# FIRST ACCEPTANCE CORPORATION

3813 Green Hills Village Drive
Nashville, TN 37215

Telephone: (615) 844-2800

## QUARTERLY REPORT

**FOR THE QUARTER ENDED September 30, 2023**

**ISSUER'S EQUITY SECURITIES**

Common Stock
Par Value $.01 per share
75,000,000 Shares Authorized
38,161,487 Shares Outstanding at September 30, 2023

**First Acceptance Corporation is responsible for the content of this Quarterly Report. The securities described in this document are not registered with, and the information contained in this report has not been filed with, or approved by, the U.S. Securities and Exchange Commission.**

**FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES**
**TABLE OF CONTENTS**

This report reviews the financial condition and results of operations of First Acceptance Corporation. The information in this report updates the Annual Information and Disclosure Statement and Annual Report for the year ended December 31, 2022 previously filed by the Company with the OTCQX. Accordingly, this report should therefore be reviewed in conjunction with these year-end reports and any other interim reports or updates since provided.

**Forward-Looking Statements**

This report contains forward-looking statements. All statements made in this report, other than statements of historical fact, are forward-looking statements. You can identify these statements from our use of the words “may,” “should,” “could,” “potential,” “continue,” “plan,” “forecast,” “estimate,” “project,” “believe,” “intent,” “anticipate,” “expect,” “target,” “is likely,” “will,” or the negative of these terms and similar expressions. These forward-looking statements may include, among other things, statements and assumptions relating to:

- the accuracy and adequacy of our loss reserving methodologies;
- income (loss), income (loss) per share and other financial performance measures;
- the anticipated effects on our results of operations or financial condition from recent and expected economic developments;
- the financial condition of, and other issues relating to the strength of and liquidity available to, issuers of securities held in our investment portfolio;
- and our business and growth strategies.

We believe that our expectations are based on reasonable assumptions. However, these forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results to differ materially from our expectations of future results, performance or achievements expressed or implied by these forward-looking statements. In addition, our past results of operations do not necessarily indicate our future results. We discuss these and other uncertainties in “Risk Factors” of our Annual Report for the year ended December 31, 2022 filed by the Company with the OTCQX.

You should not place undue reliance on any forward-looking statements. These statements speak only as of the date of this report. Except as otherwise required by applicable laws, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this report, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report.

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

Name of the Company or Issuer:
First Acceptance Corporation

Address of Principal Office:
3813 Green Hills Village Drive
Nashville, TN 37215
Telephone: 615-844-2800
Web: www.acceptance.com

**Item 2. Shares Outstanding**

| Common shares | 9/30/2023 | 12/31/2022 |
|---|---|---|
| Authorized: | 75,000,000 shares | 75,000,000 shares |
| Outstanding: | 38,161,487 shares | 37,687,980 shares |
| Freely Tradable (public float): | 10,291,166 shares | 10,144,257 shares |
| Number of beneficial holders owning at least 100 shares: | approx. 1,200 holders | approx. 1,200 holders |
| Number of registered holders: | 239 holders | 236 holders |
| Preferred shares | | |
| Authorized: | 10,000,000 shares | 10,000,000 shares |
| Outstanding: | 0 shares | 0 shares |
| Freely Tradable (public float): | 0 shares | 0 shares |
| Number of record holders: | 0 holders | 0 holders |

**Item 3. Interim Consolidated Financial Statements**

The interim consolidated financial statements of First Acceptance Corporation as of September 30, 2023 are attached hereto as Exhibit 3.1 and are hereby incorporated by reference into this Quarterly Report, including:

(1) Consolidated Balance Sheets;
(2) Consolidated Statements of Operations;
(3) Consolidated Statements of Stockholders' Equity;
(4) Consolidated Statements of Cash Flows; and
(5) Notes to Consolidated Financial Statements

**Item 4. Management's Discussion and Analysis of Financial Condition and Consolidated Results of Operations**

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in "Risk Factors" in our Annual Report for year ended December 31, 2022 filed by the Company with OTCQX. The following discussion should be read in conjunction with our consolidated financial statements included with this report and our consolidated financial statements and related Management's Discussion and Analysis of Financial Condition and Results of Operations for year ended December 31, 2022 included in our Annual Report for the year ended December 31, 2022 filed by the Company with the OTCQX.

**General**

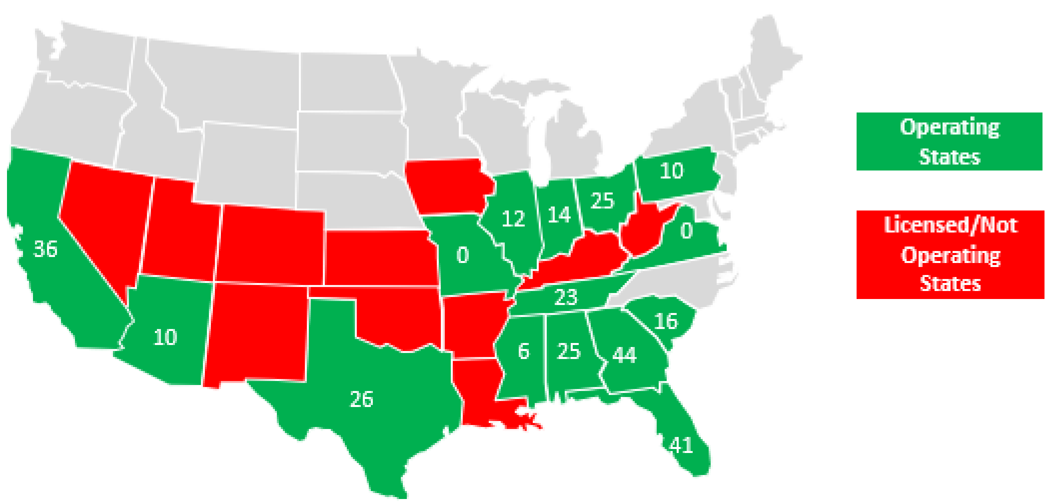
We own and operate "Acceptance Insurance," an insurance agency headquartered in Nashville, Tennessee. We operate under an "Agency Model" and sell insurance and related products underwritten and serviced by our own insurance companies, known as the First Acceptance Insurance Group, ("Acceptance business") and through third-party carriers for which we receive a commission ("3PC business"). We are also licensed to write insurance in 11 other states that are not currently utilized.

Acceptance Insurance primarily sells non-standard personal automobile insurance through our own insurance companies and third-party carriers. Non-standard personal automobile insurance is sought after by individuals because of their inability or unwillingness to obtain standard insurance coverage due to various factors including their payment preference, failure to have maintained continuous insurance coverage, or their driving record. We also offer a variety of other commissionable third-party products such as roadside assistance and in most states, we also sell an insurance product for renters that we underwrite. We believe that our agency-focused operations provide us with a variety of insurance alternatives for our core customers as well as the ability to provide products that suit other potential customers.

Acceptance Insurance currently leases and operates 288 retail locations (as presented below) staffed with employee-agents. In addition to our retail locations, we can complete sales over the phone through employee-agents in our call center or over the internet through our consumer-based website and mobile platform. (The states of Missouri and Virginia are internet and call center only.) Approximately 50% of our Acceptance business policies in force are now sold through independent agents as compared to 15% this time last year. Of this amount, 28% of total policies in force come from one independent agent who is engaged in a technology driven method of delivering insurance through an app that is commonly referred to as "Insurtech."

During the first nine months of 2023, we closed 36 unprofitable locations, primarily in Texas and Illinois. However, in 2023, the Company has worked actively to increase the number of appointed independent agents. This process is expected to continue in the future, and the Company believes that the variable cost structure of this sales channel will contribute towards reducing its expense ratio.

**Retail Locations by State**



**Consolidated Results of Operations**

***Overview***

Our insurance operations actively generate revenues from selling non-standard personal automobile insurance products. We currently conduct our servicing and underwriting operations in 15 states through three insurance company subsidiaries: First Acceptance Insurance Company, Inc., First Acceptance Insurance Company of Georgia, Inc. and First Acceptance Insurance Company of Tennessee, Inc., and as an insurance agency through Acceptance Insurance Agency of Tennessee, Inc. Our insurance revenues are primarily generated from:

- premiums earned, including policy and renewal fees, from sales of policies written and assumed by our insurance company subsidiaries;
- commission and fee income, including agency fees and commissions and fees for other ancillary products and policies sold on behalf of third-party insurance carriers;
- billing fees and service charges on policies written and assumed by our insurance company subsidiaries; and
- investment income earned on the invested assets of the insurance company subsidiaries.

The following tables present premiums earned by state (in thousands). Premiums earned are presented in the state in which the underlying insured risk of the related Acceptance business is located.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2023 | 2022 | 2023 | 2022 |
| Georgia | $ 31,199 | $ 14,832 | $ 76,817 | $ 40,242 |
| Florida | 27,703 | 11,001 | 65,170 | 28,501 |
| Alabama | 8,547 | 8,662 | 25,991 | 25,759 |
| California | 6,798 | 3,214 | 18,494 | 6,577 |
| South Carolina | 6,394 | 2,358 | 14,591 | 6,166 |
| Tennessee | 6,139 | 4,955 | 17,605 | 14,277 |
| Arizona | 5,030 | 1,764 | 12,294 | 4,047 |
| Pennsylvania | 4,536 | 2,342 | 10,668 | 6,590 |
| Texas | 4,151 | 2,112 | 9,183 | 6,053 |
| Ohio | 3,811 | 2,988 | 10,206 | 8,987 |
| Indiana | 2,247 | 1,869 | 5,925 | 5,776 |
| Mississippi | 1,638 | 1,394 | 4,427 | 4,236 |
| Illinois | 1,161 | 1,535 | 3,995 | 4,440 |
| Virginia | 72 | 73 | 231 | 244 |
| Missouri | 28 | 24 | 78 | 69 |
| | $ 109,454 | $ 59,123 | $ 275,675 | $ 161,964 |

Our insurance companies present a combined ratio as a measure of their overall underwriting profitability. The components of the statutory combined ratio are as follows:

*Loss Ratio* - Loss ratio is the ratio (expressed as a percentage) of losses and loss adjustment expenses ("LAE") incurred to premiums earned and is a basic element of underwriting profitability. We calculate this ratio based on all direct and assumed premiums earned, net of ceded reinsurance.

*Expense Ratio* - Expense ratio is the ratio (expressed as a percentage) of insurance operating expenses (including depreciation and amortization) to premiums earned. Insurance operating expenses are reduced by billing fees and service charges from insureds. This is a measurement that illustrates relative management efficiency in administering our insurance companies.

*Combined Ratio* - Combined ratio is the sum of the loss ratio and the expense ratio. If the combined ratio is at or above 100%, an insurance company cannot be profitable without sufficient investment income.

The following table presents the loss, expense, and combined ratios for our insurance companies:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2023 | 2022 | 2023 | 2022 |
| Loss | 69.1% | 85.5% | 70.6% | 80.0% |
| Expense | 23.8% | 32.0% | 26.8% | 30.0% |
| Combined | 92.9% | 117.5% | 97.4% | 110.0% |

***Three and Nine Months Ended September 30, 2023 Compared with the Three and Nine Months Ended September 30, 2022***

*Consolidated Results*

Revenues for the three months ended September 30, 2023 increased 74% to $133.6 million from $76.8 million in the same period in the prior year. Income before income taxes, for the three months ended September 30, 2023 was $9.4 million, compared with loss before taxes of $10.8 million for the three months ended September 30, 2022. Net income for the three months ended September 30, 2023 was $7.2 million, compared with net loss of $8.6 million for the three months ended September 30, 2022. Diluted net income per share was $0.19 for the three months ended September 30, 2023, compared with diluted net loss per share of $0.23 for the same period in the prior year.

For the three months ended September 30, 2023, we recognized unfavorable prior period loss and LAE development of $1.6 million compared with unfavorable prior period loss and LAE development of $5.4 million, for the same period in the prior year. Revenues and net income for the three months ended September 30, 2023 included $0.1 million in net losses on investments, compared with net losses of $0.4 million for the same period in the prior year.

Revenues for the nine months ended September 30, 2023 increased 61% to $344.2 million from $214.4 million in the same period in the prior year. Income before income taxes, for the nine months ended September 30, 2023 was $15.0 million, compared with loss before income taxes of $19.6 million for the nine months ended September 30, 2022. Net income for the nine months ended September 30, 2023 was $11.5 million, compared with net loss of $15.3 million for the nine months ended September 30, 2022. Diluted net income per share was $0.30 for the nine months ended September 30, 2023, compared with diluted net loss per share of $0.41 for the same period in the prior year.

For the nine months ended September 30, 2023, we recognized unfavorable prior period loss and LAE development of $1.3 million compared with unfavorable prior period loss and LAE development of $4.9 million, for the same period in the prior year. Revenues and net income for the nine months ended September 30, 2023 included $0.7 million in net gains on investments, compared with $1.2 million in net losses on investments for the same period in the prior year.

*Premiums Earned*

Premiums earned increased by $50.4 million, or 85%, to $109.5 million for the three months ended September 30, 2023, from $59.1 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, premiums earned increased by $113.7 million, or 70%, to $275.7 million from $162.0 million for the nine months ended September 30, 2022. These increases in premiums earned were driven significantly by the impact of recent premium rate increases and by an increase in the Acceptance policies in-force compared to the prior year, primarily as a result of the growth in the independent agent channel. The growth in this channel was driven by the growth and state expansion of the Company's largest independent agent who utilizes a technology driven "Insurtech" method of distribution.

The average in-force premium for Acceptance policies-in-force as of September 30, 2023 has increased 12% from the same period in the prior year and is expected to further increase as a result of the continuing impact of premium rate actions taken by the Company in response to the increase in loss severity in the latter half of 2022.

*Commission and Fee Income*

Commission and fee income increased by $1.5 million, or 11%, to $14.8 million for the three months ended September 30, 2023, from $13.3 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, commission and fee income increased by $ 4.4 million, or 11%, to $44.3 million from $39.9 million for the nine months ended September 30, 2022. This increase was primarily the result of an increase in agency fee income.

*Billing Fees and Service Charges*

Billing fees and service charges increased by $3.3 million, or 78%, to $7.4 million for the three months ended September 30, 2023, from $4.2 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, billing fees and service charges increased by $6.8 million, or 61%, to $17.9 million from $11.1 million for the nine months ended September 30, 2022. These increases were primarily the result of the increase in Acceptance business policies-in-force compared to the prior year.

*Investment Income*

Investment income increased by $1.5 million, to $2.1 million for the three months ended September 30, 2023, from $0.6 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, investment income increased $2.9 million, to $5.6 million, from $2.7 million for the same period in the prior year. These increases were primarily the result of higher yields on short term cash equivalents and fixed maturities as well as improved returns on other investments.

At September 30, 2023 and 2022, the tax-equivalent book yields for our managed fixed maturities and cash equivalents portfolio were 3.5% and 2.4%, respectively, with effective durations of 2.55 and 2.74 years, respectively. Yields have increased as the Company is taking advantage of the increase in interest rates by investing previously uninvested cash, and as a result, it is likely that in the future the duration will be increased.

*Net (Losses) Gains on Investments*

Net gains on investments for the nine months ended September 30, 2023 of $0.7 million included an unrealized gain of $0.4 million on equity securities and a net realized gain of $0.3 million on the sale of equity securities. The net losses on investments of $1.2 million for the nine months ended September 30, 2022 included an unrealized loss of $2.0 million on equity securities and a net realized gain of $0.8 million on the sale of equity securities and the redemption of a preferred stock.

*Loss and Loss Adjustment Expenses*

The loss ratio was 69.1% for the three months ended September 30, 2023, compared with 85.5% for the three months ended September 30, 2022. For the nine months ended September 30, 2023, the loss ratio was 70.6% compared with 80.0% for the nine months ended September 30, 2022.

We experienced unfavorable development related to prior periods of $1.6 million and $1.3 million for the three and nine months ended September 30, 2023 compared to unfavorable development of $5.4 million and $4.9 million for the three and nine months ended September 30, 2022, respectively. The unfavorable development for the three and nine months ended September 30, 2023 was primarily attributable to higher-than-expected loss severity on third-party physical damage losses for the 2022 accident year. This increased severity was primarily due to economic conditions that led to increased car prices and vehicle repair costs in the latter half of 2022.

Excluding the development related to prior periods, the loss ratio for the three months ended September 30, 2023 was 67.7% as compared with 76.4% for the three months ended September 30, 2022. Excluding the development related to prior periods, the loss ratio for the nine months ended September 30, 2023 was 70.2% as compared with 76.9% for the nine months ended September 30, 2022. These improved loss ratios are primarily the result of the impact of recent rate increases as well as a moderation of the increased severity resulting from the economic conditions that led to increased car prices and vehicle repair costs in the prior year.

*Insurance Operating Expenses*

Insurance operating expenses increased 32% to $46.6 million for three months ended September 30, 2023, from $35.2 for the three months ended September 30, 2022. For the nine months ended September 30, 2023, insurance operating expenses increased 29% to $128.8 million from $100.0 million for the nine months ended September 30, 2022. These increases were primarily the result of higher commissions to independent agents as a result of the increase in business written through this channel during the current year.

The insurance companies' expense ratio was 23.8% for the three months ended September 30, 2023, compared with 32.0% for the three months ended September 30, 2022. The insurance companies' expense ratio was 26.8% for the nine months ended September 30, 2023, compared with 30.0% for the nine months ended September 30, 2022.

*Provision (Benefit) for Income Taxes*

Income tax expense was $2.2 million for the three months ended September 30, 2023, compared with income tax benefit of $2.2 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, income tax expense was $3.5 million compared with income tax benefit of $4.3 million for the nine months ended September 30, 2022. The effective tax rate increased from 21.7% for the nine months ended September 30, 2022 to 23.3% for the nine months ended September 30, 2023 primarily as a result of the impact of state taxes.

As of September 30, 2023, the Company had gross federal net operating losses of $22.3 million. Of this net operating loss, $13.1 million was generated from P&C insurance entities and will not begin to expire until 2036. The non-P&C insurance entities generated the remaining $9.2 million of net operating loss, of which $2.7 million will begin to expire in 2036. The remaining $6.5 million can be carried forward indefinitely but are subject to an 80% taxable income limitation upon utilization. Management believes these federal operating losses will be utilized prior to expiration and thus they are not offset by the valuation allowance. The Company also has state gross operating loss carryforwards, of approximately $43.6 million ($2.5 million net) of which $36.6 million gross ($2.1 million net) have been deemed not more likely than not to be utilized before they begin to expire in 2023. Therefore, a valuation allowance has been recognized against these gross state operating loss carryforwards.

The deferred tax asset ("DTA") valuation allowance may be adjusted in future periods if management determines that it is more likely than not that some portion or all of the DTA will not be realized, or previously recognized valuation allowance should be released. In the event the DTA valuation allowance is adjusted, the Company would record an income tax expense for the adjustment.

*Interest Expense*

For the three months ended September 30, 2023 interest expense increased to $1.0 million from $0.6 million for the three months ended September 30, 2022. For the nine months ended September 30, 2023, interest expense increased to $2.8 million from $1.6 million for the nine months ended September 30, 2022. Interest expense increased primarily as a result of the increase in LIBOR and may increase further in the future should interest rates continue to rise. For additional information, see “Liquidity and Capital Resources” in this report.

**Liquidity and Capital Resources**

Our primary sources of funds are premiums, billing fees and service charges, and investment income from our insurance company subsidiaries as well as commissions and fee income from our non-insurance company subsidiaries. Our primary uses of funds are the payment of claims and operating expenses. Net cash provided by operating activities for the nine months ended September 30, 2023 was $49.5 million, compared with net cash used in operating activities of $11.0 million for the same period in the prior year. This increase was primarily the result of the net income from operations for the year, an increase in premium collections and an increase in loss and loss adjustment expense reserves.

Net cash used in investing activities for the nine months ended September 30, 2023 was $41.9 million, compared with $15.6 million for the same period in the prior year. This change was primarily the result of a decrease in the sale of securities in the current year and the decrease in capital expenditures. During the nine months ended September 30, 2022, the Company incurred $2.5 million in capital expenditures which included the renovation of its Nashville corporate headquarters. This corporate renovation enabled the relocation of employees and the closure of the Nashville claims office.

Our holding company requires cash for general corporate overhead expenses and for debt service related to our debentures payable. The holding company’s primary source of unrestricted cash to meet its obligations is commissions and fees from the sale of insurance policies and ancillary products on behalf of third-party carriers by our agency operations. At September 30, 2023, our holding company had $0.9 million available remaining in unrestricted cash and investments. These funds and the additional unrestricted cash from the sources noted above will be used to pay our future cash requirements outside of the insurance company subsidiaries.

The holding company has debt service requirements related to the debentures payable. The debentures are interest-only and mature in full in July 2037. Effective July 1, 2023 with the sunset of LIBOR, , the debentures now accrue interest at a variable rate equal to an adjusted Three-Month CME term SOFR rate plus 375 basis points, which resets quarterly. The interest rate related to the debentures for the nine months ended September 30, 2023 ranged from 8.165% to 9.381%. In October 2023, the interest rate reset to 9.402% through January 2024. For additional information, see Note 7 to the Consolidated Financial Statements in this report regarding the sunset of LIBOR.

State insurance laws limit the amount of distributions that may be paid from our insurance company subsidiaries. At September 30, 2023, our insurance company subsidiaries could not pay any dividends due to their negative unassigned surplus.

We have three insurance company subsidiaries that are organized and domiciled under the insurance statutes of Texas, Georgia, and Tennessee. Our insurance company subsidiaries also operate under licenses issued by various state insurance authorities. Such licenses may be of perpetual duration or periodically renewable, provided we continue to meet applicable regulatory requirements.

The National Association of Insurance Commissioners ("NAIC") Model Act for risk-based capital provides formulas to determine each December 31 on an annual basis the amount of statutory capital and surplus that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. Failure to meet applicable risk-based capital requirements could subject our insurance company subsidiaries to further examination or corrective action imposed by state regulators, including limitations on their writing of additional business, state supervision or even liquidation. Although statutory risk-based capital calculations are only made as of each December 31, we believe that the insurance company subsidiaries remain above the company action levels as of September 30, 2023. There are also statutory guidelines that suggest that on an annual calendar year basis an insurance company should not exceed a ratio of net premiums written to statutory capital and surplus of 3-to-1. On a combined basis, the ratio for our insurance company subsidiaries of net premiums written for the last twelve months to statutory capital and surplus was 5.99-to-1 at September 30, 2023, which exceeds compliance with the suggested guidelines. This increased underwriting leverage is the result of the increase in premiums written and the unexpected reduction of statutory surplus in 2022 that was the result of underwriting losses. It should be noted that this is just a suggested guideline and does not automatically trigger any regulatory action. We are working towards reducing this ratio.

We believe that existing cash and investment balances, when combined with anticipated cash flows as noted above, will be adequate to meet our expected liquidity needs, for both the holding company and our insurance company subsidiaries, in both the short-term and the foreseeable future.

**Item 5. Legal Proceedings**

The Company is named as a defendant in various lawsuits, arising in the ordinary course of business, generally relating to its insurance operations. All legal actions relating to claims made under insurance policies are considered by the Company in establishing its loss and loss adjustment expense reserves. The Company also faces lawsuits from time to time that seek damages beyond policy limits, commonly known as bad faith claims, as well as class action and individual lawsuits that involve issues arising in the course of the Company's business. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB ASC 450, *Contingencies* ("FASB ASC 450"). Pursuant to FASB ASC 450, reserves for a loss may only be recognized if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will disclose, if it can be estimated, a possible range of losses or state that an estimate cannot be made. Management evaluates each legal action and records reserves for losses, as warranted, by establishing a reserve in its consolidated balance sheets in loss and loss adjustment expense reserves for bad faith claims and in other liabilities for other lawsuits. Amounts incurred are recorded in the Company's consolidated statements of comprehensive income in losses and loss adjustment expenses for bad faith claims and in insurance operating expenses for other lawsuits, unless otherwise disclosed.

**Item 6. Defaults Upon Senior Securities**

None.

**Item 7. Other Information**

None.

**Item 8. Exhibits**

3.1 Interim Consolidated Financial Statements

**Item 9. Certifications**

I, Kenneth D. Russell, Interim Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of First Acceptance Corporation;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information includes or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

November 7, 2023

<u>/s/ Kenneth D. Russell</u>
Kenneth D. Russell
Interim Chief Executive Officer

I, Brian Dickman, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of First Acceptance Corporation;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information includes or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

November 7, 2023

<u>/s/ Brian Dickman</u>
Brian Dickman
Chief Financial Officer

**Exhibit 3.1 Interim Consolidated Financial Statements**

**FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**

**(in thousands, except per share data)**

| | September 30, 2023 (Unaudited) | December 31, 2022 |
|---|---|---|
| **ASSETS** | | |
| Investments in fixed maturities, available-for-sale at fair value (amortized cost of $164,421 and $123,505, respectively) | $ 152,074 | $ 113,323 |
| Investment in equity securities at fair value (cost of $9,851 and $9,521, respectively) | 10,589 | 9,911 |
| Cash, cash equivalents, and restricted cash | 56,772 | 49,072 |
| Premiums, fees and commissions receivable, net of allowance of $491 and $375 | 179,764 | 94,278 |
| Deferred tax assets, net | 11,359 | 14,177 |
| Other investments | 4,993 | 4,528 |
| Other assets | 10,014 | 9,595 |
| Operating lease right-of-use assets | 13,660 | 14,520 |
| Property and equipment, net | 4,240 | 4,831 |
| Deferred acquisition costs | 10,365 | 7,062 |
| Goodwill | 28,786 | 28,786 |
| Identifiable intangible assets, net | 5,605 | 5,856 |
| TOTAL ASSETS | $ 488,221 | $ 355,939 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Loss and loss adjustment expense reserves | $ 143,950 | $ 107,100 |
| Unearned premiums and fees | 186,118 | 103,934 |
| Debentures payable | 40,609 | 40,575 |
| Operating lease liabilities | 13,891 | 14,724 |
| Accrued expenses | 10,152 | 8,522 |
| Other liabilities | 17,920 | 15,562 |
| Total liabilities | 412,640 | 290,417 |
| Stockholders' equity: | | |
| Preferred stock, $.01 par value, 10,000 shares authorized | — | — |
| Common stock, $.01 par value, 75,000 shares authorized; 38,161 and 37,868 issued and outstanding, respectively | 381 | 379 |
| Additional paid-in capital | 456,141 | 455,891 |
| Accumulated other comprehensive income (loss), net of tax of $(3,774) and $(3,319), respectively | (8,572) | (6,862) |
| Accumulated deficit | (372,369) | (383,886) |
| Total stockholders' equity | 75,581 | 65,522 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 488,221 | $ 355,939 |

See notes to consolidated financial statements.

**FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**
**(in thousands, except per share data)**

| | Three Months Ended September 30, 2023 | Three Months Ended September 30, 2022 | Nine Months Ended September 30, 2023 | Nine Months Ended September 30, 2022 |
|---|---|---|---|---|
| Revenues: | | | | |
| Premiums earned | $ 109,454 | $ 59,123 | $ 275,675 | $ 161,964 |
| Commission and fee income | 14,750 | 13,261 | 44,324 | 39,884 |
| Billing fees and service charges | 7,443 | 4,153 | 17,935 | 11,114 |
| Investment income | 2,125 | 619 | 5,573 | 2,673 |
| Net (losses) gains on investments | (146) | (385) | 674 | (1,197) |
| | 133,626 | 76,771 | 344,181 | 214,438 |
| Costs and expenses: | | | | |
| Losses and loss adjustment expenses | 75,695 | 50,516 | 194,734 | 129,518 |
| Insurance operating expenses | 46,649 | 35,236 | 128,790 | 99,986 |
| Other operating expenses | 189 | 236 | 580 | 679 |
| Stock-based compensation | 75 | 74 | 232 | 218 |
| Depreciation | 519 | 835 | 1,705 | 1,871 |
| Amortization of identifiable intangibles assets | 114 | 32 | 311 | 194 |
| Interest expense | 989 | 643 | 2,817 | 1,570 |
| | 124,230 | 87,572 | 329,169 | 234,036 |
| Income (loss) before income taxes | 9,396 | (10,801) | 15,012 | (19,598) |
| Provision (benefit) for income taxes | 2,192 | (2,153) | 3,495 | (4,256) |
| Net income (loss) | $ 7,204 | $ (8,648) | $ 11,517 | $ (15,342) |
| Net income (loss) per share: | | | | |
| Basic | $ 0.19 | $ (0.23) | $ 0.30 | $ (0.41) |
| Diluted | $ 0.19 | $ (0.23) | $ 0.30 | $ (0.41) |
| Number of shares used to calculate net (loss) income per share: | | | | |
| Basic | 38,161 | 37,744 | 38,058 | 37,794 |
| Diluted | 38,379 | 37,744 | 38,233 | 37,794 |
| Reconciliation of net income (loss) to other comprehensive income: | | | | |
| Net income (loss) | $ 7,204 | $ (8,648) | $ 11,517 | $ (15,342) |
| Net unrealized change in investments, net of tax of $(355), $(850), $(455) and $(2,649), respectively | (1,333) | (3,196) | (1,710) | (9,963) |
| Comprehensive income (loss) | $ 5,871 | $ (11,844) | $ 9,807 | $ (25,305) |
| | | | | |
| Detail of net gains (losses) on investments: | | | | |
| Net realized gains on sales and redemptions | $ 93 | $ 208 | $ 326 | $ 789 |
| Net unrealized gains (losses) on equity securities (includes reclassification for realized (gains) losses of $(94), $(208), $(337) and $(723), respectively) | (239) | (593) | 348 | (1,986) |
| Net gains (losses) on investments | $ (146) | $ (385) | $ 674 | $ (1,197) |

See notes to consolidated financial statements.

## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

**(Unaudited)**

| | Common Stock | | Additional paid-in | Accumulated other comprehensive | Accumulated | Total stockholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | capital | income (loss) | deficit | equity |
| Balances at December 31, 2021 | 38,006 | $ 380 | $ 456,252 | $ 2,663 | $ (366,398) | $ 92,897 |
| Net loss | — | — | — | — | (15,342) | (15,342) |
| Net unrealized change on investments (net of tax benefit of $2,649) | — | — | — | (9,963) | — | (9,963) |
| Stock-based compensation | 5 | — | 218 | — | — | 218 |
| Issuance of shares under Employee Stock Purchase Plan | 41 | 1 | 67 | — | — | 68 |
| Vested restricted stock units, net of repurchases | 62 | 1 | (26) | — | — | (25) |
| Retirement of Treasury Stock | (370) | (4) | (732) | — | — | (736) |
| Balances at September 30, 2022 | 37,744 | $ 378 | $ 455,779 | $ (7,300) | $ (381,740) | $ 67,117 |

| | Common Stock | | Additional paid-in | Accumulated other comprehensive | Accumulated | Total stockholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | capital | income | deficit | equity |
| Balances at December 31, 2022 | 37,868 | $ 379 | $ 455,891 | $ (6,862) | $ (383,886) | $ 65,522 |
| Net income | — | — | — | — | 11,517 | 11,517 |
| Net unrealized change on investments (net of tax benefit of $455) | — | — | — | (1,710) | — | (1,710) |
| Stock-based compensation | 7 | — | 232 | — | — | 232 |
| Issuance of shares under Employee Stock Purchase Plan | 83 | 1 | 52 | — | — | 53 |
| Vested restricted stock units, net of repurchases | 203 | 1 | (34) | — | — | (33) |
| Balances at September 30, 2023 | 38,161 | $ 381 | $ 456,141 | $ (8,572) | $ (372,369) | $ 75,581 |

See notes to consolidated financial statements.

**FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(in thousands)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2023 | 2022 |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 11,517 | $ (15,342) |
| Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities: | | |
| Unrealized (gains) losses on equity securities | (348) | 1,986 |
| Depreciation | 1,705 | 1,871 |
| Amortization of identifiable intangibles assets | 311 | 194 |
| Stock-based compensation | 232 | 218 |
| Deferred income taxes | 3,275 | (4,267) |
| Investment income from other investments | (549) | 196 |
| Realized gains on sales and redemptions of investments | (326) | (789) |
| Other | (264) | (463) |
| Change in: | | |
| Premiums, fees, and commission receivable | (85,370) | (35,333) |
| Deferred acquisition costs | (3,303) | (3,935) |
| Loss and loss adjustment expense reserves | 36,850 | 6,260 |
| Unearned premiums and fees | 82,184 | 36,878 |
| Other assets | (419) | 349 |
| Accrued expenses | 1,630 | 1,068 |
| Other liabilities | 2,358 | 105 |
| Other | 58 | 25 |
| Net cash provided by (used in) operating activities | 49,541 | (10,979) |
| Cash flows from investing activities: | | |
| Purchases of investments | (52,797) | (34,504) |
| Maturities and redemptions of investments | 10,263 | 15,804 |
| Sale of investments | 1,763 | 5,028 |
| Purchases of other investments | (587) | - |
| Distributions from other investments | 671 | 1,193 |
| Capital expenditures | (1,114) | (3,059) |
| Acquisitions of identifiable intangible assets | (60) | (23) |
| Net cash used in investing activities | (41,861) | (15,561) |
| Cash flows from financing activities: | | |
| Purchase of treasury stock at cost | — | (736) |
| Net proceeds from issuance of common stock | 53 | 68 |
| Taxes remitted in relation to employee restricted stock units exercised | (33) | (25) |
| Net cash provided by (used in) financing activities | 20 | (693) |
| Net change in cash, cash equivalents, and restricted cash | 7,700 | (27,233) |
| Cash, cash equivalents, and restricted cash, beginning of period | 49,072 | 60,826 |
| Cash, cash equivalents, and restricted cash, end of period | $ 56,772 | $ 33,593 |

See notes to consolidated financial statements.

## 1. General

The consolidated financial statements of First Acceptance Corporation (the "Company") included herein have been prepared without audit. Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been omitted. In the opinion of management, the consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the interim periods.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in its Annual Report for the year ended December 31, 2022 filed by the Company with OTCQX.

For the nine months ended September 30, 2023, 20% of insurance company operating revenues resulted from insurance policies produced by a single independent agent.

## 2. Investments

***Investments, Available-for-Sale***

The following tables summarize the Company's investment in fixed securities (in thousands).

| September 30, 2023 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Fixed maturities, available-for-sale: | | | | |
| U.S. government and agencies | $ 14,259 | $ — | $ (171) | $ 14,088 |
| Political subdivisions | 3,940 | — | (185) | 3,755 |
| Revenue and assessment | 9,558 | - | (372) | 9,186 |
| Corporate bonds | 67,871 | — | (2,537) | 65,334 |
| Asset-backed securities | 21,693 | 2 | (442) | 21,253 |
| Collateralized mortgage obligations: | | | | |
| Agency backed | 45,274 | — | (9,022) | 36,252 |
| Non-agency backed – residential | 809 | 447 | (44) | 1,212 |
| Non-agency backed – commercial | 1,017 | — | (23) | 994 |
| Total fixed maturities, available-for-sale | $ 164,421 | $ 449 | $ (12,796) | $ 152,074 |

The following tables set forth the amount of gross unrealized losses by current severity (as compared to amortized cost) and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

The fair value and gross unrealized losses of investments in fixed maturities for the nine months ended September 30, 2023 by length of time that individual securities have been in a continuous unrealized loss position follows (in thousands).

| Length of Gross Unrealized Losses at September 30, 2023: | Fair Value of Securities with Gross Unrealized Losses | Gross Unrealized Losses | Severity of Gross Unrealized Losses: Less than 5% | 5% to 10% | Greater than 10% |
|---|---|---|---|---|---|
| Less than or equal to: | | | | | |
| Three months | $ 27,102 | $ (376) | $ (376) | $ — | $ — |
| Six months | 33,360 | (736) | (732) | — | (4) |
| Nine months | 2,591 | (89) | (47) | — | (42) |
| Twelve months | — | — | — | — | — |
| Greater than twelve months | 85,773 | (11,595) | (489) | (2,254) | (8,853) |
| Total | $ 148,826 | $ (12,796) | $ (1,644) | $ (2,254) | $ (8,899) |

| September 30, 2023 | Less than 12 months: Fair Value | Less than 12 months: Gross Unrealized Losses | 12 months or longer: Fair Value | 12 months or longer: Gross Unrealized Losses | Total Gross Losses |
|---|---|---|---|---|---|
| Fixed maturities, available-for-sale: | | | | | |
| U.S. government and agencies | $ 8,472 | $ (98) | $ 4,621 | $ (73) | $ (171) |
| Political subdivisions | 501 | (6) | 2,384 | (179) | (185) |
| Revenue and assessment | 5,589 | (171) | 3,597 | (201) | (372) |
| Corporate bonds | 31,979 | (644) | 33,355 | (1,893) | (2,537) |
| Asset-backed securities | 15,016 | (214) | 5,749 | (228) | (442) |
| Collateralized mortgage obligations: | | | | | |
| Agency backed | 184 | (1) | 36,067 | (9,021) | (9,022) |
| Non-agency backed – residential | 318 | (44) | — | — | (44) |
| Non-agency backed – commercial | 994 | (23) | — | — | (23) |
| Total fixed maturities, available-for-sale | $ 63,053 | $ (1,201) | $ 85,773 | $ (11,595) | $ (12,796) |

For the nine months ended September 30, 2023 the Company had 108 fixed maturities with gross unrealized losses that have been in a gross unrealized loss position for less than or equal to 12 months and 64 fixed maturities with gross unrealized losses that have been in a gross unrealized loss position for greater than 12 months.

For the nine months ended September 30, 2023 and 2022, the Company did not recognize any other-than-temporary impairment ("OTTI") charges on its fixed maturities, available for sale in net income (loss). Unrealized gains and losses on equity securities (preferred stocks and mutual funds) are recognized as a component of net income (loss). The Company believes that the securities having unrealized losses at June 30, 2023 were not other-than-temporarily impaired and are attributable to the increase in interest rates since the time when they were originally purchased. The Company also does not intend to sell any of these securities, and it is more likely than not that the Company will not be required to sell any of these securities before the recovery of their amortized cost basis.

## 3. Losses and Loss Adjustment Expenses Incurred and Paid

Information regarding the reserve for unpaid losses and loss adjustment expenses ("LAE") is as follows (in thousands).

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2023 | 2022 | 2023 | 2022 |
| Liability for unpaid losses and LAE at beginning of period, gross | $ 123,866 | $ 89,044 | $ 107,100 | $ 93,278 |
| Reinsurance balances receivable | (7) | (103) | (97) | (90) |
| Liability for unpaid losses and LAE at beginning of period, net | 123,859 | 88,941 | 107,003 | 93,188 |
| Add: Provision for losses and LAE: | | | | |
| Current period | 74,109 | 45,151 | 193,462 | 124,576 |
| Prior periods | 1,586 | 5,365 | 1,272 | 4,942 |
| Net losses and LAE incurred | 75,695 | 50,516 | 194,734 | 129,518 |
| Less: Losses and LAE paid: | | | | |
| Current period | 15,786 | 29,841 | 78,694 | 64,710 |
| Prior periods | 39,823 | 10,175 | 79,098 | 58,555 |
| Net losses and LAE paid | 55,609 | 40,016 | 157,792 | 123,265 |
| Liability for unpaid losses and LAE at end of period, net | 143,945 | 99,441 | 143,945 | 99,441 |
| Reinsurance balances receivable | 5 | 97 | 5 | 97 |
| Liability for unpaid losses and LAE at end of period, gross | $ 143,950 | $ 99,538 | $ 143,950 | $ 99,538 |

The unfavorable development for the three and nine months ended September 30, 2023 was primarily attributable to higher-than-expected loss severity on third-party physical damage losses for the 2022 accident year.

## 4. Income Taxes

The provision (benefit) for income taxes consisted of the following (in thousands).

| | Three Months Ended September 30, 2023 | Three Months Ended September 30, 2022 | Nine Months Ended September 30, 2023 | Nine Months Ended September 30, 2022 |
|---|---|---|---|---|
| Federal: | | | | |
| Current | $ — | $ — | $ — | $ — |
| Deferred | 2,008 | (2,181) | 3,104 | (4,201) |
| | 2,008 | (2,181) | 3,104 | (4,201) |
| State: | | | | |
| Current | 127 | 43 | 220 | 11 |
| Deferred | 57 | (15) | 171 | (66) |
| | 184 | 28 | 391 | (55) |
| | $ 2,192 | $ (2,153) | $ 3,495 | $ (4,256) |

The provision (benefit) for income taxes differs from the amounts computed by applying the statutory federal corporate tax rate of 21% to income before income taxes as a result of the following (in thousands).

| | Three Months Ended September 30, 2023 | Three Months Ended September 30, 2022 | Nine Months Ended September 30, 2023 | Nine Months Ended September 30, 2022 |
|---|---|---|---|---|
| Provision (benefit) for income taxes at statutory rate | $ 1,973 | $ (2,269) | $ 3,152 | $ (4,116) |
| Tax effect of: | | | | |
| Tax-exempt investment income | (5) | (11) | (14) | (28) |
| Stock-based compensation benefits not realized | — | — | (9) | (11) |
| State income taxes, net of federal income tax benefit and state valuation allowance | 169 | 28 | 334 | (57) |
| Other | 55 | 99 | 32 | (44) |
| | $ 2,192 | $ (2,153) | $ 3,495 | $ (4,256) |

ASC Topic 740, Income Taxes, establishes procedures to measure deferred tax assets and liabilities and assess whether a valuation allowance relative to existing deferred tax assets is necessary. Management assesses the likelihood of realization of the Company's deferred tax assets and the need for a valuation allowance with respect to those assets based on the weight of available positive and negative evidence. As of September 30, 2023 and December 31, 2022, management determined that a valuation allowance of $2.4 million and $2.7 million was necessary relative to certain state taxes and OTTI which are not expected to be realized, respectively. Management also determined at September 30, 2023 and December 31, 2022 that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the remaining deferred tax assets not covered by this valuation allowance.

As of September 30, 2023, the Company had gross federal net operating losses of $22.3 million. Of this net operating loss, $13.1 million was generated from P&C insurance entities and will not begin to expire until 2036. The non-P&C insurance entities generated the remaining $9.2 million of net operating loss, of which $2.7 million will begin to expire in 2036 and $6.5 million can be carried forward indefinitely but are subject to an 80% taxable income limitation upon utilization. Management believes these federal operating losses will be utilized prior to expiration and thus they are not offset by the valuation allowance. The Company also has state gross operating loss carryforwards, gross of the valuation allowance discussed above, of approximately $43.6 million ($2.5 million net) of which $36.6 million gross ($2.1 million net) have been deemed not more likely than not to be utilized before they begin to expire in 2023 and thus a valuation allowance has been recognized against these gross state operating loss carryforwards.

## 5. Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets and lease liabilities on our consolidated balance sheet. The Company does not have any finance leases.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Lease terms may include options to extend the lease when it is reasonably certain that the option will be exercised. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Company has operating leases for retail stores, corporate offices, and certain equipment. The leases have remaining lease terms of one year to six years, some of which include options to extend the leases for up to five years, and some of which include options to terminate the leases within one year. Operating lease costs and cash flows the nine months ended September 30, 2023 were $6.5 million and $6.7 million, respectively. Operating lease costs and cash flows for the nine months ended September 30, 2022 were both $6.1 million.

Supplemental balance sheet information related to leases is as follows:

| | September 30, 2023 | September 30, 2022 |
|---|---|---|
| Operating lease right-of-use assets | $ 13,660 | $ 16,998 |
| Operating lease liabilities | 13,891 | 17,044 |
| Weighted average remaining lease term | 4.09 years | 4.54 years |
| Weighted average discount rate | 6.64% | 6.50% |

Maturities of operating lease liabilities were as follows:

| For the Year Ended December 31, | Amount |
|---|---|
| 2023 (excluding the nine months ended September 30, 2023) | $ 1,773 |
| 2024 | 5,341 |
| 2025 | 3,198 |
| 2026 | 1,689 |
| 2027 | 1,116 |
| Thereafter | 2,805 |
| Total lease payments | $ 15,922 |
| Less imputed interest | (2,031) |
| Total | $ 13,891 |

## 6. Debentures Payable

In July 2017, the Financial Conduct Authority in the United Kingdom, which is the government body responsible for regulating LIBOR announced that it would no longer require banks or financial institutions to make LIBOR submissions after 2021 which would result in the sunset of LIBOR. However, they did publish some US LIBOR rates until June 30, 2023. This change has been accounted for as a continuation of the current arrangement in accordance with ASU 2020-04, "*Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financials Reporting*."

On March 15, 2022, the Adjustable Interest Rate (LIBOR) Act was signed into law. Under this Act, on the first London banking day after June 30, 2023, the three-month CME term SOFR (as defined in the final regulations), as adjusted to the spread adjustment (0.26161 percent), has become the benchmark replacement for the Three-Month LIBOR.

**7. Recent Accounting Pronouncements Adopted**

As of January 1, 2023, the Company adopted ASU No. 2016-13, *"Financial Instruments – Credit Losses (Topic 326)"* which requires financial assets measured at amortized cost to be presented at the net amount expected to be collected. The allowance for credit losses is based on relevant information, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The increases and decreases in the credit loss are reflected as a component of net income (loss). The adoption of this pronouncement had no impact for the nine months ended September 30, 2023. However, this pronouncement would apply to any future OTTI recorded by the Company.