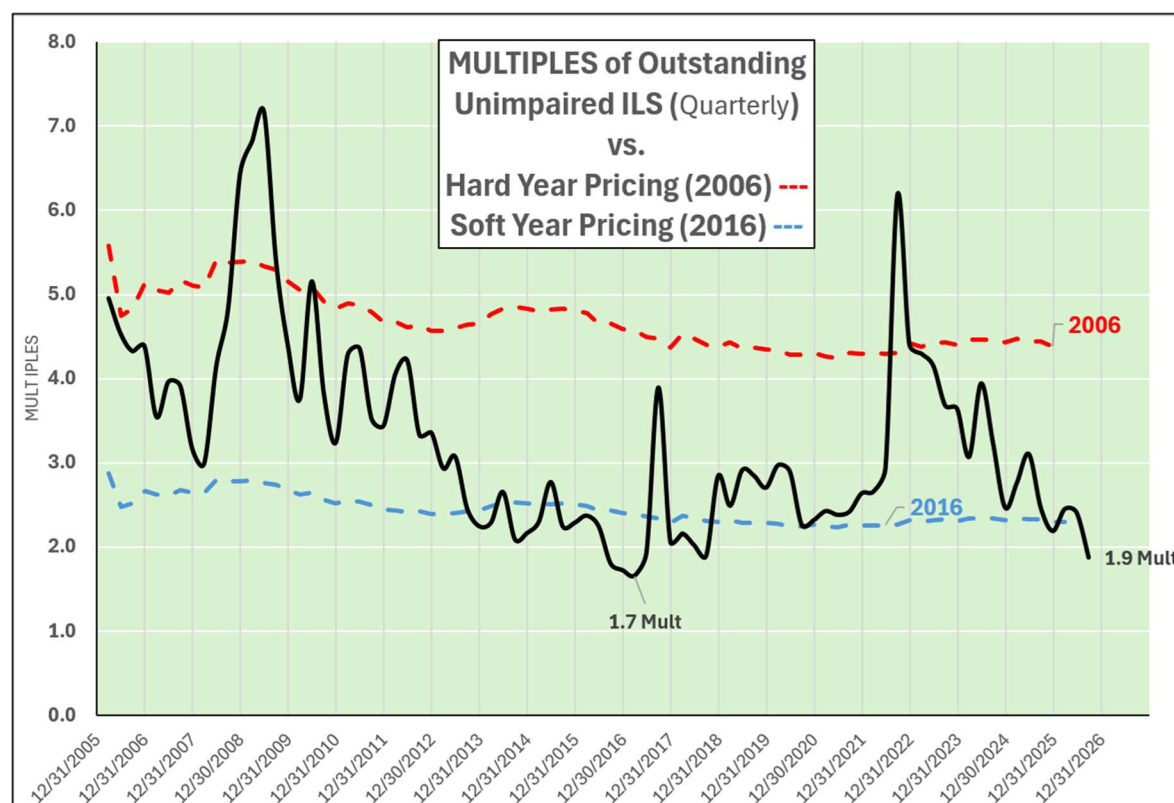


Soft Markets

How soft can they go; how long can they last?

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Extraordinarily, as we enter the last few days of Q3, Tropical Storm Fay and Tropical storm Gonzalo, only the sixth and seventh named Atlantic storms of the 2026 season, are dissipating in mid Atlantic. There have been no named hurricanes in the North Atlantic in 2026. All the hurricane action has been in the Eastern Pacific where three hurricanes - Nolo, Odalys and Polo, are lined up to potentially hit Hawaii and/or Mexico's West coast. Polo, now downgraded somewhat, reached a Cat 5 intensity. It was the sixteenth named



storm in the Eastern Pacific. No doubt all of this is in some way due to an extremely strong El Nino and a warm Northern Pacific hot spot. Exactly how those things happen is beyond our abilities to say. However, the effect on the catastrophe reinsurance market and particularly the Cat Bonds market is easy to see. Prices are high, yields are low, the market is quite soft. Important questions therefore are - How soft can it get? and - How long can it last?

How soft can ILS markets go?

The weighted average *yields* on the *outstanding portfolio* of Cat Bonds at the end of Q3 2026, has fallen to a low of 4.89% against a weighted average expected loss [EL] of 2.61%. These figures imply a “MULTIPLE” of 1.9 ($=4.89\% / 2.61\%$). The multiple is the critical measure when it comes to assessing the comparative softness of the current market. Furthermore, calculating it historically allows us to gage current softness against past experience. However, it is not a trivial exercise. It needs to be explained in a couple of steps. The first graphic shows an initial overview of multiples for the past twenty years (2006-Q3 2026).

Three lines are depicted on the graph. The heavy black line is the multiple, measured quarterly, as the weighted average yield divided by the weighted average EL for each quarter-end's *portfolio of outstanding unimpaired* Cat Bonds. Unimpaired means not suspected of, or encumbered by, actual losses. We also ignore bonds which have less than three months to maturity.

Based on that line alone, the lowest quarterly multiple was experienced at Q1 2017. It was 1.7, not too much below the present 1.9. So, we have seen softer quarterly markets, but only a few.

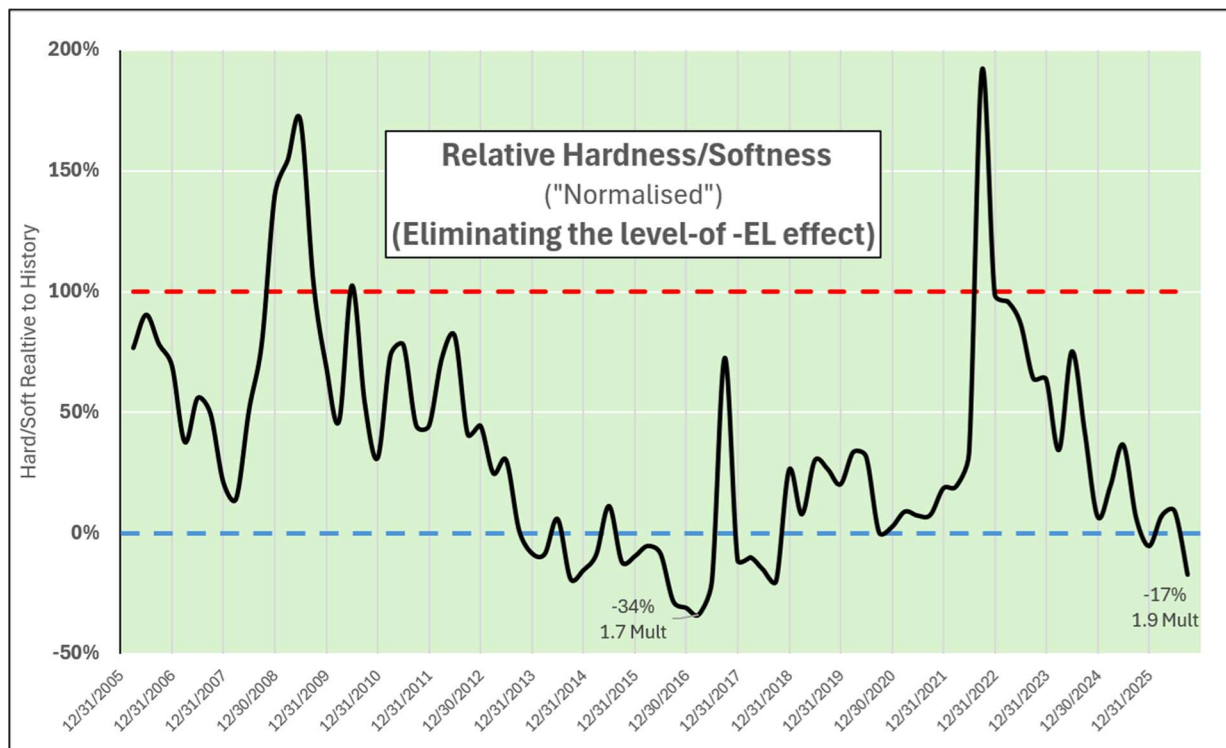
This view of history might also lead one to assume that the extremes in the past have been greater than the present. Note the two hard peaks.

The two dotted lines on the graph represent, respectively, the hardest (2006) and the softest (2016) years in this twenty year record. This *annual* measure is calculated by using only *new issues* during each calendar year. So, it is a different basis for comparison – pricing of *quarterly outstandings* vs pricing of *new issues for each year*. The quarterly measure picks up unwanted seasonal factors as well as the softness or hardness of the market. The annual measure does not.

Each annual *issuance* is summarised into a model (multiple as a function of EL). (We use a power equation, but almost identical results can be obtained using a simple linear equation.) Then we plug the quarterly EL into that equation to show, in the case of the

upper dotted line, what the multiple would have been if it had been priced in the hardest year – 2006. To reinforce the point, as an example, the *unimpaired portfolio of outstandings* at the end 2023 has a multiple 3.6. That same portfolio with the same EL, would have been priced at a multiple of 4.4 in 2006. Similarly, if priced in 2016 (the softest year), it would have had a multiple of 2.3 – represented in the lower dotted line.

The area between the two dotted lines represents the range of pricing that can be expected most of the time. The dotted lines themselves are guide-lines for past hard and soft pricing. They are not limits. Clearly some quarters fall outside the lines as the present quarter does. Nor do past extremes necessarily represent the best or worst possible pricings. New pricing extremes can be made, and probably will be, in the future.



There is one further ammendment that should be made to the graph. Notice that the multiples in the dotted line fluctuate. Essentially that arises because the ELs of each year's issuances fluctuate. The trend of those EL changes for the past twenty years has been up. In 2006 the ELs of the *portfolios of outstandings* were around 1.24%, in 2016 they were 2.1% and now in 2026 they are around 2.61%. ELs have been rising. The market has taken on more risk.

Combine that with the knowledge that lower risk has higher multiples, and vice versa, and it becomes apparent that a true historical comparison has to be independent of

the level of each years EL. Here, we do that by setting the upper dotted line as 100% and the lower dotted line as 0% and then redrawing the quarterly measure relative to those (straightened) lines. This thereby eliminates the EL-level effect.

Now the historical perspective changes slightly. The present quarter low is still not the lowest we have seen and could go lower still. That would be unusual in the fourth quarter. Most readings from Q3 to Q4 seasonally tighten pricing as the Jan 1st renewal season approaches. But, as the graph shows, in 2016 there was no seasonal bounce and the softness continued on into Q1 2017. That could happen again.

Another revealing feature of the EL-level-adjusted graph is that the extreme hard pricing at the end of 2022, caused by hurricane IAN was actually “harder” than the pricing during the Global Financial Crisis [GFC] of 2008. The GFC was not a natural catastrophe and we often leave it out of our various analyses, but as a pricing reference it is useful. In 2008 all assets, including ILS, were being dumped as managers scrambled for liquidity. Yields on ILS skyrocketed as prices fell, thereby hardening the market. However dramatic that was, adjusted for the EL level, it did not harden the market as much as the immediate reaction to hurricane IAN in 2022. See the two peaks.

How long can the soft market last?

We do not know. Only the Deities can determine the duration of the soft markets. Declarations of disciplined underwriting sadly do not always prevail. Sudden and large catastrophes that cause a massive loss of capital in the insurance markets are usually the proximate cause of ending a soft market.

The longest soft market of the past twenty years was four years, from 2013 to 2017. It only ended with the succession of losses from hurricanes Harvey, Irma, and Maria later in 2017.

If the rest of 2026 runs loss-free then we would expect the soft market to last at least another year (until next year’s hurricane season). However, late forming storms in the Atlantic have happened before and can happen again and still cause big losses.

It is also well to remember that the activity in the Pacific is still with us.

Even though exposure to wind losses in Hawaii, California or Mexico represent only a small fraction of the currently outstanding portfolio EL, one could still be exposed to a full limit loss on any deal containing those exposures however small the sliver is.