PALOMAR HOLDINGS INC. (PLMR)

Part 2: Palomar's Offshore Debt Empire

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- Palomar Holdings, Inc. (PLMR, "Palomar") has raised about $895 million of debt in an offshore shell company. The debt is in the form of "catastrophe bonds". In this article, we refer to this shell company as the "cat bond company".

- The amount of money residing in the cat bond company is significant. It's equal to 96% of the "total investments" stated in Palomar's most recent 10-Q.

- The cat bond company has purportedly existed solely to reinsure Palomar. But it has little to do with conventional reinsurance. Palomar has paid over $100 million in recent years for this "reinsurance" without receiving any visible benefit.

- Conventional insurance companies typically rely on stockholders' equity to back their insurance policies. But Palomar's cat bond company is almost 100% debt-funded. Its liabilities are thousands of times more than its equity.

- Palomar does not consolidate its cat bond company. But there is considerable doubt about whether it is required to be consolidated under current accounting rules. In our opinion, common sense says it clearly should be consolidated.

- There are huge risks and huge potential rewards in Palomar's cat bond company. For one thing, we don't know where the current $895 million of borrowed money is invested. Obviously, the lack of knowledge regarding this massive investment pool is a huge risk by itself. State insurance regulators in the United States demand detailed information about an insurance (or reinsurance) company's investments. But those regulators know nothing about the investments of Palomar's cat bond company.

We do know that in the past, one of Palomar's cat bond companies was invested 100% in equities. "Equities" means the stock market. The potential stock market gains generated by $895 million are obviously huge. For example, if that money was invested in an S&P 500 index fund between June 2021 to June 2024, the resulting gain would be about $276 million. Common sense says that this stock market gain should go to Palomar shareholders. But at this point, who gets the benefit of these gains is not publicly disclosed.

Of course, there are also risks in stock market investments. If the S&P 500 index happens to decline over 56% as it did between October 2007 and March 2009, the loss on a $895 million stock portfolio would be on the order of $500 million. Palomar's cat bond company probably could not backstop a $1 million dollar loss, much less a $500 million dollar one. Even Palomar Holding itself would be hard-pressed to backstop that kind of loss. $500 million is more than Palomar's entire paid-in capital as of 9/30/24.

- So the question arises: Who reaps the huge potential gains and bears the huge potential losses of this $895 million debt-funded investment pool? In our opinion, that is an important question that Palomar shareholders need to ask.