



POSITIVE PHYSICIANS HOLDINGS, INC.

A Pennsylvania Company
100 Berwyn Park, Suite 220
850 Cassatt Road, Berwyn, PA 19312

Telephone: 888-335-5335
www.positivephysicians.com

Federal EIN: 83-0824448
SIC Code: 6331

QUARTERLY REPORT

For the Period Ending September 30, 2021 (the "Reporting Period")

The number of shares outstanding of our common stock is 3,615,500 as of September 30, 2021 (the end of reporting period).

The number of shares outstanding of our common stock is 3,615,500 as of June 30, 2021 (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 (Loss)</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 declared the outbreak of COVID-19, which began in December 2019, a pandemic and the U.S. federal government 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 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 were detected have taken 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 have closely monitored the spread of COVID-19 and continue to assess its potential effects on our business.

As a result of restrictions put in place to address COVID-19 and the related economic downturn, the Company 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.

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.

Because forward-looking information is subject to various risks and uncertainties, actual results may differ materially from that expressed or implied by the forward-looking information. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected or projected. These forward-looking statements speak only as of the date of the report. The Company expressly disclaims any obligation to publicly release any updates or revisions to reflect any change in the Company's expectations with regard to any change in events, conditions or circumstances on which any such statement is based.

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. The Company's standing in Pennsylvania is currently active.

On September 7, 2021, through a newly formed wholly owned subsidiary of PPHI, Positive Professionals Management LLC ("PPM"), the Company entered into an asset purchase agreement with Diversus, Inc. and its wholly owned subsidiary, Diversus Management, LLC ("Diversus Management") (collectively, "Diversus"). Prior to the acquisition, Diversus had managed and administered essentially all of the operations of Positive Insurance Company under the terms of a management agreement. The acquisition includes the working capital of Diversus at closing, the transfer and/or assignment of employment agreements and contracts with key third party vendors, including the lease of our home office, and full membership assignments of Gateway Risk Services, LLC ("Gateway") and Specialty Insurance Agency LLC ("SIA"). Prior to the acquisition, Gateway and SIA provided claims processing and risk management services and insurance policy brokerage services, respectively, to Positive Insurance Company and third party customers.

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, Michigan, and Florida. 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.

In connection with the aforementioned asset purchase, effective September 7, 2021 PPM entered into a management agreement with Positive Insurance Company to provide the insurance affiliate with management and administrative services. Under the post-closing structure of the Company, Gateway, a wholly owned subsidiary of PPM, provides claims processing and risk management services to Positive Insurance Company and third party customers. Under a newly formed wholly owned subsidiary of PPM, Positive Professionals Insurance Agency LLC ("PPIA"), SIA provides insurance policy brokerage services to Positive Insurance Company and third party customers.

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: Mark J. Keyser
Interim Chief Financial Officer
Positive Physicians Holdings, Inc.
100 Berwyn Park, Suite 220
850 Cassatt Road, Berwyn, PA 19312
Telephone: 888-335-5335
Email: mkeyser@charterlane.com

Item 2. Shares Outstanding

The following table shows our common stock share ownership as of September 30, 2021:

	<u>September 30, 2021</u>
Number of shares authorized	10,000,000
Number of shares outstanding ⁽¹⁾	3,654,238
Freely tradable shares (public float)	311,567
Total number of shareholders on record	~ 100

(1) Shares outstanding include vested stock options of 38,738 that were exercisable as of September 30, 2021, as additional shares would need to be issued by the Company, if exercised.

As of September 30, 2021, 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, 2021 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, 2021 and 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 (Loss)
- 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 for the year ended December 31, 2020.

The interim consolidated financial statements and the accompanying notes for the three and nine months ended September 30, 2021 and 2020 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, 2021.

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 subsidiaries (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 for the year ended December 31, 2020.

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.

On September 7, 2021, through a newly formed wholly owned subsidiary of PPHI, Positive Professionals Management LLC (“PPM”), the Company entered into an asset purchase agreement with Diversus, Inc. and its wholly owned subsidiaries, Diversus Management, LLC (“Diversus Management”) (collectively, “Diversus”). Prior to the acquisition, Diversus had managed and administered essentially all of the operations of Positive Insurance Company under the terms of a management agreement. The acquisition includes the working capital of Diversus at closing, the transfer and/or assignment of employment agreements and contracts with key third party vendors, including the lease of our home office, and full membership assignments of Gateway Risk Services, LLC (“Gateway”) and Specialty Insurance Agency LLC (“SIA”). Prior to the acquisition, Gateway and SIA provided claims processing and risk management services and insurance policy brokerage services, respectively, to Positive Insurance Company and third party customers. Hereinafter, Diversus, Gateway, and SIA are collectively referred to as the “Diversus Companies.”

Positive Insurance Company writes medical malpractice insurance for healthcare providers practicing in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, Michigan, and Florida. Prior to September 7, 2021, Diversus Management managed and administered essentially all of the operations of Positive Insurance Company under the terms of a management agreement. Pursuant to the terms of the agreement, effective March 27, 2019, Diversus Management provided 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. Positive Insurance Company might have also incurred quarterly performance management fees based on its combined ratio and net earned premiums. Positive Insurance Company remained 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.

Effective September 7, 2021, PPM entered into a management agreement with PPIC to provide its insurance affiliate with management and administrative services. The management agreement has been approved by the Pennsylvania Insurance Department.

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, Michigan, and Florida. 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 through reduced credits, a development which we expect to continue and extend through our policy renewals in 2021. 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, more recently, Florida and Georgia in the first quarter of 2021. We received approval on premium rates in Florida in September 2021 and in Texas in November 2021. We are currently in the process of obtaining approval on premium rates in Georgia. No new business was written in Florida during the three months ended September 30, 2021.

Effects of COVID-19

As a result of the COVID-19 pandemic, we saw 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 changed their surgical practice to non-surgical because of closure of surgery centers or hospital operating room availability. We received notification for such requests from our policyholders which went into effect on June 30, 2020 and necessary reimbursements or credits against future payments were applied. During 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. 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 care 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, 2021, one-half of the premiums would be earned in 2021 and the other half would be earned in 2022.

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 unrealized holding gains and losses on equity securities 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 did start to see price increases with our policy renewals toward the latter part of 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 \$2,147,731 in the third quarter of 2021, compared to net loss of \$65,541 in the third quarter of 2020. The decrease for the quarter was primarily driven by the strengthening of our loss reserves and, to a lesser extent, higher non-recurring expenses related to the acquisition of the Diversus companies. For the first nine months, we had a net loss of \$2,373,899 in 2021, compared to \$830,181 in the prior year. The current year decrease in the first nine months was primarily due to the same factors noted above along with modest realized investment gains recognized in 2021 compared to realized losses recognized during the same period

last year. The realized losses in the first nine months of 2020 were mainly due to fluctuations in the unrealized position on our equity securities.

For the third quarter of 2021, we had an operating loss of \$2,138,261, compared to \$64,076 in prior year. During the first nine months, we had an operating loss of \$2,411,614 in 2021, compared to operating income of \$334,544 in the prior year. The decline in our operating results was primarily due to the strengthening of our loss reserves recorded in the third quarter of 2021. In addition, the first nine months of 2020 included an income tax benefit resulting from the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) which did not recur in 2021.

Total revenues were \$5,653,091 in the third quarter of 2021, compared to \$5,614,210 for the same period in the prior year. For the quarter, lower realized investment gains, net investment income, and lower net premiums earned partially offset by the revenue earned by Gateway and SIA. For the first nine months, total revenues were \$17,125,549 in 2021, compared to \$14,941,004 in 2020. The increase in revenues during the first nine months reflects the aforementioned unrealized losses on equity securities recognized in prior year which did not recur in current year as well as higher net premiums earned, partially offset by a reduction in net investment income.

The major components of consolidated revenues and net loss for the three and nine months ended September 30, 2021 and 2020 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
<i>Revenues:</i>				
Net premiums earned	\$ 5,006,850	\$ 5,022,962	\$ 15,275,600	\$ 14,407,394
Net investment income	562,008	593,102	1,705,988	2,007,945
Realized investment gains (losses), net	(11,987)	(1,854)	47,741	(1,474,335)
Other income	96,220	—	96,220	—
Total revenues	<u>5,653,091</u>	<u>5,614,210</u>	<u>17,125,549</u>	<u>14,941,004</u>
<i>Expenses:</i>				
Losses and loss adjustment expenses	5,835,723	3,415,871	13,023,848	9,797,285
Other underwriting expenses	2,545,644	2,302,778	7,141,293	6,994,629
Interest expense	2,406	273	2,406	2,128
Total expenses	<u>8,362,773</u>	<u>5,718,922</u>	<u>20,167,547</u>	<u>16,794,042</u>
Loss before income taxes	(2,709,682)	(104,712)	(3,041,998)	(1,853,038)
Income tax benefit	(561,951)	(39,171)	(668,099)	(1,022,857)
Net loss	<u>\$(2,147,731)</u>	<u>\$ (65,541)</u>	<u>\$(2,373,899)</u>	<u>\$ (830,181)</u>
Underwriting loss ⁽¹⁾	<u>\$(2,189,019)</u>	<u>\$ (133,558)</u>	<u>\$(2,614,680)</u>	<u>\$ (636,156)</u>
Operating income (loss)	<u>\$(2,138,261)</u>	<u>\$ (64,076)</u>	<u>\$(2,411,614)</u>	<u>\$ 334,544</u>

(1) Underwriting loss excludes holding company and captive expenses (of PPHI and PPM since September 7, 2021) of \$1,164,498 and \$562,129 for the three months September 30, 2021 and 2020, and \$2,274,861 and \$1,748,364 for the nine months ended September 30, 2021 and 2020, respectively.

Premiums Written and Premiums Earned

The comparative changes in premiums written and premiums earned for the three and nine months ended September 30, 2021 and 2020 are reflected in the tables below.

	Three Months Ended September 30,		% Change
	2021	2020	
<i>Premiums written:</i>			
Direct	\$ 5,850,169	\$ 5,731,073	2.1%
Ceded	365,617	552,290	(33.8)%
Premiums written, net of reinsurance	<u>\$ 5,484,552</u>	<u>\$ 5,178,783</u>	5.9%
<i>Premiums earned:</i>			
Direct	\$ 5,985,195	\$ 5,988,571	(0.1)%
Ceded	978,345	965,609	1.3%
Premiums earned, net of reinsurance	<u>\$ 5,006,850</u>	<u>\$ 5,022,962</u>	(0.3)%

	Nine Months Ended September 30,		
	2021	2020	% Change
Premiums written:			
Direct	\$ 17,897,427	\$ 16,964,925	5.5%
Ceded	2,777,923	2,975,735	(6.6)%
Premiums written, net of reinsurance	<u>\$ 15,119,504</u>	<u>\$ 13,989,190</u>	8.1%
Premiums earned:			
Direct	\$ 18,435,928	\$ 17,054,642	8.1%
Ceded	3,160,328	2,647,248	19.4%
Premiums earned, net of reinsurance	<u>\$ 15,275,600</u>	<u>\$ 14,407,394</u>	6.0%

The growth in direct premiums written during the third quarter and first nine months of 2021, compared to the same periods last year, is due to new business bound in the current year. Ceded premiums written, which are determined based on a percentage of direct premiums earned, were relatively comparable between both 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,	
	2021	2020
Average cash and invested assets	\$ 124,770,054	\$ 124,211,838
Net investment income	1,705,988	2,007,945
Annualized return on average cash and invested assets	1.82%	2.16%

Net investment income was \$1,705,988 for the first nine months of 2021, compared to \$2,007,945 for the first nine months of 2020. The average monthly net investment income decreased from \$223,000 during the first nine months last year to \$190,000 in the first nine months this year. The decrease in net investment income reflects lower investment yields in 2021, resulting from turnover of securities within the investment portfolio.

Realized Investment Gains (Losses), Net

Net realized investment gains (losses) for the three and nine months ended September 30, 2021 and 2020 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Total gain on sales of investments	\$ 2,160	\$ 32,232	\$ 8,132	\$ 81,596
Unrealized gain (loss) on equity securities	(14,147)	(34,086)	39,609	(1,555,931)
Total net realized investment gains (losses)	<u>\$ (11,987)</u>	<u>\$ (1,854)</u>	<u>\$ 47,741</u>	<u>\$ (1,474,335)</u>

The unrealized loss on equity securities during the first nine months of 2020 was primarily attributable to market volatility associated with the COVID-19 pandemic. During the second quarter last year, we sold the bulk of our 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,	
	2021	2020	2021	2020
Loss and LAE ratio	117.1 %	68.0%	85.4%	68.0%
Expense ratio ⁽¹⁾	33.6%	34.7%	34.0%	36.4%
Combined ratio	150.7%	102.7%	119.4%	104.4%

(1) Expense ratio excludes holding company and captive expenses (of PPHI and PPM since September 7, 2021) of \$1,164,498 and \$562,129 for the three months September 30, 2021 and 2020, and \$2,274,861 and \$1,748,364 for the nine months ended September 30, 2021 and 2020, respectively.

The increase in the loss and LAE ratio for the third quarter and first nine months of 2021, compared to the same periods in 2020, primarily reflects the strengthening of our loss reserves in prior accident/report years recorded in the third quarter of 2021 of \$2,812,000, partially offset by improvement in the expected current accident/report year of \$456,000. The adverse prior year loss reserve development of \$2,812,000 recorded in the third quarter of 2021 was primarily related to reserve strengthening in the 2019 and 2018 accident/report years.

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, were \$2,524,644 for the third quarter of 2021, compared to \$2,302,778 for the third quarter of 2020. For the first nine months of 2021, other underwriting expenses were \$7,141,293 in 2021, compared to \$6,994,629 for the same period in 2020. Other underwriting expenses increased for both periods in the current year primarily due to non-recurring costs relating to the acquisition of the Diversus companies and higher employee-related expenses.

Income Tax Expense (Benefit)

The provision for income taxes for the three and nine months ended September 30, 2021 resulted in income tax benefits of \$561,951 and \$668,099, compared to income tax benefits of \$39,171 and \$1,022,857 for the same periods in 2020, respectively. The Company's effective tax rate for both years was 21%.

On March 27, 2020, President Trump signed the 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, we reduced our NOL balance during the first nine months of 2020 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, 2021 and December 31, 2020.

As of September 30, 2021

	Case Reserves	IBNR Reserves	Total Reserves
Medical professional liability	\$ 36,327,709	\$ 22,651,733	\$ 58,979,442
Total net reserves	36,327,709	22,651,733	58,979,442
Reinsurance recoverable on unpaid claims	8,019,672	2,591,312	10,610,984
Gross reserves	<u>\$ 44,347,381</u>	<u>\$ 25,243,045</u>	<u>\$ 69,590,426</u>

As of December 31, 2020

	Case Reserves	IBNR Reserves	Total Reserves
Medical professional liability	\$ 32,816,233	\$ 22,547,601	\$ 55,363,834
Total net reserves	32,816,233	22,547,601	55,363,834
Reinsurance recoverable on unpaid claims	5,253,919	5,061,661	10,315,580
Gross reserves	<u>\$ 38,070,152</u>	<u>\$ 27,609,262</u>	<u>\$ 65,679,414</u>

In the third quarter of 2021, we recorded \$2,812,000 of prior year adverse loss reserve development, partially offset by improvement in the expected current accident/report year of \$456,000. 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, 2021 and 2020 were as follows:

	Nine Months Ended September 30,	
	2021	2020
Cash flows provided by (used in) operating activities	\$ 3,738,254	\$ (3,500,412)
Cash flows (used in) provided by investing activities	(8,257,655)	53,057
Cash flows provided by (used in) financing activities	2,703,949	(48,495)
Net decrease in cash and cash equivalents and restricted cash	<u>\$ (1,815,452)</u>	<u>\$ (3,495,850)</u>

Cash flows from operating activities improved during the first nine months of 2021, compared to the first nine months of 2020, primarily due to timing of loss and expense payments between years and increased collections of premiums in current year. Cash flows from investing activities decreased during the first nine months of 2021, compared to the first nine months of 2020, reflecting the sales of equity securities in prior year and the acquisition of the Diversus Companies in September 2021. Cash flows from financing activities increased for the current year primarily due to the execution of a master credit agreement with Oak Street Bank, LLC.

At the PPHI 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, 2021, we had \$9,377,875 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. In connection with the asset purchase of the Diversus Companies, PPHI made a capital contribution of \$6,000,000 to PPM.

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, 2021, Positive Insurance Company had statutory surplus of \$38,845,533.

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, 2021, the average duration of our fixed maturity security investments that support the insurance reserves was approximately 3.4 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 \$3,818,248 at September 30, 2021.

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

	September 30, 2021		December 31, 2020	
	Fair Value	Amortized Cost/Cost	Fair Value	Amortized Cost/Cost
U.S. government	\$ 4,778,565	\$ 4,698,541	\$ 11,108,213	\$ 10,988,463
States, territories, and possessions	884,651	868,738	936,364	916,703
Subdivisions of states, territories, and possessions	10,476,938	10,171,395	12,485,451	12,015,681
Industrial and miscellaneous	90,858,563	88,470,343	81,575,982	77,444,191
Total fixed maturity securities	106,998,717	104,209,017	106,106,010	101,365,038
Equity securities	267,475	628,256	227,866	628,256
	<u>\$107,266,192</u>	<u>\$104,837,273</u>	<u>\$106,333,876</u>	<u>\$101,993,294</u>

The fair value of our investment portfolio increased during the first nine months of 2021, primarily due to additional investment in our fixed maturity securities, mainly corporate bonds. The total net unrealized gain on our investment portfolio at September 30, 2021 was \$2,428,919, nearly 2.3% of the amortized cost or cost basis, compared to an overall net unrealized gain of \$4,340,582 at December 31, 2020.

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

	September 30, 2021	December 31, 2020	YTD Change
Fixed maturity securities:			
Unrealized gains	\$ 3,094,888	\$ 4,814,033	\$(1,719,145)
Unrealized losses	(305,188)	(73,061)	(232,127)
Net fixed maturity securities unrealized gains	<u>2,789,700</u>	<u>4,740,972</u>	<u>(1,951,272)</u>
Equity securities:			
Unrealized gains	14,344	1,332	13,012
Unrealized losses	(375,125)	(401,722)	26,597
Net equity securities unrealized losses	<u>(360,781)</u>	<u>(400,390)</u>	<u>39,609</u>
Net unrealized gain	<u>\$ 2,428,919</u>	<u>\$ 4,340,582</u>	<u>\$(1,911,663)</u>

For our fixed maturity securities that were temporarily impaired at September 30, 2021 and December 31, 2020, 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, 2021:						
U.S. government	\$ 1,628,419	\$ 1,130	\$ 199,292	\$ 708	\$ 1,827,711	\$ 1,838
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	72,514	2,738	72,514	2,738
Industrial and miscellaneous	21,369,539	285,780	297,558	14,832	21,667,097	300,612
Total fixed maturity securities	<u>\$ 22,997,958</u>	<u>\$ 286,910</u>	<u>\$ 569,364</u>	<u>\$ 18,278</u>	<u>\$ 23,567,322</u>	<u>\$ 305,188</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, 2020:						
U.S. government	\$ 1,969,008	\$ 3,609	\$ 436,381	\$ 17,716	\$ 2,405,389	\$ 21,325
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	70,834	4,463	70,834	4,463
Industrial and miscellaneous	1,292,441	46,128	125,259	1,145	1,417,700	47,273
Total fixed maturity securities	<u>\$ 3,261,449</u>	<u>\$ 49,737</u>	<u>\$ 632,474</u>	<u>\$ 23,324</u>	<u>\$ 3,893,923</u>	<u>\$ 73,061</u>

At September 30, 2021, we had gross unrealized losses on fixed maturity securities of \$305,188, compared to gross unrealized losses on fixed maturity securities of \$73,061 at December 31, 2020. The increase in gross unrealized losses during the first nine months of 2021 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, 2021, there were no material changes to our critical accounting estimates. For a full discussion of our critical accounting estimates, refer to page 29 under Part D in our 2020 Annual Report.

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 12, 2021

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

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

I, Mark J. Keyser, 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 12, 2021

/s/ Mark J. Keyser

Mark J. Keyser
Interim Chief Financial Officer

Exhibit 3.1 Interim Consolidated Financial Statements.

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

	<u>September 30, 2021</u> (Unaudited)	<u>December 31, 2020</u>
Assets		
Available-for-sale fixed maturity securities, at fair value	\$ 106,998,717	\$ 106,106,010
Equity securities, at fair value	267,475	227,866
Total investments	107,266,192	106,333,876
Cash and cash equivalents	16,924,794	18,877,746
Restricted cash	137,500	
Accrued investment income	684,853	676,997
Premiums receivable	6,676,289	8,425,746
Other receivables	102,849	—
Reinsurance recoverable	10,652,316	10,357,039
Income taxes recoverable	1,589,652	2,055,261
Unearned ceded premiums	789,150	1,171,555
Deferred acquisition costs	2,516,864	2,611,445
Deferred income taxes	1,359,418	294,604
Goodwill	5,767,000	—
Intangible assets, net of accumulated amortization	5,919,834	—
Right-of-use lease asset	698,619	—
Prepaid management fee	—	7,500,000
Other assets	356,167	139,994
Total assets	<u>\$ 161,441,497</u>	<u>\$ 158,444,263</u>
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss adjustment expenses	\$ 69,590,426	\$ 65,679,414
Unearned premiums	12,781,057	13,319,558
Reinsurance payable	2,311,519	1,681,645
Accounts payable, accrued expenses, and other liabilities	2,993,104	3,557,594
Lease liability	699,354	—
Note payable, net of debt issuance costs	2,704,268	—
Total liabilities	<u>91,079,728</u>	<u>84,238,211</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	49,610,738	49,539,617
Retained earnings	18,511,013	20,884,912
Accumulated other comprehensive income	2,203,863	3,745,368
Total stockholders' equity	<u>70,361,769</u>	<u>74,206,052</u>
Total liabilities and stockholders' equity	<u>\$ 161,441,497</u>	<u>\$ 158,444,263</u>

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

Positive Physicians Holdings, Inc.
Consolidated Statements of Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues				
Net premiums earned	\$ 5,006,850	\$ 5,022,962	\$15,275,600	\$ 14,407,394
Net investment income	562,008	593,102	1,705,988	2,007,945
Realized investment gains (losses), net	(11,987)	(1,854)	47,741	(1,474,335)
Other income	96,220	—	96,220	—
Total revenues	<u>5,653,091</u>	<u>5,614,210</u>	<u>17,125,549</u>	<u>14,941,004</u>
Expenses				
Losses and loss adjustment expenses, net	5,835,723	3,415,871	13,023,848	9,797,285
Other underwriting expenses	2,524,644	2,302,778	7,141,293	6,994,629
Interest expense	2,406	273	2,406	2,128
Total expenses	<u>8,362,773</u>	<u>5,718,922</u>	<u>20,167,547</u>	<u>16,794,042</u>
Loss before provision for income taxes	(2,709,682)	(104,712)	(3,041,998)	(1,853,038)
Provision for income taxes	(561,951)	(39,171)	(668,099)	(1,022,857)
Net loss	<u>\$ (2,147,731)</u>	<u>\$ (65,541)</u>	<u>\$ (2,373,899)</u>	<u>\$ (830,181)</u>
Loss per common share:				
Common stock - basic	<u>\$ (0.59)</u>	<u>\$ (0.02)</u>	<u>\$ (0.66)</u>	<u>\$ (0.23)</u>
Common stock - diluted	<u>\$ (0.59)</u>	<u>\$ (0.02)</u>	<u>\$ (0.66)</u>	<u>\$ (0.23)</u>

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

Positive Physicians Holdings, Inc.
Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net loss	\$ (2,147,731)	\$ (65,541)	\$ (2,373,899)	\$ (830,181)
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available-for-sale fixed maturity securities:				
Unrealized holding gain (loss) during the period, net of income tax expense (benefit) of \$(105,499) and \$45,845 for the three months ended September 30, 2021 and 2020 and \$(409,767) and \$496,129 for the nine months September 30, 2021 and 2020, respectively	(394,718)	204,696	(1,533,373)	1,941,554
Reclassification adjustments for gains included in net loss, net of income tax expense of \$(574) and \$(8,568) for the three months ended September 30, 2021 and 2020 and \$(2,162) and \$(19,980) for the nine months ended September 30, 2021 and 2020, respectively	(2,160)	(32,233)	(8,132)	(75,163)
Other comprehensive income (loss)	(396,878)	172,463	(1,541,505)	1,866,391
Comprehensive income (loss)	<u>\$ (2,544,609)</u>	<u>\$ 106,922</u>	<u>\$ (3,915,404)</u>	<u>\$ 1,036,210</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, 2021 (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, July 1, 2021	\$ 36,155	\$49,587,031	\$ 20,658,744	\$ 2,600,741	\$ 72,882,671
Stock based compensation expense	—	23,707	—	—	23,707
Net loss	—	—	(2,147,731)	—	(2,147,731)
Other comprehensive loss	—	—	—	(396,878)	(396,878)
Balance, September 30, 2021	<u>\$ 36,155</u>	<u>\$49,610,738</u>	<u>\$ 18,511,013</u>	<u>\$ 2,203,863</u>	<u>\$ 70,361,769</u>

Nine Months Ended September 30, 2021 (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, January 1, 2021	\$ 36,155	\$49,539,617	\$ 20,884,912	\$ 3,745,368	\$ 74,206,052
Stock based compensation expense	—	71,121	—	—	71,121
Net loss	—	—	(2,373,899)	—	(2,373,899)
Other comprehensive loss	—	—	—	(1,541,505)	(1,541,505)
Balance, September 30, 2021	<u>\$ 36,155</u>	<u>\$49,610,738</u>	<u>\$ 18,511,013</u>	<u>\$ 2,203,863</u>	<u>\$ 70,361,769</u>

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>

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

Positive Physicians Holdings, Inc.
Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2021	2020
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net loss	\$ (2,373,899)	\$ (830,181)
Adjustments to reconcile net loss to net cash flows provided by (used in) operating activities:		
Deferred income taxes	(655,047)	195,120
Net realized gains on sales of investments	(8,132)	(81,596)
Unrealized (gains) losses on equity securities	(39,609)	1,555,931
Amortization of fixed maturity premiums	292,729	240,723
Depreciation and amortization expense	1,015,222	1,111,129
Stock based compensation expense	71,121	94,829
Changes in operating assets and liabilities:		
Accrued investment income	(7,856)	13,256
Premiums receivable	1,749,457	511,371
Other receivables	237,338	—
Reinsurance recoverable	(295,277)	(1,516,115)
Income taxes recoverable	465,609	(847,640)
Unearned ceded premiums	382,405	(328,486)
Deferred acquisition costs	94,581	76,221
Right-of-use lease asset	11,639	—
Other assets	(147,754)	(107,370)
Losses and loss adjustment expenses	3,911,012	(492,447)
Unearned premiums	(538,501)	(89,717)
Reinsurance payable	629,874	121,724
Accounts payable, accrued expenses, and other liabilities	(1,045,754)	(3,127,164)
Lease liability	(10,904)	—
Net cash flows provided by (used in) operating activities	<u>3,738,254</u>	<u>(3,500,412)</u>
Cash flows from investing activities:		
Proceeds from maturities and sales of fixed maturity securities	17,919,204	15,931,214
Purchases of fixed maturity securities	(21,047,780)	(22,491,888)
Proceeds from sales of equity securities	—	6,026,885
Purchases of equity securities	—	(332,624)
Net sales of short-term investments	—	919,470
Acquisition of Diversus Companies, net of cash acquired of \$890,034	(5,129,079)	—
Net cash flows (used in) provided by investing activities	<u>(8,257,655)</u>	<u>53,057</u>
Cash flows from financing activities:		
Debt issuance costs paid	(46,051)	—
Proceeds from issuance of note payable	2,750,000	—
Payments of note payable	—	(48,495)
Net cash flows provided by (used in) financing activities	<u>2,703,949</u>	<u>(48,495)</u>
Net change in cash and cash equivalents and restricted cash	(1,815,452)	(3,495,850)
Cash and cash equivalents and restricted cash, at beginning of period	18,877,746	20,988,081
Cash and cash equivalents and restricted cash, at end of period	<u>\$ 17,062,294</u>	<u>\$ 17,492,231</u>
Cash paid during the period for interest	<u>\$ 2,406</u>	<u>\$ 2,128</u>
Cash recovered during the period for income taxes	<u>\$ 456,559</u>	<u>\$ —</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 subsidiaries (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.

On May 18, 2020, the Company received a written notice from the Listing Qualifications Department of Nasdaq indicating that the Company was 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.

On September 7, 2021, through a newly formed wholly owned subsidiary of PPHI, Positive Professionals Management LLC (“PPM”), the Company entered into an asset purchase agreement with Diversus, Inc. and its wholly owned subsidiary, Diversus Management, LLC (collectively, “Diversus”). Prior to the acquisition, Diversus had managed and administered essentially all of the operations of Positive Insurance Company under the terms of a management agreement. The acquisition includes the working capital of Diversus at closing, the transfer and/or assignment of employment agreements and contracts with key third party vendors, including the lease of our home office, and full membership assignments of Gateway Risk Services, LLC (“Gateway”) and Specialty Insurance Agency LLC (“SIA”). Hereinafter, Diversus, Gateway, and SIA are collectively referred to as the “Diversus Companies.”

Prior to the acquisition, Gateway and SIA provided claims processing and risk management services and insurance policy brokerage services, respectively, to Positive Insurance Company and third party customers. In connection with the asset purchase, effective September 7, 2021 PPM entered into a management agreement with Positive Insurance Company and PPHI to provide the insurance affiliate with management and administrative services. Under the post-closing structure of the Company, Gateway, a wholly owned subsidiary of PPM, provides claims processing and risk management services to Positive Insurance Company and third party customers. Under a newly formed wholly owned subsidiary of PPM, Positive Professionals Insurance Agency LLC (“PPIA”), SIA provides insurance policy brokerage services to Positive Insurance Company and third party customers.

Positive Insurance Company

Positive Insurance Company writes medical malpractice insurance for healthcare providers practicing in Pennsylvania, New Jersey, Ohio, Delaware, Maryland, South Carolina, Michigan, and Florida. Diversus Management, LLC (“Diversus Management”) managed and administered essentially all of the operations of Positive Insurance Company under the terms of a management agreement through September 7, 2021. Pursuant to the terms of the agreement, effective March 27, 2019, Diversus Management provided 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. Positive Insurance Company might have also incurred quarterly performance management fees based on Positive Insurance Company’s combined ratio and net earned premiums. Positive Insurance Company remained 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, Michigan, and Florida. 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.

Gateway and SIA provide claims processing and risk management services and insurance policy brokerage services, respectively, to Positive Insurance Company and third party customers. Since September 7, 2021, the services provided by PPM and its wholly owned subsidiaries to Positive Insurance Company and PPHI are eliminated upon consolidation in the accompanying consolidated financial statements.

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 had 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 might have been 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. With the asset purchase of the Diversus Companies effective as of September 7, 2021, the option agreement was terminated.

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, 2021 are not necessarily indicative of the results that may be expected for the year ending December 31, 2021.

Our consolidated financial statements include our accounts and those of our wholly owned subsidiaries. We have eliminated all inter-company accounts and transactions in consolidation. The consolidated financial statements include the accounts of the Diversus Companies since their acquisition on September 7, 2021.

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 for the year ended December 31, 2020.

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.

Restricted Cash

Restricted cash represents amounts held for the benefit of third parties and is contractually restricted as to withdrawal or usage. Amount represents balances pledged as collateral to meet financing agreements.

The following table provides a reconciliation of Cash and Cash Equivalents and Restricted Cash reported within the Consolidated Balance Sheets that total to the amounts shown in the Consolidated Statements of Cash Flows:

	2021	2020
Cash and cash equivalents	\$ 16,924,794	\$ 18,877,746
Restricted cash	137,500	—
Total Cash and cash equivalents and Restricted cash shown on Consolidated Statements of Cash Flows	\$ 17,062,294	\$ 18,877,746

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.

Business Combinations

The Company accounts for its business combinations using the acquisition method of accounting. Under this method, assets and liabilities are recognized at fair value at the date of acquisition. The excess of the purchase price over the fair value of assets acquired net of liabilities assumed is recognized as goodwill. Certain adjustments to the assessed fair values of the assets or liabilities made

subsequent to the acquisition date, but within the measurement period, which is up to one year, are recorded as adjustments to goodwill. Any adjustments subsequent to the measurement period are recorded to earnings. Results of operations of the acquired entity are included in the Company's consolidated results from the date of the acquisition onward and include amortization expense arising from acquired tangible and intangible assets. The Company expenses all costs incurred related to an acquisition in the accompanying consolidated statements of operations.

Goodwill

Goodwill represents the excess of the purchase price related to a business combination over the fair value of the net assets acquired. The Company does not amortize goodwill, but rather it is tested for impairment annually and whenever events or circumstances make it more likely than not that an impairment may have occurred. The Company assesses goodwill for possible impairment by comparing the carrying amount of the Company's net assets to their fair value. If the carrying value of the net assets is greater than the fair value of the net assets, the difference is recognized as an impairment loss. There was no impairment of goodwill at September 30, 2021.

Intangible Assets

Amortizing identifiable intangible assets represent the cost of customer relationships, covenants not-to-compete, and trademarks. In valuing these assets, the Company makes assumptions regarding useful lives and projected growth rates, and significant judgment is required. The Company periodically reviews identifiable intangibles for impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amounts of the assets exceed their respective fair values, additional impairment tests are performed to measure the amount of the impairment loss, if any. There was no impairment of intangible assets at September 30, 2021.

Prepaid Management Fee

Prior to September 7, 2021, the prepaid management fee comprised costs incurred by the Company to execute a new management agreement with Diversus Management and it was being amortized on a straight-line basis over the seven-year useful life of the former agreement. With the asset purchase of the Diversus Companies on September 7, 2021, the prepaid management fee of the Company was effectively settled and eliminated upon consolidation within the accompanying consolidated financial statements.

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, 2021 and December 31, 2020 or gross written premium for the three and nine months ended September 30, 2021 and 2020. 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.

Debt Issuance Costs

Unamortized debt issuance costs consisting of direct costs of origination such as legal costs are reported in the accompanying consolidated balance sheets as a direct deduction from the face amount of the related debt obligation. Debt issuance costs are amortized on a straight-line basis over the term of related debt obligation and are reported as a component of interest expense in the accompanying consolidated statements of operations.

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.

Claims processing and risk management services provided to third party customers are earned as the services are provided. Insurance policy brokerage services provided to third party customers are recognized as revenue at a point in time, when the insurance policies are incepted, based on a specified percentage of the face value of the policies written. The variability of the brokerage commission revenue ends when the insurance policy is incepted and the fixed fee is determined.

Comprehensive Income (Loss)

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 (loss), and are reflected in the accompanying consolidated statements of comprehensive income (loss). 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. PPIX, PCA, and PIPE remain subject to examination by the Internal Revenue Service for tax years 2017 and 2018 as well as the final short stub period in 2019. Beginning with the 2019 tax year, the Company files a consolidated federal income tax return, subject to a tax sharing agreement under which taxes are allocated on a separate tax return basis. The Company recognized an income tax benefit of \$13,191 related to interest and penalties in the accompanying consolidated statements of operations for the nine months ended September 30, 2021. No such amounts were recognized during the same period in 2020.

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

Effective with entering into the asset purchase agreement for the Diversus Companies on September 7, 2021, the Company adopted the following accounting pronouncements upon the acquisition date.

The Financial Accounting Standards Board ("FASB") issued guidance through the issuance of Accounting Standards Update ("ASU" or "Update") 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and its clarifying amendments that created ASC Topic 606, *Revenue from Contracts with Customers*. ASC Topic 606 supersedes the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. ASC Topic 606 applies to the claims processing and risk management services and the insurance policy brokerage services of the Company. The adoption of this guidance did not have a material impact on our financial condition or results of operations given that the majority of our business is outside the scope of this guidance.

In February 2016, the FASB issued ASU 2016-12, *Leases (Topic 842)*. The amendments to this Update increase transparency and comparability among entities by recognizing right-of-use assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current GAAP and disclosing key information about leasing arrangements. ASU 2016-12 applies to the assumption of our home office lease. The adoption of this guidance did not have a material impact on our results of operations, financial condition or liquidity.

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 pronouncement is relevant to the Company's consolidated financial statements:

In June 2016, the FASB issued 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. Acquisition of the Diversus Companies

On September 7, 2021, the Company entered into an asset purchase agreement with Diversus, Inc. and its wholly owned subsidiary, Diversus Management, LLC (collectively, "Diversus") for \$12.6 million, including \$6.0 million in cash and \$6.5 million reflecting the effective settlement of a preexisting relationship, the Prepaid management fee. See Note 13. Agreements with Diversus for additional information.

Diversus had managed and administered essentially all of the operations of PPIC under the terms of a management agreement. The acquisition includes the working capital of Diversus at closing, the transfer and/or assignment of employment agreements and contracts with key third party vendors, including the lease of our home office, and full membership assignments of Gateway Risk Services LLC and Specialty Insurance Agency LLC.

The asset purchase agreement of the Diversus Companies on September 7, 2021 was accounted for under the acquisition method of accounting. Accordingly, the Company conducted an assessment of the net assets acquired and recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values, while transaction costs associated with the acquisition were expensed as incurred.

The following assets and liabilities were initially recognized in connection with the acquisition as of September 7, 2021:

Consideration:	
Cash paid	\$ 5,500,000
Liabilities assumed	519,113
Prepaid management fee	6,547,619
Total consideration transferred	<u>\$ 12,566,732</u>
Identifiable net assets:	
Cash	\$ 890,034
Accounts receivable	340,187
Right-of-use lease asset	710,258
Other assets	78,775
Accounts payable, accrued expenses, and other liabilities	(481,264)
Lease liability	(710,258)
Total identifiable net assets	827,732
Goodwill	5,767,000
Other intangible assets	5,972,000
Total	<u>\$ 12,566,732</u>

The amount of the Company's revenues and net income included in the accompanying consolidated statement of operations before elimination of intercompany transactions for the period from September 7, 2021 through September 30, 2021 related to the operations of Gateway and SIA were \$121,845 and \$11,723, respectively. Effective with the execution of the new management agreement between PPM, Positive Insurance Company, and PPHI as of September 7, 2021, the acquired operations of Diversus Management were terminated as of the same date.

Intangible assets consisted of the following at September 30, 2021:

	September 30, 2021
Customer relationships	\$ 5,430,000
Trademarks	470,000
Covenants not-to-compete	72,000
	<u>5,972,000</u>
Less accumulated amortization	52,166
	<u>\$ 5,919,834</u>

Customer relationships, trademarks, and covenants not-to-compete acquired as part of the Diversus Companies asset purchase are amortized on a straight-line basis over a range of two to ten years. Amortization expense for the period ended September 30, 2021 was \$52,166. Future amortization expense for the ensuing five years is \$626,000, \$623,000, \$590,000, \$590,000, and \$590,000, and \$2,953,000 thereafter.

6. 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, 2021 and December 31, 2020 are as follows:

	Amortized Cost/Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2021				
U.S. government	\$ 4,698,541	\$ 81,862	\$ 1,838	\$ 4,778,565
States, territories, and possessions	868,738	15,913	—	884,651
Subdivisions of states, territories, and possessions	10,171,395	308,281	2,738	10,476,938
Industrial and miscellaneous	88,470,343	2,688,832	300,612	90,858,563
Total fixed maturity securities	<u>\$104,209,017</u>	<u>\$ 3,094,888</u>	<u>\$ 305,188</u>	<u>\$106,998,717</u>

	Amortized Cost/Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2020				
U.S. government	\$ 10,988,463	\$ 141,075	\$ 21,325	\$ 11,108,213
States, territories, and possessions	916,703	19,661	—	936,364
Subdivisions of states, territories, and possessions	12,015,681	474,233	4,463	12,485,451
Industrial and miscellaneous	77,444,191	4,179,064	47,273	81,575,982
Total fixed maturity securities	<u>\$ 101,365,038</u>	<u>\$ 4,814,033</u>	<u>\$ 73,061</u>	<u>\$ 106,106,010</u>

The table below sets forth the contractual maturity profile of our investments in fixed maturity securities at September 30, 2021 and December 31, 2020. 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, 2021		December 31, 2020	
	Amortized Cost/Cost	Fair Value	Amortized Cost/Cost	Fair Value
Due in less than one year	\$ 12,502,260	\$ 12,647,047	\$ 11,539,731	\$ 11,604,979
Due after one year to five years	66,131,404	68,431,450	63,654,608	66,741,475
Due after five years to ten years	24,261,004	24,547,123	24,615,645	26,098,900
Due after ten years	1,314,349	1,373,097	1,555,054	1,660,656
	<u>\$ 104,209,017</u>	<u>\$ 106,998,717</u>	<u>\$ 101,365,038</u>	<u>\$ 106,106,010</u>

Realized gains and losses are determined using the specific identification method. During the three and nine months ended September 30, 2021 and 2020, proceeds from maturities and sales and gross realized gains and losses on securities are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Proceeds	\$ 4,404,498	\$ 3,695,734	\$ 17,919,204	\$ 21,958,099
Gross gains	2,606	33,106	11,327	856,261
Gross losses	446	874	3,195	774,665

The components of net realized investment gains (losses) for the three and nine months ended September 30, 2021 and 2020 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Gain on sales of fixed maturity securities	\$ 2,160	\$ 32,233	\$ 8,132	\$ 75,163
Gain (loss) on sales of equity securities	—	(1)	—	6,433
Total gain on sales of investments	2,160	32,232	8,132	81,596
Unrealized gain (loss) on equity securities	(14,147)	(34,086)	39,609	(1,555,931)
Total net realized investment gains (losses)	<u>\$ (11,987)</u>	<u>\$ (1,854)</u>	<u>\$ 47,741</u>	<u>\$ (1,474,335)</u>

The components of net investment income for the three and nine months ended September 30, 2021 and 2020 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Fixed maturity securities	\$ 575,871	\$ 586,428	\$ 1,738,466	\$ 1,831,480
Cash and short-term investments	3,919	20,109	18,557	157,350
Equity securities	2,807	4,512	8,460	77,117
Other income	7,125	7,125	21,375	21,375
	<u>589,722</u>	<u>618,174</u>	<u>1,786,858</u>	<u>2,087,322</u>
Less: investment expenses	27,714	25,072	80,870	79,377
Net investment income	<u>\$ 562,008</u>	<u>\$ 593,102</u>	<u>\$ 1,705,988</u>	<u>\$ 2,007,945</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, 2021 and December 31, 2020:

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, 2021:						
U.S. government	\$ 1,628,419	\$ 1,130	\$ 199,292	\$ 708	\$ 1,827,711	\$ 1,838
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	72,514	2,738	72,514	2,738
Industrial and miscellaneous	21,369,539	285,780	297,558	14,832	21,667,097	300,612
Total fixed maturity securities	<u>\$22,997,958</u>	<u>\$ 286,910</u>	<u>\$ 569,364</u>	<u>\$ 18,278</u>	<u>\$23,567,322</u>	<u>\$ 305,188</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, 2020:						
U.S. government	\$1,969,008	\$ 3,609	\$ 436,381	\$ 17,716	\$2,405,389	\$ 21,325
States, territories, and possessions	—	—	—	—	—	—
Subdivisions of states, territories, and possessions	—	—	70,834	4,463	70,834	4,463
Industrial and miscellaneous	1,292,441	46,128	125,259	1,145	1,417,700	47,273
Total fixed maturity securities	<u>\$3,261,449</u>	<u>\$ 49,737</u>	<u>\$ 632,474</u>	<u>\$ 23,324</u>	<u>\$3,893,923</u>	<u>\$ 73,061</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, 2021 and 2020, 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, 2021:

	Total	Level 1	Level 2	Level 3
U.S. government	\$ 4,778,565	\$ —	\$ 4,778,565	\$ —
States, territories, and possessions	884,651	—	884,651	—
Subdivisions of states, territories and possessions	10,476,938	—	10,476,938	—
Industrial and miscellaneous	90,858,563	—	90,858,563	—
Total fixed maturity securities	106,998,717	—	106,998,717	—
Equity securities	267,475	267,475	—	—
	<u>\$107,266,192</u>	<u>\$ 267,475</u>	<u>\$106,998,717</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, 2020:

	Total	Level 1	Level 2	Level 3
U.S. government	\$ 11,108,213	\$ —	\$ 11,108,213	\$ —
States, territories, and possessions	936,364	—	936,364	—
Subdivisions of states, territories and possessions	12,485,451	—	12,485,451	—
Industrial and miscellaneous	81,575,982	—	81,575,982	—
Total fixed maturity securities	106,106,010	—	106,106,010	—
Equity securities	227,866	227,866	—	—
	<u>\$106,333,876</u>	<u>\$ 227,866</u>	<u>\$106,106,010</u>	<u>\$ —</u>

7. Deferred Acquisition Costs

The following table summarizes the movements in deferred acquisition costs for the three and nine months ended September 30, 2021 and 2020:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Balance, beginning of period	\$ 2,516,119	\$ 2,594,469	\$ 2,611,445	\$ 2,584,486
Amount capitalized during the period	1,458,530	1,282,611	4,202,817	4,055,296
Amount amortized during the period	1,457,785	1,368,815	4,297,398	4,131,517
Balance, end of period	<u>\$ 2,516,864</u>	<u>\$ 2,508,265</u>	<u>\$ 2,516,864</u>	<u>\$ 2,508,265</u>

8. 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 Delaware or 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 May 1, 2021.

The Company also has a reinsurance agreement with Keystone Captive Group (“Keystone”), a protected unincorporated cell of Positive Physicians Captive Insurance Company, which is a wholly owned subsidiary of Positive Insurance Company. Keystone is owned by an insured of Positive Insurance Company.

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, 2021, 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, 2021 and 2020 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Premiums written:				
Direct	\$ 5,850,169	\$ 5,731,073	\$17,897,427	\$16,964,925
Ceded	365,617	552,290	2,777,923	2,975,735
Premiums written, net of reinsurance	<u>\$ 5,484,552</u>	<u>\$ 5,178,783</u>	<u>\$15,119,504</u>	<u>\$13,989,190</u>
Premiums earned:				
Direct	\$ 5,985,195	\$ 5,988,571	\$18,435,928	\$17,054,642
Ceded	978,345	965,609	3,160,328	2,647,248
Premiums earned, net of reinsurance	<u>\$ 5,006,850</u>	<u>\$ 5,022,962</u>	<u>\$15,275,600</u>	<u>\$14,407,394</u>
Losses and loss adjustment expenses incurred:				
Direct	\$ 6,521,369	\$ 4,666,722	\$15,236,882	\$12,610,977
Ceded	685,646	1,250,851	2,213,034	2,813,692
Losses and loss adjustment expenses incurred, net of reinsurance	<u>\$ 5,835,723</u>	<u>\$ 3,415,871</u>	<u>\$13,023,848</u>	<u>\$ 9,797,285</u>

9. Losses and Loss Adjustment Expenses

At September 30, 2021, the Company estimated that its liability for unpaid losses and loss adjustment expenses (“LAE”) for all insurance policies issued by its insurance business was \$69,590,426. 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, 2021 that had not yet been reported to the Company. At September 30, 2021, the Company also estimated that its reinsurance recoverable on unpaid claims was \$10,610,984.

In the third quarter of 2021, the Company recorded adverse prior period loss reserve development of \$2,812,000. The adverse loss development primarily reflected reserve strengthening in the 2019 and 2018 accident/report years, and was partially offset by improvement in the expected current accident/report year of \$456,000.

Management believes that its unpaid losses and LAE are fairly stated at September 30, 2021. 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, 2021, 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. There were no significant changes in the methodologies and assumptions used to develop the liabilities for losses and LAE during the nine months ended September 30, 2021.

10. Income Taxes

At September 30, 2021 and December 31, 2020, the Company had no unrecognized tax benefits, no accrued interest and penalties, and no significant uncertain tax positions. The Company recognized an income tax benefit of \$13,191 related to interest and penalties during the nine months ended September 30, 2021. No such amount was recognized during the first half of 2020.

At September 30, 2021 and December 31, 2020, the Company had unused net operating loss (“NOL”) carryforwards of \$4,085,147 and \$1,553,414, 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, 2021 also includes taxable losses generated by the holding company and PPM.

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, the Company reduced its NOL balance during the first nine months of 2020 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.

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, 2021 and December 31, 2020, 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, 2021 and December 31, 2020.

11. Lease Commitment

At September 30, 2021, the right-of-use lease asset and the lease liability was \$698,619 and \$699,355, respectively. The lease consists of a real estate operating lease of our home office that is amortized on a straight-line basis over the term of the lease, which expires in November 2025. At September 30, 2021, the remaining lease term and discount rate for the lease was 4.2 years and 1.75%, respectively. Rent expense for the period ended September 30, 2021 was \$14,747.

Future minimum lease payments under the operating lease are expected to be as follows at September 30, 2021:

Year Ending December 31,	Total
Remainder of 2021	\$ 42,208
2022	171,288
2023	175,579
2024	179,985
2025	169,009
Total undiscounted lease payments	738,069
Less: present value adjustment	38,715
Net lease liability	\$ 699,354

12. Note Payable

On September 7, 2021, PPM and PPIA entered into a master credit agreement with Oak Street Funding, LLC (“Oak Street”). The amount of the loan with Oak Street is for \$2,750,000, with a 12- year term, and payable in monthly installments at an interest rate based on the prime rate, adjusted for an applicable margin (1.75% interest rate at September 30, 2021). The balance of the loan at September 30, 2021 was \$2,750,000.

In connection with the execution of the note payable agreement, PPM and PPIA incurred debt issuance costs of \$46,051. The balance of the debt issuance costs at September 30, 2021 was \$45,731. The Company is amortizing the debt issuance costs on a straight-line basis over the term of the note payable agreement.

13. Agreements with Diversus

On September 7, 2021, Positive Insurance Company entered into a management agreement with PPM, whereby PPM provides management and administrative services to its insurance affiliate. Positive Insurance Company’s agreement with PPM replaced the management agreement with Diversus Management effective September 7, 2021.

Positive Insurance Company had 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 agreement, which became effective March 27, 2019, Positive Insurance Company incurred management fees at 11%. Positive Insurance Company might have also incurred quarterly performance management fees based on its combined ratio and net earned premiums. No quarterly performance fees were payable under the terms of the agreement at September 30, 2021 and December 31, 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,	
	2021	2020	2021	2020
Management fees	\$ 746,553	\$ 1,094,243	\$ 2,910,275	\$ 3,237,231

In connection with the execution of the former 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 sheet at December 31, 2020 and was being amortized on a straight-line basis over a period of seven years. With the acquisition of the Diversus Companies on September 7, 2021, the prepaid management fee was effectively settled and eliminated upon consolidation in the accompanying consolidated financial statements.

For the period from July 1, 2021 through September 7, 2021 and for the three months ended September 30, 2020, the Company incurred amortization expense of \$238,095 and \$357,143, respectively. For the period from January 1, 2021 through September 7, 2021 and for the nine months ended September 30, 2020, the Company incurred amortization expense of \$952,381 and \$1,071,429

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 and Andrews Outsource Solutions LLC (“AOS”), both of which were 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. On September 7, 2021, the full membership assignments of Gateway were acquired by PPM. Fees incurred by Positive Insurance Company under these contracts, prior to September 7, 2021, are recorded as loss adjustment expenses in the consolidated statements of operations as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Claims processing and risk management services	\$ 51,250	\$ 78,875	\$ 205,000	\$ 874,325

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 SIA. On September 7, 2021, the full membership assignments of SIA were acquired by PPM. These commissions, prior to September 7, 2021, 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,	
	2021	2020	2021	2020
Commissions	\$ 17,893	\$ 19,142	\$ 87,030	\$ 97,348

14. 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, 2021, 3,615,500 shares of common stock remain issued and outstanding.

The holding company has cash and other liquid assets aggregating \$9,377,875 at September 30, 2021. The holding company’s principal source of liquidity is tax share payments for which it received \$355,850 from Positive Insurance Company during the first nine months of 2021. Its future liquidity will also include 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. In connection with the asset purchase of the Diversus Companies, PPHI made a capital contribution of \$6,000,000 to PPM.

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.

15. 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, 2021 and 2020.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Basic and diluted loss per common share:				
Numerator:				
Net loss	<u>\$ (2,417,731)</u>	<u>\$ (65,541)</u>	<u>\$ (2,373,899)</u>	<u>\$ (830,181)</u>
Denominator:				
Weighted average shares outstanding	<u>3,615,500</u>	<u>3,615,500</u>	<u>3,615,500</u>	<u>3,615,500</u>
Basic and diluted loss per common share	<u>\$ (0.59)</u>	<u>\$ (0.02)</u>	<u>\$ (0.66)</u>	<u>\$ (0.23)</u>

The effects of 7,747 and 7,747 stock options were excluded from the computations of diluted loss per common share for the three months ended September 30, 2021 and 2020, and the effects of 61,980 and 30,990 stock options were excluded for the nine months ended September 30, 2021 and 2020, respectively, because they were anti-dilutive.

16. Subsequent Events

Subsequent events have been evaluated through November 12, 2021, which is the date the interim consolidated financial statements were available to be issued. No subsequent events requiring recognition or disclosure were noted.