UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2020

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ___________ to ___________

Commission File Number: 001-38873

Palomar Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**83-3972551**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7979 Ivanhoe Avenue, Suite 500 La Jolla, California	**92037**
(Address of principal executive offices)	(Zip Code)

(619) 567-5290
Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $0.0001 per share	PLMR	Nasdaq Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☒	Smaller reporting company ☒
Emerging growth company ☒	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

Number of shares of the registrant’s common shares outstanding at May 1, 2020: 24,254,862

PALOMAR HOLDINGS, INC.

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Item 1: Financial Statements

Palomar Holdings, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except shares and par value data)

	March 31, 2020 (Unaudited)	December 31, 2019
Assets		
Investments:		
Fixed maturity securities available for sale, at fair value (amortized cost: $274,864 in 2020; $211,278 in 2019)	$ 273,358	$ 217,151
Equity securities, at fair value (cost: $21,459 in 2020; $21,336 in 2019)	22,876	22,328
Total investments	296,234	239,479
Cash and cash equivalents	23,845	33,119
Restricted cash	314	230
Accrued investment income	1,774	1,386
Premium receivable	34,938	36,237
Deferred policy acquisition costs	26,714	25,201
Reinsurance recoverable on unpaid losses and loss adjustment expenses	13,854	12,952
Reinsurance recoverable on paid losses and loss adjustment expenses	5,168	4,303
Prepaid reinsurance premium	25,644	26,105
Prepaid expenses and other assets	13,603	14,861
Property and equipment, net	811	845
Intangible assets	744	744
Total assets	$ 443,643	$ 395,462
Liabilities and stockholders' equity		
Liabilities:		
Accounts payable and other accrued liabilities	$ 10,320	$ 13,555
Reserve for losses and loss adjustment expenses	18,352	16,821
Unearned premiums	137,105	130,373
Ceded premium payable	10,027	11,383
Funds held under reinsurance treaty	2,069	1,658
Income and excise taxes payable	3,917	1,117
Deferred tax liabilities, net	1,033	1,999
Total liabilities	182,823	176,906
Stockholders' equity:		
Preferred stock, $0.0001 par value, 5,000,000 shares authorized as of March 31, 2020 and December 31, 2019, respectively, 0 shares issued and outstanding as of March 31, 2020 and December 31, 2019	—	—
Common stock, $0.0001 par value, 500,000,000 shares authorized, 24,239,861 and 23,468,750 shares issued and outstanding as of March 31, 2020 and December 31, 2019, respectively	2	2
Additional paid-in capital	216,334	180,012
Accumulated other comprehensive (loss) income	(1,147)	4,686
Retained earnings	45,631	33,856
Total stockholders' equity	260,820	218,556
Total liabilities and stockholders' equity	$ 443,643	$ 395,462

See accompanying notes.

Palomar Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Income (Loss) and Comprehensive Income (Loss) (Unaudited)

(in thousands, except shares and per share data)

	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
Revenues:		
Gross written premiums	$ 71,494	$ 54,031
Ceded written premiums	(29,495)	(26,106)
Net written premiums	41,999	27,925
Change in unearned premiums	(7,193)	(9,575)
Net earned premiums	34,806	18,350
Net investment income	2,035	960
Net realized and unrealized gains on investments	440	2,411
Commission and other income	738	586
Total revenues	38,019	22,307
Expenses:		
Losses and loss adjustment expenses	1,863	316
Acquisition expenses	13,046	6,975
Other underwriting expenses (includes stock-based compensation of $442 and $22,961 for the three months ended March 31, 2020 and 2019, respectively)	7,951	28,853
Interest expense	—	429
Total expenses	22,860	36,573
Income (loss) before income taxes	15,159	(14,266)
Income tax expense	3,384	145
Net income (loss)	11,775	(14,411)
Other comprehensive income, net:		
Net unrealized gains (losses) on securities available for sale for the three months ended March 31, 2020 and 2019, respectively	(5,833)	2,187
Net comprehensive income (loss)	$ 5,942	$ (12,224)
Per Share Data:		
Basic earnings per share	$ 0.49	$ (0.85)
Diluted earnings per share	$ 0.48	$ (0.85)
Weighted-average common shares outstanding:		
Basic	24,119,263	17,000,000
Diluted	24,778,608	17,000,000

See accompanying notes.

Palomar Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Changes in Stockholders’ Equity (Unaudited)

(in thousands, except share data)

	Number of Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2018	17,000,000	$ 2	$ 68,498	$ (563)	$ 28,355	$ 96,292
Other comprehensive income, net of tax	—	—	—	2,187	—	2,187
Distribution to stockholder	—	—	—	—	(5,120)	(5,120)
Stock-based compensation	—	—	22,961	—	—	22,961
Net loss	—	—	—	—	(14,411)	(14,411)
Balance at March 31, 2019	17,000,000	$ 2	$ 91,459	$ 1,624	$ 8,824	$ 101,909
Balance at December 31, 2019	23,468,750	$ 2	$ 180,012	$ 4,686	$ 33,856	$ 218,556
Other comprehensive loss, net of tax	—	—	—	(5,833)	—	(5,833)
Stock-based compensation	—	—	442	—	—	442
Issuance of common stock in stock offering, net of offering costs	750,000	—	35,464	—	—	35,464
Issuance of common stock pursuant to employee stock purchase plan	21,111	—	416	—	—	416
Net income	—	—	—	—	11,775	11,775
Balance at March 31, 2020	24,239,861	$ 2	$ 216,334	$ (1,147)	$ 45,631	$ 260,820

See accompanying notes.

Palomar Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
Operating activities		
Net cash provided by operating activities	$ 21,804	$ 2,457
Investing activities		
Purchases of property and equipment	(24)	(27)
Purchases of fixed maturity securities	(71,442)	(14,738)
Purchases of equity securities	(123)	(21,430)
Sales and maturities of fixed maturity securities	7,740	12,547
Sales of equity securities	—	27,278
Securities receivable or payable, net	(3,025)	—
Net cash (used in) provided by investing activities	(66,874)	3,630
Financing activities		
Proceeds from stock offering, net of offering costs	35,464	—
Proceeds from common stock issued under employee stock purchase plan	416	—
Distribution to stockholder	—	(5,120)
Net cash provided by (used in) financing activities	35,880	(5,120)
Net increase (decrease) in cash, cash equivalents and restricted cash	(9,190)	967
Cash, cash equivalents and restricted cash at beginning of period	33,349	9,924
Cash, cash equivalents and restricted cash at end of period	$ 24,159	$ 10,891
Supplementary cash flow information:		
Cash paid for income taxes	$ —	$ —
Cash paid for interest	$ —	$ 444

The following table summarizes our cash and cash equivalents and restricted cash and cash equivalents within the Condensed Consolidated Balance Sheets (in thousands):

	March 31, 2020 (unaudited)	December 31, 2019
Cash and cash equivalents	$ 23,845	$ 33,119
Restricted cash	314	230
Cash and cash equivalents and restricted cash	$ 24,159	$ 33,349

See accompanying notes.

Palomar Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Summary of Operations and Basis of Presentation

Summary of Operations

Palomar Holdings, Inc. (the Company) is an insurance holding company that was incorporated in Delaware on March 14, 2019. Prior to incorporation in Delaware, the Company was known as GC Palomar Holdings (GCPH), which was a Cayman Islands incorporated insurance holding company formed on October 4, 2013 when GC Palomar Investor LP (GCPI) acquired control of GCPH. The Company has several wholly owned subsidiaries including a U.S. insurance subsidiary, Palomar Specialty Insurance Company (PSIC) and a Bermuda based reinsurance subsidiary, Palomar Specialty Reinsurance (PSRE).

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and include the accounts of the Company and its wholly-owned subsidiaries. These condensed consolidated financial statements do not contain all information and footnotes required by U.S. GAAP for complete consolidated financial statements. For a more complete description of the Company's business and accounting policies, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019.

In the opinion of management, all adjustments necessary for a fair presentation of the condensed consolidated financial statements have been included. Such adjustments consist only of normal recurring items. All intercompany balances and transactions have been eliminated in consolidation. Interim results are not necessarily indicative of results of operations for the full year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the condensed consolidated financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein. All revisions to accounting estimates are recognized in the period in which the estimates are revised. Significant estimates reflected in the Company's condensed consolidated financial statements include, but are not limited to, reserves for losses and loss adjustment expenses, reinsurance recoverables on unpaid losses, and the fair values of investments.

Recent Accounting Pronouncements

The Company currently qualifies as an emerging growth company ("EGC") under the Jumpstart Our Business Startups Act of 2012, or the JOBS Act. The Company is currently electing to adopt new or revised accounting guidance within the same time periods as private companies as permitted by its status as an EGC.

The Company will continue to be an EGC for the first five fiscal years after its initial public offering ("IPO"), unless certain changes occur such as becoming a large accelerated filer. The Company will become a large accelerated filer on December 31, 2020 if the market value of its shares held by non-affiliates exceeds $700 million on June 30, 2020. If the Company becomes a large accelerated filer, it will no longer have the option to adopt guidance within the same time periods as private companies.

Recently adopted accounting pronouncements

In August 2018, the FASB issued "ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. Among other things, this new guidance eliminates the need to disclose transfers between Level 1 and Level 2 of the fair value hierarchy, changes the policy for timing of transfers and the valuation processes for Level 3 fair value measurements and includes requirements to disclose quantitative information about Level 3 measurements. The Company adopted this guidance on January 1, 2020 and adoption did not have an impact on the Company's condensed consolidated financial statements. The Company will continue to monitor the composition of its investment portfolio and will make appropriate disclosures based on this guidance.

Recently issued accounting pronouncements not yet adopted

In February 2016, the FASB issued new guidance for accounting for leases, "ASU 2016-02, *Leases (Topic 842)*." Under current guidance, leases are only included on the balance sheet if the criteria to classify the agreement as a capital lease are met. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months.

This guidance was subsequently amended multiple times and offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. This new guidance requires a modified retrospective adoption, applying the new standard to all leases existing at the date of initial application, with early adoption permitted. An entity may choose to use the standard's effective date, rather than the beginning of the earliest comparative period presented, as the date of initial application. An entity would record the effects of initially applying the new guidance as a cumulative-effect adjustment to retained earnings. Consequently, an entity's reporting for the comparative periods presented in the year of adoption would continue to be in accordance with the current guidance, including the current disclosure requirements.

To facilitate transition, the new guidance includes a package of practical expedients that entities may elect to apply on adoption. The package of practical expedients relates to the identification and classification of leases and initial direct costs for leases that commenced before the effective date. The new guidance also includes a practical expedient permitting the use of hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset.

Under the Company's current status as an EGC, this update will be effective for annual reporting periods beginning after December 15, 2020, and interim reporting periods within fiscal years beginning after December 31, 2021 with early adoption permitted. The Company is currently evaluating the impact that this new guidance will have on its condensed 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*." Current guidance delays the recognition of credit losses until it is probable a loss has been incurred. This updated guidance will require financial assets measured at amortized cost to be presented at the net amount expected to be collected by means of an allowance for credit losses that runs through net income. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses, with the amount of the allowance limited to the amount by which fair value is below amortized cost. In 2019, the FASB issued amendments to this guidance which provide an option to irrevocably elect to measure certain individual financial assets at fair value instead of amortized cost and provide additional clarification and implementation guidance.

Under the Company's current status as an EGC, this update and its amendments will be effective for annual reporting periods beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted, but not before annual reporting periods beginning on or after December 15, 2018. The Company is currently evaluating the impact that this new guidance will have on its condensed consolidated financial statements.

2. Investments

The Company's available-for-sale investments are summarized as follows:

March 31, 2020	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
Fixed maturities:				
U.S. Governments	$ 16,623	$ 927	$ —	$ 17,550
States, territories, and possessions	2,836	208	—	3,044
Political subdivisions	2,304	45	(16)	2,333
Special revenue excluding mortgage/asset-backed securities	26,982	686	(229)	27,439
Industrial and miscellaneous	167,292	3,296	(5,503)	165,085
Mortgage/asset-backed securities	58,827	1,303	(2,223)	57,907
Total available-for-sale investments	$ 274,864	$ 6,465	$ (7,971)	$ 273,358

December 31, 2019	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
Fixed maturities:				
U.S. Governments	$ 13,371	$ 321	$ (13)	$ 13,679
States, territories, and possessions	2,298	147	—	2,445
Political subdivisions	1,913	29	—	1,942
Special revenue excluding mortgage/asset-backed securities	18,139	343	(46)	18,436
Industrial and miscellaneous	124,726	4,326	(39)	129,013
Mortgage/asset-backed securities	50,831	824	(19)	51,636
Total available-for-sale investments	$ 211,278	$ 5,990	$ (117)	$ 217,151

Security holdings in an unrealized loss position

As of March 31, 2020, the Company held 223 fixed maturity securities in an unrealized loss position with a total estimated fair value of $105.7 million and total gross unrealized losses of $8.0 million. As of December 31, 2019, the Company held 51 fixed maturity securities in an unrealized loss position with a total estimated fair value of $20.9 million and total gross unrealized losses of $0.1 million.

The aggregate fair value and gross unrealized losses of the Company's investments aggregated by investment category and the length of time these individual securities have been in a continuous unrealized loss position as of March 31, 2020 and December 31, 2019, are as follows:

March 31, 2020	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	More Than 12 Months Fair Value	More Than 12 Months Unrealized Losses	Total Fair Value	Total Unrealized Losses
	(in thousands)					
Fixed maturity securities:						
U.S. Governments	$ —	—	$ —	$ —	$ —	$ —
States, territories, and possessions	—	—	—	—	—	—
Political subdivisions	385	(16)	—	—	385	(16)
Special revenue excluding mortgage/asset-backed securities	8,850	(229)	—	—	8,850	(229)
Industrial and miscellaneous	70,872	(5,503)	—	—	70,872	(5,503)
Mortgage/asset-backed securities	25,566	(2,223)	—	—	25,566	(2,223)
Total	$ 105,673	$ (7,971)	$ —	$ —	$ 105,673	$ (7,971)

December 31, 2019	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	More Than 12 Months Fair Value	More Than 12 Months Unrealized Losses	Total Fair Value	Total Unrealized Losses
	(in thousands)					
Fixed maturity securities:						
U.S. Governments	$ 1,235	$ (11)	$ 1,827	$ (2)	$ 3,062	$ (13)
States, territories, and possessions	—	—	—	—	—	—
Political subdivisions	—	—	—	—	—	—
Special revenue excluding mortgage/asset-backed securities	3,548	(46)	—	—	3,548	(46)
Industrial and miscellaneous	6,929	(38)	188	(1)	7,117	(39)
Mortgage/asset-backed securities	7,035	(19)	182	—	7,217	(19)
Total	$ 18,747	$ (114)	$ 2,197	$ (3)	$ 20,944	$ (117)

The Company considers the following factors in determining whether declines in the fair value of investments are other-than-temporary:

- The significance of the decline in fair value compared to the cost basis,
- The time period during which there has been a significant decline in fair value,
- Whether the unrealized loss is credit-driven or a result of changes in market interest rates,
- A fundamental analysis of the business prospects and financial condition of the issuer,
- The Company's intent to sell the securities as of each reporting date, and
- If the Company does not expect to recover the entire amortized cost basis or cost of the investment.

Based on the Company's reviews as of March 31, 2020, the Company determined that the fixed maturity securities' unrealized losses were primarily the result of the widening credit spreads during the three months ended March 31, 2020 which more than offset declines in interest rates during that period. While the Company held some securities in industries such as energy and airlines, the Company believes it will be able to recover its investment in these securities given the financial condition and near-term prospects of the issuers. The Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before the recovery of their amortized cost basis. Therefore, none of the fixed maturity securities were written down during the three months ended March 31, 2020.

Contractual maturities of available-for-sale fixed maturity securities

The amortized cost and fair value of fixed maturity securities at March 31, 2020, by contractual maturity, are shown below.

	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$ 11,548	$ 11,572
Due after one year through five years	87,088	87,408
Due after five years through ten years	79,345	77,926
Due after ten years	38,056	38,545
Mortgage and asset-backed securities	58,827	57,907
	$ 274,864	$ 273,358

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

Net investment income summary

Net investment income is summarized as follows:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Interest income	$ 2,001	$ 1,010
Dividend income	125	30
Investment expense	(91)	(80)
Net investment income	$ 2,035	$ 960

Net realized and unrealized investment gains and losses

The following table presents net realized and unrealized investment gains and losses:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Realized gains:		
Gains on sales of fixed maturity securities	$ 15	$ 44
Gains on sales of equity securities	—	66
Total realized gains	15	110
Realized losses:		
Losses on sales of fixed maturity securities	—	(66)
Losses on sales of equity securities	—	(156)
Total realized losses	—	(222)
Net realized investment gains (losses)	15	(112)
Net unrealized gains on equity securities	425	2,523
Net realized and unrealized gains on investments	$ 440	$ 2,411

Proceeds from the sale of fixed maturity securities were $0.8 million and $9.9 million for the three months ended March 31, 2020 and 2019, respectively.

The Company places securities on statutory deposit with certain state agencies to retain the right to do business in those states. These securities are included in available-for-sale investments on the balance sheet. At March 31, 2020 and December 31, 2019, the carrying value of securities on deposit with state regulatory authorities was $5.4 million and $5.1 million, respectively.

3. Fair value measurements

Fair value is defined as the price that the Company would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market of the investment.

The three-tier hierarchy of inputs is summarized in the three broad levels listed below:

Level 1—Unadjusted quoted prices are available in active markets for identical investments as of the reporting date.

Level 2—Pricing inputs are quoted prices for similar investments in active markets; quoted prices for identical or similar investments in inactive markets; or valuations based on models where the significant inputs are observable or can be corroborated by observable market data.

Level 3—Pricing inputs into models are unobservable for the investment. The unobservable inputs require significant management judgment or estimation.

To measure fair value, the Company obtains quoted market prices for its investment securities from its outside investment managers. If a quoted market price is not available, the Company uses prices of similar securities. The fair values obtained from the outside investment managers are reviewed for reasonableness and any discrepancies are investigated for final valuation.

The fair value of the Company's investments in fixed maturity securities is estimated using relevant inputs, including available market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. An Option Adjusted Spread model is also used to develop prepayment and interest rate scenarios. Industry standard models are used to analyze and value securities with embedded options or prepayment sensitivities. These fair value measurements are estimated based on observable, objectively verifiable market information rather than market quotes; therefore, these investments are classified and disclosed in Level 2 of the hierarchy.

The following tables present the Company's fair value hierarchy for financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2020 and December 31, 2019.

March 31, 2020	Level 1	Level 2	Level 3	Total
		(in thousands)		
Assets:				
Fixed maturity securities				
U.S. Governments	$ —	$ 17,550	$ —	$ 17,550
States, territories, and possessions	—	3,044	—	3,044
Political subdivisions	—	2,333	—	2,333
Special revenue excluding mortgage/asset-backed securities	—	27,439	—	27,439
Industrial and miscellaneous	—	165,085	—	165,085
Mortgage/asset-backed securities	—	57,407	500	57,907
Equity securities	22,876	—	—	22,876
Cash, cash equivalents, and restricted cash	14,724	9,435	—	24,159
Total assets	$ 37,600	$ 282,293	$ 500	$ 320,393

December 31, 2019	Level 1	Level 2	Level 3	Total
		(in thousands)		
Assets:				
Fixed maturity securities				
U.S. Governments	$ —	$ 13,679	$ —	$ 13,679
States, territories, and possessions	—	2,445	—	2,445
Political subdivisions	—	1,942	—	1,942
Special revenue excluding mortgage/asset-backed securities	—	18,436	—	18,436
Industrial and miscellaneous	—	129,013	—	129,013
Mortgage/asset-backed securities	—	50,136	1,500	51,636
Equity securities	—	22,328	—	22,328
Cash, cash equivalents, and restricted cash	28,350	4,999	—	33,349
Total assets	$ 28,350	$ 242,978	$ 1,500	$ 272,828

The carrying amounts of financial assets and liabilities reported in the accompanying condensed consolidated balance sheet including cash and cash equivalents, restricted cash, receivables, reinsurance recoverable, and accounts payable and other accrued liabilities approximate fair value due to their short term-maturity.

Transfers between Level 3 and Level 2 securities result from changes in the availability of market observable inputs and are recorded at the beginning of the reporting period. As of March 31, 2020 and December 31, 2019, the Company had $0.5 million and $1.5, respectively of fixed income securities classified as Level 3 due to the availability of market observable inputs. The $1.5 million of Level 3 securities held at December 31, 2019 was transferred to Level 2 during the three months ended March 31, 2020.

4. Reserve for Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the ending reserve balances for losses and loss adjustment expenses:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Reserve for losses and loss adjustment expenses net of reinsurance recoverables at beginning of period	$ 3,869	$ 4,165
Add: Incurred losses and loss adjustment expenses, net of reinsurance, related to:		
Current year	2,179	278
Prior years	(316)	38
Total incurred	1,863	316
Deduct: Loss and loss adjustment expense payments, net of reinsurance, related to:		
Current year	351	106
Prior years	883	2,043
Total payments	1,234	2,149
Reserve for losses and loss adjustment expense net of reinsurance recoverables at end of period	4,498	2,332
Add: Reinsurance recoverables on unpaid losses and loss adjustment expenses at end of period	13,854	10,296
Reserve for losses and loss adjustment expenses gross of reinsurance recoverables on unpaid losses and loss adjustment expenses at end of period	$ 18,352	$ 12,628

Considerable variability is inherent in the estimate of the reserve for losses and LAE. Although management believes the liability recorded for losses and LAE is adequate, the variability inherent in this estimate could result in changes to the ultimate liability, which may be material to stockholders' equity.

The Company experienced favorable development of $0.3 million in the three months ended March 31, 2020 and adverse development of $0.04 million in the three months ended March 31, 2019 related to prior year losses.

Favorable development in the three months ended March 31, 2020 was primarily due to lower than anticipated frequency and severity of claims in the specialty homeowners and residential flood lines of business.

Unfavorable development during for the three months ended March 31, 2019 was primarily due to development of a Hurricane Michael claim offset by favorable development in the Specialty Homeowners line of business due to lower than originally anticipated frequency and severity of claims.

5. Long-term debt

In September 2018, the Company completed a private placement financing of $20.0 million floating rate senior secured notes (Floating Rate Notes). These Floating Rate Notes were redeemed in May 2019 pursuant to their terms and the Company did not have any debt subsequent to May 2019. The Company incurred and paid $0.4 million in interest expense related to the Floating Rate Notes for the three months ended March 31, 2019.

6. Income Taxes

Prior to March 2019, the Company was a Cayman Islands incorporated holding company with U.K. tax residency. On March 14, 2019, the Company implemented a domestication (the Domestication) pursuant to Section 388 of the Delaware General Corporation Law and Section 206 of the Companies Law (2018 Revision), as amended, of the Cayman Islands pursuant to which it became a Delaware corporation and no longer subject to the laws of the Cayman Islands.

Historically, the Company's Bermuda based subsidiary, PSRE, was not required to pay any taxes on its income or capital gains but was subject to a 1% U.S. federal excise tax on reinsurance premiums assumed. The Company intends to make an irrevocable election for PSRE to be taxed as a U.S. domestic corporation under Section 953(d) of the Code effective January 1, 2019.

Prior to 2019, the Company maintained a valuation allowance on the U.S. tax attributes due to significant negative evidence, including cumulative U.S. losses in the most recent three-year period and our assessment that the realization of the net deferred tax assets did not meet the "more likely than not" criteria under *ASC 740, Income Taxes*. Management assessed available positive and negative evidence to estimate whether sufficient future taxable income would be generated to permit use of the existing deferred tax assets. The projected reversal of temporary differences, the Domestication, and projected future operating income in the U.S. represents significant positive evidence, which outweighed the historical negative evidence.

Based on this evidence, management determined it was more likely than not that the federal deferred tax assets are recoverable and therefore the associated valuation allowance was released as of March 31, 2019. State NOL carryforwards, due to the limited carryforward period, do not meet the "more likely than not" criteria and the Company will continue to maintain a valuation allowance on the associated deferred tax assets. The Company decreased the valuation allowance on the federal deferred tax assets by $1.7 million as a result of this analysis. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period change or if objective negative evidence in the form of cumulative losses is no longer present.

The tax expense for the three months ended March 31, 2020 differs from the statutory rate of 21% due to miscellaneous differences between taxable income calculated under GAAP and IRS regulations. The tax expense for the three months ended March 31, 2019 differs significantly the statutory rate of 21% primarily due to a U.S. tax benefit of $1.7 million for the reversal of a significant portion of the Company's U.S. deferred tax valuation allowance offset by tax expense of $4.8 million from the addback related to the stock compensation charge recognized during the quarter that is not deductible for tax purposes.

7. Capital Stock

As of March 31, 2020 and December 31, 2019, the Company has 5,000,000 preferred shares authorized with a par value of $0.0001 and no preferred shares issued and outstanding. As of March 31, 2020 and December 31, 2019, the Company has 500,000,000 common shares authorized and 24,239,861 and 23,468,750 common shares issued and outstanding, respectively, with a par value of $0.0001. Additional paid in capital is $216.3 million as of March 31, 2020 and $180.0 million as of December 31, 2019.

On March 15, 2019, the Company effected a 17,000,000 for one forward stock split in conjunction with domestication in the United States. All share and per share information included in the condensed consolidated financial statements and notes to the condensed consolidated financial statements have been retroactively adjusted to reflect the stock split for the Company's common stock for all periods presented.

On April 22, 2019, the Company completed its IPO with the sale of 6,468,750 shares of common stock at a price to the public of $15.00 per share, including 843,750 shares sold upon the exercise in full of the underwriter's option to purchase additional shares. After underwriter discounts and commissions and offering expenses, net proceeds from the IPO were approximately $87.4 million.

On January 9, 2020, the Company completed a secondary offering in which the Company sold 750,000 shares of stock to the public at a price of $49.00 per share (along with 5,000,000 shares sold by existing shareholders). The

Company received net proceeds of approximately $35.5 million, after deducting underwriting discounts and commissions and offering costs.

Common stock reserved for future issuance consists of the following as of March 31, 2020:

Stock options outstanding under 2019 Equity Incentive Plan	1,052,095
Restricted stock units outstanding under 2019 Equity Incentive Plan	6,191
Shares authorized for future issuance under 2019 Equity Incentive Plan	2,045,776
Shares authorized for future issuance under 2019 Employee Stock Purchase Plan	458,889
Total	3,562,951

8. Stock-Based Compensation

The below table summarizes the Company's stock-based compensation expense for each period presented:

	Three months ended March 31,	
	2020	2019
	(in thousands)	
Stock-Based Compensation	$ 442	$ 22,961

Stock-based compensation expense is recognized on a straight-line basis over the vesting period of equity-based awards. The Company does not apply a forfeiture rate to unvested awards and accounts for forfeitures as they occur. All stock-based compensation is included in other underwriting expenses in the Company's Unaudited Condensed Consolidated Statement of Income (Loss) and Comprehensive Income (Loss).

The Company recognized approximately $23.0 million of stock-based compensation expense in March 2019 relating to the modification of its 2014 Management Incentive Plan. The Company began recognizing stock-based compensation expense relating to its 2019 Equity Incentive Plan and the 2019 Employee Stock Purchase Plan upon their inception and initial stock grants in April 2019 and all stock based compensation expense recognized subsequent to April 2019 relates to the 2019 Equity Incentive Plan and 2019 Employee Stock Purchase Plan.

Management Incentive Plan prior to IPO

The Company's former parent, GC Palomar Investor LP, adopted a 2014 Management Incentive Plan (in the form of profits interests) on February 12, 2014 under which certain officers and employees of PSIC and its affiliates were entitled to Class P Units in GC Palomar Investor LP. Class P unit holders were expected to realize value only upon the occurrence of liquidity events meeting requisite financial thresholds after the Class A unit holders recovered their investment. The Class P unit holders had no voting rights. The Company did not record stock based compensation expense related to this plan prior to 2019 because no liquidity events were probable of occurring.

On March 15, 2019, the Company modified its 2014 Management Incentive Plan by eliminating the requirement of a liquidity event to occur for the holders of its Class P units to realize value. The 12,552,825 Class P units outstanding were modified such that the vesting of each Class P unit holder's awards was accelerated and their Class P distribution percentages were determined and distributed based on these percentages. This modification resulted in a stock compensation charge and corresponding increase to additional paid-in capital of $23.0 million during the quarter ending March 31, 2019.

2019 Equity Incentive Plan

On April 16, 2019, the Company's 2019 Equity Incentive Plan (the 2019 Plan) became effective. The 2019 Plan provides for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units (RSUs), performance shares and units, and other cash-based or share-based awards. In addition, the 2019 Plan contains a mechanism through which the Company may adopt a deferred compensation arrangement in the future.

A total of 2,400,000 shares of common stock were initially authorized and reserved for issuance under the 2019 Plan. This reserve increases on January 1 of each year through 2029 by an amount equal to the smaller of: 3% of the number of shares of common stock issued and outstanding on the immediately preceding December 31, or an amount determined by the board of directors.

Stock Options

Recipients of stock options can purchase shares of the Company's common stock at a price equal to the stock's fair market value on the grant date, determined by the closing price of the Company's stock on the grant date. Stock options vest over a two or four year period with 25% or 50% vesting on the first anniversary of the grant date and the remainder vesting monthly over the remaining period, subject to continued employment. Stock options expire ten years after the grant date.

The following table summarizes stock option transactions for the 2019 Plan for the three months ended March 31, 2020:

	Number of shares	Weighted-average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2019	1,046,373	$ 17.05	9.33	$ 35,039
Options granted	5,722	55.59		
Options exercised	—	—		
Options canceled	—	—		
Outstanding at March 31, 2020	1,052,095	$ 17.26	9.08	$ 43,030
Vested and Exercisable at March 31, 2020	—	$ —	—	$ —

As of March 31, 2020, the Company had approximately $2.9 million of total unrecognized stock-based compensation expense related to stock options expected to be recognized over a weighted-average period of 2.03 years.

The fair value of each option granted during the three months ended March 31, 2020 was estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

Risk free rate of return (1)	1.50% - 1.52%
Expected share price volatility (2)	18.13% - 18.29%
Expected life in years (3)	5.64 - 6.08 years
Dividend yield (4)	0%

(1) Determined based on the U.S. Treasury yield in effect at the time of the grant for zero-coupon U.S. Treasury notes with remaining terms similar to the expected term of the options.
(2) Determined based on analysis of the volatility of a peer group of publicly traded companies.
(3) Determined using the "simplified method" for estimating the expected option life, which is the average of the weighted-average vesting period and contractual term of the option as the Company does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time its common stock has been publicly traded.
(4) Determined to be zero as the Company has not historically issued dividends.

Restricted Stock Units

Restricted stock units are valued on their grant date and will vest on the first anniversary of the grant date. The fair value of RSUs is determined using the closing price of the Company's common stock on the grant date.

The following table summarizes RSU transactions for the 2019 Plan for the three months ended March 31, 2020:

	Number of shares	Weighted-average grant date fair value
Non vested outstanding at December 31, 2019	6,066	$ 16.49
Granted	125	58.06
Vested	—	—
Forfeited	—	—
Non vested outstanding at March 31, 2020	6,191	$ 17.32

As of March 31, 2020, the Company had approximately $0.1 million of total unrecognized stock-based compensation expense related to RSUs expected to be recognized over a weighted-average period of 0.07 years.

2019 Employee Stock Purchase Plan

On April 16, 2019, the Company's 2019 Employee Stock Purchase Plan (the 2019 ESPP) became effective. A total of 240,000 shares of common stock are initially authorized and reserved for issuance under the 2019 ESPP. In addition, the 2019 ESPP provides for annual increases in the number of shares available for issuance on January 1 of each year through 2029, equal to the smaller of 240,000 shares of the Company's common stock or such other amount as may be determined by the board of directors.

Under the 2019 ESPP, employees can purchase Company stock at a discount via payroll withholdings. The 2019 ESPP is administered through employee participation in discrete offering periods. During each discrete offering period employee funds are withheld, and the stock purchase occurs upon the conclusion of the offering period. The Company issued 21,111 shares pursuant to the ESPP during the three months ended March 31, 2020.

9. Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income (AOCI) are as follows:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Beginning Balance	$ 4,686	$ (563)
Other comprehensive income (loss) before reclassification	(7,368)	2,632
Federal income tax (expense) benefit	1,547	(459)
Other comprehensive income (loss) before reclassification, net of tax	(5,821)	2,173
Amounts reclassified from AOCI	(15)	18
Federal income tax expense	3	(4)
Amounts reclassified from AOCI, net of tax	(12)	14
Other comprehensive income (loss)	(5,833)	2,187
Balance at end of period	$ (1,147)	$ 1,624

10. Earnings Per Share

The following table sets out earnings per share of common stock:

	Three months ended March 31, 2020	Three months ended March 31, 2019
	(in thousands, except shares and per share data)	
Net income (loss)	$ 11,775	$ (14,411)
Weighted average common shares outstanding:		
Basic	24,119,263	17,000,000
Common Share equivalents	659,345	—
Diluted	24,778,608	17,000,000
Earnings per share:		
Basic	$ 0.49	$ (0.85)
Diluted	$ 0.48	$ (0.85)

Common share equivalents relate primarily to outstanding stock options and RSUs under the 2019 Plan and unpurchased shares under the 2019 ESPP.

11. Cash Distribution

In March 2019, the Company made a one-time cash distribution totaling approximately $5.1 million to its then-sole stockholder, GC Palomar Investor LP, enabling it to distribute funds to its partners, including Genstar Capital, in order to allow such partners to satisfy tax obligations incurred as a result of the Domestication transactions.

12. Underwriting information

The Company has a single reportable segment and offers primarily earthquake, wind, and flood insurance products. Gross written premiums (GWP) by product are presented below:

	Three Months Ended March 31, 2020		2019	
	($ in thousands)			
	Amount	% of GWP	Amount	% of GWP
Product				
Residential Earthquake	$ 28,756	40.2 %	$ 29,308	54.3 %
Commercial All Risk	12,456	17.4 %	7,565	14.0 %
Commercial Earthquake	10,848	15.2 %	6,532	12.1 %
Specialty Homeowners	9,845	13.8 %	7,780	14.4 %
Hawaii Hurricane	2,695	3.8 %	2,074	3.8 %
Residential Flood	1,526	2.1 %	772	1.4 %
Other	5,368	7.5 %	—	— %
Total Gross Written Premiums	$ 71,494	100.0 %	$ 54,031	100.0 %

Gross written premiums by state are as follows:

	Three Months Ended March 31,			
	2020		2019	
	($ in thousands)			
	Amount	% of GWP	Amount	% of GWP
State				
California	$ 32,751	45.8 %	$ 30,449	56.4 %
Texas	15,791	22.1 %	10,439	19.3 %
Hawaii	3,052	4.3 %	2,091	3.9 %
Washington	2,606	3.6 %	1,594	3.0 %
South Carolina	2,410	3.4 %	1,669	3.1 %
Oregon	2,097	2.9 %	1,456	2.7 %
North Carolina	1,684	2.4 %	740	1.4 %
Alabama	1,529	2.1 %	1,010	1.9 %
Other	9,574	13.4 %	4,583	8.3 %
Total Gross Written Premiums	$ 71,494	100.0 %	$ 54,031	100.0 %

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion and analysis below includes certain forward-looking statements that are subject to risks, uncertainties and other factors described in part II, item 1A of this Quarterly Report. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors.

The results of operations for the three months ended March 31, 2020 are not necessarily indicative of the results that may be expected for the full year ended December 31, 2020, or for any other future period. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report, and in conjunction with our audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K as filed with the SEC on February 28, 2020.

References to the "Company," "Palomar," "we," "us," and "our" are to Palomar Holdings, Inc. and its subsidiaries, unless the context otherwise requires.

Overview

We are a rapidly growing and profitable company focused on the provision of specialty property insurance. We focus on certain markets that we believe are underserved by other insurance companies, such as the markets for earthquake, wind and flood insurance. We provide specialty property insurance products in our target markets to both individuals and businesses. We use proprietary data analytics and a modern technology platform to offer our customers flexible products with customized and granular pricing on an admitted basis. We distribute our products through multiple channels, including retail agents, program administrators, wholesale brokers, and in partnership with other insurance companies. Our business strategy is supported by a comprehensive risk transfer program with reinsurance coverage that we believe provides both consistency of earnings and appropriate levels of protection in the event of a major catastrophe. Our management team combines decades of insurance industry experience across specialty underwriting, reinsurance, program administration, distribution, and analytics.

Founded in 2014, we have significantly grown our business and have generated attractive returns. We have organically increased gross written premiums from $16.6 million for the year ended December 31, 2014, our first year of operations, to $252.0 million for the year ended December 31, 2019, a compound annual growth rate ("CAGR") of approximately 72%. For the three months ended March 31, 2020, we experienced average monthly premium retention rates above 94% for our Residential Earthquake, Commercial Earthquake, and Hawaii Hurricane lines and approximately 90% overall across all lines of business, providing strong visibility into future revenue. In February 2014, Palomar Specialty Insurance Company was awarded an "A−" (Excellent) (Outlook Stable) rating from A.M. Best Company (A.M. Best), a leading rating agency for the insurance industry. In February 2019, A.M. Best affirmed our "A−" (Excellent) (Outlook Stable) rating for Palomar Specialty Insurance Company and affirmed our "A−" (Excellent) (Outlook Stable) group rating for Palomar Holdings, Inc. This rating reflects A.M. Best's opinion of our financial strength, operating performance and ability to meet obligations to policyholders and is not an evaluation directed towards the protection of investors.

In April 2019, we closed our Initial Public Offering (IPO) and received net proceeds of approximately $87.4 million, after deducting underwriting discounts and commissions and offering costs.

On January 9, 2020, we, along with certain selling stockholders, completed a registered sale (January 2020 Secondary Offering) of 5,750,000 shares of common stock at a public offering price of $49.00 per share. Of the 5,750,000 shares sold, 750,000 represented the underwriters' exercise of their option to purchase additional shares. The offering was comprised of 5,000,000 shares sold by certain selling stockholders and 750,000 shares sold by us. Our net proceeds from the January 2020 Secondary Offering were approximately $35.5 million, after deducting underwriting discounts and commissions and offering costs.

We believe that our market opportunity, distinctive products, and differentiated business model position us to grow our business profitably.

COVID-19 Pandemic and Impact on Palomar

The ongoing COVID-19 Pandemic ("Pandemic") and response thereto has significantly impacted financial markets, businesses, households, and communities and has caused a contraction in business activity and volatility in financial markets. Continuation of the Pandemic could cause additional reduction in business activity and financial market instability. The extent of the impact of the Pandemic on our operational and financial performance will depend on several factors, including the duration of the Pandemic and actions taken by government and health officials in response, all of which are uncertain and cannot be predicted.

The most immediate impact of the Pandemic has been on our operations, as we took several actions to protect the health of the public and our employees and comply with directives and advice of governmental authorities. In March 2020, as more information about the potential impacts of the Pandemic became apparent, we directed the majority of our employees to work from home and put all business travel on hold indefinitely. We also implemented safeguards for employees who play critical roles to ensure operational reliability, established protocols for employees who interact directly with the public and began providing employees a reimbursement to help manage incremental costs associated with remote work. In addition, we enacted extra physical security and cybersecurity measures to further safeguard our systems to serve the operational needs of our remote workforce and ensure uninterrupted service to brokers and policyholders.

The initial economic impacts of the Pandemic, as well as the various stay at home orders and mandated closures of certain business, have caused a significant temporary slowdown in certain sectors of the economy and a corresponding increase in unemployment. We have experienced an increase in the number of business interruption claims related to the Pandemic. Our all risk and commercial earthquake (Difference in Conditions or "DIC") policies offer business interruption coverage for insureds for a loss in business income caused by physical damage to the structure. All of these policies are written on an admitted basis and all of our all risk policies have an Insurance Services Office (ISO) virus exclusion. Our DIC policies require physical damage to the structure caused by the covered perils, whether it be an earthquake or flood. We are acknowledging, investigating, assessing and adjudicating each and every one of these claims and providing the policyholder requisite consideration. We have responded to the hardships many customers are facing and have taken a number of steps to support our customers and communities, including implementing a premium grace period to accommodate late payments across all lines of business in all states where we operate.

Our results of operations depend, in part, on the performance of our investment portfolio. During the first quarter of 2020, we experienced a decrease in the fair value of our investment portfolio due to unrealized losses on the value of our fixed income securities. The Pandemic's impact on the economy and financial markets could reduce our net investment income and result in realized investment losses in future periods.

Adverse events such as health-related concerns about working in our offices, the inability to travel, potential impact on our business partners and customers, and other matters affecting the general work and business environment could harm our business and delay the implementation of our business strategy. We cannot anticipate all the ways in which the current global health crisis and financial market conditions could adversely impact our business in the future.

Components of Our Results of Operations

Gross Written Premiums

Gross written premiums are the amounts received or to be received for insurance policies written or assumed by us during a specific period of time without reduction for policy acquisition costs, reinsurance costs or other deductions. The volume of our gross written premiums in any given period is generally influenced by:

- New business submissions;
- Binding of new business submissions into policies;
- Renewals of existing policies; and

- Average size and premium rate of bound policies.

Our gross written premiums are also impacted when we assume unearned in-force premiums due to new partnerships or other business reasons. In periods where we assume a large volume of unearned premiums, our gross written premiums may increase significantly compared to prior periods and the increase may not be indicative of future trends.

Ceded Written Premiums

Ceded written premiums are the amount of gross written premiums ceded to reinsurers. We enter into reinsurance contracts to limit our exposure to potential losses as well as to provide additional capacity for growth. Ceded written premiums are earned over the reinsurance contract period in proportion to the period of risk covered. The volume of our ceded written premiums is impacted by the level of our gross written premiums and any decision we make to increase or decrease limits, retention levels and co-participations. Our ceded written premiums can also be impacted significantly in certain periods due to changes in quota share agreements. In periods where we start or stop ceding a large volume of our premiums, ceded written premiums may increase or decrease significantly compared to prior periods and these fluctuations may not be indicative of future trends.

Net Earned Premiums

Net earned premiums represent the earned portion of our gross written premiums, less the earned portion that is ceded to third-party reinsurers under our reinsurance agreements. Our insurance policies generally have a term of one year and premiums are earned pro rata over the term of the policy.

Commission and Other Income

Commission and other income consist of commissions earned on policies written on behalf of third party insurance companies and where we have no exposure to the insured risk and certain fees earned in conjunction with underwriting policies.

Losses and Loss Adjustment Expenses

Losses and loss adjustment expenses represent the costs incurred for losses. These expenses are a function of the size and term of the insurance policies we write and the loss experience associated with the underlying coverage. In general, our losses and loss adjustment expenses are affected by:

- The occurrence, frequency and severity of catastrophe events such as earthquakes, hurricanes and floods in the areas where we underwrite polices relating to these perils;
- Our net reinsurance recoverables;
- The volume and severity of non-catastrophe attritional losses;
- The mix of business written by us;
- The geographic location and characteristics of the policies we underwrite;
- Changes in the legal or regulatory environment related to the business we write;
- Trends in legal defense costs; and
- Inflation in housing and construction costs.

Losses and loss adjustment expenses are based on an actuarial analysis of the estimated losses, including losses incurred during the period and changes in estimates from prior periods. Losses and loss adjustment expenses may be paid out over multiple years.

Acquisition Expenses

Acquisition expenses are principally comprised of the commissions we pay retail agents, program administrators and wholesale brokers, net of ceding commissions we receive on business ceded under certain reinsurance contracts. In addition, acquisition expenses include premium-related taxes. Acquisition expenses related to each policy we write are deferred and amortized to expense in proportion to the premium earned over the policy life.

Other Underwriting Expenses

Other underwriting expenses represent the general and administrative expenses of our insurance operations including employee salaries and benefits, software and technology costs, office rent, stock-based compensation, licenses and fees, and professional services fees such as legal, accounting, and actuarial services.

Interest Expense

Interest expense consists of interest expense on our Floating Rate Notes during the three months ended March 31, 2019. We did not have any debt or incur any interest expense after May 2019.

Net Investment Income

We earn investment income on our portfolio of invested assets. Our invested assets are primarily comprised of fixed maturity securities, and may also include cash and cash equivalents, and equity securities. The principal factors that influence net investment income are the size of our investment portfolio, the yield on that portfolio and expenses due to external investment managers. As measured by amortized cost, which excludes changes in fair value, caused by changes in interest rates, the size of our investment portfolio is mainly a function of our invested equity capital along with premium we receive from our insureds, less payments on policyholder claims and other operating expenses.

Net Realized and Unrealized Gains and Losses on Investments

Net realized and unrealized gains and losses on investments are a function of the difference between the amount received by us on the sale of a security and the security's cost-basis, mark-to-market adjustments as well as any "other-than-temporary" impairments recognized in earnings.

Income Tax Expense

Currently our income tax expense consists mainly of federal income taxes imposed on our operations. Our 2019 income tax expense was significantly impacted by the reversal of our U.S. federal deferred tax valuation allowance in March 2019, offset by an addback related to a nondeductible stock compensation charge.

Key Financial and Operating Metrics

We discuss certain key financial and operating metrics, described below, which provide useful information about our business and the operational factors underlying our financial performance.

Underwriting revenue is a non-GAAP financial measure defined as total revenue, excluding net investment income and net realized and unrealized gains and losses on investments. See "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of total revenue calculated in accordance with GAAP to underwriting revenue.

Underwriting income is a non-GAAP financial measure defined as income before income taxes excluding net investment income, net realized and unrealized gains and losses on investments and interest expense. See "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of income before income taxes calculated in accordance with GAAP to underwriting income.

Adjusted net income is a non-GAAP financial measure defined as net income excluding the impact of certain items that may not be indicative of underlying business trends, operating results, or future outlook, net of tax impact. We calculate the tax impact only on adjustments which would be included in calculating our income tax expense using the effective tax rate at the end of each period. See “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of net income calculated in accordance with GAAP to adjusted net income.

Return on equity is net income expressed on an annualized basis as a percentage of average beginning and ending stockholders’ equity during the period.

Adjusted return on equity is a non-GAAP financial measure defined as adjusted net income expressed on an annualized basis as a percentage of average beginning and ending stockholders’ equity during the period. See “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of return on equity calculated using unadjusted GAAP numbers to adjusted return on equity.

Loss ratio, expressed as a percentage, is the ratio of losses and loss adjustment expenses, to net earned premiums.

Expense ratio, expressed as a percentage, is the ratio of acquisition and other underwriting expenses, net of commission and other income to net earned premiums.

Combined ratio is defined as the sum of the loss ratio and the expense ratio. A combined ratio under 100% generally indicates an underwriting profit. A combined ratio over 100% generally indicates an underwriting loss.

Adjusted combined ratio is a non-GAAP financial measure defined as the sum of the loss ratio and the expense ratio calculated excluding the impact of certain items that may not be indicative of underlying business trends, operating results, or future outlook. See “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of combined ratio calculated using unadjusted GAAP numbers to adjusted combined ratio.

Diluted adjusted earnings per share is a non-GAAP financial measure defined as adjusted net income divided by the weighted-average common shares outstanding for the period, reflecting the dilution which could occur if equity-based awards are converted into common share equivalents as calculated using the treasury stock method. See “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of diluted earnings per share calculated in accordance with GAAP to diluted adjusted earnings per share.

Tangible stockholders’ equity is a non-GAAP financial measure defined as stockholders’ equity less intangible assets. See “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of stockholders’ equity calculated in accordance with GAAP to tangible stockholders’ equity.

Results of Operations

Three months ended March 31, 2020 compared to three months ended March 31, 2019

The following table summarizes our results for the three months ended March 31, 2020 and 2019:

	Three months ended March 31, 2020	Three months ended March 31, 2019	Change	Percent Change
	($ in thousands, except per share data)			
Revenue:				
Gross written premiums	$ 71,494	54,031	$ 17,463	32.3 %
Ceded written premiums	(29,495)	(26,106)	(3,389)	13.0 %
Net written premiums	41,999	27,925	14,074	50.4 %
Net earned premiums	34,806	18,350	16,456	89.7 %
Commission and other income	738	586	152	25.9 %
Total underwriting revenue (1)	35,544	18,936	16,608	87.7 %
Losses and loss adjustment expenses	1,863	316	1,547	489.6 %
Acquisition expenses	13,046	6,975	6,071	87.0 %
Other underwriting expenses	7,951	28,853	(20,902)	(72.4)%
Underwriting income (loss) (1)	12,684	(17,208)	29,892	(173.7)%
Interest expense	—	(429)	429	(100.0)%
Net investment income	2,035	960	1,075	112.0 %
Net realized and unrealized gains on investments	440	2,411	(1,971)	(81.8)%
Income (loss) before income taxes	15,159	(14,266)	29,425	(206.3)%
Income tax expense	3,384	145	3,239	NM
Net income (loss)	$ 11,775	$ (14,411)	$ 26,186	(181.7)%
Adjustments:				
Expenses associated with stock offerings and tax restructuring	253	358	(105)	NM
Stock-based compensation expense	442	22,961	(22,519)	NM
Tax impact	(149)	(75)	(74)	NM
Adjusted net income (1)	$ 12,321	$ 8,833	$ 3,488	39.5 %
Key Financial and Operating Metrics				
Annualized return on equity	19.7 %	(58.2)%		
Annualized adjusted return on equity	20.6 %	35.7 %		
Loss ratio	5.4 %	1.7 %		
Expense ratio	58.2 %	192.1 %		
Combined ratio	63.6 %	193.8 %		
Adjusted combined ratio (1)	61.6 %	66.7 %		
Diluted earnings per share	$ 0.48	$ (0.85)		
Diluted adjusted earnings per share (1)	$ 0.50	$ 0.52		

NM- not meaningful

(1) Indicates non-GAAP financial measure; see “Reconciliation of Non-GAAP Financial Measures” for a reconciliation of the non-GAAP financial measures to their most directly comparable financial measures prepared in accordance with GAAP.

Gross Written Premiums

Gross written premiums increased $17.5 million, or 32.3% to $71.5 million for the three months ended March 31, 2020 compared to $54.0 million for the three months ended March 31, 2019. Premium growth was primarily due to an increased volume of policies written across our lines of business which was driven by new business generated with existing partners, strong premium retention rates for existing business, expansion of our products' distribution footprint, and new partnerships. The changes in gross written premiums were most notable in the following lines of business:

- Residential Earthquake, which represented approximately 40.2% of our gross written premiums for the three months ended March 31, 2020, decreased by $0.6 million, or 1.9%, for the three months ended March 31, 2020 compared to the same period in the prior year. During the prior year three month period, we entered into a new homeowners carrier partnership in which we assumed $6.6 million of unearned premiums. Excluding the impact of this unearned premium assumption, our Residential Earthquake gross written premiums increased by $6.1 million, or 26.7%.

- Commercial All Risk, which represented approximately 17.4% of our gross written premiums for the three months ended March 31, 2020, increased by $4.9 million, or 64.7%, for the three months ended March 31, 2020 compared to the same period in the prior year.

- Commercial Earthquake, which represented approximately 15.2% of our gross written premiums for the three months ended March 31, 2020, increased by $4.3 million, or 66.1%, for the three months ended March 31, 2020 compared to the same period in the prior year.

- Specialty Homeowners, which represented approximately 13.8% of our gross written premiums for the three months ended March 31, 2020, increased by $2.1 million, or 26.5%, for the three months ended March 31, 2020 compared to the same period in the prior year.

- Hawaii Hurricane, which represented approximately 3.8% of our gross written premiums for the three months ended March 31, 2020, increased by $0.6 million or 29.9%, for the three months ended March 31, 2020 compared to the same period in the prior year.

- Residential Flood, which represented approximately 2.1% of our gross written premiums for the three months ended March 31, 2020 increased by $0.8 million or 97.7%, for the three months ended March 31, 2020 compared to the same period in the prior year.

- Other gross written premiums consist of premiums related to our Assumed Reinsurance program and our Inland Marine products. The increase was primarily due to premiums from our Assumed Reinsurance program and may not be indicative of trends in future periods.

Ceded Written Premiums

Ceded written premiums increased $3.4 million, or 13.0%, to $29.5 million for the three months ended March 31, 2020 from $26.1 million for the three months ended March 31, 2019. The increase was primarily due to an increase in excess of loss (XOL) reinsurance expense commensurate with growth in exposure, offset by decreased quota share cession primarily in our commercial all risk line. Ceded written premiums as a percentage of gross written premiums decreased to 41.3% for the three months ended March 31, 2020 from 48.3% for the three months ended March 31, 2019. This decrease was due to the decreased quota share cession on our commercial all risk line and due to the increase in gross written premiums in our residential earthquake and commercial earthquake lines, which are not subject to quota share reinsurance agreements.

Net Written Premiums

Net written premiums increased $14.1 million, or 50.4%, to $42.0 million for the three months ended March 31, 2020 from $27.9 million for the three months ended March 31, 2019. The increase was primarily due to an increase in gross written premiums, primarily in our commercial all risk and commercial earthquake lines, offset by increased ceded written premiums.

Net Earned Premiums

Net earned premiums increased $16.4 million, or 89.7%, to $34.8 million for the three months ended March 31, 2020 from $18.4 million for the three months ended March 31, 2019 due primarily to the earning of increased gross written premiums offset by the earning of ceded written premiums under reinsurance agreements. The table below shows the amount of premiums we earned on a gross and net basis and net earned premiums as a percentage of gross earned premiums in each period presented:

	Three Months Ended March 31,			
	2020	2019	Change	% Change
	($ in thousands)			
Gross earned premiums	$ 64,974	$ 40,892	$ 24,082	58.9 %
Ceded earned premiums	(30,168)	(22,542)	(7,626)	33.8 %
Net earned premiums	$ 34,806	$ 18,350	$ 16,456	89.7 %
Net earned premium ratio	53.6%	44.9%		

Commission and Other Income

Commission and other income increased $0.1 million or 25.9% to $0.7 million for the three months ended March 31, 2020 from $0.6 million for the three months ended March 31, 2019 due primarily to an increase in policy related fees associated with an increased volume of premiums written.

Losses and Loss Adjustment Expenses

Losses and loss adjustment expenses increased $1.5 million, or 489.6%, to $1.9 million for the three months ended March 31, 2020 from $0.3 million for the three months ended March 31, 2019. Losses increased during the three months ended March 31, 2020 due to higher attritional losses on our commercial all risk and specialty homeowners lines of business due to the growth of those lines and changes in quota share agreements whereby we retained a higher amount of premiums and losses.

Acquisition Expenses

Acquisition expenses increased $6.0 million, or 87.0%, to $13.0 million for the three months ended March 31, 2020 from $7.0 million for the three months ended March 31, 2019. The primary reason for the increase was higher earned premiums which resulted in higher commissions and premium-related taxes. Acquisition expenses as a percentage of gross earned premiums were 20.1% for the three months ended March 31, 2020 compared to 17.1% for the three months ended March 31, 2019. Acquisition expenses as a percentage of gross earned premiums increased due to lower earned ceding commissions primarily related to our commercial all risk line. Acquisition expenses as a percentage of gross earned premiums fluctuates based on mix of business produced and quota share arrangements in place.

Other Underwriting Expenses

Other underwriting expenses decreased $20.9 million, or 72.4%, to $8.0 million for the three months ended March 31, 2020 from $28.9 million for the three months ended March 31, 2019.

Other underwriting expenses as a percentage of gross earned premiums were 12.2% for the three months ended March 31, 2020 compared to 70.6% for the three months ended March 31, 2019. Excluding the impact of expenses relating to stock offerings and tax restructuring and stock-based compensation, other underwriting expenses as a percentage of gross earned premiums were 11.2% for the three months ended March 31, 2020 compared to 13.5% for the three months ended March 31, 2019.

Interest Expense

Interest expense decreased $0.4 million to zero for the three months ended March 31, 2020 from $0.4 million for the three months ended March 31, 2019. Interest expense decreased as we did not have any debt during the three months ended March 31, 2020 whereas we had outstanding Floating Rate Notes during the three months ended March 31, 2019.

Net Investment Income and Net Realized and Unrealized Gains on Investments

Net investment income increased $1.0 million, or 112.0%, to $2.0 million for the three months ended March 31, 2020 from $1.0 million for the three months ended March 31, 2019. The increase was primarily due to a higher average balance of investments during the three months ended March 31, 2020 due primarily to proceeds from our April 2019 IPO, investing of cash generated from operations, and proceeds from our January 2020 secondary offering.

Net realized and unrealized gains on investments decreased $2.0 million, or 81.8%, to $0.4 million for the three months ended March 31, 2020 from $2.4 million for the three months ended March 31, 2019. We had a higher balance of equity securities during the prior year period and saw appreciation on those equity securities during that period. Currently, we mainly invest in investment grade fixed maturity securities, including U.S. government issues, state government issues, mortgage and asset-backed obligations, and corporate bonds. The following table summarizes the components of our investment income for each period presented:

	Three Months Ended March 31,			
	2020	**2019**	**Change**	**% Change**
	($ in thousands)			
Interest income	$ 2,001	$ 1,010	$ 991	98.1 %
Dividend income	125	30	95	316.7 %
Investment management fees and expenses	(91)	(80)	(11)	13.8 %
Net investment income	2,035	960	1,075	112.0 %
Net realized and unrealized gains on investments	440	2,411	(1,971)	(81.8)%
Total	$ 2,475	$ 3,371	$ (896)	(26.6)%

Income Tax Expense

Income tax expense increased to $3.4 million for the three months ended March 31, 2020 from $0.1 million for the three months ended March 31, 2019 as we had higher pre-tax income during the three months ended March 31, 2020. For the three months ended March 31, 2019, our income tax expense was significantly impacted by the reversal of our U.S. federal deferred tax valuation allowance in March 2019, offset by an addback related to a nondeductible stock compensation charge related to the modification of our management incentive plan in March 2019.

Reconciliation of Non-GAAP Financial Measures

Underwriting Revenue

We define underwriting revenue as total revenue excluding net investment income and net realized and unrealized gains and losses on investments. Underwriting revenue represents revenue generated by our underwriting operations and allows us to evaluate our underwriting performance without regard to investment income. We use this metric as we believe it gives our management and other users of our financial information useful insight into our underlying business performance. Underwriting revenue should not be viewed as a substitute for total revenue calculated in accordance with GAAP, and other companies may define underwriting revenue differently.

Total revenue calculated in accordance with GAAP reconciles to underwriting revenue as follows:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Total revenue	$ 38,019	$ 22,307
Net investment income	(2,035)	(960)
Net realized and unrealized gains on investments	(440)	(2,411)
Underwriting revenue	$ 35,544	$ 18,936

Underwriting Income

We define underwriting income as income before income taxes excluding net investment income, net realized and unrealized gains and losses on investments, and interest expense. Underwriting income represents the pre-tax profitability of our underwriting operations and allows us to evaluate our underwriting performance without regard to investment income. We use this metric as we believe it gives our management and other users of our financial information useful insight into our underlying business performance. Underwriting income should not be viewed as a substitute for pre-tax income calculated in accordance with GAAP, and other companies may define underwriting income differently.

Income (loss) before income taxes calculated in accordance with GAAP reconciles to underwriting income as follows:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Income (loss) before income taxes	$ 15,159	$ (14,266)
Net investment income	(2,035)	(960)
Net realized and unrealized gains on investments	(440)	(2,411)
Interest expense	—	429
Underwriting income (loss)	$ 12,684	$ (17,208)

Adjusted Net Income

We define adjusted net income as net income excluding the impact of certain items that may not be indicative of underlying business trends, operating results, or future outlook, net of tax impact. We calculate the tax impact only on adjustments which would be included in calculating our income tax expense using the effective tax rate at the end of each period. We use adjusted net income as an internal performance measure in the management of our operations because we believe it gives our management and other users of our financial information useful insight into our results of operations and our underlying business performance. Adjusted net income should not be viewed as a substitute for net income calculated in accordance with GAAP, and other companies may define adjusted net income differently.

Net income (loss) calculated in accordance with GAAP reconciles to adjusted net income as follows:

	Three Months Ended March 31,	
	2020	2019
	(in thousands)	
Net income (loss)	$ 11,775	$ (14,411)
Adjustments:		
Expenses associated with stock offerings and tax restructuring	253	358
Stock-based compensation expense	442	22,961
Tax impact	(149)	(75)
Adjusted net income	$ 12,321	$ 8,833

Annualized Adjusted Return on Equity

We define adjusted return on equity as adjusted net income expressed on an annualized basis as a percentage of average beginning and ending stockholders' equity during the period. We use adjusted return on equity as an internal performance measure in the management of our operations because we believe it gives our management and other users of our financial information useful insight into our results of operations and our underlying business performance. Adjusted return on equity should not be viewed as a substitute for return on equity calculated using unadjusted GAAP numbers, and other companies may define adjusted return on equity differently.

Annualized adjusted return on equity is calculated as follows:

	Three Months Ended March 31,	
	2020	2019
	($ in thousands)	
Annualized adjusted net income	$ 49,284	$ 35,332
Average stockholders' equity	$ 239,688	$ 99,101
Annualized adjusted return on equity	20.6 %	35.7 %

Adjusted Combined Ratio

We define adjusted combined ratio as the sum of the loss ratio and the expense ratio calculated excluding the impact of certain items that may not be indicative of underlying business trends, operating results, or future outlook. We use adjusted combined ratio as an internal performance measure in the management of our operations because we believe it gives our management and other users of our financial information useful insight into our results of operations and our underlying business performance. Adjusted combined ratio should not be viewed as a substitute for combined ratio calculated using unadjusted GAAP numbers, and other companies may define adjusted combined ratio differently.

Adjusted combined ratio is calculated as follows:

	Three Months Ended March 31,	
	2020	2019
	($ in thousands)	
Numerator: Sum of losses and loss adjustment expenses, acquisition expenses, and other underwriting expenses, net of commission and other income	$ 22,122	$ 35,558
Denominator: Net earned premiums	$ 34,806	$ 18,350
Combined ratio	63.6 %	193.8 %
Adjustments to numerator:		
Expenses associated with stock offerings and tax restructuring	$ (253)	$ (358)
Stock-based compensation expense	(442)	(22,961)
Adjusted combined ratio	61.6 %	66.7 %

Diluted adjusted earnings per share

We define diluted adjusted earnings per share as adjusted net income divided by the weighted-average common shares outstanding for the period, reflecting the dilution which could occur if equity-based awards are converted into common share equivalents as calculated using the treasury stock method. We use diluted adjusted earnings per share as an internal performance measure in the management of our operations because we believe it gives our management and other users of our financial information useful insight into our results of operations and our underlying business performance. Diluted adjusted earnings per share should not be viewed as a substitute for diluted earnings per share calculated in accordance with GAAP, and other companies may define diluted adjusted earnings per share differently.

Diluted adjusted earnings per share is calculated as follows:

	Three Months Ended March 31,	
	2020	2019
	($ in thousands, except per share data)	
Adjusted net income	$ 12,321	$ 8,833
Weighted-average common shares outstanding, diluted	24,778,608	17,000,000
Diluted adjusted earnings per share	$ 0.50	$ 0.52

Tangible Stockholders' Equity

We define tangible stockholders' equity as stockholders' equity less intangible assets. Our definition of tangible stockholders' equity may not be comparable to that of other companies, and it should not be viewed as a substitute for stockholders' equity calculated in accordance with GAAP. We use tangible stockholders' equity internally to evaluate the strength of our balance sheet and to compare returns relative to this measure.

Stockholders' equity calculated in accordance with GAAP reconciles to tangible stockholders' equity as follows:

	March 31, 2020	December 31, 2019
	(in thousands)	
Stockholders' equity	$ 260,820	$ 218,556
Intangible assets	(744)	(744)
Tangible stockholders' equity	$ 260,076	$ 217,812

Liquidity and Capital Resources

Sources and Uses of Funds

We operate as a holding company with no business operations of our own. Consequently, our ability to pay dividends to stockholders and pay taxes and administrative expenses is largely dependent on dividends or other distributions from our subsidiaries and affiliates, whose ability to pay us is highly regulated.

Our U.S. insurance company subsidiary is restricted by statute as to the amount of dividends that it may pay without the prior approval of the Oregon and California Insurance Commissioners. Generally, insurers may pay dividends without advance regulatory approval only from earned surplus and only to the extent that all dividends paid in the twelve months ending on the date of the proposed dividend do not exceed the greater of (i) 10% of their statutory policyholders' surplus as of December 31 of the preceding year or (ii) 100% of their statutory net income (excluding realized investment gains or losses) for the calendar year preceding the year in which the value is being determined. In addition, a domestic insurer may only declare a dividend from earned surplus, which does not include surplus arising from unrealized capital gains or revaluation of assets. A domestic insurer may declare a dividend from other than earned surplus only if the Insurance Commissioner approves the declaration prior to payment of the dividend. Our U.S. insurance company subsidiary may pay a dividend or distribution no greater than $10.3 million to us in 2020 without the prior approval of the Oregon and California Insurance Commissioners due to our U.S. Insurance Company Subsidiary's earned surplus of $10.3 million as of December 31, 2019. In addition, there is no assurance that dividends of the maximum amount calculated under any applicable formula would be permitted by state insurance regulators. In the future, state insurance regulatory authorities may adopt statutory provisions more restrictive than those currently in effect.

Insurance companies in the United States are also required by state law to maintain a minimum level of policyholder's surplus. Oregon and California's state insurance regulators have a risk-based capital standard designed to identify property and casualty insurers that may be inadequately capitalized based on inherent risks of the insurer's assets and liabilities and its mix of net written premium. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action. As of March 31, 2020 and December 31, 2019, the total adjusted capital of our U.S. insurance subsidiary was in excess of its respective prescribed risk-based capital requirements.

Under the Insurance Act and related regulations, our Bermuda reinsurance subsidiary is required to maintain certain solvency and liquidity levels, which it maintained as of March 31, 2020 and December 31, 2019.

Our Bermuda reinsurance subsidiary maintains a Class 3A license and thus must maintain a minimum liquidity ratio in which the value of its relevant assets is not less than 75% of the amount of its relevant liabilities for general business. Relevant assets include cash and cash equivalents, fixed maturity securities, accrued interest income, premiums receivable, losses recoverable from reinsurers, and funds withheld. The relevant liabilities include total general business insurance reserves and total other liabilities, less sundry liabilities. As of March 31, 2020 and December 31, 2019, we met the minimum liquidity ratio requirement.

Bermuda regulations limit the amount of dividends and return of capital paid by a regulated entity. A Class 3A insurer is prohibited from declaring or paying a dividend if it is in breach of its minimum solvency margin, its enhanced capital requirement, or its minimum liquidity ratio, or if the declaration or payment of such dividend would cause such a breach. If a Class 3A insurer has failed to meet its minimum solvency margin on the last day of any financial year, it will also be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year. Furthermore, the Insurance Act limits the ability of our Bermuda reinsurance subsidiary to pay dividends or make capital distributions by stipulating certain margin and solvency requirements and by requiring approval from the BMA prior to a reduction of 15% or more of a Class 3A insurer's total statutory capital as reported on its prior year statutory balance sheet. Moreover, an insurer must submit an affidavit to the BMA, sworn by at least two directors and the principal representative in Bermuda of the Class 3A insurer, at least seven days prior to payment of any dividend which would exceed 25% of that insurer's total statutory capital and surplus as reported on its prior year statutory balance sheet. The affidavit must state that in the opinion of those swearing the declaration of such dividend has not caused the insurer to fail to meet its relevant margins.

Further, under the Companies Act, our Bermuda reinsurance subsidiary may only declare or pay a dividend, or make a distribution out of contributed surplus, if it has no reasonable grounds for believing that: (1) it is, or would after the payment be, unable to pay its liabilities as they become due or (2) the realizable value of its assets would be less than its liabilities.

Pursuant to Bermuda regulations, the maximum amount of dividends and return of capital available to be paid by a reinsurer is determined pursuant to a formula. Under this formula, the maximum amount of dividends and return of capital available from our Bermuda subsidiary during 2020 is calculated to be approximately $5.7 million. However, this dividend amount is subject to annual enhanced solvency requirement calculations. There were no dividends approved or paid in 2019 and there have been no dividends approved or paid in 2020.

Cash Flows

Our primary sources of cash flow are written premiums, investment income, reinsurance recoveries, sales and redemptions of investments, and proceeds from offerings of equity securities. We use our cash flows primarily to pay reinsurance premiums, operating expenses, losses and loss adjustment expenses, and income taxes.

Our cash flows from operations may differ substantially from our net income due to non-cash charges or due to changes in balance sheet accounts.

The timing of our cash flows from operating activities can also vary among periods due to the timing by which payments are made or received. Some of our payments and receipts, including loss settlements and subsequent reinsurance receipts, can be significant. Therefore, their timing can influence cash flows from operating activities in any given period. The potential for a large claim under an insurance or reinsurance contract means that our insurance subsidiaries may need to make substantial payments within relatively short periods of time, which would have a negative impact on our operating cash flows.

Management believes that our cash receipts from written premiums, investment income, proceeds from investment sales and redemptions, and reinsurance recoveries, if necessary, are sufficient to cover cash outflows in the foreseeable future.

The following table summarizes our cash flows for the three months ended March 31, 2020 and 2019:

	Three months ended March 31,	
	2020	**2019**
	($ in thousands)	
Cash provided by (used in):		
Operating activities	$ 21,804	$ 2,457
Investing activities	(66,874)	3,630
Financing activities	35,880	(5,120)
Change in cash, cash equivalents, and restricted cash	$ (9,190)	$ 967

Our cash flow from operating activities has been positive in each period shown above. Variations in operating cash flow between periods are primarily driven by variations in our gross and ceded written premiums and the volume and timing of premium receipts, claim payments, and reinsurance payments. In addition, fluctuations in losses and loss adjustment expenses and other insurance operating expenses impact operating cash flow.

Cash used in investing activities for the three months ended March 31, 2020 related primarily to purchases of fixed income and equity securities in excess of sales and maturities. Cash provided by investing activities for the three months ended March 31, 2019 related primarily to sales and maturities of fixed income and equity securities in excess of purchases.

Cash provided by financing activities for three months ended March 31, 2020 was related to the receipt of $35.5 million in net proceeds from the January 2020 Secondary Offering and the receipt of $0.4 million in proceeds related to the issuance of common stock pursuant to our employee stock purchase plan. Cash used in financing activities for the three months ended March 31, 2019 was related to a one-time cash distribution of $5.1 million to our then sole stockholder, GC Palomar Investor LP in March 2019.

We do not have any current plans for material capital expenditures other than current operating requirements. We believe that we will generate sufficient cash flows from operations to satisfy our liquidity requirements for at least the next 12 months and beyond. The key factor that will affect our future operating cash flows is the frequency and severity of catastrophic loss events. To the extent our future operating cash flows are insufficient to cover our net losses from catastrophic events, we had $320.4 million in cash and investment securities available at March 31, 2020. We also have the ability to access additional capital through pursuing third-party borrowings, sales of our equity or debt securities or entrance into a reinsurance arrangement.

Notes Payable

In September 2018, the Company completed a private placement financing of $20.0 million floating rate senior secured notes (Floating Rate Notes). These Floating Rate Notes were redeemed in May 2019 pursuant to their terms and the Company did not have any debt subsequent to May 2019. The Company incurred and paid $0.4 million in interest expense related to the Floating Rate Notes for the three months ended March 31, 2019

Stockholders' Equity

At March 31, 2020 total stockholders' equity was $260.8 million and tangible stockholders' equity was $260.1 million, compared to total stockholders' equity of $218.6 million and tangible stockholders' equity of $217.8 million as of December 31, 2019. Stockholders' equity increased for the three months ended March 31, 2020 primarily due to the receipt of $35.5 million in net proceeds from our January 2020 Secondary Offering. In addition, it increased due to $11.8 million in net income and $0.4 million related to the issuance of common stock pursuant to our employee stock purchase plan. Finally, it increased due to $0.4 million stock-based compensation expense, which was treated as additional paid in capital. These items were offset by a $5.8 million decrease to other comprehensive income caused by unrealized losses on fixed maturity investments.

Tangible stockholders' equity is a non-GAAP financial measure. See "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of stockholders' equity in accordance with GAAP to tangible stockholders' equity.

Investment Portfolio

Our primary investment objectives are to maintain liquidity, preserve capital and generate a stable level of investment income. We purchase securities that we believe are attractive on a relative value basis and seek to generate returns in excess of predetermined benchmarks. Our Board of Directors approves our investment guidelines in compliance with applicable regulatory restrictions on asset type, quality and concentration. Our current investment guidelines allow us to invest in taxable and tax-exempt fixed maturities, as well as publicly traded mutual funds and common stock of individual companies. Our cash and invested assets consist of cash and cash equivalents, fixed maturity securities, and equity securities. As of March 31, 2020, the majority of our investment portfolio, or $273.4 million, was comprised of fixed maturity securities that are classified as available-for-sale and carried at fair value with unrealized gains and losses on these securities, net of applicable taxes, reported as a separate component of accumulated other comprehensive income. Also included in our investment portfolio were $22.9 million of equity securities, primarily comprised of mutual funds that provide exposure to the U.S. investment-grade bond market. In addition, we maintained a non-restricted cash and cash equivalent balance of $23.8 million at March 31, 2020. Our fixed maturity securities, including cash equivalents, had a weighted average effective duration of 3.81 and 3.49 years and an average rating of "A1/A+" and "A1/A+" at March 31, 2020 and December 31, 2019, respectively. Our fixed income investment portfolio had a book yield of 2.85% as of March 31, 2020, compared to 2.9% as of December 31, 2019.

At March 31, 2020 and December 31, 2019 the amortized cost and fair value on available-for-sale securities were as follows:

March 31, 2020	Amortized Cost or Cost	Fair Value	% of Total Fair Value
	($ in thousands)		
Fixed maturities:			
U.S. Governments	$ 16,623	$ 17,550	6.4 %
States, territories, and possessions	2,836	3,044	1.1 %
Political subdivisions	2,304	2,333	0.9 %
Special revenue excluding mortgage/asset-backed securities	26,982	27,439	10.0 %
Industrial and miscellaneous	167,292	165,085	60.4 %
Mortgage/asset-backed securities	58,827	57,907	21.2 %
Total available-for-sale investments	$ 274,864	$ 273,358	100.0 %

December 31, 2019	Amortized Cost or Cost	Fair Value	% of Total Fair Value
	($ in thousands)		
Fixed maturities:			
U.S. Governments	$ 13,371	$ 13,679	6.3 %
States, territories, and possessions	2,298	2,445	1.1 %
Political subdivisions	1,913	1,942	0.9 %
Special revenue excluding mortgage/asset-backed securities	18,139	18,436	8.5 %
Industrial and miscellaneous	124,726	129,013	59.4 %
Mortgage/asset-backed securities	50,831	51,636	23.8 %
Total available-for-sale investments	$ 211,278	$ 217,151	100.0 %

The following tables provide the credit quality of investment securities as of March 31, 2020 and December 31, 2019:

March 31, 2020	Estimated Fair Value	% of Total
	($ in thousands)	
Rating		
AAA	$ 90,482	33.1 %
AA	32,803	12.0 %
A	90,481	33.1 %
BBB	51,938	19.0 %
BB	7,654	2.8 %
	$ 273,358	100.0 %

December 31, 2019	Estimated Fair Value	% of Total
	($ in thousands)	
Rating		
AAA	$ 83,821	38.6 %
AA	24,321	11.2 %
A	69,488	32.0 %
BBB	32,138	14.8 %
BB	7,383	3.4 %
	$ 217,151	100.0 %

The amortized cost and fair value of our available-for-sale investments in fixed maturity securities summarized by contractual maturity as of March 31, 2020 were as follows:

March 31, 2020	Amortized Cost	Fair Value	% of Total Fair Value
	($ in thousands)		
Due within one year	$ 11,548	$ 11,572	4.2 %
Due after one year through five years	87,088	87,408	32.0 %
Due after five years through ten years	79,345	77,926	28.5 %
Due after ten years	38,056	38,545	14.1 %
Mortgage and asset-backed securities	58,827	57,907	21.2 %
	$ 274,864	$ 273,358	100.0 %

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

Reinsurance

We purchase a significant amount of reinsurance from third parties that we believe enhances our business by reducing our exposure to potential catastrophe losses, limiting volatility in our underwriting performance, and providing us with greater visibility into our future earnings. Reinsurance involves transferring, or ceding, a portion of our risk exposure on policies that we write to another insurer, the reinsurer, in exchange for a premium. To the extent that our reinsurers are unable to meet the obligations they assume under our reinsurance agreements, we remain liable for the entire insured loss; see "Risk Factors—Risks Related to Our Business and Industry—We may be unable to purchase third-party reinsurance or otherwise expand our catastrophe coverage in amounts we desire on commercially acceptable terms or on terms that adequately protect us, and this inability may materially adversely affect our business, financial condition and results of operations."

We use treaty reinsurance and, on a limited basis, facultative reinsurance coverage. Treaty coverage refers to a reinsurance contract that is applied to a group or class of business where all the risks written meet the criteria for that class. Our treaty reinsurance program primarily consists of catastrophe excess of loss ("XOL") coverage, in which the reinsurer(s) agree to assume all or a portion of the ceding company's losses relating to a group of policies occurring in relation to specified events, subject to customary exclusions, in excess of a specified amount. Additionally, we buy program specific reinsurance coverage for specific lines of business on a quota share, property per risk or a facultative basis. In quota share reinsurance, the reinsurer agrees to assume a specified percentage of the ceding company's losses arising out of a defined class of business in exchange for a corresponding percentage of premiums, net of a ceding commission. Property per risk coverage is similar to catastrophe XOL coverage except that the treaty applies in individual property losses rather than in the aggregate for all claims associated with a single catastrophic loss occurrence. Facultative coverage refers to a reinsurance contract on individual risks as opposed to a group or class of business. We use facultative reinsurance selectively to supplement limits or to cover risks or perils excluded from other reinsurance contracts.

We have a robust program utilizing a mix of traditional reinsurers and insurance linked securities. As of January 1, 2020, we purchased reinsurance from over 85 reinsurers, who either have an "A−" (Excellent) (Outlook Stable) or better financial strength rating by A.M. Best or post collateral. Our reinsurance contracts include special termination provisions that allow us to cancel and replace any participating reinsurer that is downgraded below a rating of "A−" (Excellent) (Outlook Stable) from A.M. Best, or whose surplus drops by more than 20%. Torrey Pines Re Ltd., the special purpose insurer established in Bermuda, comprises $166 million or 12.7% of total catastrophe XOL limit we have in effect. Torrey Pines Re Ltd. was funded by over 25 different investors, with the largest investor representing less than 2% of our total catastrophe XOL reinsurance limit. Our largest single XOL reinsurer comprises 5.9% of the total catastrophe XOL reinsurance limit we have in effect. In addition to ceding risk to traditional reinsurers, we purchase collateralized limit from the insurance linked securities ("ILS") market.

Currently, we retain $5 million of risk per earthquake or wind event, inclusive of any amounts retained through our Bermuda reinsurance subsidiary, and our reinsurance program currently provides for coverage up to $1.2 billion for earthquake events, subject to customary exclusions. Currently, our first event retention represents 1.9% of our stockholders' equity. We believe our current reinsurance program provides coverage well in excess of our theoretical losses from any recorded historical event. We regularly model our hypothetical losses from historically significant catastrophes, including the 1906 San Francisco and 1994 Northridge earthquakes. Under our current reinsurance program, should an event equivalent to either of these two events recur, our hypothetical net loss would be capped at our current net retention of $5 million per such event.

To mitigate potential volatility in reinsurance market conditions, we currently purchase XOL reinsurance coverage at two different renewals during the year, on January 1st and on June 1st. Additionally, we divide our catastrophe XOL treaty into multiple layers and place many of the layers on alternating 24 month contracts. At each reinsurance treaty renewal, we consider any plans to change the underlying insurance coverage we offer, our current capital, our risk appetite, and the cost and availability of reinsurance coverage. Many of our reinsurance contracts have multi-year terms and additional features, such as expanded coverage windows for catastrophe events, that we believe provide us with significant protection and flexibility should market conditions change. In the event of a catastrophe that impacts our reinsurance contracts, our contracts typically include prepaid reinstatements that limits our net loss to $5 million retention per event. For layers that are not reinstateable (commonly known as "single shot") such as Torrey Pines Re, the we have arranged cascading coverage that drops down in order to eliminate any potential gap in coverage in the catastrophe program for subsequent event(s).

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements (as defined by applicable regulations of the SEC) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Critical accounting estimates

We identified the accounting estimates which are critical to the understanding of our financial position and results of operations. Critical accounting estimates are defined as those estimates that are both important to the portrayal of our financial condition and results of operations and require us to exercise significant judgment. We use significant judgment concerning future results and developments in applying these critical accounting estimates and in preparing our condensed consolidated financial statements. These judgments and estimates affect our reported amounts of assets, liabilities, revenues and expenses and the disclosure of our material contingent assets and liabilities. Actual results may differ materially from the estimates and assumptions used in preparing the condensed consolidated financial statements. We evaluate our estimates regularly using information that we believe to be relevant. Our critical accounting policies and estimates are described in our annual consolidated financial statements and the related notes in our 2019 Annual Report on Form 10-K filed with the SEC on February 28, 2020.

There have been no significant changes in our critical accounting policies and estimates as compared to the critical accounting policies and estimates disclosed in Management's Discussion and Analysis of Financial Condition and Operations included in our 2019 Annual Report on Form 10-K

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Market risk is a general term describing the potential economic loss associated with adverse changes in the fair value of financial instruments. Our condensed consolidated balance sheets include assets and liabilities with estimated fair values that are subject to market risk. Our primary market risks have been equity price risk associated with investments in equity securities and interest rate risk associated with investments in fixed maturities.

Credit risk is the potential loss resulting from adverse changes in an issuer's ability to repay its debt obligations. General concern exists about a number of issuers experiencing financial difficulties as a result of the impact of the

COVID-19 pandemic. In general, we manage the exposure to credit risk in our investment portfolio by investing in high quality securities and by diversifying our holdings.

We monitor our investment portfolio to ensure that credit risk does not exceed prudent levels. The majority of our investment portfolio is invested in high credit quality, investment grade fixed maturity securities. We also invest in higher yielding fixed maturities and equity securities. Our fixed maturity portfolio has an average rating by at least one nationally recognized rating organization of “AA−,” with approximately 78.2% rated “A−” or better. At March 31, 2020, none of our fixed maturity portfolio was unrated or rated below investment grade. Our fixed maturity portfolio includes some securities issued with financial guaranty insurance. We purchase fixed maturities based on our assessment of the credit quality of the underlying assets without regard to insurance.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures defined under Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective.

Changes in Internal Controls over Financial Reporting

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

The effectiveness of any system of controls and procedures is subject to certain limitations, and, as a result, there can be no assurance that our controls and procedures will detect all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be attained.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are party to legal proceedings which arise in the ordinary course of business. We believe that the outcome of such matters, individually and in the aggregate, will not have a material adverse effect on our condensed consolidated financial position.

Item 1A. Risk Factors

A description of the risks and uncertainties associated with our business is set forth below. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The risks and uncertainties described below may not be the only ones we face. If any of the risks actually occur, our business, financial condition, results of operations and prospects could be materially and adversely affected. In that event, the market price of our common stock could decline. Additional risks and uncertainties of which we are unaware, or that we currently deem immaterial also may become important factors that affect us.

Risks Related to Our Business and Industry

We and our customers could be negatively and adversely impacted by the Pandemic, which may result in a decline in demand for our products, a decrease in underwriting income and a decrease in the value of our investment portfolio.

The ongoing Pandemic and response thereto have significantly impacted financial markets, businesses, households, and communities and has caused a contraction in business activity and volatility in financial markets. Continuation of the Pandemic could cause additional reduction in business activity and financial market instability. The extent of the impact of the Pandemic on our operational and financial performance will depend on several factors, including the duration of the outbreak, the ability for our customers to continue to pay premiums, contraction of the insurance and reinsurance markets, the ability for reinsurers to satisfy claims, and actions taken by government and health officials in response, all of which are uncertain and cannot be predicted.

Disruptions to the economy from the Pandemic could cause our customers to have less need for insurance coverage, cancel or cease payment on existing insurance policies, modify their coverage, or not renew the policies they hold with us. Policyholders may exaggerate or even falsify claims to obtain higher claims payments. Any of these outcomes would reduce our underwriting income.

We underwrite a significant amount of our commercial insurance policies for businesses such as hotels, motels, retail, and professional services. These businesses largely require patrons to generate profits and are located in areas that are quarantined in response to the Pandemic. A prolonged quarantine or ongoing changes in patron behavior as a result of the Pandemic would have a negative adverse impact on these insureds and their revenue streams, which consequently will impact their ability to meet their financial obligations, including purchasing or renewing insurance policies.

In addition, our results of operations depend, in part, on the performance of our investment portfolio. The Pandemic's impact on the economy and financial markets could reduce our net investment income and result in realized investment losses in future periods.

Claims arising from unpredictable and severe catastrophe events, including those caused by global climate change, could reduce our earnings and stockholders' equity and limit our ability to underwrite new insurance policies.

Our insurance operations expose us to claims arising out of unpredictable catastrophe events, such as earthquakes, hurricanes, windstorms, floods and other severe events. Furthermore, the actual occurrence, frequency and magnitude of such events are uncertain. While there can be no certainty surrounding the timing and magnitude of earthquakes, some observers believe that significant shifts in the tectonic plates, including the San Andreas Fault, may occur in the future. Over the past several years, changing weather patterns and climatic conditions, such as global warming, have added to the unpredictability and frequency of natural disasters in certain parts of the world, including the markets in which we operate. Climate change may increase the frequency and severity of extreme weather events. This effect has led to conditions in the ocean and atmosphere, including warmer-than-average sea-surface temperatures and low wind shear that increase hurricane activity. Hurricane activity typically increases between June and November of each year, though the actual occurrence and magnitude of such events is uncertain. The occurrence of a natural disaster or other catastrophe loss could materially adversely affect our business, financial condition, and results of operations. Additionally, any increased frequency and severity of such weather events, including hurricanes, could have a material adverse effect on our ability to predict, quantify, reinsure and manage catastrophe risk and may materially increase our losses resulting from such catastrophe events.

The extent of losses from catastrophes is a function of both the frequency and severity of the insured events and the total amount of insured exposure in the areas affected. The frequency and severity of catastrophes are inherently unpredictable and the occurrence of one catastrophe does not make the occurrence of another catastrophe more or less likely. Increases in the replacement cost and concentrations of insured property, the effects of inflation, and changes in cyclical weather patterns may increase the severity of claims from catastrophe events in the future. Claims from catastrophe events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year, which could materially adversely affect our financial condition, possibly to the extent of eliminating our total stockholders’ equity. For example, Hurricane Harvey in August 2017 caused our gross losses and loss adjustment expenses to increase 66% from the prior year. Our ability to underwrite new insurance policies could also be materially adversely impacted as a result of corresponding reductions in our capital. In addition, a natural disaster could materially impact the financial condition of our policyholders, resulting in loss of premiums.

As of January 1, 2020, we retain $5 million of risk per earthquake or wind event, inclusive of any amounts retained through our Bermuda reinsurance subsidiary, and our reinsurance program currently provides for coverage up to $1.2 billion for earthquake events, subject to customary exclusions, with coverage in excess of our estimated peak zone 1 in 250 year PML event and in excess of our A.M. Best requirement. While we only select reinsurers whom we believe to have acceptable credit and a minimum A.M. Best rating of “A−”, if our reinsurers are unable to pay the claims for which they are responsible, we ultimately retain primary liability. Furthermore, our earthquake policies do not provide coverage for fire damage arising from an earthquake. In addition, we maintain reinsurance coverage equivalent or better to 1 in 250 year PML for our other lines. While we believe this risk transfer program insulates us from volatility in our earnings, one severe catastrophe event could result in claims that substantially exceed the limits of our reinsurance coverage.

Our reinsurers may not pay claims on a timely basis, or at all, which may materially adversely affect our business, financial condition and results of operations.

Our ability to grow our business is dependent in part in our ability to secure reinsurance for a substantial portion of the risk associated with our policies. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the ceding insurer) of our primary liability to our policyholders. Our current reinsurance program is designed to limit our risk retention to $5 million of risk per earthquake or wind event, inclusive of any amounts retained through our Bermuda reinsurance subsidiary, and provide coverage up to $1.2 billion for earthquake events, subject to customary exclusions. However, particularly in the event of a major catastrophe our reinsurers may not pay claims made by us on a timely basis, or they may not pay some or all these claims. For example, the Pandemic has put financial pressure on the insurance market due to several factors, including the inability of customers to pay premiums and increased claims for business interruption. Increased claim demands for business interruption has put substantial financial pressure on the insurance and reinsurance market which may impact the ability of insurers and reinsurers to satisfy the liability under their policies.

In addition, reinsurers may default in their financial obligations to us as the result of insolvency, lack of liquidity, operational failure, fraud, asserted defenses based on agreement wordings or the principle of utmost good faith, asserted deficiencies in the documentation of agreements or other reasons. Any disputes with reinsurers regarding coverage under reinsurance contracts could be time consuming, costly, and uncertain of success. If a catastrophic event were to occur and our reinsurers were unable to satisfy their commitments to us, we may be unable to satisfy the liability to our policyholders. We evaluate each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims and existing case law and consider including any amounts deemed uncollectible from the reinsurer in a reserve for uncollectible reinsurance. As of March 31, 2020, we had $19.0 million of aggregate reinsurance recoverables. These risks could cause us to incur increased net losses, and, therefore, adversely affect our financial condition.

We may be unable to purchase third-party reinsurance or otherwise expand our catastrophe coverage in amounts we desire on commercially acceptable terms or on terms that adequately protect us, and this inability may materially adversely affect our business, financial condition and results of operations.

We purchase a significant amount of reinsurance from third parties that we believe enhances our business by reducing our exposure to potential catastrophe losses and reducing volatility in our underwriting performance, providing us with greater visibility into our future earnings. Reinsurance involves transferring, or ceding, a portion of our risk exposure on policies that we write to another insurer, the reinsurer, in exchange for a premium. We primarily use treaty reinsurance, consisting of catastrophe excess of loss ("XOL") coverage, and, on a limited basis, facultative reinsurance coverage. Treaty coverage refers to a reinsurance contract that is applied to a group or class of business where all the risks written meet the criteria for that class. Facultative coverage refers to a reinsurance contract on individual risks as opposed to a group or class of business.

Our catastrophe XOL treaties are divided into layers, many of which are placed using alternating 24-month contracts. From time to time, market conditions have limited, and in some cases prevented, insurers from obtaining the types and amounts of reinsurance they consider adequate for their business needs. As a result, we may not be able to purchase reinsurance in the areas and for the amounts we desire or on terms we deem acceptable or at all. In addition to limit purchased from traditional reinsurers, we have expanded our catastrophe XOL coverage to incorporate collateralized protection from the insurance linked securities ("ILS") market. In May 2017, we closed a $166 million 144A catastrophe bond offering completed through Torrey Pines Re Ltd., a special purpose insurer in Bermuda, that provides fully collateralized protection over a three-year risk period. We may seek to expand our catastrophe XOL coverage through similar bond offerings in the future but there can be no assurances that we will be able to complete such offerings on acceptable terms, if at all. If we are unable to renew our expiring contracts, enter into new reinsurance arrangements on acceptable terms or expand our catastrophe coverage through future bond offerings or otherwise, our loss exposure could increase, which would increase our potential losses related to catastrophe events. If we are unwilling to bear an increase in loss exposure, we could have to reduce the level of our underwriting commitments, both of which could materially adversely affect our business, financial condition and results of operations.

Many reinsurance companies have begun to exclude certain coverages from, or alter terms in, the reinsurance contracts we enter into with them. As a result, we, like other insurance companies, write insurance policies which to some extent do not have the benefit of reinsurance protection. These gaps in reinsurance protection expose us to greater risk and greater potential losses.

We utilize several risk management and loss limitation methods, including relying on estimates and models. If these methods fail to adequately manage our exposure to losses from catastrophe events, our losses could be materially higher than our expectations, and our business, financial condition, and results of operations could be materially adversely affected.

Our approach to risk management relies on subjective variables that entail significant uncertainties. We manage our exposure to catastrophe losses by analyzing the probability and severity of the occurrence of catastrophe events and the impact of such events on our overall underwriting and investment portfolio. We monitor and mitigate our exposure through a number of methods designed to minimize risk, including underwriting specialization, modeling and data systems, data quality control, strategic use of policy deductibles and regular review of aggregate exposure and probable maximum loss reports, which report the maximum amount of losses that one would expect based on computer or actuarial modeling techniques. These estimates, models, data and scenarios may not produce accurate predictions; consequently, we could incur losses both in the risks we underwrite and to the value of our investment portfolio.

In addition, output from our risk modeling software is based on third-party data that we believe to be reliable. The estimates and assumptions we use are dependent on many variables, such as loss adjustment expenses, insurance-to-value, storm or earthquake intensity, building code compliance and demand surge, which is the temporary inflation of costs for building materials and labor resulting from increased demand for rebuilding services in the aftermath of a catastrophe. Accordingly, if the estimates and assumptions used in our risk models are incorrect or if our risk models prove to be an inaccurate forecasting tool, the losses we might incur from an actual catastrophe could be materially higher than our expectation of losses generated from modeled catastrophe scenarios, and our business, financial condition, and results of operations could be materially adversely affected. In addition, our third-party data providers may change the estimates or assumptions that we use in our risk models and/or their data may be inaccurate. Changes in these estimates or assumptions or the use of inaccurate third-party data could cause our actual losses to be materially higher than our current expectation of losses generated by modeled catastrophe scenarios, which in turn could materially adversely affect our business, financial condition, and results of operations.

We run many model simulations in order to understand the impact of these assumptions on a catastrophe's loss potential. Furthermore, there are risks associated with catastrophe events, which are either poorly represented or not represented at all by catastrophe models. Each modeling assumption or un-modeled risk introduces uncertainty into probable maximum loss estimates that management must consider. These uncertainties can include, but are not limited to, the following:

- The models do not address all the possible hazard characteristics of a catastrophe peril (e.g., the precise path and wind speed of a hurricane);
- The models may not accurately reflect the true frequency of events;
- The models may not accurately reflect a risk's vulnerability or susceptibility to damage for a given event characteristic;
- The models may not accurately represent loss potential to insurance or reinsurance contract coverage limits, terms and conditions; and
- The models may not accurately reflect the impact on the economy of the area affected or the financial, judicial, political, or regulatory impacts on insurance claim payments during or following a catastrophe event.

Our investment portfolio may be adversely impacted by ratings downgrades, increased bankruptcies and credit spread widening in distressed industries, such as energy, gaming, lodging and leisure, autos, airlines and retail due to the Pandemic. Further disruptions in global financial markets due to the continuing impact of the Pandemic could result in potential impairments in our fixed income portfolio. In addition, declines in fixed income yields would result in decreases in net investment income from future investment activity, including re-investments.

As a result of these factors and contingencies, our reliance on assumptions and data used to evaluate our entire risk portfolio and specifically to estimate a probable maximum loss is subject to a high degree of uncertainty that could result in actual losses that are materially different from our probable maximum loss estimates and our financial results could be adversely affected.

A decline in our financial strength rating may adversely affect the amount of business we write.

Participants in the insurance industry use ratings from independent ratings agencies, such as A.M. Best, as an important means of assessing the financial strength and quality of insurers. In setting its ratings, A.M. Best performs quantitative and qualitative analysis of a company's balance sheet strength, operating performance and business profile. A.M. Best financial strength ratings range from "A++" (Superior) to "F" for insurance companies that have been publicly placed in liquidation. As of December 31, 2019, A.M. Best has assigned a financial strength rating of "A−" (Excellent) (Outlook Stable) to us. A.M. Best assigns ratings that are intended to provide an independent opinion of an insurance company's ability to meet its obligations to policyholders and such ratings are not evaluations directed to investors and are not a recommendation to buy, sell or hold our common stock or any other securities we may issue. A.M. Best's analysis includes comparisons to peers and industry standards as well as assessments of operating plans, philosophy and management. A.M. Best periodically reviews our financial strength rating and may revise it downward or revoke it at A.M. Best's discretion based primarily on its analyses of our balance sheet strength (including capital adequacy and loss adjustment expense reserve adequacy), operating performance and business profile. Factors that could affect such analyses include, but are not limited to:

- If we change our business practices from our organizational business plan in a manner that no longer supports A.M. Best's rating;
- If unfavorable financial, regulatory or market trends affect us, including excess market capacity;
- If our losses exceed our loss reserves;
- If we have unresolved issues with government regulators;
- If we are unable to retain our senior management or other key personnel;
- If our investment portfolio incurs significant losses; or
- If A.M. Best alters its capital adequacy assessment methodology in a manner that would adversely affect our rating.

These and other factors could result in a downgrade of our financial strength rating. A downgrade or withdrawal of our rating could result in any of the following consequences, among others:

- Causing our current and future distribution partners and insureds to choose other, more highly-rated competitors;
- Increasing the cost or reducing the availability of reinsurance to us; or
- Severely limiting or preventing us from writing new and renewal insurance contracts.

In addition, in view of the earnings and capital pressures experienced by many financial institutions, including insurance companies, it is possible that rating organizations will heighten the level of scrutiny that they apply to such institutions, will increase the frequency and scope of their credit reviews, will request additional information from the companies that they rate or will increase the capital and other requirements employed in the rating organizations' models for maintenance of certain ratings levels. If our credit rating were to be downgraded, or general market conditions were to ascribe higher risk to our rating levels, due to the Pandemic, our access to capital markets and the cost of any equity or debt financing will be negatively impacted. We can offer no assurance that our rating will remain at its current level. It is possible that such reviews of us may result in adverse ratings consequences, which could have a material adverse effect on our financial condition and results of operations.

The effects of the Pandemic have significantly affected the global and U.S. economies and financial markets, and may further disrupt our operations and the operations of our insureds, agents, and third parties upon which we rely.

The current Pandemic health emergency has caused significant disruption in the global and U.S. economies and financial markets. On March 11, 2020, the World Health Organization formally declared the COVID-19 outbreak to be a pandemic. The spread of COVID-19 caused illness, quarantines, cancellation of events and travel, business and school shutdowns, reduction in business activity, widespread unemployment, supply chain interruptions, and overall economic and financial market instability. The U.S. currently has the most reported COVID-19 cases in the world, and all 50 states and the District of Columbia have reported cases of infected individuals. All U.S. states, including California and Texas, where we generated more than one-half of our gross written premiums for the three months ended March 31, 2020, have declared states of emergency. Impacts to our business could be widespread and material impacts may result, including but not limited to, the following:

- employees contracting COVID-19;
- reductions in our operating effectiveness as our employees work from home;
- unavailability of key personnel necessary to conduct our business activities;

- unprecedented volatility in financial markets that could materially affect our investment portfolio valuations and returns;
- government mandates and/or legislative changes, including premium grace periods and presumed Pandemic compensability for all or certain insured groups;
- increases in frequency and/or severity of compensable claims;
- increased credit risk;
- business disruption to independent insurance agents and brokers and/or our partners that market and sell our insurance products; and
- business disruptions to third parties that we outsource certain business functions to and whose technology upon which we rely.

We are taking precautions to protect the safety and well-being of our employees while providing uninterrupted service to our policyholders and claimants. However, no assurance can be given that these actions will be sufficient, nor can we predict the level of disruption that will occur to our employees' ability to continue to provide customer support and service as they work from home. Furthermore, should the Pandemic and its related macro-economic risks continue for an extended period of time, demand for our insurance products would be negatively impacted and the level and severity of our compensable claims could increase, each of which could result in a material adverse effect on our results of operations and financial condition.

Our business is concentrated in California and Texas and, as a result, we are exposed more significantly to California and Texas loss activity and regulatory environments.

Our policyholders and insurance risks are currently concentrated in California and Texas, which generated 56% and 18% of our gross written premiums, respectively, for the year ended December 31, 2019 and 46% and 22% of our gross written premiums, respectively, for the three months ended March 31, 2020. Any single, major catastrophe event, series of events or other condition causing significant losses in California or Texas could materially adversely affect our business, financial condition and results of operations. Additionally, unfavorable business, economic or regulatory conditions in these states may result in a significant reduction of our premiums or increase our loss exposure. Accordingly, the loss environment and unfavorable business, economic, demographic, natural perils, competitive, and regulatory conditions in California and Texas, including the impacts of the ongoing Pandemic, could negatively impact our business We are exposed to business, economic, political, judicial and regulatory risks due to this concentration that are greater than the risks faced by insurance companies that conduct business over a more extensive geographic area.

Changes in California or Texas political climates could result in new or changed legislation affecting the property and casualty insurance industry in general and insurers writing residential earthquake and wind coverage in particular.

We could be adversely affected by the loss of one or more key executives or by an inability to attract and retain qualified personnel.

We depend on our ability to attract and retain experienced personnel and seasoned key executives who are knowledgeable about our business. The pool of talent from which we actively recruit is limited and may fluctuate based on market dynamics specific to our industry and independent of overall economic conditions. As such, higher demand for employees having the desired skills and expertise could lead to increased compensation expectations for existing and prospective personnel, making it difficult for us to retain and recruit key personnel and maintain labor costs at desired levels. In particular, our future success is substantially dependent on the continued service of our Co-Founder and Chief Executive Officer, Mac Armstrong, and our Chief Financial Officer, Christopher Uchida. Should any of our key executives terminate their employment with us, or if we are unable to retain and attract talented personnel, we may be unable to maintain our current competitive position in the specialized markets in which we operate, which could adversely affect our results of operations.

We rely on a select group of brokers and program administrators, and such relationships may not continue.

The distribution networks of our products are multi-faceted and distinct to each line of business. Our relationship with our brokers or program administrators may be discontinued at any time. Even if the relationships do continue, they may not be on terms that are profitable for us. We distribute a significant portion of our Residential Earthquake, Commercial Earthquake, Specialty Homeowners and Hawaii Hurricane products through longstanding relationships with two program administrators. Each of the four products managed by the program administrators operates as a separate program that is governed by an independent, separately negotiated agreement with unique terms and conditions, including geographic scope, key men provisions, economics and exclusivity. These programs also feature separate managerial oversight and leadership, policy administration systems and retail agents originating policies. In total, these four products accounted for $148.6 million or 59.0% of our gross written premiums for the year ended December 31, 2019 and $71.5 million or 52% for the three months ended March 31, 2020. This amount includes our Value Select Residential Earthquake program, which represents the majority of our Residential Earthquake premium and is administered through a mutually exclusive program administrator agreement with Arrowhead for the states of California, Oregon and Washington. The termination of a relationship with one or more significant brokers or program administrators could result in lower gross written premiums and could have a material adverse effect on our results of operations or business prospects.

Unexpected changes in the interpretation of our coverage or provisions, including loss limitations and exclusions, in our policies could have a material adverse effect on our financial condition and results of operations.

There can be no assurances that specifically negotiated loss limitations or exclusions in our policies will be enforceable in the manner we intend. As industry practices and legal, judicial, social, and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. For example, many of our policies limit the period during which a policyholder may bring a claim, which may be shorter than the statutory period under which such claims can be brought against our policyholders. While these limitations and exclusions help us assess and mitigate our loss exposure, it is possible that a court or regulatory authority or an executive action could nullify or void a limitation or exclusion, such as limitations on business interruption claims caused by pandemics or other crises, or legislation could be enacted modifying or barring the use of such limitations or exclusions. These types of governmental actions could result in higher than anticipated losses and loss adjustment expenses, which could have a material adverse effect on our financial condition or results of operations. In addition, court decisions, such as the 1995 Montrose decision in California could read policy exclusions narrowly so as to expand coverage, thereby requiring insurers to create and write new exclusions.

These issues may adversely affect our business by either broadening coverage beyond our underwriting intent or by increasing the frequency or severity of claims. In some instances, these changes may not become apparent until sometime after we have issued insurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is issued.

Competition for business in our industry is intense.

We face competition from other specialty insurance companies, standard insurance companies and underwriting agencies that are larger than we are and that have greater financial, marketing, and other resources than we do. Some of these competitors also have longer operating history and more market recognition than we do in certain lines of business. In addition, we compete against state or other publicly managed enterprises including the California Earthquake Authority (“CEA”), the National Flood Insurance Program and the Texas Wind Insurance Association. If the CEA decided to provide coverage to non-CEA member carriers or lessened the capital requirements for membership, we would face additional competition in our markets, and our operating results could be adversely affected. Furthermore, it may be difficult or prohibitively expensive for us to implement technology systems and processes that are competitive with the systems and processes of these larger companies.

In particular, competition in the insurance industry is based on many factors, including price of coverage, the general reputation and perceived financial strength of the company, relationships with brokers, terms and conditions of products offered, ratings assigned by independent rating agencies, speed of claims payment and reputation, and the experience and reputation of the members of our underwriting team in the particular lines of insurance and reinsurance we seek to underwrite. In recent years, the insurance industry has undergone increasing consolidation, which may further increase competition.

A number of new, proposed or potential industry or legislative developments could further increase competition in our industry. These developments include:

- An increase in capital-raising by companies in our lines of business, which could result in new entrants to our markets and an excess of capital in the industry; and

- The deregulation of commercial insurance lines in certain states and the possibility of federal regulatory reform of the insurance industry, which could increase competition from standard carriers.

We may not be able to continue to compete successfully in the insurance markets. Increased competition in these markets could result in a change in the supply and demand for insurance, affect our ability to price our products at risk-adequate rates and retain existing business, or underwrite new business on favorable terms. If this increased competition so limits our ability to transact business, our operating results could be adversely affected.

The failure of our information technology and telecommunications systems could adversely affect our business.

Our business is highly dependent upon our information technology and telecommunications systems, including our underwriting system. We rely on these systems to interact with brokers and insureds, to underwrite business, to prepare policies and process premiums, to perform actuarial and other modeling functions, to process claims and make claims payments, and to prepare internal and external financial statements and information. Some of these systems may include or rely on third-party systems not located on our premises or under our control. Events such as natural catastrophes, pandemics (including the COVID-19 Pandemic), terrorist attacks, industrial accidents or computer viruses may cause our systems to fail or be inaccessible for extended periods of time. While we have implemented business contingency plans and other reasonable plans to protect our systems, sustained or repeated system failures or service denials could severely limit our ability to write and process new and renewal business, provide customer service, pay claims in a timely manner or otherwise operate in the ordinary course of business.

Our operations depend on the reliable and secure processing, storage, and transmission of confidential and other data and information in our computer systems and networks. Computer viruses, hackers, employee misconduct, and other external hazards could expose our systems to security breaches, cyber-attacks or other disruptions. In addition, we routinely transmit and receive personal, confidential and proprietary data and information by electronic means and are subject to numerous data privacy laws and regulations enacted in the jurisdictions in which we do business.

While we have implemented security measures designed to protect against breaches of security and other interference with our systems and networks, our systems and networks may be subject to breaches or interference. Any such event may result in operational disruptions as well as unauthorized access to or the disclosure or loss of our proprietary information or our customers' data and information, which in turn may result in legal claims, regulatory scrutiny and liability, reputational damage, the incurrence of costs to eliminate or mitigate further exposure, the loss of customers or affiliated advisors, reputational harm or other damage to our business. In addition, the trend toward general public notification of such incidents could exacerbate the harm to our business, financial condition and results of operations. Even if we successfully protect our technology infrastructure and the confidentiality of sensitive data, we could suffer harm to our business and reputation if attempted security breaches are publicized. We cannot be certain that advances in criminal capabilities, discovery of new vulnerabilities, attempts to exploit vulnerabilities in our systems, data thefts, physical system or network break-ins or inappropriate access, or other developments will not compromise or breach the technology or other security measures protecting the networks and systems used in connection with our business.

Recently, the majority of our employees have been working outside of our primary offices as a result of the Pandemic. We believe this additional remote work increases the need for our information technology and telecommunications systems to work properly and creates additional operational risk and difficulty should these systems fail.

Any failure to protect our intellectual property rights could impair our ability to protect our intellectual property, proprietary technology platform and brand, or we may be sued by third parties for alleged infringement of their proprietary rights.

Our success and ability to compete depend in part on our intellectual property, which includes our rights in our proprietary technology platform and our brand. We primarily rely on copyright, trade secret and trademark laws, and confidentiality agreements with our employees, customers, service providers, partners and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property may be inadequate. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. Additionally, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability and scope of our intellectual property rights. Our failure to secure, protect and enforce our intellectual property rights could adversely affect our brand and adversely impact our business.

Our success depends also in part on our not infringing on the intellectual property rights of others. Our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry. In the future, third parties may claim that we are infringing on their intellectual property rights, and we may be found to be infringing on such rights. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our services, or require that we comply with other unfavorable terms. Even if we were to prevail in such a dispute, any litigation could be costly and time-consuming and divert the attention of our management and key personnel from our business operations.

Because we provide our program administrators with specific quoting and binding authority, if any of them fail to comply with pre-established guidelines, our results of operations could be adversely affected.

We market and distribute certain of our insurance products through program administrators that have limited quoting and binding authority and that in turn sell our insurance products to insureds through retail agents and wholesale brokers. These program administrators can bind certain risks without our initial approval. If any of these program administrators fail to comply with our underwriting guidelines and the terms of their appointments, we could be bound on a particular risk or number of risks that were not anticipated when we developed the insurance products or estimated losses and loss adjustment expenses. Such actions could adversely affect our results of operations.

Because our business depends on insurance brokers and program administrators, we are exposed to certain risks arising out of our reliance on these distribution channels that could adversely affect our results.

Certain premiums from policyholders, where the business is produced by brokers, are collected directly by the brokers and forwarded to our U.S. insurance subsidiary. In certain jurisdictions, when the insured pays its policy premium to its broker for payment on behalf of our U.S. insurance subsidiary, the premium might be considered to have been paid under applicable insurance laws and regulations. Accordingly, the insured would no longer be liable to us for those amounts, whether or not we have actually received the premium from that broker. Consequently, we assume a degree of credit risk associated with the brokers with which we work. We review the financial condition of potential new brokers before we agree to transact business with them. Although the failure by any of our brokers to remit premiums to us has not been material to date, there may be instances where our brokers collect premiums but do not remit them to us and we may be required under applicable law to provide the coverage set forth in the policy despite the related premiums not being paid to us. Additionally, the loss or disruption of business of a number of our agents and brokers or the failure or inability of these agents and brokers to successfully market our insurance products, including impacts related to the Pandemic, could have a material adverse effect on our business, financial condition, and results of operations.

Because the possibility of these events occurring depends in large part upon the financial condition and internal operations of our brokers, we monitor broker behavior and review financial information on an as-needed basis. If we are unable to collect premiums from our brokers in the future, our underwriting profits may decline and our financial condition and results of operations could be materially and adversely affected.

Our failure to accurately and timely pay claims could materially and adversely affect our business, financial condition, results of operations, and prospects.

We must accurately and timely evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately and timely, including the training and experience of our claims representatives, including our third party claims administrators ("TPAs"), the effectiveness of our management, and our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately and timely could lead to regulatory and administrative actions or material litigation, undermine our reputation in the marketplace and materially and adversely affect our business, financial condition, results of operations, and prospects.

In addition, if we do not manage our TPAs effectively, or if our TPAs are unable to effectively handle our volume of claims, our ability to handle an increasing workload could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, our business could suffer from decreased quality of claims work which, in turn, could adversely affect our operating margins.

We employ third-party licensed software for use in our business, and the inability to maintain these licenses, errors in the software we license or the terms of open source licenses could result in increased costs or reduced service levels, which would adversely affect our business.

Our business relies on certain third-party software obtained under licenses from other companies. We anticipate that we will continue to rely on such third-party software in the future. Although we believe that there are commercially reasonable alternatives to the third-party software we currently license, this may not always be the case, or it may be difficult or costly to replace. In addition, integration of new third-party software may require significant work and require substantial investment of our time and resources. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties, which may not be available on commercially reasonable terms or at all. Many of the risks associated with the use of third-party software cannot be eliminated, and these risks could negatively affect our business.

Additionally, the software powering our technology systems incorporates software covered by open source licenses. The terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that the licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to operate our systems. In the event that portions of our proprietary software are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code or re-engineer all or a portion of our technology systems, each of which could reduce or eliminate the value of our technology systems. Such risk could be difficult or impossible to eliminate and could adversely affect our business, financial condition, and results of operations.

Adverse economic factors, including recession, inflation, periods of high unemployment or lower economic activity could result in the sale of fewer policies than expected or an increase in the frequency of claims and premium defaults, and even the falsification of claims, or a combination of these effects, which, in turn, could affect our growth and profitability.

Factors, such as business revenue, economic conditions, the volatility and strength of the capital markets, and inflation can affect the business and economic environment. These same factors affect our ability to generate revenue and profits. In an economic downturn that is characterized by higher unemployment, declining spending, and reduced corporate revenue, the demand for insurance products is generally adversely affected, which directly affects our premium levels and profitability. Negative economic factors may also affect our ability to receive the appropriate rate for the risk we insure with our policyholders and may adversely affect the number of policies we can write, and our opportunities to underwrite profitable business. In an economic downturn, our customers may have less need for insurance coverage, cancel or cease payment on existing insurance policies, modify their coverage, or not renew the policies they hold with us. Existing policyholders may exaggerate or even falsify claims to obtain higher claims payments. These outcomes would reduce our underwriting profit to the extent these factors are not reflected in the rates we charge.

We underwrite a significant portion of our insurance in California and Texas. Any economic downturn in either state could have an adverse effect on our financial condition and results of operations.

Performance of our investment portfolio is subject to a variety of investment risks that may adversely affect our financial results.

Our results of operations depend, in part, on the performance of our investment portfolio. We seek to hold a diversified portfolio of investments that is managed by a professional investment advisory management firm in accordance with our investment policy and routinely reviewed by our Investment Committee. Our investments are subject to general economic conditions and market risks as well as risks inherent to particular securities.

Our primary market risk exposures relate to changes in interest rates and credit quality considerations. Future increases in interest rates could cause the values of our fixed maturity securities portfolios to decline, with the magnitude of the decline depending on the duration of securities included in our portfolio and the amount by which interest rates increase. Some fixed maturity securities have call or prepayment options, which create possible reinvestment risk in declining rate environments. Other fixed maturity securities, such as mortgage-backed and asset-backed securities, carry prepayment risk or, in a rising interest rate environment, may not prepay as quickly as expected.

The value of our investment portfolio is subject to the risk that certain investments may default or become impaired due to deterioration in the financial condition of one or more issuers of the securities we hold, or due to deterioration in the financial condition of an insurer that guarantees an issuer's payments on such investments. Downgrades in the credit ratings of fixed maturities also have a significant negative effect on the market valuation of such securities.

Such factors could reduce our net investment income and result in realized investment losses. Our investment portfolio is subject to increased valuation uncertainties when investment markets are illiquid. The valuation of investments is more subjective when markets are illiquid, thereby increasing the risk that the estimated fair value (i.e., the carrying amount) of the securities we hold in our portfolio does not reflect prices at which actual transactions would occur.

We also invest in marketable equity securities, generally through mutual funds and exchange-traded funds that provide exposure to the U.S. investment-grade bond market. These securities are carried on the balance sheet at fair market value and are subject to potential losses and declines in market value. Our equity invested assets totaled $22.9 million as of March 31, 2020.

Risks for all types of securities are managed through the application of our investment policy, which establishes investment parameters that include but are not limited to, maximum percentages of investment in certain types of securities and minimum levels of credit quality, which we believe are within applicable guidelines established by the National Association of Insurance Commissioners ("NAIC"), the Oregon Division of Financial Regulation and the California Department of Insurance.

Although we seek to preserve our capital, we cannot be certain that our investment objectives will be achieved, and results may vary substantially over time. In addition, although we seek to employ investment strategies that are not correlated with our insurance and reinsurance exposures, losses in our investment portfolio may occur at the same time as underwriting losses and, therefore, exacerbate the adverse effect of the losses on us.

Our investment portfolio may be adversely impacted by ratings downgrades, increased bankruptcies and credit spread widening in distressed industries, such as energy, gaming, lodging and leisure, autos, airlines and retail due to the Pandemic. Further disruptions in global financial markets due to the continuing impact of the Pandemic could result in additional net realized investment losses, including potential impairments in our fixed income portfolio. In addition, declines in fixed income yields would result in decreases in net investment income from future investment activity, including re-investments.

We could be forced to sell investments to meet our liquidity requirements.

We invest the premiums we receive from our insureds until they are needed to pay policyholder claims. Consequently, we seek to manage the duration of our investment portfolio based on the duration of our losses and loss adjustment expense reserves to provide sufficient liquidity and avoid having to liquidate investments to fund claims. Risks such as inadequate losses and loss adjustment reserves or unfavorable trends in litigation could potentially result in the need to sell investments to fund these liabilities. We may not be able to sell our investments at favorable prices or at all. Sales could result in significant realized losses depending on the conditions of the general market, interest rates, and credit issues with individual securities.

We are subject to extensive regulation, which may adversely affect our ability to achieve our business objectives. In addition, if we fail to comply with these regulations, we may be subject to penalties, including fines and suspensions, which may adversely affect our financial condition and results of operations.

Our U.S. insurance company subsidiary, Palomar Specialty Insurance Company, is subject to extensive regulation in Oregon, its state of domicile, California, where it is commercially domiciled, and to a lesser degree, the other states in which it operates. Our Bermuda reinsurance subsidiary, Palomar Specialty Reinsurance Company Bermuda Ltd. (“Palomar Re”), is subject to regulation in Bermuda. Most insurance regulations are designed to protect the interests of insurance policyholders, as opposed to the interests of investors or stockholders. These regulations generally are administered by a department of insurance in each state and relate to, among other things, capital and surplus requirements, investment and underwriting limitations, affiliate transactions, dividend limitations, changes in control, solvency and a variety of other financial and non-financial aspects of our business. Significant changes in these laws and regulations could further limit our discretion or make it more expensive to conduct our business. State insurance regulators and the Bermuda Monetary Authority (the BMA), also conduct periodic examinations of the affairs of insurance and reinsurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. These regulatory requirements may impose timing and expense constraints that could adversely affect our ability to achieve some or all of our business objectives.

Our U.S. insurance subsidiary is part of an “insurance holding company system” within the meaning of applicable California and Oregon statutes and regulations. As a result of such status, certain transactions between our U.S. insurance subsidiary and one or more of their affiliates, such as a tax sharing agreement or cost sharing arrangement, may not be effected unless the insurer has provided notice of that transaction to the California Department of Insurance or the Oregon Division of Financial Regulation, as applicable, at least 30 days prior to engaging in the transaction and the California Department of Insurance or the Oregon Division of Financial Regulation, as applicable, has not disapproved such transaction within the 30-day time period. These prior notification requirements may result in business delays and additional business expenses. If our U.S. insurance subsidiary fails to file a required notification or fail to comply with other applicable insurance regulations in California or Oregon, we may be subject to significant fines and penalties and our working relationship with the California Department of Insurance or the Oregon Division of Financial Regulation, as applicable, may be impaired.

In addition, state insurance regulators have broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, where there is uncertainty as to applicability, we follow practices based on our interpretations of regulations or practices that we believe generally to be followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, state insurance regulators could preclude or temporarily suspend us from carrying on some or all of our activities or could otherwise penalize us. This could adversely affect our ability to operate our business. Further, changes in the level of regulation of the insurance industry or changes in laws or regulations themselves or interpretations by regulatory authorities could interfere with our operations and require us to bear additional costs of compliance, which could adversely affect our ability to operate our business.

Our U.S. insurance subsidiary is subject to risk-based capital requirements, based upon the "risk based capital model" adopted by the NAIC, and other minimum capital and surplus restrictions imposed under Oregon and California law. These requirements establish the minimum amount of risk-based capital necessary for a company to support its overall business operations. It identifies property and casualty insurers that may be inadequately capitalized by looking at certain inherent risks of each insurer's assets and liabilities and its mix of net written premium. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action, including supervision, rehabilitation or liquidation. Failure to maintain our risk-based capital at the required levels could adversely affect the ability of our U.S. insurance subsidiary to maintain regulatory authority to conduct our business. See also "Regulation—Required Licensing."

Our Bermuda reinsurance subsidiary is subject to regulation from the European Union. The European Union adopted the Economic Substance Act 2018 and the Economic Substance Regulations 2018 (together, the "ES Requirements"). As an insurance company, our Bermuda subsidiary conducts a relevant activity and will be subject to the ES Requirements. As a result, our Bermuda subsidiary may be required to change or increase our business operations in Bermuda in order to meet the new requirements. Compliance with the ES Requirements is required with effect from July 1, 2019.

We may become subject to additional government or market regulation, which may have a material adverse impact on our business.

Our business could be adversely affected by changes in state laws, including those relating to asset and reserve valuation requirements, surplus requirements, limitations on investments and dividends, enterprise risk and risk-based capital requirements, and, at the federal level, by laws and regulations that may affect certain aspects of the insurance industry, including proposals for preemptive federal regulation. The U.S. federal government generally has not directly regulated the insurance industry except for certain areas of the market, such as insurance for flood, nuclear and terrorism risks. However, the federal government has undertaken initiatives or considered legislation in several areas that may affect the insurance industry, including tort reform, corporate governance and the taxation of reinsurance companies. In addition, the Bermuda reinsurance regulatory framework has become subject to increased scrutiny in many jurisdictions. As a result, the BMA has implemented and imposed additional requirements on the companies it regulates, which requirements could adversely impact the operations of our reinsurance subsidiary.

Any government mandates and/or legislative changes related to the ongoing Pandemic, including mandated premium refunds or credits and extended premium grace periods, could have a material adverse effect on our results of operations and financial condition. Premium grace periods could significantly increase our expenses while decreasing our short-term revenues which would adversely impact our liquidity.

Changes in tax laws as a result of the enactment of recent tax legislation could impact our operations and profitability.

Legislation commonly known as the Tax Cuts and Jobs Act (the Tax Act) was signed into law on December 22, 2017. The Tax Act made significant changes to the U.S. federal income tax rules for taxation of individuals and corporations, generally effective for taxable years beginning after December 31, 2017. In the case of individuals, the tax brackets have been adjusted, the top federal income rate has been reduced to 37%, special rules have reduced taxation of certain income earned through pass-through entities and various deductions have been eliminated or limited, including limiting the deduction for state and local taxes to $10,000 per year, decreasing the mortgage interest deduction on new homes to $750,000 and eliminating the home equity line of credit interest deduction for loans that are not considered home acquisition debt.

Changes in these deductions may affect taxpayers in states with high residential home prices and high state and local taxes, such as California, and may also negatively impact the housing market. This in turn may negatively impact our growth in these markets if there is lower demand in the housing market as a consequence of the Tax Act.

If states increase the assessments that Palomar Specialty Insurance Company is required to pay, our business, financial condition and results of operations would suffer.

Certain jurisdictions in which Palomar Specialty Insurance Company is admitted to transact business require property and casualty insurers doing business within that jurisdiction to participate in insurance guaranty associations. These organizations pay contractual benefits owed pursuant to insurance policies issued by impaired, insolvent or failed insurers. They levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer is engaged. States may also assess admitted companies in order to fund their respective department of insurance operations. Some states permit member insurers to recover assessments paid through full or partial premium tax offset or in limited circumstances by surcharging policyholders.

Palomar Specialty Insurance Company is licensed to conduct insurance operations on an admitted basis in 27 states and has applied for state approval for licenses in additional states. As Palomar Specialty Insurance Company grows, our share of any assessments in each state in which it underwrites business on an admitted basis may increase. We paid assessments of $1.1 million in 2018, $14,750 in 2019 and have paid $0.3 million during the three months ended March 31, 2020. The increase in assessments paid during 2018 was primarily amounts assessed by the Texas Windstorm Insurance Association and Texas Fair Plan Association relating to Hurricane Harvey, with such amounts recovered from our reinsurers. We cannot predict with certainty the amount of future assessments, because they depend on factors outside our control, such as insolvencies of other insurance companies as well as the occurrence of significant catastrophes similar to Hurricane Harvey. Generally speaking, assessments are covered by our catastrophe XOL treaties and, to the extent we have experienced a net loss from an event in excess of our net retention, assessments would be recovered from our reinsurers with no additional expense to us. However, although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the ceding insurer) of our primary liability to our policyholders. Significant assessments could result in higher than expected operating expenses and have a material adverse effect on our business, financial condition or results of operations. In addition, while some states permit member insurers to recover assessments paid through full or partial premium tax offset or, in limited circumstances, by surcharging policyholders, there is no certainty that offsets or surcharges will be permitted in connection with any future assessments.

Because we are a holding company and substantially all of our operations are conducted by our insurance subsidiaries, our ability to pay dividends depends on our ability to obtain cash dividends or other permitted payments from our insurance subsidiaries.

The continued operation and growth of our business will require substantial capital. We do not intend to declare and pay cash dividends on shares of our common stock in the foreseeable future. Because we are a holding company with no business operations of our own, our ability to pay dividends to stockholders largely depends on dividends and other distributions from our insurance subsidiaries, Palomar Specialty Insurance Company and Palomar Re. State insurance laws, including the laws of Oregon and California, and the laws of Bermuda restrict the ability of Palomar Specialty Insurance Company and Palomar Re, respectively, to declare stockholder dividends. State insurance regulators require insurance companies to maintain specified levels of statutory capital and surplus. The maximum dividend distribution absent the approval or non-disapproval of the insurance regulatory authority in Oregon and California is limited by Oregon law at ORS 732.576 and California law at Cal. Ins. Code 1215.5(g). Dividend payments are further limited to that part of available policyholder surplus that is derived from net profits on our business. State insurance regulators have broad powers to prevent the reduction of statutory surplus to inadequate levels, and there is no assurance that dividends up to the maximum amounts calculated under any applicable formula would be permitted. Moreover, state insurance regulators that have jurisdiction over the payment of dividends by Palomar Specialty Insurance Company may in the future adopt statutory provisions more restrictive than those currently in effect.

Our Bermuda reinsurance subsidiary is highly regulated and is required to comply with various conditions before it is able to pay dividends or make distributions to us. Bermuda law, including the Insurance Act 1978, as amended (“Insurance Act”) and the Companies Act 1981, as amended (“Companies Act”) impose restrictions on our Bermuda reinsurance subsidiary’s ability to pay dividends to us based on solvency margins and surplus and capital requirements. These restrictions, and any other future restrictions adopted by the BMA, could have the effect, under certain circumstances, of significantly reducing dividends or other amounts payable to us by our Bermuda reinsurance subsidiary without affirmative approval of the BMA.

Any determination to pay dividends in the future will be at the discretion of our Board of Directors and will depend upon results of operations, financial condition, restrictions imposed by applicable law and other factors our Board of Directors deems relevant. Consequently, investors may need to sell all or part of their holdings of our common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking immediate cash dividends should not purchase our common stock.

Our operating results have in the past varied from quarter to quarter and may not be indicative of our long-term prospects.

Our operating results are subject to fluctuation and have historically varied from quarter to quarter. We expect our quarterly results to continue to fluctuate in the future due to a number of factors, including the general economic conditions in the markets where we operate, the frequency of occurrence or severity of catastrophe or other insured events, fluctuating interest rates, claims exceeding our loss reserves, competition in our industry, deviations from expected premium retention rates of our existing policies and contracts, adverse investment performance, and the cost of reinsurance coverage. Additionally, the rapid development and fluidity of the Pandemic precludes any prediction as to the ultimate impact of COVID-19 on our business. The full extent of the impact and effects of COVID-19 on our business, operations, liquidity, financial condition and results of operations remain uncertain at this time.

We seek to underwrite products and make investments to achieve favorable returns on tangible stockholders' equity over the long term. Our opportunistic nature and focus on long-term growth in tangible equity may result in fluctuations in gross written premiums from period to period as we concentrate on underwriting contracts that we believe will generate better long-term, rather than short-term, results. Accordingly, our short-term results of operations may not be indicative of our long-term prospects.

We may act based on inaccurate or incomplete information regarding the accounts we underwrite.

We rely on information provided by insureds or their representatives when underwriting insurance policies. While we may make inquiries to validate or supplement the information provided, we may make underwriting decisions based on incorrect or incomplete information. It is possible that we will misunderstand the nature or extent of the activities or facilities and the corresponding extent of the risks that we insure because of our reliance on inadequate or inaccurate information.

Our employees could take excessive risks, which could negatively affect our financial condition and business.

As an insurance enterprise, we are in the business of binding certain risks. The employees who conduct our business, including executive officers and other members of management, underwriters, product managers and other employees, do so in part by making decisions and choices that involve exposing us to risk. These include decisions such as setting underwriting guidelines and standards, product design and pricing, determining which business opportunities to pursue, and other decisions. We endeavor, in the design and implementation of our compensation programs and practices, to avoid giving our employees incentives to take excessive risks. Employees may, however, take such risks regardless of the structure of our compensation programs and practices. Similarly, although we employ controls and procedures designed to monitor employees' business decisions and prevent them from taking excessive risks, these controls and procedures may not be effective. If our employees take excessive risks, the impact of those risks could have a material adverse effect on our financial condition and business operations.

We may require additional capital in the future, which may not be available or may only be available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Many factors will affect the amount and timing of our capital needs, including our growth rate and profitability, our claims experience, and the availability of reinsurance, market disruptions, and other unforeseeable developments. If we need to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our stockholders could result. In the case of debt financings, we may be subject to covenants that restrict our ability to freely operate our business. In any case, such securities may have rights, preferences and privileges that are senior to those of the shares of common stock offered hereby. If we cannot obtain adequate capital on favorable terms or at all, we may not have sufficient funds to implement our operating plans and our business, financial condition or results of operations could be materially adversely affected.

We may not be able to manage our growth effectively.

We intend to grow our business in the future, which could require additional capital, systems development and skilled personnel. However, we must be able to meet our capital needs, expand our systems and our internal controls effectively, allocate our human resources optimally, identify and hire qualified employees and effectively incorporate the components of any businesses we may acquire in our effort to achieve growth. The failure to manage our growth effectively could have a material adverse effect on our business, financial condition and results of operations.

If actual renewals of our existing contracts do not meet expectations, our written premium in future years and our future results of operations could be materially adversely affected.

Most of our contracts are written for a one-year term. In our financial forecasting process, we make assumptions about the rates of renewal of our prior year's contracts. The insurance and reinsurance industries have historically been cyclical businesses with intense competition, often based on price. If actual renewals do not meet expectations or if we choose not to write a renewal because of pricing conditions, our written premium in future years and our future operations would be materially adversely affected.

We may change our underwriting guidelines or our strategy without stockholder approval.

Our management has the authority to change our underwriting guidelines or our strategy without notice to our stockholders and without stockholder approval. As a result, we may make fundamental changes to our operations without stockholder approval, which could result in our pursuing a strategy or implementing underwriting guidelines that may be materially different from the strategy or underwriting guidelines described in our public filings.

The effects of litigation on our business are uncertain and could have an adverse effect on our business.

As is typical in our industry, we continually face risks associated with litigation of various types, including disputes relating to insurance claims under our policies as well as other general commercial and corporate litigation. Although we are not currently involved in any material litigation with our customers, other members of the insurance industry are the target of class action lawsuits and other types of litigation, some of which involve claims for substantial or indeterminate amounts, and the outcomes of which are unpredictable. This litigation is based on a variety of issues, including insurance and claim settlement practices. We cannot predict with any certainty whether we will be involved in such litigation in the future or what impact such litigation would have on our business.

Changes in accounting practices and future pronouncements may materially affect our reported financial results.

Developments in accounting practices may require us to incur considerable additional expenses to comply, particularly if we are required to prepare information relating to prior periods for comparative purposes or to apply the new requirements retroactively. Our consolidated financial statements are prepared in accordance with Generally Accepted Accounting Principles ("GAAP"). The impact of changes in GAAP cannot be predicted but may affect the calculation of net income, stockholders' equity and other relevant financial statement line items.

In addition to compliance with GAAP on a consolidated basis, our U.S. insurance subsidiary, Palomar Specialty Insurance Company, is required to comply with statutory accounting principles ("SAP"). SAP and various components of SAP are subject to constant review by the NAIC and its task forces and committees, as well as state insurance departments, in an effort to address emerging issues and otherwise improve financial reporting. Various proposals are pending before committees and task forces of the NAIC, some of which, if enacted, could have negative effects on insurance industry participants. The NAIC continuously examines existing laws and regulations. We cannot predict whether or in what form such reforms will be enacted and, if so, whether the enacted reforms will positively or negatively affect us.

We rely on the use of credit scoring in pricing and underwriting certain of our insurance policies and any legal or regulatory requirements that restrict our ability to access credit score information could decrease the accuracy of our pricing and underwriting process and thus decrease our ability to be profitable.

We use credit scoring as a factor in pricing and underwriting decisions where allowed by state law. Consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against some groups of people and are calling for laws and regulations to prohibit or restrict the use of credit scoring in underwriting and pricing. Laws or regulations that significantly curtail or regulate the use of credit scoring, if enacted in a large number of states in which we operate, could impact the integrity of our pricing and underwriting processes, which could, in turn, materially and adversely affect our business, financial condition, results of operations and prospects, and make it harder for us to be profitable over time.

Risks Related to Ownership of Our Common Stock

Genstar Capital owns a significant amount of our common stock and has the ability to exert significant influence over us and our corporate decisions.

Genstar Capital currently controls approximately 14.6% of our common stock. Currently, one of our directors, James Ryan Clark, is affiliated with Genstar Capital. Mr. Clark has fiduciary duties to us and, in addition, has duties to Genstar Capital. As a result, Mr. Clark may face real or apparent conflicts of interest with respect to matters affecting both us and Genstar Capital, whose interests may be adverse to ours in some circumstances

In addition, we are party to a Stockholders Agreement with Genstar Capital that permits Genstar Capital to exert influence over us and our corporate decisions. The Stockholders Agreement specifies that until such time as Genstar Capital beneficially owns less than 10% of our outstanding common stock we will not take certain significant actions specified therein without the prior written consent of Genstar Capital, including, but not limited to, (i) amendments or modifications to our or our subsidiaries' organizational documents in a manner that adversely affects Genstar Capital, (ii) making any payment or declaration of any dividend or other distribution on any shares of our common stock, (iii) merging or consolidating with or into any other entity, or transferring all or substantially all of our or our subsidiaries' assets, taken as a whole, to another entity, or entering into or agreeing to undertake any transaction that would constitute a "Change of Control" as defined in our or our subsidiaries' credit facilities, (iv) other than in the ordinary course of business with vendors, customers and suppliers, entering into or effecting any (A) acquisition by us or any of our subsidiaries of the equity interests or assets of any person, or the acquisition by us or any of our subsidiaries of any business, properties, assets, or person, in one transaction or a series of related transactions or (B) disposition of assets of us or any of our subsidiaries or the shares or other equity interests of any of our subsidiary, in each case where the amount of consideration for any such acquisition or disposition exceeds $15 million in any single transaction, or an aggregate amount of $30 million in any series of transactions during a calendar year, (v) undertaking any liquidation, dissolution or winding up, and (vi) changing the size of the Board of Directors.

Under the Stockholders Agreement, Genstar Capital has the right, but not the obligation, to nominate (a) 50% of our directors, as long as Genstar Capital beneficially owns 50% or more of our outstanding common stock, (b) 40% of our directors, as long as Genstar Capital beneficially owns 40% or more, but less than 50% of our outstanding common stock, (c) 30% of our directors, as long as Genstar Capital beneficially owns 30% or more, but less than 40% of our outstanding common stock, (d) 20% of our directors, as long as Genstar Capital beneficially owns 20% or more, but less than 30% of our outstanding common stock, (e) 10% of our directors, as long as Genstar Capital beneficially owns 10% or more, but less than 20% of our outstanding common stock, in each case rounded up to the nearest whole number of directors. If Genstar Capital is able to exert significant influence over our Board of Directors as a result of their nomination rights pursuant to the Stockholders Agreement, our other stockholders may have limited ability to influence corporate matters and, as a result, we may take actions that our other stockholders do not view as beneficial.

As a result of its ownership and the Stockholders Agreement, Genstar Capital is able to influence matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other extraordinary transactions. Genstar Capital may have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. The concentration of ownership could deprive stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and may ultimately affect the market price of our common stock. In addition, the requirement to obtain Genstar Capital's prior consent for certain transactions, including acquisitions and dispositions, may adversely impact our ability to operate our business or take advantage of certain opportunities.

We incur significant costs as a result of operating as a public company, and our management is required to devote substantial time to complying with public company regulations.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. We are subject to the reporting requirements of the Exchange Act, which require, among other things, that we file with the SEC annual, quarterly and current reports with respect to our business and financial condition and therefore we need to have the ability to prepare financial statements that comply with all SEC reporting requirements on a timely basis. In addition, we are subject to other reporting and corporate governance requirements, including certain requirements of and certain provisions of the Sarbanes-Oxley Act and the regulations promulgated thereunder, which impose significant compliance obligations upon us. In particular, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and, to the extent that we are no longer an "emerging growth company" as defined in the JOBS Act, our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management efforts. We must maintain accounting and financial staff and consultants with appropriate public company reporting, technical accounting, and internal control knowledge to satisfy the ongoing requirements of Section 404 and provide internal audit services.

The Sarbanes-Oxley Act and the Dodd-Frank Act, as well as new rules subsequently implemented by the SEC and Nasdaq, have increased regulation of, and imposed enhanced disclosure and corporate governance requirements on, public companies. Our efforts to comply with these evolving laws, regulations and standards increases our operating costs and divert management's time and attention from revenue-generating activities.

These requirements also place significant additional demands on our finance and accounting staff and on our financial accounting and information systems. We may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Other expenses associated with being a public company include increases in auditing, accounting and legal fees and expenses, investor relations expenses, increased directors' fees and director and officer liability insurance costs, registrar and transfer agent fees and listing fees, as well as other expenses. As a public company, we are required, among other things, to:

- prepare and file periodic reports and distribute other stockholder communications, in compliance with the federal securities laws and requirements of Nasdaq;
- define and expand the roles and the duties of our Board of Directors and its committees;
- institute comprehensive compliance and investor relations functions; and
- evaluate and maintain our system of internal control over financial reporting, and report on management's assessment thereof, in compliance with rules and regulations of the SEC and the Public Company Accounting Oversight Board.

We may not be successful in complying with these requirements, and compliance with them could materially adversely affect our business. The increased costs decrease our net income and may require us to reduce costs in other areas of our business or increase the prices of our products or services. For example, these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance. We cannot predict or estimate the amount or timing of additional costs we may incur to respond to these requirements. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, our Board committees or as executive officers.

In addition, if we fail to implement and maintain the required controls with respect to our internal accounting and audit functions, our ability to report our results of operations on a timely and accurate basis could be impaired. If we do not implement the required controls in a timely manner or with adequate compliance, we may be subject to sanctions or investigation by regulatory authorities, such as the SEC or Nasdaq. Any such action could harm our reputation and the confidence of investors in, and clients of, our company and could negatively affect our business and cause the price of our shares of common stock to decline.

We are required by Section 404 of the Sarbanes-Oxley Act to evaluate the effectiveness of our internal control over financial reporting. If we are unable to achieve and maintain effective internal controls, our operating results and financial condition could be harmed and the market price of our common stock may be negatively affected.

As a public company with SEC reporting obligations, we are required to document and test our internal control procedures to satisfy the requirements of Section 404(b) of the Sarbanes-Oxley Act, which requires annual assessments by management of the effectiveness of our internal control over financial reporting. We are an emerging growth company, and thus we are exempt from the auditor attestation requirement of Section 404(b) of Sarbanes-Oxley until such time as we no longer qualify as an emerging growth company. See also “We qualify as an emerging growth company, and any decision on our part to comply with reduced reporting and disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.” Regardless of whether we qualify as an emerging growth company, we will still need to implement substantial internal control systems and procedures in order to satisfy the reporting requirements under the Exchange Act and applicable requirements.

During the course of our assessment, we may identify deficiencies that we are unable to remediate in a timely manner. Testing and maintaining our internal control over financial reporting may also divert management’s attention from other matters that are important to the operation of our business. We may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404(b) of Sarbanes-Oxley. If we conclude that our internal control over financial reporting is not effective, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or their effect on our operations. Moreover, any material weaknesses or other deficiencies in our internal control over financial reporting may impede our ability to file timely and accurate reports with the SEC. Any of the above could cause investors to lose confidence in our reported financial information or our common stock listing on Nasdaq to be suspended or terminated, which could have a negative effect on the trading price of our common stock.

We qualify as an emerging growth company, and any decision on our part to comply with reduced reporting and disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.

We are an “emerging growth company,” and, for as long as we continue to be an emerging growth company, we currently intend to take advantage of exemptions from various reporting requirements applicable to other public companies but not to “emerging growth companies,” including, but not limited to, not being required to have our independent registered public accounting firm audit our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our registration statements, periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We will cease to be an emerging growth company upon the earliest of: (i) the end of the fiscal year following the fifth anniversary of the IPO; (ii) the first fiscal year after our annual gross revenue is $1.07 billion or more; (iii) the date on which we have, during the previous three-year period, issued more than $1.0 billion in non-convertible debt securities; or (iv) the end of any fiscal year in which the market value of our common stock held by non-affiliates exceeded $700 million as of the end of the second quarter of that fiscal year.

We cannot predict whether investors will find our common stock less attractive if we choose to rely on these exemptions while we are an emerging growth company. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and the price of our common stock may be more volatile.

Under the JOBS Act, emerging growth companies can also delay adopting new or revised accounting standards until such time as those standards apply to private companies. We plan to avail ourselves of this exemption from new or revised accounting standards and, therefore, we may not be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

Our operating results and stock price may be volatile, or may decline regardless of our operating performance, and holders of our common stock could lose all or part of their investment.

Our quarterly operating results are likely to fluctuate in the future as a publicly traded company. In addition, securities markets worldwide have experienced, and are likely to continue to experience, significant price and volume fluctuations. This market volatility, as well as general economic, market or political conditions, could subject the market price of our shares to wide price fluctuations regardless of our operating performance. Although we believe we have adequate sources of liquidity over the short- and long-term, the success of our operations, the global economic outlook, and the pace of sustainable growth in our markets, in each case, in light of the market volatility and uncertainty as a result of the Pandemic, among other factors, could impact our business and liquidity. You should consider an investment in our common stock to be risky, and you should invest in our common stock only if you can withstand a significant loss and wide fluctuation in the market value of your investment. The market price of our common stock is likely to continue to be subject to significant fluctuations in response to the factors described in this “Risk Factors” section and other factors, many of which are beyond our control. Among the factors that could affect our stock price are:

- market conditions in the broader stock market;
- actual or anticipated fluctuations in our quarterly financial and operating results;
- introduction of new products or services by us or our competitors;
- issuance of new or changed securities analysts’ reports or recommendations;
- results of operations that vary from expectations of securities analysis and investors;
- short sales, hedging and other derivative transactions in our common stock;
- guidance, if any, that we provide to the public, any changes in this guidance or our failure to meet this guidance;
- strategic actions by us or our competitors;
- announcement by us, our competitors or our acquisition targets;
- sales, or anticipated sales, of large blocks of our stock, including by our directors, executive officers and principal stockholders;
- additions or departures in our Board or Directors, senior management or other key personnel;
- regulatory, legal or political developments;
- public response to press releases or other public announcements by us or third parties, including our filings with the SEC;
- litigation and governmental investigations;
- changing economic conditions, including those caused by the Pandemic;
- changes in accounting principles;
- any indebtedness we may incur or securities we may issue in the future;
- default under agreements governing our indebtedness;

- exposure to capital and credit market risks that adversely affect our investment portfolio or our capital resources;
- changes in our credit ratings;
- exchange rate fluctuations; and
- other events or factors, including those from natural disasters, war, pandemics, acts of terrorism, or responses to these events.

The securities markets have from time to time experienced extreme price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of particular companies. As a result of these factors, investors in our common stock may not be able to resell their shares at or above the price at which they purchased their shares. These broad market fluctuations, as well as general market, economic and political conditions, such as recessions, loss of investor confidence or interest rate changes, may negatively affect the market price of our common stock.

In addition, the stock markets, including Nasdaq, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to securities class action litigation that, even if unsuccessful, could be costly to defend, divert management's attention and resources or harm our business.

Our certificate of incorporation provides that Genstar Capital has no obligation to offer us corporate opportunities.

Genstar Capital and the member of our Board of Directors who is affiliated with Genstar Capital, by the terms of our certificate of incorporation, will not be required to offer us any corporate opportunity of which they become aware and could take any such opportunity for themselves or offer it to other companies in which they have an investment, unless such opportunity is expressly offered to them solely in their capacity as our directors. We, by the terms of our certificate of incorporation, expressly renounce any interest in any such corporate opportunity to the extent permitted under applicable law, even if the opportunity is one that we would reasonably be deemed to have pursued if given the opportunity to do so. Our certificate of incorporation cannot be amended to eliminate our renunciation of any such corporate opportunity arising prior to the date of any such amendment. Genstar Capital is in the business of making investments in portfolio companies and may from time to time acquire and hold interests in businesses that compete with us, and Genstar Capital has no obligation to refrain from acquiring competing businesses. Any competition could intensify if an affiliate or subsidiary of Genstar Capital were to enter into or acquire a business similar to ours. These potential conflicts of interest could have a material adverse effect on our business, financial condition, results of operations or prospects if attractive corporate opportunities are allocated by Genstar Capital to itself, its portfolio companies or its other affiliates instead of to us.

Anti-takeover provisions in our organizational documents could delay a change in management and limit our share price.

Provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to acquire control of us even if such a change in control would increase the value of our common stock and prevent attempts by our stockholders to replace or remove our current Board of Directors or management.

Our charter documents contain anti-takeover provisions that will hinder takeover attempts and could reduce the market value of our common stock or prevent sale at a premium. Our anti-takeover provisions:

- permit the Board of Directors to establish the number of directors and fill any vacancies and newly created directorships;
- provide that our Board of Directors are classified into three classes with staggered, three year terms and that directors may only be removed for cause;
- require super-majority voting to amend provisions in our certificate of incorporation and bylaws;

- include blank-check preferred stock, the preference, rights and other terms of which may be set by the Board of Directors and could delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise benefit our stockholders;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- specify that special meetings of our stockholders can be called only by our Board of Directors, the chairman of our Board of Directors, or our chief executive officer;
- prohibit stockholder action by other than unanimous written consent;
- provide that vacancies on our Board of Directors may be filled only by a majority of directors then in office, even though less than a quorum;
- prohibit cumulative voting in the election of directors; and
- establish advance notice requirements for nominations for election to our Board of Directors or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, (excluding Genstar Capital), from merging or combining with us for a period of time.

Our certificate of incorporation and bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Our certificate of incorporation and bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for the following civil actions:

- any derivative action or proceeding brought on our behalf;
- any action asserting a claim of breach of a fiduciary duty by any of our directors, officers, employees or agents or our stockholders;
- any action asserting a claim arising pursuant to any provision of the DGCL or our certificate of incorporation or bylaws or as to which the DGCL confers jurisdiction on the Court of Chancery of the State of Delaware;
- any action to interpret, apply, enforce or determine the validity of our certificate of incorporation or our bylaws; or
- any action asserting a claim governed by the internal affairs doctrine.

However, this provision would not apply to suits brought to enforce a duty or liability created by the Exchange Act. Furthermore, this provision applies to Securities Act claims and Section 22 of the Securities Act creates concurrent jurisdiction for federal and state courts over all suits brought to enforce any duty or liability created by the Securities Act or the rules and regulations thereunder. Accordingly, there is uncertainty as to whether a court would enforce such provision, and our stockholders will not be deemed to have waived our compliance with the federal securities laws and the rules and regulations thereunder. This choice of forum provision, if enforced, may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and other employees, although our stockholders will not be deemed to have waived our compliance with federal securities laws and the rules and regulations thereunder. Alternatively, if a court were to find the choice of forum provision contained in our certificate of incorporation and bylaws to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could have a material adverse effect on our business, financial condition or results of operations.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends, in part, on the research and reports that securities or industry analysts publish about us or our business and our industry. If one or more of the analysts who cover us downgrades our common stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our common stock could decrease, which could cause our stock price and trading volume to decline.

Applicable insurance laws may make it difficult to effect a change of control.

Under applicable Oregon and California insurance laws and regulations, no person may acquire control of a domestic insurer until written approval is obtained from the state insurance commissioner following a public hearing on the proposed acquisition. Such approval would be contingent upon the state insurance commissioner's consideration of a number of factors including, among others, the financial strength of the proposed acquiror, the acquiror's plans for the future operations of the domestic insurer and any anti-competitive results that may arise from the consummation of the acquisition of control. Oregon and California insurance laws and regulations pertaining to changes of control apply to both the direct and indirect acquisition of ten percent or more of the voting stock of an Oregon-domiciled or California-domiciled insurer. Accordingly, the acquisition of ten percent or more of our common stock would be considered an indirect change of control of Palomar Holdings, Inc. and would trigger the applicable change of control filing requirements under Oregon and California insurance laws and regulations, absent a disclaimer of control filing and its acceptance by the Oregon and California Insurance Departments. These requirements may discourage potential acquisition proposals and may delay, deter or prevent a change of control of Palomar Holdings, Inc., including through transactions that some or all of the stockholders of Palomar Holdings, Inc. might consider to be desirable. See also "Regulation—Changes of Control."

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None

Use of Proceeds

In April 2019, we closed our Initial Public Offering (IPO) and received net proceeds of approximately $87.4 million, after deducting underwriting discounts and commissions and offering costs.

There has been no material change in the expected use of the net proceeds from our IPO, as described in our final Prospectus filed with the SEC on April 17, 2019 pursuant to Rule 424(b).

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Palomar Holdings, Inc.

Date: May 6, 2020

By: /s/ Mac Armstrong
Mac Armstrong
Chief Executive Officer
(Principal Executive Officer)

Date: May 6, 2020

By: /s/ T. Christopher Uchida
T. Christopher Uchida
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 31.1

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Mac Armstrong, certify that:

1. I have reviewed this report on Form 10-Q of Palomar Holdings, Inc.;

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

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant is made known to me by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ Mac Armstrong
Mac Armstrong
Chief Executive Officer

Exhibit 31.2

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, T. Christopher Uchida, certify that:

1. I have reviewed this report on Form 10-Q of Palomar Holdings, Inc.;

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

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant is made known to me by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ T. Christopher Uchida
T. Christopher Uchida
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Palomar Holdings, Inc. (the "Company") for the quarter ended March 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Mac Armstrong, as Chief Executive Officer of the Company, and T. Christopher Uchida, Chief Financial Officer, hereby certify pursuant to Title 18, Chapter 63, Section 1350 of the United States Code, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 6, 2020	By: /s/ Mac Armstrong Name: Mac Armstrong Title: Chief Executive Officer (Principal Executive Officer)
Date: May 6, 2020	By: /s/ T. Christopher Uchida Name: T. Christopher Uchida Title: Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)