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12th December 2022

Cost of insurance against defaults on sovereign debt jumps by 102% as global economic concerns mount

- **91% of countries see cost of insurance against defaults on their sovereign debt rise**
- **Cancellation of corporate contracts with governments more likely – corporates looking to insure against risk**

The cost of insuring against sovereign debt defaults has increased by an average of 102% over the past year*, shows research by global specialty (re)insurance group Chaucer.

The last twelve months has seen the cost of Credit Default Swaps used to insure against a default on the debt of a third party, such as a government, soar as the global economy has deteriorated.

Investors are increasingly concerned that the sharp hike in interest rates globally, which have led to soaring debt servicing costs for governments and an economic slowdown, have increased the risk of countries defaulting. In the past year, yields on government bonds have risen sharply, from 0.68% to 3.15% on UK 10-year gilts.

The increase in the value of the dollar has also added to the cost of servicing that portion of emerging market Government debt that is denominated in dollars.

Chaucer says that 90.9% of the 88 countries in its study have seen the cost of Credit Default Swaps on their sovereign debt rise.

The UK has seen the cost of its Credit Default Swaps (CDS) on its sovereign debt rise by 148% over the past year.

Whilst the cost of insuring against a sovereign debt default has risen sharply in the last year interest in other forms of insuring against the impact of a government getting into financial difficulty have also soared, for example “contract frustration insurance”.

Governments keen to cut expenditure can be tempted to cancel corporate contracts to reduce spending. Contract frustration insurance protects against this.

While emerging economies are most likely to be most affected by governments going through radical cost cutting measures and cancelling commercial contracts, demand for contract frustration insurance against the actions of Western economies is also growing.

In the wake of the 2007 Global Financial Crisis, outsourcing and IT contracts were cancelled by governments across developed economies. A repeat of a global recession now could affect government contracts for corporates from industries as varied as construction, infrastructure and property.

Contract frustration insurance provides companies with cover for non-performance of contractual obligations, including non-payment and non-honouring, by foreign state-owned and government entities, i.e. non delivery of goods or services due to a trigger event, such as a default by a government entity.

Contract frustration insurance can also protect against cancellation of licences issued by foreign governments, as well as sanctions and boycotts that result in interruption, defaults or other losses. Losses have to be because of a political force majeure event and/or an event from action by a supranational or government entity.

Jonathan Bint, Senior Analyst & Underwriter at Chaucer says: "What is noticeable is the demand for insurance against contract frustration in major G7 economies. Normally demand for insurance against Governments cancelling contracts is restricted to more volatile economies. Now we are seeing demand for this kind of insurance to cover contracts in countries like the UK, France and Italy."

"Rising sovereign debt, interest rate hikes and negative economic growth make a perfect storm for the global economy and businesses could be left exposed to government contracts being cancelled without safeguards in place."

"Contract frustration insurance can offer protection against the risk of governments cancelling contracts, which could mean the difference between a business surviving or not."

With interest rates anticipated to rise higher across developed economies with inflation still rampant, CDS may increase in value even more in the coming months.

CDS rose 112% on average across Europe, 54% in the Americas, 179% in Asia & Pacific, 70% across Africa and 1% in the Middle East.

*16th November 2022
**MarketWatch

Increase in cost of a 5-year CDS by country

Country	Value of five-year contract for debt default on Nov 16 2021	Value of 5-year contract for debt default on Nov 16 2022	% Change
Pakistan	394.5	5078.1	1187%
Sri Lanka	1653.8	8607.8	420%
Hungary	53.7	211.6	294%
Ecuador	659.6	2460.4	273%
Romania	80.1	297.2	271%
Bulgaria	49.0	172.2	252%
Kazakhstan	64.4	223.8	247%
Mongolia	231.0	721.4	212%
Serbia	93.4	287.5	208%
Morocco	97.5	275.2	182%
El Salvador	1044.4	2891.1	177%

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About Chaucer
Chaucer are a leading specialty (re)insurance group working with brokers, coverholders and clients to protect and support business activities around the world. Our services are accessed both through Lloyd's of London and the company markets.

We are defined by an enterprising, bespoke approach to (re)insurance, enabled by the individual character, experience and imagination of our expert teams.

Chaucer is a member of the China Re Group and backed by their financial and operational resources. China Re is one of the world's largest reinsurance companies whose outstanding and comprehensive strength is rated A (excellent) by AM Best and A (strong) by S&P Global Rating.

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