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FT: USAA Sells First Meteor Strike 'Cat Bonds'

USAA, the US insurer, has sold \$130m of catastrophe bonds that allow investors to collect yields of 15 per cent or more by betting on the chances of a meteor strike or volcanic eruption.

The bonds are the first to cater to these two types of natural disasters, but investors nevertheless clamoured to buy the new debt. The size of the deal was increased from a planned \$100m, underscoring strong appetite for insurance-linked catastrophe bonds, sales of which are on course to reach record levels this year.

The USAA cat bonds, known as Residential Reinsurance 2014 Ltd Series 2014-I, met "robust" demand from investors, according to people close to the sale.

In addition to providing coverage for a meteor strike and the standalone risk of a volcanic eruption – two firsts for the insurance-linked industry – the USAA bonds also cover so-called "unmodelled" risks of wildfires, severe thunderstorms and blizzards in US states where such disasters are not typically assessed.

"They [USAA] have a number of larger cat bond deals still in effect," said Steve Evans, owner of Artemis.bm, which collects data on insurance-linked debt. "What they tend to do is use these smaller issues in order to test the market a little bit. Last year they issued some of the riskiest notes ever, this year they've chosen to test by including meteor and volcanic eruption risk."

The USAA sale comes on the back of continued strong demand for cat bonds, which offer investors higher yields as well as returns that are uncorrelated to other types of securities.

Such bonds allow insurers to transfer some of the risk that they will have to pay out billions of dollars in the event of a major natural disaster. While the debt offers juicy returns, investors are at risk of losing their principal if catastrophes such as earthquakes or hurricanes do occur.

The amount of cat bonds and insurance-linked debt sold so far this year has reached \$5.5bn, according to Artemis.bm, taking the amount of the debt sold over the past 12 months to a record \$9.2bn.

"In recent cat bond deals the majority have priced at the mid or upper-end of pricing guidance, which shows investors have reached a place where they feel they can't go down any more on pricing," said Mr Evans.

USAA's debt deal was divided into two classes of bonds. The size of the riskiest class of the bonds, where investors receive a coupon of 15 per cent in exchange for an expected loss rate of about 11 per cent, was increased from \$50m to \$80m.

A third of these riskier bonds went to hedge funds while another third went to cat bond funds that specialise in investing in insurance-linked debt, said people familiar with the deal.

Almost two thirds of the \$50m second class of the bonds, with a coupon of 3.5 per cent for an expected loss rate of less than 1 per cent, were sold to pension funds and money managers.

USAA declined to comment on the sale, which was run by Goldman Sachs and Swiss Re Capital Markets.

By Tracy Alloway in New York

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