Solution in Search of a Problem

By Richard J. Tucker

A good consultant is supposed to come up with solutions to their clients' problems. However, the most elegant solution will not be perceived as such until the problem or issue is important enough to the client for them to want to spend time and resources on a solution. Until that time, your idea may gather dust on the shelf along with those of other dormant geniuses.

The consultant / client relationship comes in many forms. There is the traditional actuarial consultant with insurance company clients. Within an insurance company, a product actuary may be the consultant while the client is the marketing department or sales force. My situation as a reinsurance intermediary has me providing risk management solutions to my ceding company clients. Every type of consultant / client relationship can experience a disconnect between a solution and finding the pertinent problem to be solved.

I doubt that I'm alone in the number of times that I felt that I had the best idea since sliced bread, and couldn't understand why others were not as excited as I was about it. Being a Douglas Adams fan and having recently seen the movie version of "Hitchhiker's Guide to the Galaxy", it is somewhat like coming up with the answer "42" to life, the universe, and everything, but not knowing what the question was. (The next book tells us that the question is "What is 6 times 9?").

Once you have the solution and go looking for the problem to solve, you could find:

1. Your constituents are sitting by the phone waiting for you to call and solve their problem.
2. The solution is indeed elegant, and clients want your assistance in due order.
3. Your clients need your assistance in understanding and evaluating the problem that you have come to solve.
4. The problem you perceived does not exist, at least not at the magnitude that you thought.
5. Your idea stinks.

Item (5) is a potential topic for another article, item (2) is an enviable position to be in, and I've never experienced item (1). Items (3) and (4) are the range of what this article addresses.

An example of this that I'm currently working on is the reinsurance of equity indexed annuities. The concept is that equity indexed annuities are a natural product hedge for variable annuity guaranteed benefits. EIA's are "call-based", meaning they produce value if the market goes up. Variable annuity guaranteed benefits are "put-based," meaning they produce value if the market goes down. An insurance entity containing both products will have a more balanced risk profile than an entity containing just one or the other. I believe that the ceding and/or assuming of these risks can facilitate the employment of this natural product hedge.

When this idea was first broached by my company over 10 years ago, it was ahead of its time because neither of the product areas had sufficiently matured. Variable annuity guaranteed benefits matured first, but the EIA market is just maturing now. For the first time, our clients are interested in learning about this solution. The education process must be completed before I finally find out if I've found a viable solution to a problem in need of a solution.

This education is a two-sided process. I start out briefing my ceding company client on the reinsurance structure I've created for their benefit. The solution is based on needs and desires that I've distilled from ongoing discussions with my clients as well as industry-based knowledge. Any solution needs to be refined as it goes through a continuous feedback loop with the client.

Using my EIA example, one of my reinsurance programs helped to stabilize the cost of providing the index participation inherent in the product. As background, when capital market derivatives are used to fund the index participation, the cost of doing so is sensitive to interest rates and equity volatility. One of the features of the substitute reinsurance program was to reduce the cost sensitivity attributable to both factors. Upon discussion with the client, I learned that it is better to continue to allow the cost of reinsurance to float with the level of interest rates. As interest rates go up, the amount of money available from the EIA product to fund index participation goes up, so it is appropriate for the reinsurance cost to similarly reflect the level of interest rates.

Not every idea takes 10 years to come to fruition. In fact, most will die much sooner than that. To maximize your efforts, you need to maintain a close ongoing relationship with your clients. Understand their needs and problems. Keep abreast of where the marketplace is heading. This should minimize your harebrained schemes. The surviving ideas need to find their place among the economic priorities of your clients. This gestation period is not readily predictable. Your role as a consultant is to counsel your clients and to be there when they need you. Present them with new ideas and opportunities. If the idea is truly valuable, it will usually reach the point of economic viability. You cannot predict when this will occur, so it is best to always have multiple ideas in various stages of consideration.

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