Conversation with a CRO: An Interview with Nick Silitch

Nick Silitch, Chief Risk Officer, Prudential Financial

The Joint Risk Management Section is pleased to announce the start of a new feature series, "Conversation with a CRO." Going forward, each issue of *Risk Management* will include an open and candid Q&A with one of the top risk practitioners in the insurance industry, offering insights into the major issues facing the industry and how the very best in the industry are addressing the issues.

In this, the first in our new series, *Risk Management* is honored to have been given the opportunity to interview Nick Silitch, CRO of Prudential Financial. Never one to hold back on expressing a view, and always ready to engage in a lively discussion, our interview with Nick held much excited anticipation, and we were not disappointed.

Nick was interviewed at his office on Oct. 23, 2017 by Tony Dardis and Awa Koné, of Milliman, Inc.

Nick Silitch is one of the most respected and well known risk practitioners in the financial services industry. As CRO of Prudential Financial, Nick oversees Prudential's risk management infrastructure and risk profile globally. Nick chairs the organization's Enterprise Risk Committee that evaluates current and emerging risks relevant to the company, and is a member of Prudential's Senior Management Council. Nick joined Prudential in 2010 after many years in the banking industry, including nearly 30 years at the Bank of New York Mellon, and is unique in that regard having held senior management positions in both the insurance and banking sectors.

In this wide-ranging discussion with Nick, we were keen to get his perspectives on the topics of risk culture, the use of economic capital, and the role of actuaries in risk management, which were all topics on which Nick had many interesting perspectives.

Q: What are things that can be done to ensure a successful "risk culture" in an insurance organization? What can CROs be doing to make risk management part of their company's strategic decision making?

A: I don't believe in having a risk culture. What companies need to do is start with a foundation that establishes a *company-specific, company-wide culture whereby an appreciation of the value of risk management runs throughout the DNA of the company*. And flowing from that, all strategic decisions then reflect consideration of the balance between the risk profile and opportunity cost associated with that decision and the potential return. If you have a culture that embraces risk management, you will have a chance to be able to grow a healthy organization that actively considers risk and return as it moves forward, which is a good framework for a financial company.

An example of this at Prudential is our risk appetite, which has been bought into across the organization, so there is a common goal in optimizing strategies across multiple financial lenses, whether statutory, economic, or liquidity for the benefit of

shareholders and other key stakeholders. The risk function acts as scorekeeper and stage setter for the risk appetite, but it is owned by the collective organization: the businesses, corporate functions and the board. As a result, the risk function is integral to and becomes involved early on in strategic discussions. For example, as soon as the company starts to consider a new acquisition or a new product, we start asking how this fits into our overall risk appetite.

Q: How do you know then that you have the right culture?

A: I live it every day. Here at Prudential, we truly have an open door policy where everyone is encouraged to speak up. It is a remarkable privilege to work in and be responsible for continuing to cultivate such a healthy environment.

One thing for sure is that knowing you have the right culture is not a matter of ticking the boxes. It's not something you can test or manage to. You could try coming up with say five to six attributes for a successful culture that incorporates risk, but the danger in that is you manage to these attributes and then lose the soul of your culture. You know you have a great culture if whenever confronted with uncomfortable decisions the organization makes the right one. If you are fortunate enough to have this type of culture, the worry is that it could change. As a result, boards, senior managers and other stakeholders need to keep a careful watch on it so that the core of the culture is open dialogue and an active consideration of risk and return.

Q: What role can economic capital (or internal capital) have? What are potential barriers to a successful economic capital program and how can insurers overcome them?

A: The concept of economic capital has been amongst the most misused ideas in finance over the last twenty years. The notion that the modeling of your risks to a certain confidence interval would allow you to be able to equate a dollar of market risk to a dollar of investment, insurance or operational risk is appealing, yet largely unattainable, and of modest use even if successful. The amount of data that we have on many of the risks that we take does not support precise 5 in 10,000 type tail measurements without making heroic and often faulty assumptions. Furthermore, the historic relationships of these risks to one another can break down as tail outcomes are explored.

The value in the exercise of modeling your risks is the understanding that is gained in the shape of the distribution and the role that each input can play in the shaping of that tail. Broad understanding and agreement (line businesses, board and corporate functions) as to the nature of the risks that you take is critical to developing an open, transparent risk dialogue and allowing the organization to collaboratively engage in the management of risk and return. For this reason, economic capital models are important components of the risk management tool box, but must be partnered with deterministic stress testing and an understanding of statutory capital and liquidity implications for an effective risk management framework.

Only when understanding this complete picture can the organization endeavor to optimize outcomes for all relevant stakeholders.

Where economic capital can be useful on its own merit is as a tool for the pricing of risks, ensuring that the economic risk and return profiles stay balanced as we seek to optimize across, largely more conservative, statutory capital requirements.

Q: Do you have priority in your risk appetite limits?

A: We have a risk appetite statement, not limits on risk appetite. It is a high-level idea of how we want to operate the company during periods of stress. Then, we develop financial metrics as interpretations of these high-level ideas and set risk-type limits so we can stay within the desired parameters. We have board limits and operating limits. Our operating limits leave enough room so there is little danger of breaching board limits.

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Q: Actuaries already play a role in the risk management arena, but could probably do more. How do you see the role of actuaries in this space?

A: Of course, there is a huge role for actuaries in the insurance industry, and I don't think actuaries can do a better job than they have been doing in their fields of expertise. *Being an actuary is its own highly specialized skillset* and while there is tremendous value to the core competency it doesn't mean you are qualified to practice as a risk professional. For instance, a highly qualified investment professional doesn't equate to an investment risk professional, a markets professional doesn't equate to a market risk professional and an actuary doesn't equate to an insurance

risk professional. Each skillset is a critical underpinning to being a strong risk professional, but you must also possess other skills sets. And this is because risk management at the core requires a slightly different focus. Indeed, a good risk manager has to:

- Challenge the status quo;
- Understand the distribution of tail outcomes as well as the best estimate;
- Manage complexity arising from there being multiple agendas around a variety of issues; and
- Understand quantitative and qualitative analytical risk frameworks and the strengths and weaknesses of both.

What's a more useful question to ask here is how well are the actuarial and risk professionals communicating and collaborating? I have an extremely close relationship and open dialogue with our chief actuary, and we have tremendous respect for each other. A healthy dialogue between actuaries and the risk team is essential to the overall management of an insurance company.

Q: Much attention has been given by the industry in recent years to building out model risk management capabilities. What would you view as the key to a successful model risk management program?

A: Model risk for banking is high touch and predictive, which is different than the insurance industry. However, in insurance the rigor in actuarial models is tested regularly and fairly rigorously. Every year there is a model validation process with the auditors and with assumptions unlocking. Therefore, in essence, the core principles of SR 11-7 have existed for years within the insurance accounting, actuarial and financial reporting frameworks. As a result, companies need to be careful to build model risk programs that consider existing strengths and build enhancements around documentation and rigor.

Also critical for model risk, similar to other risk, is the maintenance of open and transparent dialogue around the development and use of models, and the incorporation of models into our business plan. Strong, transparent governance of assumptions and key model components is essential.

Q: Cyber risk is another "operational risk" that has gained increasing focus in recent years. What would you view as some of the biggest issues around cyber risk and how to best manage these issues?

A: Cyber risk is constantly changing and is a focus for a lot of people on both sides.

In this day and age, you have to assume that anybody can possess personal information about other individuals, making the verification of customers' identities more difficult.

Banks are losing a lot of money due to cybercrime every year. Additionally, the cyber threat has evolved over time. It used to be that cyber criminality was focused on individuals. But, over the past decade or more, we are seeing hackers getting more sophisticated and going after companies. As an industry, we invest a lot of resources in this risk. But, the game is constantly changing and the bar will continue to rise. This is why we—and the industry at large—continue to stay focused on the evolving cyber landscape. If this escalation continues unchecked, at some point firms may collectively consider changing how they engage with customers.

Q: Since we are on the topic of threats, in your opinion, what are the main trends in risk in the next three to five years that insurance companies will be facing?

A: Evolution in the uses of data, digital and technology platforms are going to change business models—how we underwrite, how we service customers—and as that happens, there will be operational and products risks.

Advancements in genetics and disease management might make for a different world—influencing mortality and longevity at the extremes in addition to bringing about complex moral and legal issues to consider as well as a potential uneven distribution of information on personal data.

Climate change for P&C. A one degree increase in ocean temperatures changes catastrophe models exponentially.

On the asset side, the industry needs to be cognizant of the fact that the companies we invest in are going through the same economic, political and technological issues that we are facing in the insurance industry, resulting in changing and evolving business models. Therefore, from an investment perspective we have to keep an open mindset. ■

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