Third Quarter 2020 Earnings Call Transcript
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PRESENTATION

Operator

Good morning, and welcome to the Palomar Holdings, Inc. Third Quarter 2020 Earnings Conference Call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference line will be opened for questions, with instructions to follow at that time. As a reminder, this conference call is being recorded.

I would now like to turn the call over to Mr. Chris Uchida, Chief Financial Officer. Please go ahead, sir.

Chris Uchida

Thank you, Operator, and good morning everyone.

We appreciate your participation in our third quarter 2020 earnings call. With me here today is Mac Armstrong, our Chairman, Chief Executive Officer and Founder. As a reminder, a telephonic replay of this call will be available on the Investor Relations section of our website through 11:59 p.m. Eastern Time on November 18, 2020.

Before we begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These include remarks about Management's future expectations, beliefs, estimates, plans and prospects. Such statements are subject to a variety of risks, uncertainties and other factors that could cause actual

results to differ materially from those indicated or implied by such statements, including, but not limited to, risks and uncertainties relating to the COVID-19 pandemic. Such risks and other factors are set forth in our quarterly report on Form 10-Q that will be filed with the Securities and Exchange Commission. We do not undertake any duty to update such forward looking statements.

Additionally, during today's call, we will discuss certain non-GAAP measures, which we believe are useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with U.S. GAAP. A reconciliation of these non-GAAP measures to their most comparable GAAP measure can be found in our earnings release.

At this point, I'll turn the call over to Mac.

Mac Armstrong

Thank you, Chris, and good morning, everyone. I hope those of you with us today continue to be safe and healthy.

Today I'll speak to our third quarter results at a high level and speak to our operations, before turning the call over to Chris to discuss the financial results in more detail.

For the third quarter ended September 30, 2020, we experienced several notable achievements.

First, the momentum of our business remained strong as evident in our year-over-year gross written premium growth of 55.4%, a figure that included meaningful growth across several product lines as we increased our position as a specialty insurance leader.

Second, Palomar Excess & Surplus Insurance Company, or "PESIC", our newly established Surplus Lines insurer, launched in August and bound policies across several lines of business during the third quarter. We believe PESIC will only enhance our ability to pursue profitable growth and respond favorably to a further hardening rate environment.

Third, during the quarter we continued to expand our distribution network, executing several new partnerships in lines like Residential Earthquake and Flood, and rolled out new products to existing and new distribution partners.

Fourth, we sustained our commitment to building a world class team and grew our headcount by 10%. Among the key additions to our team, we welcomed Jason Sears, an experienced E&S, Casualty and Programs Insurance Executive, as Senior Vice President of Programs, to lead our Program business as well as the scaling and diversification of PESIC.

Lastly, and subsequent to quarter end, we formally launched our ESG Committee of the Board of Directors, which will not only help articulate and measure the Company's values but reinforce Palomar's reputation as a forward thinking employer and partner.

Turning to the third quarter, our country experienced an unusual frequency of severe weather, from the Midwest derecho to an unprecedented windstorm season to the devastating wildfires in our home state of California. Palomar and our policyholders were impacted by the spate of hurricanes that made landfall in the United States, including Hurricanes Hanna, Isaias, Laura, Sally and Beta. I am very proud of our team's rapid response as we worked to help our policyholders and their communities recover from these damaging events. Our swift actions are best exemplified by the fact that at the time of this report 87% of our Specialty Homeowners claims from the aforementioned storms are closed or settled. Due in large part to the impact from losses associated with these events, during the third quarter we reported a net loss of $15.7 million, compared to net income of $7.5 million in the third quarter of 2019. This result is

disappointing as it clouds the results of an otherwise strong quarter, more so for our lines of business not exposed to the Gulf of Mexico, approximately 80%.

While we could go on about the incredibly low probability of the 2020 wind season and how the hard market will allow us to take rate and recoup our losses, and that is something we intend to do, I want to discuss the improvements we have begun to execute. Palomar's culture is premised on continuous improvement, problem solving and agility; it is also analytically-driven. As such we will apply the data we have gathered and lessons we have learned across our Organization to improve and enhance our underwriting, analytics and risk transfer operations, and moreover drive consistency in results and predictability in earnings.

As we learn and grow as a business, we will rigorously optimize our Reinsurance program, product suite and geographic mix in light of market opportunity, risk-adjusted return on capital and payback analysis. With respect to Palomar's Reinsurance program, we will look to implement new coverages that further protect the balance sheet and earnings stream from severe and frequent events. It is worth highlighting that Palomar secured incremental Reinsurance coverage in October that preserved our $10 million per event retention through June 1, 2021. As it pertains to underwriting and exposure management, in October we decided to exit Commercial All Risk on admitted basis in Alabama, Louisiana and Mississippi, as well as Specialty Homeowners in Louisiana. Additionally, we are reducing our exposure to risks with a short proximity to the coast for Commercial All Risk. These actions, among others, reflect our focus on remaining agile, preserving our ability to invest in our core markets and new initiatives like PESIC, and importantly, achieve the requisite payback from a catastrophe for Palomar, our Investors and our reinsurance partners. We feel the achievability of these measures are feasible in light of what we expect will be an incrementally harder insurance market.

Operationally, we remain fairly insulated from COVID-19 and continue to believe the pandemic will not have a material impact on our profitability or growth. It is our belief that our exposure to business interruption remains negligible, as our Commercial Property policies require loss from physical damage to the property from the named peril and feature virus exclusions.

Turning to third quarter results, we experienced meaningful growth across several product lines as we expanded our position as a specialty insurance leader, driven specifically by our newer lines of business like Inland Marine, which experienced growth of 316% during the third quarter. Our Builder's Risk and Motor Truck Cargo offerings continue to demonstrate strong traction and an encouraging market opportunity. Another major driver was our Commercial Earthquake business which grew 115% compared to the prior year period. Commercial lines growth was a function of new distribution sources, expanded geographic footprint, incremental product traction and most importantly, sustained pricing increases. Our third quarter Commercial policy average rate increase on renewals was 14.1% versus 14.2% in the second quarter

With respect to our Residential business, it is worth highlighting the growth of two products, Flood and Residential Earthquake. Flood grew 50% year-over-year across eleven geographically diverse states while Residential Earthquake grew 13% year-over-year with a prior year comparable in the third quarter of 2019 that saw a large surge in new business following the Ridgecrest earthquakes in July of that year.

During the third quarter, our book experienced premium retention rates of 90%, which increased from 88% achieved during the second quarter. Premium retention for our Residential and Commercial Earthquake, Hawaii Hurricane and Residential Flood lines of business were all in excess of 92%. This continues to be a testament to the unique value our products offer insureds and distribution partners.

Moving on to our newly launched E&S Company, PESIC, we expect it will add an additional dimension of capability and growth for Palomar. As previously described, PESIC will also enable us to further leverage our analytically driven underwriting framework to write business on a national scale and to insure certain risks that our admitted products cannot currently satisfy. For example, PESIC allows Palomar to compete

in the Layered and Shared Commercial Property market, an area where there is currently a high-level of market dislocation. In August, we entered into a new partnership with the Special Risk Underwriting division of leading wholesaler AMWINS, to underwrite and produce Layered and Shared Property business for PESIC. We certainly anticipate this partnership and PESIC on the whole will be a growth driver for 2021 and beyond.

Expanding our distribution network remains a key priority and we are proud of the progress we made during the quarter. During the third quarter, our retail and wholesale active producers increased 6% sequentially from the second quarter. Carrier partnerships continue to be a differentiated channel for our business, and in the third quarter we entered into multiple new partnerships including another Residential Earthquake partnership motivated by the continued dislocation of the California Homeowners market. Our flood business entered into a new partnership with Torrent Technologies, a flood insurance technology company and subsidiary of Marsh. The partnership will give Torrent's distribution access to our Residential Flood offering in the 11 states we currently write business. These relationships take time to develop, and we are proud to provide valuable solutions to other insurance carriers. Separately, we continued to execute our geographic expansion initiatives by growing the geographic footprint of our admitted carrier to 31 states across the nation.

We are also excited to announce the launch of our new Real Estate Errors and Omissions product offering. This is a line of business that our team has extensive prior experience with and we believe it will be a beneficial addition to our product suite.

As we grow PESIC and all of our business, we believe it is vital that we sustain investments in technology, analytics and talent. I already mentioned the growth of our team and the addition of Jason Sears to spearhead the execution of our Program and E&S efforts. The third quarter also included two developments within our existing Leadership team that we believe reflect the ongoing evolution and focus of our business and strategy. In early August, Jon Christianson, our former Chief Operating Officer, took the role of Chief Underwriting Officer. In concert with his promotion, we subsequently promoted our Chief Technology Officer, Britt Morries, to assume the role of Chief Operating Officer. The vital role that technology plays across Palomar and Britt's instrumental role in building out our technology team and platform made him a natural choice. We also expect to have Britt's replacement as CTO in place by the end of the first quarter.

Yesterday, we announced a renewal rights transaction with affiliates of GeoVera Holdings whereby Palomar will offer policies to all GeoVera Hawaii Residential Hurricane policyholders upon renewal. This transaction will considerably increase our footprint in the State of Hawaii, a market we first entered into in 2015, and have actively looked to deepen our presence.

Lastly, subsequent to quarter end, we formally launched our ESG and Diversity, Inclusion, Community Engagement and Equality, or "DICE", committees which will reaffirm and pursue our efforts and ongoing dedication to the environment, health and safety, corporate social responsibility, corporate governance, and sustainability. The ESG Committee will meet on a quarterly basis led by myself and Board members Daryl Bradley and Martha Notaras. This Committee will be responsible for holding the Company and Management accountable for our progress toward ESG goals as established by Palomar Management and in consultation with our team members. We believe that diversity, equality and inclusion yield greater organizational creativity and productivity, which helps us serve our customers and partners more effectively. Delivering on our diversity commitment returns greater value to our Shareholders and ultimately makes a positive impact on the communities in which we do business.

With that, I will turn the call over to Chris to discuss our results in more detail.

Chris Uchida

Thank you, Mac.

Please note that during my portion, when referring to any per share figure, I am referring to per diluted common share as calculated using the treasury stock method. This methodology requires us to exclude common share equivalents, such as outstanding stock options, during periods when we incur a net loss and include them in profitable periods. We have adjusted the calculations accordingly.

As you have seen in the earnings release, we have added new metrics describing our results including and excluding catastrophe losses. We believe that this additional information provides better visibility into our business and results. Going forward, we will continue to show these metrics.

For the third quarter of 2020, we reported a net loss of $15.7 million, or negative $0.62 per share, compared to net income of $7.5 million, or $0.31 per share, for the same quarter in 2019. On an adjusted basis, excluding catastrophe losses, our net income for the third quarter was $13.7 million, or $0.52 per share, compared to $9.6 million, or $0.40 per share, for the same quarter of 2019.

Gross written premiums for the third quarter were $103.0 million, representing an increase of 55.4% compared to the prior-year's third quarter. We continue to see healthy new business, rate increases and strong premium retention with contributions across all our product offerings.

Ceded written premiums for the third quarter were $41.6 million, representing an increase of 48.1% compared to the prior-year's third quarter. The increase was primarily due to an increase in Reinsurance expense commensurate with our growth. Our risk transfer strategy remains a critical component of our business, especially as we demonstrate sustained top-line growth. As we grow our business, we expect to incur additional excess of loss Reinsurance expense as we maintain a conservative level of overall coverage. As of June 1 of this year, we retained $10 million per earthquake or wind event, and we purchased $1.4 billion of total Reinsurance coverage for earthquake events. Additionally, after multiple hurricane events during the quarter, we purchased backup Reinsurance coverage maintaining our $10 million event retention. The additional expense of $6 million for this coverage began in the fourth quarter and will run through June 1 of 2021.

Net earned premiums for the third quarter were $42.0 million, an increase of 51.9% compared to the prior-year's third quarter. Our results improved primarily due to the earning of increased gross written premiums, offset by the earning of ceded written premiums under Reinsurance agreements. For the third quarter of 2020, net earned premiums as a percentage of gross earned premiums were 52.9% compared to 51.8% in the third quarter of 2019.

We believe the ratio of net earned premiums to gross earned premiums is a better metric for assessing our business versus the ratio of net written premiums to gross written premiums. As previously discussed last quarter, we expect that ratio to be around 53% to 54% on an annual basis, lower at the beginning of a new excess of loss treaty and higher at the end with our expected growth in earned premium. This quarter's results are in line with that expectation, but the additional expense for the backup Reinsurance layer will adjust the ratio slightly below the normalized level, beginning in the fourth quarter.

Commission and other income was $816,000 for the three months ended September 30, 2020 compared to $709,000 for the same period in 2019. The increase was primarily due to an increase in policy related fees associated with an increased volume of premiums written.

Losses and loss adjustment expenses, or LAE, incurred in the third quarter were $41.1 million compared to $2.4 million in the prior-year's third quarter. Our losses during the quarter were primarily the result of increased catastrophe activity from Hurricanes Hanna, Isaias, Laura, Sally, and Beta. We define catastrophe losses as certain losses resulting from events involving multiple claims and policyholders, including earthquakes, hurricanes, floods, convective storms, terrorist acts or other aggregating events.

This definition captures the catastrophes losses from this quarter and Hurricanes Harvey and Florence from previous periods. We had catastrophe losses of $36.5 million for the third quarter of 2020, within the range provided in October, a catastrophe loss ratio of 86.9%, compared to no catastrophe losses for the third quarter of 2019. Our loss ratio excluding catastrophe losses for the quarter was 10.8% compared to 8.8% in the third quarter of 2019. The increase in our attritional loss ratio is in line with the expectation that our loss ratio would increase with our growth, and as we diversify the book of business into lines like Inland Marine where there is attritional loss.

Our expense ratio for the third quarter of 2020 was 59.4% compared to 64.6% in the same quarter of 2019. As we have previously discussed, we expected the expense ratio to increase 2 to 2.5 points sequentially, compared to previous quarters, from structural changes to our SHF and investments in PESIC. These changes will not have a material impact on net income, but do impact our ratios such as the expense ratio, combined ratio, and net earned premium to gross earned premium ratio.

The combined ratio for the third quarter was 157.1% compared to a combined ratio of 73.4% for the prior-year's third quarter. Excluding the catastrophe losses in the quarter, our adjusted combined ratio was 68.9% for the third quarter, compared to 63.6% in the third quarter of 2019. We believe that given the unprecedented activity in the third quarter, this is a better measure of our results for comparison purposes, and offers a better sense of our business on a steady-state basis.

Net investment income for the third quarter was $2.1 million, an increase of 23.7% compared to the prior-year's third quarter. The increase was largely due to a higher average balance of investments during the three months ended September 30, 2020, due primarily to proceeds from our primary stock offerings during the period, as well as cash generated from operations. Funds are generally invested conservatively in high-quality securities, including government agency, asset- and mortgage-backed securities, municipal and corporate bonds with an average credit quality of A1/A+.

Our fixed income investment portfolio book yield during the third quarter was 2.33% compared to 2.90% for the third quarter of 2019. The weighted average duration of our fixed-maturity investment portfolio, including cash equivalents, was four years at quarter end. Cash and invested assets totaled $450 million at quarter end compared to $263.2 million at September 30, 2019. For the third quarter, we recognized realized and unrealized gains on investments in the consolidated statement of income of $24,400 compared to $361,000 in the prior-year's third quarter.

Our effective tax rate for the third quarter of 2020 was 28.2% compared to 21.1% for the third quarter of 2019; higher this quarter with the pre-tax loss in conjunction with the discrete tax deduction of stock related compensation. This would decrease the effective tax rate in periods of pre-tax income. Excluding any unforeseen events, we anticipate that our tax rate exclusive of discrete permanent items will settle around the 21% mark for the 2020 year.

Our Stockholders' equity was $361.9 million at September 30, 2020 compared to $218.6 million at December 31, 2019. For the third quarter of 2020, annualized return on equity was negative 17.0% compared to 14.6% during the third quarter of 2019. Our annualized adjusted return on equity excluding catastrophe losses during the third quarter was 14.8% compared to 18.8% during the third quarter of 2019. The change in annualized return on equity and annualized—and adjusted return on equity excluding catastrophe losses reflects a significant increase in the Company's stockholders' equity, primarily due to $125.5 million in capital raised across multiple stock offerings during 2020.

Looking to the remainder of the year, given the heightened CAT activity during the third quarter and into the fourth quarter, we are adjusting our full year 2020 outlook. We previously projected adjusted net income between $50.5 million and $53.0 million; this range did not assume any losses from major catastrophes as we define them. We are now anticipating, full year adjusted net income excluding catastrophe losses of $51.0 million to $52.0 million, which equates to a growth rate of 35% to 37% year

over year. These assumptions include the additional Reinsurance purchased and assume that there are no additional major losses from business interruption legislation.

As of September 30, 2020, we had 26,271,615 diluted shares outstanding as calculated using the treasury stock method. We do not anticipate a material increase to this number during the year ahead.

With that, I'd like to ask the Operator to open up the line for any questions. Operator?

Operator

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions. Thank you.

Our first question comes from the line of Matt Carletti with JMP securities. Please proceed with your question.

Matthew Carletti

Hi. Thanks. Good morning.

Mac, I was hoping you could maybe dive in a little bit deeper to your opening comments about some of the potential adjustments you're making to the book, kind of as you learn from the frequency of events that took place in the quarter. I appreciate kind of you walked through a few lines and talking about kind of on the primary side of exposure reduction.

Can you talk a little bit about maybe some of the reinsurance tools that might be available to you to help cap that as well? If those are things that you'd expect to kind of proceed with, or do you think that a lot of the actions you've taken on the inward side of the business would suffice?

Mac Armstrong

Hey, Matt, great to hear from you. Thanks for the question. It's a great one.

I think the sum and substance of it is we need to do both. We need to take the underwriting actions that I can go into more detail on, in addition to solve for the balance sheet protection, because if we do the first, the former, then we're going to be very successful in the latter. But we need to marry those two and put them together in concert. I think it starts with, when you look at our business we have the luxury of certain lines having terrific margins and terrific growth opportunity and growth prospects in front of them.

When you marry that with our culture, that's premised around problem solving, using data analytics to interpret data, I think what we try to do is be self-effacing and look to continuously improve. When you have the wind season like we did it gives you a pretty big lens into how the book is performing.

We have a target ROE on our individual products. It's in excess of what we deliver on an aggregated basis, because it's based on a net basis – a dollar capital, is a dollar capital. So when we looked at the third quarter, what we saw in the Commercial All Risk business, is that we were not going to hit the target ROE certainly with the losses, but moreover, not going to hit a target ROE in those markets that would generate sufficient CAT payback.

So if you think about it, if we're—we have a target ROI of 20%, we need to make sure that we can get over time an average ROE of 20% in states like Louisiana, Mississippi, and Alabama. So when we

applied that methodology, we just couldn't see a market opportunity that would get enough rate and have enough premium in that segment to generate the CAT payback. So that led us to take the steps that we've done like exiting Mississippi, Alabama, and Louisiana on the Commercial All Risk business, as well as exiting Specialty Homeowners in Louisiana.

Turning to Reinsurance, I think if we do that we are going to materially reduce our exposure in areas where we've generated loss. We're going to, in theory, reduce potential exposure just generally for wind storm. That will allow us to go down the path of not just buying insurance for severe events, but also protecting the balance sheet from multiple events.

What we will look to implement is either some type of an aggregate cover or a net quota share that really keeps losses from multiple events inside our retention. So as I said, what it's really incumbent upon is us doing the analytics, and making some tough choices, as well as making thoughtful, informed choices, that will reduce our exposure, improve the underlying results from an underwriting standpoint, and then furthermore, protecting the balance sheet with new types of risk transfer that aren't just focused on major severe events, but also are potentially more frequent events.

Matthew Carletti

Great, and thank you for that. That's very well thought out as is usually the case.

Just one other quick one if I could. You mentioned a bit about buying the backup cover and keeping the per event retention at $10 million, or capping it at $10 million. Is that how we should think about delta in data and the potential impacts they might have in Q4? Or are there other items that work to that, might not be just kind of '20 on the high side?

Mac Armstrong

Yes, you should continue to assume that losses from a single event would be $10 million. We have secured incremental coverage, as Chris and I both pointed out, and that is kind of locked in and there is some incremental expense, but it's expense that we will happily incur to maintain that level of protection.

Matthew Carletti

Okay, great. Thank you for the answers and best of luck.

Mac Armstrong

Thanks, Matt.

Operator

Our next question comes from line of Paul Newsome with Piper Sandler. Please proceed with your question.

Paul Newsome

Good morning.

I was hoping you could give us a little bit more detail on any sort of numbers behind the expected growth rates of the firm. Obviously, quite stunning, over the last couple years. Then, as part of that, I assume that the run-off of the Commercial All Risk and Specialty Home insurances in those CAT prone lines will have at least some impact on the growth perspective, but can you give us a sense of maybe how big that would be?

Mac Armstrong

Sure, Paul, this is Mac.

What I would say is, first and foremost, we were pleased with the growth that we achieved in the quarter and a growth in core lines, like Residential Quake, Commercial Earthquake, newer lines, like in the Marine and Flood. We've also introduced some new partnerships and introduced some new products that are just getting off the ground. So we think there's considerable greenfield and growth in front of us that generate the target returns that we expect it and that you all, as Investors, expect from us, which candidly makes difficult decisions that we've made around shrinking the All Risk book easier, in some ways, as well as the small stuff that we're taking and exiting Louisiana, in Specialty Homeowners.

I think, it's really more of an effort to reduce exposure than reduced premium, those markets were not that large in totality, when you look at, state-by-state details of the filings—that's in a yellow book filing. So it will certainly—–the All Risk line, the growth rate will come down in that book. Certainly on the admitted side will contract, but there is ample growth in other segments. So whether it's PESIC, or the lines that I mentioned, that will more than compensate for it.

I think it's also worth pointing out that, while we took the decision to exit Louisiana on the Specialty Homeowners side of the business, the rest of that book is performing rather well, on a pretax basis. Texas, Mississippi, Alabama, the Carolinas, the states in which we write that, has a combined ratio inside of 80%. In certain states, it's less than 70%. So that book is well, and it grew rapidly in the third quarter. It's continuing to perform, and it is generating the requisite payback that we need to see for CAT exposure.

So long winded way of saying, I think there's adequate growth outside of All Risk. That book will come down, but we'll still feel very good about the growth prospects for '21 and beyond.

Paul Newsome

Great. My second question, I think we all expected as the book moved away from earthquakes that we would see the higher attritional ratios and —loss ratios overtime. But I don't think most of us built in any material CAT load, respectively. But as the businesses change, particularly with some of these new efforts, should we be thinking about some level of a CAT load in our expectations in 2021-2022?

Mac Armstrong

Paul, I'll let Chris chime in.

What I would say is, the way we define CAT is really going to be losses that are material and more than likely going to be resolved in Reinsurance losses. If you look to the third quarter of 2019, there were storms like Dorian, Marco and others. So, there will be CAT and PCS loss that is in our standard loss ratio, and that's reflected in the 10%-plus that we incurred on kind of a normalized basis on steady state basis. So, I think we still incur severe weather activity in our normal losses, because of the exposures that we write. But a storm like Laura or Sally is a different animal.

Chris, I'll let you offer your thoughts too.

Chris Uchida

Yes. I won't try to tell you exactly how to create your model, I think, generally, obviously, we are hyper focused on CAT and trying to mitigate the risks that it can cause in our book. But we generally do not put it into our model, and—it's also reflected in the way we give the guidance. We know that events happen,

but we aren't going to be some predictors of when they're going to happen, and the severity that they're going to hit us at.

So, we do not usually think about large CATs when we're doing our projections, because I think it would provide too much noise and say, oh, we think a CAT's going to happen in Q1. That didn't happen. Then we outperformed for that. That's not how we think about our book. We think about our book from an operational standpoint, and make sure that the core is doing everything that it needs to do. Then we build the model with Reinsurance, whether it be quota shares, access a lot; and then strategically with underwriting, to hope in to try and make sure that minimizes the volatility that those losses will have on our book.

We think about it, but we don't try and put it into our model to predict when it's going to happen. But like Mac said, we have included catastrophes, this quarter. We've backed out, some of them that are larger events, but the attritional loss ratio still does have losses from smaller events, whether it be the earthquake in Utah, or Cristobal earlier this year. So, there's other CAT-type events that are still in the attritional loss ratio. But it's really just the, what I call severe events that we've kind of separated from the rest of the book to kind of show that metric. I think we have a lot of faith in what we're doing and like Mac talked about, we're adjusting to try and protect the book. But it's really the core operations that we try and focus on, and think about with all those metrics, and then making sure that we're protected when a CAT does happen.

Mac Armstrong

Paul, the only thing that I would add, and Chris described that well, is that as we start to crystallize our thoughts on the net quota share or an aggregate, we will certainly inform you in terms of the cost that may be incremental to what's in kind of our model right now. But then also, what's the positive consequences of that in terms of potentially capping losses from a confluence of events, like we went through in the third quarter.

I think that might be a better way for us to help manage on a go forward basis is just what the shifting cost of Reinsurance and how much of that is associated with tapping, not just single event retention, but potentially some type of net quota share or aggregate dilution, that caps losses in totality from the peril.

Chris Uchida

So one other thing that I would add is that when we think about our historic numbers, the only other events would be Harvey and Florence that we'd be including in our CAT definition. So, in 2019, there was no CATs from the way, we would define them that would go into our results.

Paul Newsome

Right. Thank you very much. I will let some other folks ask questions. But appreciate the help.

Mac Armstrong

You got it.

Operator

Our next question comes from line of Mark Hughes with Truist Security. Please proceed with your question.

Mark Hughes

Thank you. Mac, you say that the lines of the accounts you're exiting are not that large. Can you give us a specific number on that?

Mac Armstrong

Well, I mean, I think they're large in terms of their TIV and their exposure. The total premium on a year-to-date in force basis for those states, on a Commercial basis is around $8.5 million. Mark?

Mark Hughes

Yes. Okay.

Mac Armstrong

Now it's going to in force at the end of September.

Mark Hughes

$8.5million dollars in force in force at September?

Mac Armstrong

Yes, and so—these are admitted policy, so they will come up for non-renewal, and so they will wind down over the course of the year. I think though, the one thing that's a little bit nebulous Mark is just the impact, that as we shift our appetite for writing certain risks on the coast and move further off the coast, that is not just limited to Mississippi, Alabama and Louisiana. That's going to be in all states, because what we saw from like a storm, like Hurricane Sally, where the expectation was that it wouldn't—whether it would intensify or just stall because it started moving basically three miles per hour so it stayed on the coast for an extended period of time, and did more damage from water than it did from wind, that informs our underwriting perspective on Coastal Risk.

Coastal Risk is, again, to all states in which we're riding in the Southeast, we’ll pull back from there. That's harder to gauge how much of that premium will be non-renewed, because it's not state specific.

Chris Uchida

One thing I'd like to add to that is, we—Mark, we’re focusing on the premium side of that. But we're thinking about this shift, more from a profitability standpoint. So, when we look at our target returns, we're taking out premium that is outside of our target return. So hopefully, when we do this move, it helps improve the overall net income and ROE of our current book.

Mac Armstrong

Yes, very good point.

Mark Hughes

The moratorium in California Homeowners, I think I saw something the other day, I'm not sure how broad it is. Does that make it a little more difficult to sell Residential Quake if there's a non-renewal quarter in place?

Mac Armstrong

Mark, I think it’s a very good question. My short answer is, it does not. Now, this is the second wave of moratoriums that California has put in place: the first one applied to, I think just under a million homes, I think around 850,000; this one's a little bit larger matter, we're close to double that. But if you look at our new business over the course of 2020, we wrote in more new business in 2020 for the first time this year than we did for 2019. That's even with the big pop that we saw in the third quarter of 2019 from the Ridgecrest earthquake.

I do not believe it's going to challenge our ability to sell Residential Earthquake in California. Frankly, the continued dislocation in the Homeowners market, whether there's a moratorium in certain segments, it's statewide, the wildfire season was longer. It was more dramatic and more pronounced and therefore more impactful, on the at a minimum of Homeowners insurers. So, the dislocation continues in there, and I think it's going to persist. I think, again, look no further than that the slew of partnerships that we continue to do in California with either new entrants on the E&S side, or incumbents that are looking to pull back in the market.

Mark Hughes

The GeoVera, why did they pursue a renewal right transaction? Is there any rate action that you need to take when you take over that book?

Mac Armstrong

Mark, I can't speak for GeoVera’s intention in their decision to exit the market. They were great to work with on this deal. We leapt at the opportunity to further bolster our presence in the market of Hawaii. It's one that we're now offering multiple products in Hawaii Hurricane and most notably in Flood and then some Builder’s Risk and Inland Marine. This deal gives us true ballast and critical mass in the market, it gives us the ability to convert approximately $17 million of premium onto our book. It's in a line that does not have attritional loss, in a line that's a great diversifier from our core Earthquake Reinsurance program. So, we're really excited about it.

Then to answer your question specifically, the rates are very comparable. So, we feel like we should have the ability to convert, and feel that the risk is adequately priced.

Mark Hughes

Thank you very much.

Mac Armstrong

Thank you.

Operator

As a reminder if you would like to ask a question, press star, one on your telephone keypad.

Our next question comes from line of David Motemaden with Evercore. Please proceed with your question.

David Motemaden

Hi, good morning, Mac.

I appreciate the commentary you've made on the underwriting actions that you've taken in All Risk and Specialty Home, exiting in those states. Then also in, I guess, writing further from the coast and the

remaining exposure. I guess I'm wondering if there is any sort of rule of thumb or any indication about the reduction in the PMLs that this will result in, or a reduction in TIV. Like it just in terms of any sort of way that we from the outside can gauge just how much the exposure has been reduced?

Mac Armstrong

Sure, Dave, and thanks for the questions. Those are good ones.

The PML that is going to come off from those states, it's not insignificant. It would probably constitute close to 15% of our total Wind PML. But that would also—and that's when you factor in Hawaii, Texas and the Carolinas. So, you now have a pretty good, diverse and uncorrelated mix.

What it does do is it gets rid of PML and AAL in a pretty correlated band, Mississippi, Alabama and Louisiana tend to correlate. So, we think that will allow us to reduce PML, it will reduce exposure, it will reduce correlated exposure. Additionally, just simplistically and I can tell that Jon Christianson and Jonathan Knutzen will roll their eyes when I say this, but it just kind of reduces targets as well, in targets, where we just don't think that there was a big enough market opportunity for us to generate the returns that we wanted.

So what I—if we have done like a kind of a roll forward, assuming kind of normal non-renewable cycles, by the middle and/or the height of one season next year, we will have less than a million of premium enforced in those markets. On the All Risk side, and there will still be some Residential business there.

David Motemaden

Got it. Okay. That's helpful. I guess just thinking about, obviously, it sounds like the rate momentum has been sustained at around 14% rate increases on the Commercial side. I guess I'm just wondering, in terms of—and I think you kind of alluded to this earlier Mac, just in terms of the additional rate that you think you can get to that would maybe offset the incremental cost of the Reinsurance, and I say this because I'm just looking at the book of business and I see 45%-ish of it is in Residential Earthquake where that is capped in terms of how much rate you can take, and you obviously, wouldn't be taking rate on that for wind risk in the Southeast U.S..

I guess, that's a long way of asking, do you think that you can get incremental rate on the Specialty Home side or on the Commercial All Risk side, that would offset the higher cost of Reinsurance?

Mac Armstrong

Yes, Dave, another, astute question. What I would say, let me answer it in a few different ways.

First and foremost, with respect to Commercial All Risk and the Wind exposed across all states, we're pushing more right now than 14% on the heels of the storms and the continued dislocation in the Property market, whether it's from wildfires, derechos, or obviously this wind season, we're not renewing an account, at less than 20%.

Furthermore, we now have the E&S company, which allows us to be even more assertive, if you would, in our renewals. That will allow us to further get more rate, provide more rate integrity and/or just better terms and conditions. So, I think we're going to see more rate. I think, as it relates to—that's on the Wind side. Commercial Earthquake we're continuing to drive rate there, 14% to 15%. There's a derivative impact of rising Reinsurance costs in market dislocations across Property that will allow us to maintain that level of rate as well and we're continuing to push mid-teen to high-teens rates on Quake.

We feel very good about the rates we're seeing in the Commercial business. I think it's important, though, to come back to, how we buy our Reinsurance outside of the new changes that we'll put in around some

type of aggregate or net quota share. We buy a considerable amount of Reinsurance to protect us from severe events. This was a season of severe events. But it's worth emphasizing that not a single event, the largest loss that we'll see, as we currently have booked on a gross basis is not going to go beyond. It's only going into our second layer Reinsurance, and it's inside of 14%, 15% of our total Wind limit.

So, we buy copious amounts, and we'll continue to do so. But I think it's more important that it does that 85% of the tower is going to be renewing the loss free, knock on wood, but it is right now as we sit here today as loss free. So, I think that gives us ample cushion to endure rate increases, which by the way we already paid at 6/1.

So, we've kind of already bear the brunt of that. So the combination of having loss free renewals, exposure that's come down because of the underwriting changes that we've made, and then a very, very conducive market to pushing rate in the primary side makes us feel like we can handle the rate increases that we'll see at 6/1, especially again, because a good portion of the renewal is in the loss rate.

Chris Uchida

One thing I might add Mac is, David, you were talking about the Residential Earthquake, and I believe we've talked about this before. The Residential Earthquake book does have an inflation guard on it. When you look at the overall retention above 90%, let's call it 90% of that book does get a 5% rate increase on an annual basis. So, it's not a zero percent rate increase. There is still some rate that we're getting on the Residential book. But like Mac said, it is loss free, when you look at it from the Reinsurance side as well.

David Motemaden

That's great color. I really appreciate that, guys. That's helpful detail.

If I could just ask just a quick one on just—overall growth continues to be very solid. I guess, I'm wondering how much of a contribution the E&S business had to this quarter's growth, if any, if much at all.

Mac Armstrong

Yes, fair question, Dave.

It was pretty modest. I think the E&S premium was in and around $9 million. We didn't launch it until August. That's when we really went to market. The majority of that was came from Commercial Quake. So, the new AmWINS program that we talked about that went live effective 8/1 in theory, but you put that business pretty far out in advance. Some of the new other partnerships that we entered into or new positions that we appointed, same thing applies.

So, with the exception of really Commercial Earthquake, everything else was really in its infancy. So, we feel pretty good about the prospects for Q4 and seeing the E&S company get traction.

David Motemaden

Yes, no, that one is sounds like there's a lot of momentum there. So, that's great. We'll stay tuned. Thanks a lot for the answers, guys.

Mac Armstrong

Thank you.

Operator

Our next question comes from line of Meyer Shields with KBW. Please proceed with your question.

Meyer Shields

Great, thanks. I guess first question, I was hoping if you could explain to me the mechanics of needing reinstatement premium I guess I naively I would have thought they would have to burn through like the whole $600 million one layer for that. So, can you explain what I'm missing please?

Mac Armstrong

So, Meyer the way we—what we have is, we have prepaid reinstatement. So essentially, we had let's just use our 20 excess of 10 layer. We—if we burn through $20 million excess of that $10 million from multiple events, we already had it reinstated. So, we basically had $40 million working for us, excess of $10 million to cover us for multiple events. That certainly applies here and we still have some of that limit in place for storms that have in the fourth quarter or earthquakes that just this happened in the future, plus then we procured another limit which is $20 million ex $10 million kind of backup the backfill that should that incremental $7 million, or excuse me, the incremental amount that's left in the $20 million ex $10 million or the $40 million blanket be totally subsumed.

Meyer Shields

Okay, so we don't have the entire tower doesn't drop down, or whatever would that be?

Mac Armstrong

No, yes, no, no, we had two limits. Yes, so we have certain layers at the top of the program that cascade down, but the—what we've done is we have reinstatements for those two layers, or those two limits, and then we bought incremental limits to backfill the two limits that we're using.

Meyer Shields

Okay, that's helpful. I don't think I had a sophisticated enough understanding. Another naive question, I guess, is it just unaffordable to maintain the pre $615 million cash point for Wind?

Mac Armstrong

Meyer, candidly, yes, with the size of the book, you would more than likely be paying a rate on lines that’s the equivalent to trading dollars. So, I think we're better served putting in some type of a net quota share or an aggregate that caps losses from multiple events at a certain level. So, that's certainly inside of what we experienced the third quarter. We could try to do it, but I just think the rate on lines would be pretty egregious.

Meyer Shields

Okay, that makes sense. Just finally, the reinstatement premium, did that impact written or earned premium at all in the third quarter, or is that all over the next three?

Chris Uchida

No, that's all over the next three. That was not placed until Q4.

Meyer Shields

Okay. Perfect. All right, thanks so much for the help.

Operator

Our next question comes from line of Adam Klauber with William Blair. Please do with your question.

Adam Klauber

Thanks. Can we talk a bit more about the rollout of PESIC? Again, you mentioned that third quarter is just getting going, fourth quarter is beginning to ramp up. Could you just for perspectives, given an idea of what's the submission levels you're seeing this quarter compared to last quarter?

Mac Armstrong

Adam, what I would tell you is that for one of our lines we wrote more last week than we did in totality of the quarter. So, it's really starting to scale for those partnerships that we entered into in Q3 and towards the end of Q3. There are several more that are forthcoming that will just be coming up to be brought online in Q4. So, it's really—submission count is somewhat negligible, but I think I could just give you kind of more anecdotal direction. I would expect us to see pretty rapid sequential growth.

Adam Klauber

Okay, and which products are being sold through PESIC?

Mac Armstrong

Right now, we are writing Commercial Earthquake, National Layered and Shared Property, which is Wind as well as Quake, and then Builder's Risk. We have a couple of new programs that will be coming along in line that will have a package of Property and Casualty components to them. But we'll give you a more color. But right now, what's really—what we wrote business in is really more Property kind of right up the middle for what we've done, Quake, Builder's Risk and kind of Layered and Shared Wind.

Adam Klauber

Okay. You mentioned the partnership with AmWINS, which is great, given AmWINS size. You were dealing with major wholesalers, AmWINs are cheap prior but on an admitted basis. Now obviously, are much more in the mainstream?

I guess could you just give some perspective that what slice of the pie did you have access before from those big wholesalers compared to what slice of the pie within your lines? Obviously, you're not doing Casualty, but within your lines? What slice of the pie do you think you have now compared to when you were just dealing with them on an admitted basis?

Mac Armstrong

What I would say Adam is, I'd really look at the wholesalers that we were working with kind of view us as a small- to mid-market account writer. That's what we're doing in All Risk and that's what we're doing in Commercial Quake with the E&S deal, we can—E&S company, we can write national schedules, we can write larger accounts where we're part of a slit, so to speak. So where we might be 10% of a $100 million account, we might be 10% of a $50 million account, when before we're only going to be—they'd only come to us for $10 million as a primary layer or standalone layer.

So it not only gives us access to a market segment, that's probably quintuple the size of where we have been in Commercial Quake or National Property, but it also allows us to kind of spread our limit more effectively, not be as concentrated as you are when you're writing kind of primary risks.

Adam Klauber

Right. Okay. Then as far as the ramp up, and we talked about near term, third quarter, very, very little. Fourth quarter again, it's much more from a sequential standpoint, but I mean, how many quarters does it really take to get deeper into, again, the AmWINS and RTs to really begin to match with their submission, which is quite sizable.

Mac Armstrong

Adam, that's a great question. I think it's also the nature, it's specific to the nature of the relationship. So us going and doing a business arrangement partnership with SRU means that you start to come on to their in force business, as well as seeing submissions from other offices that we're going to directly to our Commercial Quake or our Builder's Risk team. So, I think we can get scale with some partnerships quicker than getting just normal submission flow. So, that's been kind of our strategy. Let's get normal submission flow for our existing lines. But then let's enter into a handful of partnerships that can get us a percentage of an existing book of business.

That's why we're very excited about having someone like Jason Sears come into the Programs for us, because that allows us to go into existing lines where there are books of business that can be moved over, in addition, or are just located in addition to kind of normal submission flow. So that's our view of what SRU does.

Adam Klauber

Yes, that makes sense. Then this is sort of a bigger macro about the market, more E&S. But my sense is that the market has been more unbundling versus bundling, meaning that pick a carrier that they've grown the Wind, Earthquake, the Flood, and often thrown some of those coverages for free. I know in the last six to 12 months, what I've been hearing is that there's more of a nature to unbundle, separate those. So, I guess two questions is, one is that accel, is that unbundling accelerating, and two, does that favor Palomar and how does that favorite Palomar?

Mac Armstrong

Yes, that dynamic—Adam that dynamic is existing, it's accelerating, it's favorable to Palomar. I look no further than the Commercial Earthquake. We do 115% year-over-year, and a good reason for that is we are now able to go into Layered and Shared Property accounts that we previously did not have the ability to go into as an admitted insurer or were somewhat structurally limited in doing so. So, while we grew, the growth in third quarter is a lot faster, or was more pronounced than it was in the first half a year.

When you look at losses from all the property losses in this quarter, Wind, Fire, Midwestern Derechos, it only further sustained that dislocation and that unbundling and uncoupling.

Adam Klauber

Okay, great. Thank you.

Operator

Thank you. We have no further questions at this time. Mr. Armstrong, I would now like to turn the floor back over to you for closing comments.

Mac Armstrong

Great. Thank you, Operator, and thank you all for your time this morning.

This concludes Palomar's third quarter earnings call.

We appreciate the time and questions and as always your support. Although from a loss perspective, the third quarter was our toughest since inception, we did continue to experience very solid growth and I believe as we apply the lessons learned from this storm season, we will emerge stronger and better positioned, which will in turn further enhance the growth opportunities for the business. We will continue to focus on profitably growing Palomar and scaling Palomar's capabilities as we expand our reach and our product footprint. We are on this journey with our Investors and the team for the longer term and Palomar remains focused on delivering for all stakeholders.

Today is Veterans Day, I do want to thank all members of the armed forces for their service and all that they have done and continue to do for our country.

With that, I hope you all remain safe and healthy during this holiday season. Thanks very much and we'll speak to the fourth quarter. Have a great day.

Operator

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.