Archipelago

Fireside Interview: The Imperative of Ensuring Resiliency

Advisen 2021 Property Insights Conference @ Home Virtual Series (11/10/21-11/11/21)

Speakers:

- Hemant Shah, CEO of Archipelago
- Jeff Cohen, SVP at Zywave/Advisen

Hemant Shah:

Hey, Jeff. It's great to see you.

Jeff Cohen:

Hemant, wonderful to see you. Thank you very much for being here, being part of this program. Wonderful to have you.

Hemant:

Yes, I always enjoy our conversations, and they always end up in a really interesting place. It's great to be here at the start of your conference.

Jeff:

Thank you. To all of you, I say welcome to the beginning part of our program. This is the keynote address, cleverly disguised as a fireside chat with Hemant Shah, the CEO of Archipelago. I want to share with all of you why we asked Hemant to play this role in the program. To provide backdrop, I will share with you a point. Actually, it's your point, Hemant, that you've made to me several times, which is to have a point that matters, it must be cause for debate. I suspect it's something that you've shared with your employees over the years.

I was reminded of this because several weeks ago, I was at an offsite. We were joined by Don Bailey, who many of you know through his association with Marsh, Willis North America. He's a senior advisor to the board of directors at Zywave and I always enjoy spending time with him. He outlined his view that an online meeting can only have one of three purposes: It's to update, to debate, or to decide. I suspect that we're going to fulfill that first aspect, to update via this conversation, but if it works, it will cause a certain amount of internal debate and further thought for all of us participating.

To the audience, thank you for being here. Hemant, I think that the first thing we have to do together is wind back the clock. We are going to go beyond September of 2018 when you started Archipelago and we'll talk more about that in a moment. We're going to go beyond the 30 years or so that you spent running RMS, arguably one of the premier property catastrophe modeling companies out there, and we're going to go just ahead of that to your days as an engineering graduate student at Stanford and you're putting together a business plan, you are trying to look at the intersection between property risk and financial outcomes, you take this business plan out to some investors, you have to raise money.

I'm thinking about the state of affairs back then versus when you did the same thing 30 years later at Archipelago and I'm thinking about my recent experience back in October, out in Las Vegas with InsureTech Connect and how things have changed. I suspect when you share your response here, the audience will gain a greater appreciation for all of the various paths that lead us to today's property conference.

Hemant:

Wow. How much time have we got, Jeff? This could be a long conversation rewinding the clock 30 years. Thankful for the Touch Up My Appearance feature on the Zoom filter. You mentioned the ITC conference. I got a real workout in Vegas at that event because representing my new venture Archipelago on the second floor of the Mandalay Bay Convention Center was InsureTech Connect and on the third floor of the convention center was the same organizer's organized blueprint, which was their inaugural PropTech Convention, so with Archipelago I was going between these two worlds, which is a bit of a metaphor for the new business.

But you mentioned the early days of RMS when I was working on the business plan I got as a grad student at Stanford many years ago.

> **One of the things that has changed, if you compare and contrast my experience starting Archipelago to what it was like starting RMS when we were raising venture investment for RMS back in the early '90s, we basically got some pretty strange looks from investors when we pitched them that we were going to build a catastrophe modeling business that was going to create positive transformation in how the global insurance industry manages catastrophe risk and allocates capital efficiently to cover more risk to build more resiliency into our global society.**

They heard all those words, but their question was, "Insurance? You're going to focus on the insurance industry?" and the conversation would often end there.

Fast forward to now and InsureTech Connect and raising money for Archipelago, one thing that's really changed is insurance has become cool as a sector to attract talent, capital, venture investors.

> **There are so many opportunities to create positive change in this marketplace and one thing that really has changed over the 30 years is that there are many more investors receptive to investing in theses based upon transforming how risk and insurance are managed than it was 30-plus years ago.**

Jeff:

That's awesome. That's awesome. I wonder whether or not the debate that's going to ensue amongst our audiences, whether or not insurance is, in fact, cool. That's not where we're going to go.

First, I think what I'd like you to do is share what you were trying to accomplish leading RMS and how do you think you impacted the ecosystem that we cater to? And then we'll talk a little bit about the same thing from Archipelago's standpoint, and then we'll jump into our conversation.

Hemant:

One of the things that was just so rewarding at RMS in the work that we did in collaboration with hundreds of insurers and reinsurers and intermediaries and brokers is that we were striving to create systems change. Yes, we built a model initially for California Earthquake and then for Japan Earthquake and then for Florida Hurricane and then for European Windstorm and on and on and on. Yes, we built these very sophisticated, specific modeling tools, but they were in service of a larger mission, which is how do we create a more resilient and efficient insurance market for the provision of capital to cover these highly volatile risks?

That journey over all those years, and there were many of us creating this positive change, both within RMS and across the ecosystem, was such an opportunity to understand how the whole insurance value chain works. Had the opportunity to sit with insurance underwriters where they worked on underwriting their large corporate accounts. Had the opportunity to sit with the portfolio managers, allocating capital from one line of business to another. The reinsurance buyers, how they think about risk in their hedging strategy, the reinsurers, how they think about allocating capital to these volatile risks, and to participate as well in the creation of the alternative risk transfer market with the invention of the catastrophe bonds and new ways of attracting capital cost-effectively to deploy against risks.

Yes, we spent a lot of time thinking about earthquakes and hurricanes, but we also got a chance and I got a chance to learn how this whole value chain operates at every point along the cycle. What's the role of capital? What's the role of distribution? What's the role of data? What's the role of analytics? Throughout this journey, developed a real deep appreciation and admiration, so when the insurance industry is its best self, it's not always its best self, but when it is its best self, it plays an absolutely fundamental and vital role in our global economy.

> **I found that very motivating and it's deep in my DNA, that insurance, for all of its warts and all the things that drive us, distraction about the inefficiencies and the frustrations and the often illogical nature of how things get done, it is a vitally important market that, if it can be empowered to be its best self, can create positive change, not just for itself as a marketplace, but for the underlying economy and society it serves.**

That true north and that deep appreciation and learning of that over 25, 30 years at RMS, working with all these wonderful people across the vertical, all of that, I've taken to Archipelago, but with an important change in perspective to take that journey to the next level.

Jeff:

Definitely take us through your thought process as you and your partners approach the opportunity that confronts Archipelago.

Hemant:

At Archipelago, we are focused on a risk and insurance proposition like we were in my previous company, but from a completely different vantage point. Our core customers at Archipelago are some of the largest owners of commercial property and real assets in the world. They're large institutional owners, they're large corporate owners, and yeah, they're also large buyers of insurance.

> **Rather than thinking about risk and insurance principally from the vantage point of an insurance marketplace, I want to take this whole proposition upstream and embed more effective proactive decision-making that's data-driven about risk into the actual owners, developers, and managers of the built environment that we all work, play, and live in. It's these institutions, it's their risk, it's their capital.**

They are stewards of the property that we all operate in and they are increasingly focused on how do we, as the owners of these assets, as stewards of these assets, drive resiliency to everything we do about these assets. That includes how we think about transferring risk to the insurance market, so it's about embedding data-driven decision-making, not just with the insurers to help them underwrite price risk and reinsure risk and issue CAT bonds, but how do we embed a data-driven risk management culture and capability into the very owners of all these assets who then, yes, also insure these assets.

While our company was founded in September of 2018, we were in stealth until August of 2020. We only launched in 2020. I think there's way too much hype. We didn't launch until we actually had referenceable customers, some of the largest asset owners in the world. Since we've launched, we already have five trillion in total insured value unique property on the platform, so we're off to a pretty good start.

Jeff:

That's an incredible way to leap as you start a business, so congrats there. I want to now move to an exploration, if you will, of this idea of how our audience should approach managing resilience in times of increased volatility.

Perhaps as the first step in this conversation, I'd like to ask, when you think of resiliency, Hemant, what encompasses resiliency and how does it present itself in a way that's different from the way perhaps our audience might be thinking about the same notion?

Hemant:

> **I think of resiliency as a system of incentives and behaviors that create the very feedback loops that make our built environment more resilient and less vulnerable to incidences, losses, damages, and disruption.**

I think too often resiliency is seen as a score, a metric, an analytic, a way of pricing insurable risk. It's a way of thinking about creating a system of incentives that not only increases resiliency but creates the very feedback loops that align not only the owners of assets who are looking to increase the resiliency of their property, the insurers of the assets, and the signals and the data flow between them that create a virtuous circle that creates the very preconditions to improve the resiliency of the built environment. It's a system of interaction between these two vast markets, insurance and asset owners, to create more resiliency in our built environment.

When insurance is its best self, it's a powerful incentive for resiliency. When I think about the value proposition of insurance, and this is something I've developed in debates and late-night talks with many of my friends and associates in the insurance industry over three decades, I think of the value proposition of insurance not just providing coverage to help corporations and people recover more quickly when bad things occur. Insurance, more fundamentally, those are ex-post signals, it's more ex-ante.

> **Insurance creates a powerful incentive mechanism when accompanied by transparent signals to create a value proposition and the incentives to reduce risk in the first place. One of the things that I find very, very exciting about this market is that it creates these signals. One of the things that's frustrating about this market is those signals aren't clear enough and I think that's part of my motivation at Archipelago — to create more transparent signals that can drive resiliency systematically across this ecosystem and take risk out of the system because volatility is interesting, and given secular changes in our climate, it's not like this problem is going away anytime soon.**

Jeff:

Well, yeah, that's actually one of the points I wanted to insert here, put a little asterisk on it is this notion of time, right? Time in the insurance space, traditionally, it's a notion of sequencing. It's just, "I have my annual property renewal and my company measures results in increments of a quarter, a half year, a whole year, fiscal year," and you're talking about resiliency and I'm hearing a very long-term game. There's a clash in here.

Hemant:

Yeah, no, I've spoken a lot about this. There's kind of this impedance mismatch between. The insurance market, for a lot of logical reasons, is focused on this Groundhog Day cycle of the annual renewal and the annual pricing of the risk and where are we in the market cycle this year and how do we incrementally adapt our practices.

You step back, the owners of these assets, when they develop these assets, they're thinking increasingly, not year to year, but decade to decade.

> **The life of these assets is 20 years, 40 years, 50 years. It's not just the owners of the assets. The people that they're accountable to, their investors, their stakeholders are thinking about, "How do we ensure that these institutions that are developing and managing property are good**

> **stewards of our capital deployed against these assets that need to be managed and the risk needs to be insured over decades?" and so you have this tension between this annual cycle called "insurance" and this multi-decadal cycle called "resiliency."**

There are opportunities to reconcile those, but that's where the work needs to happen — at the intersection of those two worlds.

I think to ‘money’ in the insurance industry. Maybe I'm going to get myself in trouble with some of my friends and colleagues in the insurance industry, the insurance industry spent a lot of time talking to itself, one part of the value chain talking to another, the same issues over and over. One of the things that's been so, and I've been part of that, I've served this industry for 30 years, I have scars on my back. But one of the things that has been so refreshing about still focusing on the importance of the risk and insurance proposition, has been taking it up a level, upstream a level, and sitting with the owners who are the developers and the stewards of these assets.

They have billions, tens of billions, hundreds of billions of assets under management. They're developing these properties, they're managing these properties, they're investing these properties, they're operating these properties, and yes, they're insuring these properties. They have a different vantage point, which pulls you back from the kind of transactional nature of insurance to something more fundamental.

> **How do we create incentives and systems that systematically enable our economy to understand clearly what are the costs of risk? What drives the cost of risk? How are those likely to unfold over time? How do we systematically manage those risks, inclusively, not just transfer them, but mitigate them and take the risks out of the system in the first place?**

It's a very different vantage point, which has raised not only some challenges, in my mind, but some significant opportunities that if we can do things differently, by looking across the intersection of these two vast markets and getting them on the same page, we can drive some really positive outcomes, and to your earlier question, increase the resiliency of our economy and our built environment in our lifetimes. That's what I'm motivated to do here at Archipelago.

Jeff:

Absolutely. I would imagine that some of the changes you're talking about, then, with these very large global property owners will have a dramatic impact on the service providers. That's where we're going next. Then we'll have sort of a circuitous reverse coming all the way back, impacting those smaller companies down to individual homeowners and other aspects of personal lives.

What's happening in your view? What factors are disruptive, for lack of a better word, on the service provider front that are both encouraging the resiliency direction vector and also countering it?

Hemant:

Your comment about the large owners powering networks into the insurance industry, it sounds like you've been in a couple of my board meetings, Jeff. It's not a coincidence as well that that is a fact. Any one of these owners and Archipelago customers not only has billions to hundred-billion-plus in property values that they're managing and insuring, they have a lot of insurers.

When you and I buy insurance, we buy insurance on an app or a website from an insurer or insuretech platform. When a large owner of this scale buys insurance, they have large syndicated programs that touch dozens if not a hundred-plus insurance entities that share and layer their risk globally, so every single one of these owners is also a big trading partner of the insurance industry who has a mutuality of interest in the underlying data that defines the characteristics of the risk and enables the market to efficiently and accurately understand and price the risk.

> **A key part of what we're doing is, by focusing on initially the large owners of these assets, empowering them to source, integrate, connect, enrich high-quality data about their own properties across the life cycle of their assets, and then share in permission access to those data sets by their insurance renewals to their insurers via their broker-partners who are hungry for high-quality data to more efficiently underwrite and price their risk.**

You can create a neutrality of support on both sides of this marketplace to create higher-quality data that's more trusted that can unlock more capital deployed more efficiently to cover more risk and drive more resiliency and create more transparent feedback loops to do so to create a virtuous circle. That's a key part of our strategy — understanding how this insurance industry works and recognizing that these feedback loops can be activated to create positive change, not only for the owners of the assets but for the insurers of the assets and their broker-partners who are making the market for these assets.

Jeff:

Got it. Okay, so if we take that as that's the current state and that's the desired direction that we want to go, let me ask you to open up your crystal ball.

We're going to poke the bear a little bit and I'm going to ask you, what are some of the most logical knock-on effects that you would anticipate if the world moves in this direction that you're suggesting?

Hemant:

Oh, there's a lot of the bear and there's a lot of things to poke at. I've been a student and a fan of this marketplace for a long time and appreciate its strengths and also the challenges. I mean, I think one of the things Archipelago and advising did together was the property risk management report where we surveyed hundreds of risk managers. There was a lot of fascinating feedback and insight that came back from the risk management community of the asset owners, the buyers of risk, how they think about risk, risk management, the insurance industry, innovation, the state of the market.

> **But the one response that really got my attention more than any other was that I was surprised, not shocked, but surprised that only 29% of the risk managers that responded, only 29% said they were satisfied with their understanding of how insurers use their data in order to make decisions on how they underwrite and price their risk.**

Now, that may sound like a very technical point that you might expect from somebody like me who's an ex-catastrophe modeler and now creating a risk data platform at Archipelago to bring up.

But if you think about what that means, if you think about the most vital purpose of the insurance industry, it's not just to provide coverage ex-post, when things happen, but ex-ante, to create transparent market signals and incentives for the owner of the risk to mitigate or reduce risk in the first place.

> **If only 29%, just to use that roughly as a statistic, understand how the market is using data about their properties to underwrite and price their risk, it means 71% aren't clear, yet you're getting coverage, you're getting a price, but you're not getting clear signals in how to reduce risk in the first place. Something is broken. I mean, that is a profoundly disappointing response.**

Now, you can quibble: "Is it 29%? The context of the question, maybe it's a higher percentage." But the point is, it's not just the survey, I hear this over and over again when I talk to the large owners of these assets and their risk management teams. They're very frustrated. They don't understand these signals. They hear all kinds of explanations, and some of them are absolutely valid and grounded in data, but the signal that comes through is unclear. I think this is profoundly important for the insurance industry to embrace and understand that it's not just an annual trading relationship. If there's not a consistent way of signaling to your customer how, not only you price the risk, but how that reflects the actuality of the underwriting risk and being clear and articulate and objective and data-driven and how you communicate that, they can't act on that information. Yeah, you might issue 10 loss control engineering reports, but they got thousands of properties. They're not getting a clear, actionable signal.

I think overcoming that cognitive dissonance is one of the great challenges and opportunities for the industry because I believe, I'm an optimist. Those who know me know I'm very optimistic and I'm a big fan of this marketplace, the biggest fans get to be the biggest critics. I'm an optimist that if the insurance market can become more data-driven and transparent in how it not only underwrites and prices risk, but engages its corporate customers in why and what it means for how they should understand their own risk, and then reduce it over time and create a virtuous circle, that's a huge opportunity to create more value to increase the relevance of the insurance proposition.

It's not just the coverage to restore when something goes wrong. It's the insight in the intellectual capital that says, "We understand risk in the first place and we can help you as our customer manage and reduce your risk." That aligns the interests of the market and the big buyers in a way that's not quite aligned right now and it creates an opportunity for the industry to become even more relevant to driving resiliency in our society than it is today.

> **On the flip side, if it doesn't figure out how to do that, I mean, the ground is already shifting. These large owners have pretty big balance sheets, but they are increasingly shifting their mindset from, "The risk management team buys insurance," to, "We're part of an organization that's trying to increase resiliency. We might sell some risk, but our main purpose is we're trying to increase resiliency. We're investing in our properties, we're building our own retention." The insurance industry, if it doesn't connect these dots and become more proactively engaged in helping its customers, not just cover the risk, understand the risk and then reduce the risk, the industry could become increasingly irrelevant to how these large institutions upstream their customers think about the**

industry's role in helping them manage their resiliency over time. This shift is already taking place.

Jeff:

I'm listening to some of your thoughts and I'm hearing them with an eye towards, how does this perpetuate the industry into a place that it needs to go?

One of the things that I'm thinking about, of course, is where is capacity relative to this, I'm going to call it the "utopian ideal" that you're describing that we need to move towards? How much insurance is out there? Is it woefully insufficient? Well, does the future suggest that capacities and coverage, all of this has to just be lifted in order to meet some of these new challenges? I don't mean to cut you off, I just want to throw out this last point to you, which is: Are you heralding the onset of some sort of property Renaissance, or do you foresee this being a gradual shift in this direction?

Hemant:

I think with systems change, things go slowly, and then they go very quickly, so I am envisioning a resiliency Renaissance with the opportunity for the insurance industry to be a key catalyst, partner,and value-added contributor to how our economy builds in more resiliency fundamentally because we're going to need it.

In insurance, and I think of myself as being part of the insurance industry because that's the only market I've served my whole professional career, and adult life, for that matter, it's a large industry, right? There's a lot of moving parts in it. But if you look at the size of the industry compared to the size of the risk upstream, it's quite small.

You have individual corporations that have more risk than the entire capacity of a major market in the insurance industry can provide.This is not a criticism. This is an opportunity. If we can get more transparent data and feedback loops going between the owners of the risk and the insurers of the risk, we can get more insight that's actionable built into the flows of information and analytics. We can scale this industry.

There's a lot of capital out there. It's not just going to insurtech. There's a lot of capital going into all kinds of productive activities on a global scale. There is a lot of capital relative to how much is currently in the insurance industry. If we can unlock that opportunity, more capital can flow in that reduces the cost of capital deployed against more risk, creates more coverage, more coverage solutions, more feedback loops. Yeah, we can scale this thing up, and we really need to. We need to stop thinking about where we are in the cycle and, "Is the market hard or soft?" to, "How do we think about architecting the basis for an industry that's three to five times bigger."

> **This is not a zero-sum game where one part of the value chain wins, another part loses. It's like, how does this marketplace think through and embrace the mindset of its big corporate customers who are very large institutions thinking very fundamentally about how they govern and manage the resiliency of their enterprises, increasingly driven by very powerful stakeholders called their boards, their investors, the people that they're accountable to? How do we rethink that mindset, which is not zero-sum, win/lose, cycle this, cycle that? How do we rearchitect this marketplace to be much more relevant to their needs, and as a result, much larger, more capital, not just providing coverage, but value-added insights and actionable advice and IP to help these companies manage their risks, not just insure the risk?**

That is an opportunity for this industry and I see a Renaissance coming. The flip side is the Renaissance is coming upstream, anyways. The industry either can take this as an opportunity to reinvent its value proposition, or there's a risk it becomes increasingly not so relevant to what its biggest customers are doing and thinking when they think about risk and resiliency management. It's not just procuring insurance, it's something far more fundamental.

Jeff:

Wow. Hemant, every conversation I have with you is engaging, and this has proved to be no different. I can't thank you enough for sharing those views. I think several of them will prove to be a challenge to the industry, and certainly to some insurance buyers and risk managers. I have to say, I'm eagerly looking forward to the consequences and the vision that you've laid out for the industry.

Up next is our state of the market first panel of the conference to discuss since we'll review new approaches to property insurance, no doubt impacted by some of your remarks. Hemant, I want to say thank you very much for joining us.

Hemant:

It's a pleasure bantering with you and exploring some of these themes. I'm looking forward to the panel discussion. I know several of the panelists well. I look forward to continuing this dialogue throughout your event.

Jeff:

All right. Onto the first panel. Hemant, thank you very much.

Hemant:

Thank you, Jeff.

Want to help your organization better respond to the imperatives of resiliency? Learn more at Archipelago or schedule a demo.