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Editorial

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General Insurance and Finance (IF) special issues of *The Geneva Papers* are usually devoted to topics of financial stability, regulations, and resolution and recovery of insurers; insurance capital structure, financial markets and products, markets conditions; financial strength and trends of the insurance sector globally and nationally; governance structure, mergers and acquisitions (M&A), and valuations of insurers among the many topics related to both insurance and finance. This second special IF issue of *The Geneva Papers* provides contributions of a mix of topics on global vs. national insurance matters. The first group of papers weaves through global financial stability and Solvency II issues in macro and micro regulations. The first three of these studies focus on (1) the systemic risk of insurers vs. banks, and the recommendation that capital surcharges be used differently for insurers. The research suggests alternative macro regulation solution for insurers; (2) the impact of the extended period of low interest rates on the probability of default of German insurers; and (3) examination of the use of contingent convertible (CoCo) bonds as a possibility to enhance financial stability of banks and as incentives to insurers' investments within the Solvency II framework. This paper connects banks and insurers through the use of CoCos.

The second group of papers delves into value creation through M&A and reinsurance for the global insurance, and efficiency, size and scope for one national market. These studies provide (1) an examination of the added value of global insurance M&A; (2) a rare look into the structure of reinsurance contracts that reveals the structure of the global reinsurance markets with winning and unwinning quotes on a large number of reinsurance layers; and (3) an efficiency study of South African insurers which shows the characteristics that relates to higher efficiencies.

The third group of papers again looks at added value and insurers' market power. They differ in that the analysis looks into actual active outside interventions and their impact. The first of the two papers examines the effect of analysts and rating agencies on the valuation of insurers. The second examines the impact of governmental bailout on the pricing of insurance products and concludes that such help does not create market power.

The paper selected to lead this special issue and the first group of papers is that by Christian Thimann "On the Systemic Features of Insurance and Banking, and the Role of Leverage, Capital and Loss Absorption". It provides a non-technical exposition of the systemic risks differences and similarities between banks and insurers as players in the financial sector. By providing comparisons between the balance sheet of banks and insurers, Thimann points out the major differences in systemic risk and systemic roles of the sectors. As a consequence, he suggests that macro regulatory tools be directed differently in both sectors. He delineates the FSB's macro regulation tools for insurers and banks with emphasis on loss absorbency. The loss absorbency capacity of insurers is different since "insurers have achieved what is currently considered for banks, a partial loss absorption capacity of liabilities beyond equity, i.e. a form of bail-in". Thimann also debates the differences between systemic risk and systemic role. Overall, the study is a strong illumination of systemic risk issues and financial stability in insurance.

Following the overview paper, the second paper, "The Effects of a Low Interest Rate Environment on Life Insurers", by Elia Berdin and Helmut Gründl, drills down into financial solvency and stability issues as a result of the extended period of low interest rates. In this highly technical paper, the authors focus on the German life insurers market with a creation of a representative insurer to study the effects of the low interest rates on current asset allocation and outstanding liabilities. They simulate a stochastic term structure of interest rates and stock market returns of the insurers' portfolio with solvency as the target objective. Their results predict solvency issues under prolonged low interest rates period in Germany and conclude that "the solvency situation depends heavily on the duration mismatch between assets and liabilities".

The third paper in this group is "The Effects of Contingent Convertible (CoCo) Bonds on Insurers' Capital Requirements under Solvency II" by Tobias Niedrig and Helmut Gründl. In the context of solvency and financial stability, CoCo bonds appear to be an important tool in the capital structure of banks and possibly an important investment for insurers. Within the financial sector, insurers are holding large investments in banks and possibly in CoCos as "hybrid securities that can generate high high-yield investments in a bond-like asset class". For banks, in the aftermath of the financial crisis, CoCos receive preferred treatment under Basel II. For insurers, the incentives are not clear and the authors "evaluate the insurers' capital requirements under the proposed Solvency II standard model as well as under an internal model that ex ante anticipates additional risks due to possible conversion of the CoCo bond into bank shares". The results show some irrational incentives for CoCo investors under Solvency II. There are different results for internal models for insurers.

Overall, this group of studies connects the areas of financial regulation for both banks and insurance in the opening paper with non-technical exposition, while it became complex and highly technical in the CoCo paper. An area of great challenge to insurers' financial health, especially in the life industry, is the prolonged period of low interest rates. The insights provided by these studies could be of help during these challenging times of needs to improve on micro regulation and develop appropriate macro regulation that do not lead to negative or irrational implications.

The second part of this issue is devoted to three papers that are in the valuation arena without outside interventions. The first of these papers is "Mergers and Acquisitions in the Global Insurance Industry: Valuation Effects", by J. David Cummins, Paul Klumpes and Mary A. Weiss. This is an event study of the value creation of acquiring firms and target companies. "Both cross-border and within border transactions led to substantial value-creation for targets … .. but the within-industry gains were significantly larger". The authors' added value to the literature is in that they used global data in the area to conclude that "the findings support the general contention that M&A deals are more likely to be value creating for targets than for acquiring firms."

While M&A transactions show added value to some insurers, the second paper in this group concentrates on specific transactions that transfer and acquire risks among insurers and reinsurers. In "The Structure of Reinsurance Contracts" by M. Martin Boyer and Théodora Dupont-Courtade, we learn about the market structure of reinsurance activities as evidenced by reinsurance contracts that were realised and those that remained as bids only. The authors examined treaties of all types and of different tranches. "By bidding more or less for every tranche, the reinsurer chooses a level of risk in line with its risk-seeking profile". The authors point out the customised nature of the reinsurance transaction, the evolution of the reinsurance contracts over time, the complexity of the contracts and the differences among the lines of insurance. Since they use unique proprietary database, the examination adds value to understanding the market structure of reinsurance more deeply with results that show "that the reinsurer quotes depend on the characteristics of the tranche (limit, priority), of the treaty (tranche number, duration and line of business) and of the players (number of bids, presence of a broker)".

In contrast to the two global studies featured in this group, the third paper is limited to one national market, the South African general insurance market. In "Efficiency, Productivity and Returns to Scale Economies in the Non-Life Insurance Market in South Africa" by Abdul Latif Alhassan and Nicholas Biekpe, we learn what characteristics of this country's property/casualty insurers support greater efficiency. Relating to the papers in this group, efficiency could lead to value creation if it is signalled to the markets. In regression analysis taking the efficiency, productivity and scale economics into account, the authors find "a non-linear effect of size on efficiency and constant returns to scale. Product line diversification, reinsurance and leverage also have a significant relationship with efficiency and constant returns to scale". This study employs complex empirical analyses that can shed a light for regulators and management in the South African market.

The overall insights and lessons learned from the three studies in this group of papers is that, in M&As among insurers, and in the transfer of risks among players in the insurance sector there are attributes that can shed light on value creation. When we move into a study of one market specifically, we can see attributes that relate more significantly to efficiencies and thus, to value creations.

The third part of this issue is devoted to two papers that are also in the valuation arena, but with outside interventions. The first of the two is "The Relative Informativeness of Analysts' Stock Return Forecasts and Rating Changes for Insurance Companies" by Leon Chen and Steven W. Pottier. In this study, the authors prove the usefulness of the insurance industry analysts and rating agencies to investors. Chen and Pottier use a sample of "publicly traded insurers with financial strength ratings and target prices to find that their multivariate analysis results support their hypothesis of the usefulness of analysts and ratings".

The second paper in this group looks into bailout by the government in "Government Intervention through an Implicit Federal Backstop: Is There a Link to Market Power? by David L. Eckles and James I. Hilliard. At the start of the financial crisis in 2008, the federal government in the U.S. provided bailout to some insurance sector players, mainly to the AIG. The study investigates whether the governmental assistance created market power in terms of more competitiveness for the insurer receiving the help. The findings are that, at that time, the bailout did not give a competitive edge to the recipient of the money.

Overall, this third group of papers looks at the impact of outside stakeholders on the value and market competitiveness of insurers. The outside forces can be those that create signals on the well-being of publicly traded firms and their position in the market. Both studies provide illuminating answers to common questions, especially with the financial crisis as the backdrop.

In conclusion, for this special Insurance and Finance issue of *The Geneva Papers*, the topics, issues and challenges provided a large mix of original research. The groupings I offer in this editorial are just one option of how to view this compilation of papers. Nevertheless, the large investments by all stakeholders of the insurance industry in the area of financial stability merited placing the papers in the first group as the leading articles. This group provides significant lessons to be learned and insights for regulators and managers in the delicate calibration efforts to ensure financial stability.

The second group illuminates the areas of value creation in the insurance sector in both M&A activities and reinsurance. Understanding more fully the reinsurance contracts provides a true tool to insurance practitioners as well as for continued research. The third paper in this group is a mainstay in our field, since efficiency and productivity are centre-stage to successful industry.

In the third group, we see that, despite the assumption that governmental bailouts can lead to major distortions in the insurance markets, this did not happen in relation to the insurance market's power as a consequence of bailouts in 2008.

I hope the readers find this special issue useful in their studies in Insurance and Finance and as benchmark for future research in topics of financial stability, regulations, and resolution and recovery of insurers; insurance capital structure, financial markets and products, markets conditions; financial strength and trends of the insurance sector globally and nationally; governance structure, M&A, and valuations of insurers among the many topics related to both insurance and finance.