value due to changing interest rates.

Investments

Investments in fixed maturity securities are classified as available-for-sale and are stated at fair value. Unrealized holding gains and losses, net of related tax effects, on available-for-sale fixed maturity securities are recorded directly to accumulated other comprehensive income. Investments in equity securities are stated at fair value and unrealized holding gains and losses are credited or charged to net income (loss) as incurred and are included in realized investment gains (losses), net in the accompanying consolidated statements of operations.

Realized gains and losses on sales of equity and fixed maturity securities are recognized into income based upon the specific identification method. Interest and dividends are recognized as earned. Short-term investments are considered to be short-term, highly liquid investments that are less than one year in term to the dates of maturity at the purchase dates, and they present insignificant risk of changes in value due to changing interest rates.

The Company regularly evaluates all of its investments based on current economic conditions, credit loss experience, and other specific developments. If there is a decline in a security's net realizable value that is other than temporary, it is considered as a realized loss and the cost basis in the security is reduced to its estimated fair value.

A fixed maturity security is considered to be other-than-temporarily impaired when the security's fair value is less than its amortized cost basis and 1) we intend to sell the security, 2) it is more likely than not that we will be required to sell the security before recovery of the security's amortized cost basis, or 3) we believe we will be unable to recover the entire amortized cost basis of the security (i.e., credit loss has occurred). Other-than-temporary-impairments ("OTTI") of fixed maturity securities are separated into credit and noncredit-related amounts when there are credit-related losses associated with the impaired fixed maturity security for which management asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. The amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded in other comprehensive income (loss). A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the "credit loss."

Deferred Acquisition Costs

Certain direct acquisition costs consisting of commissions, premium taxes and certain other direct underwriting expenses that vary with and are primarily related to the successful production of business are deferred and amortized over the effective period of the related insurance policies as the underlying policy premiums are earned. The method followed in computing deferred acquisition costs limits the amount of deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and loss adjustment expenses, and certain other costs expected to be incurred as the premium is earned. Future changes in estimates, the most significant of which is expected losses and loss adjustment expenses, may require adjustments to deferred acquisition costs. If the estimation of net realizable value indicates that the deferred acquisition costs are not recoverable, then they would be written off.

Prepaid Management Fee

Prepaid management fee comprises costs incurred by the Company to execute a new management agreement with Diversus Management and is amortized on a straight-line basis over the seven-year useful life of the agreement.

Liability for Losses and Loss Adjustment Expenses

Liability for losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on prior experience, actuarial assumptions and management judgments for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates for establishing the resulting liabilities are continually reviewed. Estimating the ultimate cost of future losses and loss adjustment expenses is an uncertain and complex process. This estimation process is based upon the assumption that past developments are an appropriate indicator of future events and involves a variety of actuarial techniques that analyze experience, trends, and other relevant factors. The uncertainties involved with the reserving process include internal factors, such as changes in claims handling procedure, as well as external factors, such as economic trends and changes in the concepts of legal liability and damage awards. Accordingly, final loss settlements may vary from the present estimates, particularly when those payments may not occur until well into the future. Adjustments to previously established reserves are reflected in the operating results of the period in which the adjustment is determined to be necessary. Such adjustments could possibly be significant, reflecting any variety of new and adverse or favorable trends.

We also offer extended reporting coverage at no additional charge in the event of disability, death or retirement after a policyholder reaches the age of 55 and has been a mature-claims policyholder with Positive Insurance Company for at least one year. An extended reporting endorsement policy reserve is required to assure that premiums are not earned prematurely. This reserve is actuarially determined and the balance is included in unearned premiums in the consolidated balance sheets.

Reinsurance

The Company cedes insurance risk to other insurance companies. This arrangement allows us to minimize the net loss potential arising from large risks. Reinsurance contracts do not relieve the Company of its obligation to its policyholders. Reinsurance

premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contract.

Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, short-term investments, non-U.S. government bonds, premiums receivable, and balances recoverable from reinsurers. Non-U.S. government bonds are diversified, and no one investment accounts for greater than 5% of our invested assets. Cash and cash equivalents are deposited with financial institutions with balances that fluctuate in excess of federally insured limits. If the financial institutions were not to honor their contractual liability to us, we could incur losses. We are of the opinion that there is low risk because of the financial strength of the respective financial institutions. We are also subject to concentrations of credit risk through short-term money market investments. The credit risk related to short-term money market investments is minimized by our investing in money market funds or repurchase agreements, both secured by U.S. government securities.

No one insured accounted for over 10% of premiums receivable as of September 30, 2020 and December 31, 2019 or gross written premium for the three and nine months ended September 30, 2020 and 2019. We have reinsurance contracts with various reinsurers all of whom have A.M. Best ratings of A or better or have provided collateral to secure their obligations.

Revenue Recognition

Premiums are earned on a daily pro rata basis over the terms of the insurance policies. Unearned premium reserves are established to cover the unexpired portion of the policies in force less amounts ceded to reinsurers. For consideration received for policies with effective dates subsequent to the reporting period, the Company records an advance premium liability in lieu of written premium.

Premiums associated with tails are generally earned as written, except for the afore-mentioned extended reporting coverage in the event of disability, death or retirement. Other forms of tails, in which premiums are earned as written, include the following: 1) An insured who terminates a claims-made policy with their prior carrier, and who purchases tail coverage (extended reporting coverage) from their old carrier or obtains retroactive (prior-acts) coverage from a new carrier, or 2) Stand-alone tail coverage in which an insured is offered a tail policy by their prior carrier but seeks a competitive quote from a different carrier. Both types of tail coverage insure against claims reported after the end of the original policy period for incidents that occurred while that policy was in effect.

Comprehensive Income

Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale fixed maturity securities and unrealized losses related to factors other than credit on fixed maturity securities, are reported as a separate component in the equity section in the accompanying consolidated balance sheets. Such items, along with net income (loss), are components of comprehensive income, and are reflected in the accompanying consolidated statements of comprehensive income. Reclassifications of realized gains and losses on sales of investments out of accumulated other comprehensive income are recorded in realized investment gains (losses), net in the accompanying consolidated statements of operations.

Income Taxes

The Company accounts for income taxes under the asset and liability approach, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the consolidated financial statements and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company records net deferred tax assets to the extent it believes these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including future reversal of existing taxable temporary differences, tax planning strategies, projected future taxable income, and recent financial operations.

Prior to March 27, 2019, PPIX, PCA, and PIPE filed separate federal income tax returns. The Company did not recognize any interest and penalties in the accompanying consolidated statements of operations for the three and nine months ended September 30, 2020 and 2019. PPIX, PCA, and PIPE remain subject to examination by the Internal Revenue Service for tax years 2017 and 2018 as well as the short stub period in 2019. Beginning with the 2019 tax year, the Company files a consolidated federal income tax return.

4. Recent Accounting Pronouncements

The following discussion includes effective dates for public business entities, as well as whether specific guidance may be adopted early.

Recently Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued guidance that requires lessees to recognize leases, including operating leases, on the lessee’s balance sheet, unless a lease is considered a short-term lease. This guidance also requires entities to make new judgments to identify leases. The guidance was effective for annual and interim reporting periods beginning after December 15, 2018 and permitted early adoption. The Company’s adoption of this guidance on January 1, 2019 did not have a significant impact on our financial condition, results of operations or cash flows.

Recently Issued Accounting Pronouncements

New accounting rules and disclosure requirements can impact the results and the comparability of the Company’s consolidated financial statements. The following recently issued accounting pronouncements are relevant to the Company’s consolidated financial statements:

In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, *Financial Instruments - Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments*. The amendments in this Update require a new topic to be added (Topic 326) to the Accounting Standards Codification (“ASC”) and removes the thresholds that entities apply to measure credit losses on financial instruments measured at amortized cost, such as loans, trade receivables, reinsurance recoverables, off-balance-sheet credit exposures, and held-to-maturity securities. Under current GAAP, entities generally recognize credit losses when it is probable that the loss has been incurred. The guidance under ASU 2016-13 will remove all current recognition thresholds and will require entities under the new current expected credit loss (“CECL”) model to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that an entity expects to collect over the instrument’s contractual life. The new CECL model is based upon expected losses rather than incurred losses. Additionally, the credit loss recognition guidance for available-for-sale securities is amended and will require that credit losses on such debt securities should be recognized as an allowance for credit losses rather than a direct write-down of amortized cost balance. The ASU was effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. In November 2019, the FASB issued ASU 2019-10, *Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*, which extended the effective date of adopting ASU 2016-13. ASU 2016-13 will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption will continue to be permitted; that is, early adoption is allowed for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (that is, effective January 1, 2019, for calendar year-end companies). The Company’s expected adoption date for ASU 2016-13 is January 1, 2023. At this time, we are evaluating the potential impact of ASU 2016-13 in the Company’s consolidated financial statements.

5. Investments

The Company uses fair value measurements to record fair value adjustments to certain assets to determine fair value disclosures. Fixed maturity available-for-sale securities and equity securities are recorded at fair value on a recurring basis. FASB ASC Topic 820 “Fair Value Measurements and Disclosures” establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The three levels of the fair value hierarchy under ASC Topic 820 are as follows:

- Level 1:* Quoted (unadjusted) prices for identical assets in active markets.
- Level 2:* Other observable inputs, either directly or indirectly, including:
 - Quoted prices for similar assets in active markets;
 - Quoted prices for identical or similar assets in nonactive markets (few transactions, limited information, noncurrent prices, high variability over time, etc.);
 - Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates, etc.); and
 - Inputs that are derived principally from or corroborated by other observable market data.
- Level 3:* Unobservable inputs that cannot be corroborated by observable market data.

Under ASC Topic 820, we base fair values of assets on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in FASB ASC Topic 820. Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon our or other third-party's estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other such factors. Management uses its best judgment in estimating the fair value of financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts we could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period end and have not been re-evaluated or updated for purposes of the consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end. Additionally, changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future valuations.

We obtain one price for each security primarily from a third-party pricing service ("pricing service"), which generally uses quoted prices or other observable inputs for the determination of fair value. The pricing service normally derives the security prices through recently reported trades for identical or similar securities, making adjustments through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, non-binding broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest-level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

Amortized cost/cost, gross unrealized gains, gross unrealized losses, and fair value of fixed maturity securities by major security type for the results at September 30, 2020 and December 31, 2019 are as follows:

	Amortized Cost/Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2020				
U.S. government	\$ 12,816,595	\$ 184,841	\$ 20,366	\$ 12,981,070
States, territories, and possessions	1,085,009	60,183	—	1,145,192
Subdivisions of states, territories, and possessions	12,249,644	506,611	4,576	12,751,679
Industrial and miscellaneous	74,202,690	3,895,311	183,889	77,914,112
Total fixed maturity securities	<u>\$100,353,938</u>	<u>\$ 4,646,946</u>	<u>\$ 208,831</u>	<u>\$104,792,053</u>
December 31, 2019				
U.S. government	\$10,689,829	\$ 100,223	\$ 38,490	\$10,751,562
States, territories, and possessions	1,096,638	46,385	—	1,143,023
Subdivisions of states, territories, and possessions	12,440,863	389,472	7,470	12,822,865
Industrial and miscellaneous	69,445,114	1,591,777	6,299	71,030,592
Total fixed maturity securities	<u>\$93,672,444</u>	<u>\$ 2,127,857</u>	<u>\$ 52,259</u>	<u>\$95,748,042</u>

The table below sets forth the contractual maturity profile of our investments in fixed maturity securities at September 30, 2020 and December 31, 2019. Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

	September 30, 2020		December 31, 2019	
	Amortized Cost/Cost	Fair Value	Amortized Cost/Cost	Fair Value
Due in less than one year	\$ 17,167,109	\$ 17,275,982	\$ 8,570,607	\$ 8,584,991
Due after one year to five years	62,264,100	65,309,095	59,713,323	60,844,219
Due after five years to ten years	20,422,430	21,652,983	24,656,702	25,539,400
Due after ten years	500,299	553,993	731,812	779,432
	<u>\$100,353,938</u>	<u>\$104,792,053</u>	<u>\$93,672,444</u>	<u>\$95,748,042</u>

Realized gains and losses are determined using the specific identification method. During the three and nine months ended September 30, 2020 and 2019, proceeds from maturities and sales and gross realized gains and losses on securities and other investments are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Proceeds	\$ 3,695,734	\$ 4,047,314	\$21,958,099	\$11,354,229
Gross gains	33,106	47,226	856,261	107,124
Gross losses	874	47,962	774,665	287,804

The components of net realized investment gains (losses) for the three and nine months ended September 30, 2020 and 2019 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Gain (loss) on sales of fixed maturity securities	\$ 32,233	\$ 9,984	\$ 75,163	\$ (18,264)
Gain (loss) on sales of equity securities and other investments	(1)	(10,720)	6,433	(162,416)
Total gain (loss) on sales of investments	32,232	(736)	81,596	(180,680)
Unrealized gain (loss) on equity securities and other investments	(34,086)	(115,157)	(1,555,931)	1,090,056
Total net realized investment gains (losses)	<u>\$ (1,854)</u>	<u>\$ (115,893)</u>	<u>\$ (1,474,335)</u>	<u>\$ 909,376</u>

The components of net investment income for the three and nine months ended September 30, 2020 and 2019 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Fixed maturity securities	\$ 586,428	\$ 621,987	\$ 1,831,480	\$ 1,748,218
Cash and short-term investments	20,109	108,572	157,350	286,156
Equity securities	4,512	60,975	77,117	204,094
Other income	7,125	6,875	21,375	20,625
	618,174	798,409	2,087,322	2,259,093
Less investment expenses	25,072	28,402	79,377	94,583
Net investment income	<u>\$ 593,102</u>	<u>\$ 770,007</u>	<u>\$ 2,007,945</u>	<u>\$ 2,164,510</u>

The following tables show fair value and gross unrealized losses of our fixed maturity investments with unrealized losses that are not deemed to be other-than temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2020 and December 31, 2019:

Description of securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2020:						
U.S. government	\$2,720,677	\$ 3,222	\$ 443,076	\$ 17,144	\$3,163,753	\$ 20,366
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	70,735	4,576	70,735	4,576
Industrial and miscellaneous	3,675,310	183,613	126,128	276	3,801,438	183,889
Total fixed maturity securities	<u>\$6,395,987</u>	<u>\$ 186,835</u>	<u>\$ 639,939</u>	<u>\$ 21,996</u>	<u>\$7,035,926</u>	<u>\$ 208,831</u>

Description of securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2019:						
U.S. government	\$2,628,516	\$ 8,227	\$4,061,077	\$ 30,263	\$ 6,689,593	\$ 38,490
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	93,000	7,470	93,000	7,470
Industrial and miscellaneous	4,773,607	5,934	350,922	365	5,124,529	6,299
Total fixed maturity securities	<u>\$7,402,123</u>	<u>\$ 14,161</u>	<u>\$4,504,999</u>	<u>\$ 38,098</u>	<u>\$11,907,122</u>	<u>\$ 52,259</u>

Fair values of interest rate sensitive instruments may be affected by increases and decreases in prevailing interest rates, which generally translate, respectively, into decreases and increases in fair values of fixed maturity investments. The fair values of interest rate sensitive instruments also may be affected by the credit worthiness of the issuer, prepayment options, relative values of other investments, the liquidity of the instrument, and other general market conditions.

We evaluated each security and took into account the severity and duration of the impairment, the current rating on the bond, and the outlook for the issuer according to independent analysts. We found that the declines in fair value are most likely attributable to increases in interest rates, and there is no evidence that the likelihood of not receiving all of the contractual cash flows as expected has changed. Our fixed maturity portfolio is managed by our investment committee in concert with an outside investment manager for investment grade bond investments. By agreement, the investment manager cannot sell any security without the consent of our investment committee if such sale will result in a net realized loss.

We monitor our investment portfolio and review securities that have experienced a decline in fair value below cost to evaluate whether the decline is other than temporary. When assessing whether the amortized cost basis of the security will be recovered, we compare the present value of the cash flows likely to be collected, based on an evaluation of all available information relevant to the collectability of the security, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is referred to as the “credit loss.” If there is a credit loss, the impairment is considered to be other-than-temporary. If we identify that an other-than-temporary impairment loss has occurred, we then determine whether we intend to sell the security, or if it is more likely than not that we will be required to sell the security prior to recovering the amortized cost basis less any current-period credit losses. If we determine that we do not intend to sell, and it is more likely than not that we won’t be required to sell the security, then the amount of the impairment loss related to the credit loss will be recorded in earnings, and the remaining portion of the other-than-temporary impairment loss will be recognized in other comprehensive income (loss), net of tax. If we determine that we intend to sell the security, or that it is more likely than not that we will be required to sell the security prior to recovering its amortized cost basis less any current-period credit losses, then the full amount of the other-than-temporary impairment will be recognized in earnings.

For the nine months ended September 30, 2020 and 2019, we determined that none of our fixed maturity securities were other-than-temporarily impaired. Adverse investment market conditions, or poor operating results of underlying investments, could result in impairment charges in the future.

The table below presents the level within the fair value hierarchy generally utilized by us to estimate the fair value of assets disclosed on a recurring basis at September 30, 2020:

	Total	Level 1	Level 2	Level 3
U.S. government	\$ 12,981,070	\$ —	\$ 12,981,070	\$ —
States, territories, and possessions	1,145,192	—	1,145,192	—
Subdivisions of states, territories and possessions	12,751,679	—	12,751,679	—
Industrial and miscellaneous	77,914,112	—	77,914,112	—
Total fixed maturity securities	104,792,053	—	104,792,053	—
Equity securities	226,829	226,829	—	—
	<u>\$105,018,882</u>	<u>\$ 226,829</u>	<u>\$104,792,053</u>	<u>\$ —</u>

The table below presents the level within the fair value hierarchy generally utilized by us to estimate the fair value of assets disclosed on a recurring basis at December 31, 2019:

	Total	Level 1	Level 2	Level 3
U.S. government	\$ 10,751,562	\$ —	\$10,751,562	\$ —
States, territories, and possessions	1,143,023	—	1,143,023	—
Subdivisions of states, territories and possessions	12,822,865	—	12,822,865	—
Industrial and miscellaneous	71,030,592	—	71,030,592	—
Total fixed maturity securities	95,748,042	—	95,748,042	—
Equity securities	7,756,966	7,756,966	—	—
	<u>\$103,505,008</u>	<u>\$ 7,756,966</u>	<u>\$95,748,042</u>	<u>\$ —</u>

6. Deferred Acquisition Costs

The following table summarizes the movements in deferred acquisition costs for the three and nine months ended September 30, 2020 and 2019:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Balance, beginning of period	\$ 2,594,469	\$ 3,658,457	\$ 2,584,486	\$ 3,985,193
Amount capitalized during the period	806,565	1,310,055	2,727,440	5,070,465
Amount amortized during the period	892,769	2,224,172	2,803,661	6,311,318
Balance, end of period	<u>\$ 2,508,265</u>	<u>\$ 2,744,340</u>	<u>\$ 2,508,265</u>	<u>\$ 2,744,340</u>

7. Reinsurance

Under the Company's current reinsurance agreement, we retain a portion of our exposure and pay to the reinsurers a portion of the premiums received on all policies reinsured. Insurance policies written by us are reinsured with other insurance companies principally to:

- reduce net liability on individual risks and clash occurrences;
- mitigate the effect of individual loss occurrences;
- cover us against losses in excess of policy limits and extra contractual obligation claims;
- stabilize underwriting results; and
- increase our underwriting capacity.

Under Pennsylvania law, each insured must maintain MPLI of at least \$1,000,000 for each claim and \$3,000,000 of annual aggregate coverage. We provide primary insurance coverage up to \$500,000 per claim and \$1,500,000 of annual aggregate coverage. The Pennsylvania Medical Care Availability and Reduction of Error ("MCARE") Fund provides coverage for any losses above \$500,000 per claim up to \$1,000,000. In cases where coverage under the Pennsylvania MCARE Fund does not apply, the primary insurance provides coverage up to \$1,000,000 per claim and \$3,000,000 of annual aggregate coverage. We retain the first \$300,000 in

loss on all Pennsylvania claims and reinsurance covers the excess up to \$1,000,000 that is not covered by the Pennsylvania MCARE Fund. We cede to reinsurers any Pennsylvania claims in excess of \$1,000,000.

Other states in which we write insurance require doctors to maintain certain minimum coverage and provide a fund that provides coverage for losses above a certain amount, but some states do not prescribe insurance requirements for doctors.

We offer primary coverage up to \$1,000,000 for each claim and \$3,000,000 of annual aggregate coverage in Delaware, Maryland, Michigan, Ohio, New Jersey, and South Carolina. We retain the first \$300,000 in loss for claims from these states, and reinsurance covers the excess up to \$1,000,000. If an insured in New Jersey requests, additional coverage of \$1,000,000, each claim, each insured, each policy can be provided and is fully ceded to the reinsurer up to a maximum aggregate liability of \$2,000,000 to the reinsurer per the term of the reinsurance agreement. In South Carolina and Michigan, the insured can elect policy limits of \$200,000 per claim and, on these claims, we retain the first \$100,000 and the reinsurer covers the next \$100,000.

We also purchase additional reinsurance coverage for clash, losses in excess of policy limits and extra contractual obligation claims.

Our premiums under the current reinsurance agreement are based on a percentage of our earned premiums during the term of the agreement. The agreement was renewed on April 1, 2020.

Reinsurance does not legally discharge the insurance company issuing the policy from primary liability for the full amount due under the reinsured policies. A primary factor in the selection of reinsurers from whom we purchase reinsurance is their financial strength. Our reinsurance arrangements are generally renegotiated annually. The insolvency or inability of any reinsurer to meet its obligations to us could have a material adverse effect on our results of operations or financial condition. Our reinsurance providers, the majority of whom are longstanding partners that understand our business, are all carefully selected with the help of our reinsurance broker. We monitor the solvency of reinsurers through regular review of their financial statements and, if available, their A.M. Best ratings. Hannover Re, our current reinsurance partner, has an “A+ (Superior)” rating from A.M. Best. According to A.M. Best, companies with a rating of “A” or better “have an excellent ability to meet their ongoing obligations to policyholders.”

We generally do not assume risks from other insurance companies. However, we could be required by statute to participate in guaranty funds, which are formed to pay claims on policies issued by insolvent property and casualty insurers domiciled in certain states, such as Pennsylvania. This participation, where applicable, requires us to pay an annual assessment based on our premiums written and determined on a market share basis. As of September 30, 2020, our participation was not material.

The effect of reinsurance on premiums written, amounts earned, and losses incurred for the three and nine months ended September 30, 2020 and 2019 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Premiums written:				
Direct	\$ 5,731,073	\$ 7,307,405	\$16,964,925	\$19,288,247
Ceded	552,290	742,219	2,975,735	3,342,950
Premiums written, net of reinsurance	<u>\$ 5,178,783</u>	<u>\$ 6,565,186</u>	<u>\$13,989,190</u>	<u>\$15,945,297</u>
Premiums earned:				
Direct	\$ 5,988,571	\$ 7,969,537	\$17,054,642	\$20,398,452
Ceded	965,609	979,627	2,647,248	2,589,341
Premiums earned, net of reinsurance	<u>\$ 5,022,962</u>	<u>\$ 6,989,910</u>	<u>\$14,407,394</u>	<u>\$17,809,111</u>
Losses and loss adjustment expenses incurred:				
Direct	\$ 5,174,578	\$ 4,445,603	\$12,610,977	\$14,721,869
Ceded	1,758,707	324,547	2,813,692	3,011,697
Losses and loss adjustment expenses incurred, net of reinsurance	<u>\$ 3,415,871</u>	<u>\$ 4,121,056</u>	<u>\$ 9,797,285</u>	<u>\$11,710,172</u>

8. Losses and Loss Adjustment Expenses

At September 30, 2020, the Company estimated that its liability for unpaid losses and loss adjustment expenses (“LAE”) for all insurance policies and reinsurance contracts issued by its insurance business was \$63,115,528. This amount included estimated losses from claims plus estimated expenses to settle claims. This estimate also included estimated amounts for losses occurring on or prior to

September 30, 2020 that had not yet been reported to the Company. At September 30, 2020, the Company also estimated that its reinsurance recoverable on unpaid claims was \$8,695,568.

Management believes that its unpaid losses and LAE are fairly stated at September 30, 2020. However, estimating the ultimate claims liability is necessarily a complex and judgmental process inasmuch as the amounts are based on management's informed estimates, assumptions and judgments using data currently available. As additional experience and data become available regarding claims payment and reporting patterns, legal and legislative developments, judicial theories of liability, changes in social attitudes and economic conditions, the estimates are revised accordingly. Original estimates are also increased or decreased, as additional information becomes known regarding individual claims. If the Company's ultimate losses, net of reinsurance, prove to differ substantially from the amounts recorded at September 30, 2020, then the related adjustments could have a material adverse impact on the Company's financial condition, results of operations and liquidity.

Positive Insurance Company uses a combination of the Actual versus Expected Method, Bornhuetter-Ferguson Method, Expected Loss Ratio Method, Frequency/Severity Method, and the Incurred Loss Development Method in order to estimate its liability for losses and LAE. As of prior year-end, the loss reserve analysis assumed that the Company would no longer utilize Andrews Outsource Solutions LLC ("AOS") to provide claims processing and risk management services following 2020, a measure which was expected to reduce the amount of LAE incurred in subsequent periods. Effective July 1, 2020, the Company discontinued its LAE payments to AOS, which is a half-year sooner compared to the assumption applied at prior year-end. This change was reflected accordingly in the loss reserve analysis as of September 30, 2020. There were no other significant changes in the methodologies and assumptions used to develop the liabilities for losses and LAE during the nine months ended September 30, 2020.

9. Income Taxes

At September 30, 2020 and December 31, 2019, the Company had no unrecognized tax benefits, no accrued interest and penalties, and no significant uncertain tax positions. No interest and penalties were recognized during the nine months ended September 30, 2020 and 2019.

At September 30, 2020 and December 31, 2019, the Company had unused net operating loss ("NOL") carryforwards of \$1,247,367 and \$3,600,298, respectively, which will begin to expire in 2038, if unused. The Company's remaining unused NOLs that were generated prior to the conversions and merger in 2019 are subject to limitations under Section 382 of the Internal Revenue Code and are limited in the amount that can be utilized in any one year. The Company's NOL balance at September 30, 2020 consists of taxable losses that were generated by the holding company in 2020.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") into law. The CARES Act includes certain income tax-related law changes that have a material effect on the Company's deferred income taxes. The most significant effect on the Company's deferred income taxes is due to changes in the federal net operating loss carryback provisions which allow the Company to carryback NOLs originating in 2018 and 2019 to prior tax years with corporate income tax rates of 34% (as opposed to forward to future tax years with corporate income tax rates of 21%). As a result of this legislation, during the first nine months of 2020, the Company significantly reduced its NOL balance by \$2,969,550, or \$623,606 tax-effected, and recorded additional federal income tax refunds of \$1,205,964.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all the Company's deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), tax planning strategies, and projected future taxable income in making this assessment. At September 30, 2020 and December 31, 2019, management determined that it was more likely than not that all of the deferred tax assets will be realized by the Company in future years. Accordingly, the Company did not record a valuation allowance against its deferred tax assets at September 30, 2020 and December 31, 2019.

10. Agreements with Diversus

Positive Insurance Company has a management agreement with Diversus Management, whereby Diversus Management provides administrative services to Positive Insurance Company in exchange for fees based on a percentage of Positive Insurance Company's gross written premium, less return premium. Under the current agreement, which became effective March 27, 2019, Diversus Management earns management fees at 12%. Diversus Management may also earn quarterly performance management fees based on Positive Insurance Company's combined ratio and net earned premiums. No quarterly performance fees were payable under the terms of the agreement at September 30, 2020.

Management fees are recorded in other underwriting expenses in the consolidated statements of operations. The Company incurred management fees for the respective periods as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Management fees	\$ 1,094,243	\$ 1,236,758	\$ 3,237,231	\$ 4,173,460

In connection with the execution of the existing management agreement with Diversus Management, the Company paid Diversus \$10,000,000 to execute the agreement. Such payment is presented as prepaid management fee in the accompanying consolidated balance sheets and is amortized on a straight-line basis over a period of seven years. For each of the three months ended September 30, 2020 and 2019, the Company incurred amortization expense of \$357,143. For the nine months ended September 30, 2020 and 2019, the Company incurred amortization expense of \$1,071,429 and \$714,286, respectively. These amounts are recorded in other underwriting expenses in the consolidated statements of operations and included as part of both the current and prior year amounts disclosed in the table above.

Positive Insurance Company has contracts with Gateway Risk Services, LLC and Andrews Outsource Solutions LLC, both of which are wholly owned subsidiaries of Diversus, under which those companies provide claims processing and risk management services. Effective July 1, 2020, the Company discontinued its payments to AOS. Fees incurred by Positive Insurance Company under these contracts are recorded in other underwriting expenses in the consolidated statements of operations as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Claims processing and risk management services	\$ 78,875	\$ 416,775	\$ 874,325	\$ 1,225,025

Additionally, the former attorney-in-fact of PCA earned commissions related to our gross written premium and other accounts. Beginning March 27, 2019, these commissions were paid to Specialty Insurance Agency, LLC, a wholly owned subsidiary of Diversus. These commissions are recorded in other underwriting expenses in the consolidated statements of operations. Positive Insurance Company incurred related commission expenses for the respective periods as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Commissions	\$ 19,142	\$ (1,027)	\$ 97,348	\$ 85,245

The Company and Diversus entered into a loan agreement dated March 27, 2019 to provide a \$6,000,000 credit facility to Diversus for working capital purposes. The Company terminated the loan agreement on May 19, 2020. There was no outstanding balance on the credit facility prior to the termination of the loan agreement.

11. Common Stock

The Company is authorized to issue 10,000,000 shares of \$0.01 par value common stock. In connection with the completion of the initial public offering on March 27, 2019, 3,615,500 shares of the Company's common stock were issued. At September 30, 2020, 3,615,500 shares of common stock remain issued and outstanding.

On September 27, 2019, the Company granted its Chief Executive Officer options to purchase 216,930 shares of common stock at an exercise price of \$12.01 per share, which was the closing sale price of the Company's common stock on the date the options were granted. Of the total options, 108,465 shares will vest in equal monthly installments over a three-and-one-half year period following September 27, 2019, and the remaining 108,465 shares will vest upon the achievement by the Company of certain milestones. All vested option shares shall be exercisable for eight years from the date of vesting. The stock-based compensation expense recorded by the Company during the three and nine months ended September 30, 2020 was \$23,707 and \$94,829, respectively.

The holding company has cash and other liquid assets aggregating \$15,345,474 at September 30, 2020. The holding company's principal source of future liquidity will be dividend payments from Positive Insurance Company, which is restricted by the insurance laws and regulations of the Commonwealth of Pennsylvania as to the amount of dividends or other distributions it may pay to the Company.

An order by the Pennsylvania Insurance Department approving the conversions of PPIX, PCA, and PIPE prohibits the declaration or payment of any dividend, return of capital, or other distribution by the Company to Insurance Capital Group, LLC and Enstar Holdings (US) LLC, the two principal stockholders of the Company, or any other shareholder without the prior approval of the Pennsylvania Insurance Department, for a period of three years following the effective date of the conversions. Additionally, by the order of the Pennsylvania Insurance Department, Positive Insurance Company cannot pay a dividend to the Company for a period of three years following the effective date of the conversions without the approval of the Pennsylvania Insurance Department.

Prior to its payment of any dividend, Positive Insurance Company will be required to provide notice of the dividend to the Pennsylvania Insurance Department. This notice must be provided to the Pennsylvania Insurance Department 30 days prior to the payment of an extraordinary dividend and 10 days prior to the payment of an ordinary dividend. The Pennsylvania Insurance Department has the power to limit or prohibit dividends if Positive Insurance Company is in violation of any law or regulation.

12. Earnings (Loss) Per Share

As discussed in Note 1, the conversions of PPIX, PCA, and PIPE to stock insurance companies and the simultaneous acquisition of these companies resulted in the issuance of the Company's common stock as of March 27, 2019. The basic weighted average number of common shares outstanding was 3,615,500 for the three and nine months ended September 30, 2020 and 2019. For the period prior to the date of the conversions, the net common shares issued in the initial public offering were assumed to be outstanding since January 1, 2019.

The following table presents a reconciliation of the numerators and denominators that were used in the basic and diluted per share computations for the Company's common stock:

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Basic earnings (loss) per common share:				
Numerator:				
Net loss	\$ (65,541)	\$ (5,038)	\$ (830,181)	\$ (474,196)
Denominator:				
Weighted average shares outstanding	3,615,500	3,615,500	3,615,500	3,615,500
Basic earnings (loss) per common share	\$ (0.02)	\$ (0.00)	\$ (0.23)	\$ (0.13)
Diluted earnings (loss) per common share:				
Numerator:				
Net loss	\$ (65,541)	\$ (5,038)	\$ (830,181)	\$ (474,196)
Denominator:				
Weighted average shares outstanding - basic	3,615,500	3,615,500	3,615,500	3,615,500
Add: vested stock options	30,990	—	30,990	—
Number of shares used in diluted computation	3,646,490	3,615,500	3,646,490	3,615,500
Diluted earnings (loss) per common share	\$ (0.02)	\$ (0.00)	\$ (0.23)	\$ (0.13)

13. COVID-19

The Company's operations and business have experienced disruptions due to the conditions surrounding the COVID-19 pandemic spreading throughout the United States. These disruptions include, but are not limited to, office closures and difficulties in maintaining operational continuance during remote operations required by illness, social quarantining, and work from home orders that were in force. The Company's management has devoted substantial time and attention to assessing the potential impact of COVID-19 and those events on the Company's operations and financial position and developing operational and financial plans to address those matters.

As a result of the COVID-19 pandemic, the Company has seen premium decreases due to policy endorsements associated with doctors electing to work part time, take a leave of absence or retire. In addition, some of our insureds have elected to temporarily change their areas of practice and/or specialties. For example, a doctor may choose to drop from orthopedic surgery to office-only status due to the lack of elective surgeries. The Company has received notification for such requests from our policyholders which went into effect on June 30, 2020 and necessary reimbursements or credits against future payments have been applied. During the

first nine months of 2020, the Company recorded approximately \$300,000 in return premium adjustments, or reductions in direct premiums written, associated with these policy endorsements.

In terms of collections, prior to the pandemic, the Company's policy was to cancel any insurance policies for which premiums had not been received within 60 days subsequent to policy effective date, with notice of intent to cancel sent to the insured after 30 days post-inception date, or post-payment due date. As a result of COVID-19, the Company updated this policy and suspended cancellations of insurance contracts resulting from non-payment of premium and deferred payments until June 30, 2020 for invoices due after April 1, 2020. Due to this change in policy, the Company recorded an allowance for uncollectible premium of approximately \$170,000 at September 30, 2020 based on the aging of outstanding premiums receivable.