



THE
Metamorphosis
ROUNDTABLES

PATTERN RECOGNITION • STRATEGIC ADAPTATION • FUTURE PATHWAYS

July 10, 2023

BMO Chicago Tower
320 S. Canal Street
Chicago, IL

Presented by

BMO



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The Metamorphosis Roundtables

Transformation and Adaptation in an Era of Volatile Risk

Hosted by BMO Financial Group and The Long Run Institute
Chicago IL, July 2023

SYNTHESIS / ANALYSIS OF DISCUSSIONS

Co-Chairs

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AGENDA

- Keynote Fireside with **General Stanley McChrystal**, former Director of the Joint Chiefs of Staff and Founder of the McChrystal Group
- Roundtable One: EVENTS: Geopolitical Challenges, Political and Social Volatility
- Luncheon: Keynote Address by **Professor Juliette Kayyem**, Belfer Senior Lecturer in International Security, Harvard University
- Keynote Fireside with **Dr. Nouriel Roubini**, Professor Emeritus, Stern School of Business, New York University
- Roundtable Two: CYCLES: The Economy and Risk Dynamics

Objectives

Our objective for the roundtable was to provide senior decision-makers with the deep context and relevant insight they need to understand what has become a much more contested risk environment. Our focus is on bringing pattern recognition and proposing strategic adaptation to the increasingly turbulent and unpredictable economic and financial cycles. Events, cycles and overlapping crises in the first half of 2023 have severely tested systems and assumptions. How can we understand and respond to those emerging patterns? This is a synopsis of the key themes and ideas covered on the day. We hope this provides a useful aide memoir and stimulation for further thinking.

Synopsis

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What is risk, how do we define it?

One of the key challenges noted by speakers was the difficulties in identifying common definitions and perspectives of risk, particularly when different stakeholders engage with each other. We can think of risk in different ways.

One is in terms of probabilities – In this case risks are outcomes we can identify. They are calculable and therefore predictable. Beyond this definition, risks are uncertainties or threats – outcomes which are not normally distributed and therefore we cannot attach probabilities to them. These outcomes can be extremely disruptive, particularly in highly networked environments where unpredictable interactions are likely, and modelling of these events becomes markedly complex.

Even within the probabilistic set of risks we encounter the way in which different stakeholders choose to analyse and use the data can cause problems. Supposedly low probability outcomes (often negative in nature) can be dismissed, particularly when they do not fit within the calculus and interests of different audiences. Here we can think about interactions between the military, politicians, and corporate stakeholders, who may choose to perceive the relative downsides to a particular outcome very differently. Whilst engaging with uncertainty and threats is complex, resource intensive, and difficult to plan for, so organizations limit their commitment to do so.

Drawing on approaches to Disaster Management, we can think of disastrous/crisis events (boom) and the ‘left’ of boom, in which we try to predict and prevent these outcomes, and the ‘right’ of boom where we respond and mitigate. But the definition of what constitutes a disaster or crisis can complicate how we think about what and how we are really preparing or responding to. Are we preparing for random and rare disasters or increasingly regular and predictable outcomes?

Clarity over how we both define the risks, uncertainties, threats, and disasters we face, and subsequently how we identify and calculate the plausibility and nature of the downside outcomes, will help organizations to develop strategies and structures for managing risk.

What are the risks that threaten us?

The world is facing unprecedented uncertainty due to the unusual interconnectedness between economic, social, political, geopolitical, environmental, and technological factors. This interconnectedness has created a highly volatile risk environment and a distinct set of complexities around systemic risk that make understanding and addressing these challenges particularly difficult.

This interconnectedness and volatility are shown sharply in the economic and geo-political environments. Economic and financial risks have changed significantly in recent years, with shifts in inflation concerns and worries about stagflation due to negative aggregate supply shocks. In a

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relatively short-period interest rates have gone from being very low to rise rapidly, leading to concerns about severe debt crises in a world with high debt levels.

Whilst the paradigm of unrestricted globalization is facing significant challenges. Serious tensions between the United States and China, the war in Ukraine, and wider geo-political jockeying have manifested in economic nationalism, leading to political policies and corporate strategies encouraging the decoupling of highly interconnected economies, with growing protectionism often in the form of subsidies. One clear example of these outcomes is both political and corporate efforts to de-risk supply chains, with governments proclaiming ‘national interest’ as a driver to protect access to key products and resources, and markets using protectionist measures.

These challenges have been exacerbated by the pressures of climate change and the recent Covid-19 pandemic which disrupted economies and massively increased government debt. They have also raised geo-political tensions as questions of responsibility and national interest are debated. Subsidy wars and ongoing discussion about the role of the US dollar as the global reserve currency and the potential for de-dollarization create further instability and risk a descent into unrestricted deglobalization.

Yet, disrupting supply chains and restricting trade and investment subsequently create supply shocks, increasing inflation and raising interest rates, creating the feedback loops and complex interconnections central to our risk environment.

The need for global cooperation to tackle global problems like climate change and energy markets is understood. However, the rise of populism and nationalism creates a tension between global issues and the desire for national sovereignty, making international coordination more difficult. This has also created significant complications in enabling Foreign Direct Investment (FDI) into the developing world, which will be a crucial tool in addressing these challenges.

Interconnectivity has been exacerbated through the rise of corporate actors who act as nodes in the deployment of increasingly critical technologies. For example, Amazon Web Services provides 32% of global cloud computing infrastructure, widely used by private and government organizations. This creates forms of systemic risk if services are disrupted, yet private ownership of these assets has made regulation of them complex.

A further set of challenges are being created by rapid advances in technology. Perhaps the most prevalent and pressing are the developments in Artificial Intelligence (AI), which is being integrated into increasing numbers of corporate and political processes. Whilst AI holds out the promise of significant improvements to efficiency and productivity, for example through the exponential improvements in pattern recognition enabling better and faster planning leading to

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the improvements in logistics, the threats are also significant. The extent to which AI replaces human labour, further exacerbating inequality, concentrating economic power within corporate oligopolies, and enabling global disinformation campaigns raise significant concerns over the governance and regulation of its use.

Controlling the narratives?

Narratives are extremely powerful tools in both the conceptualisation and management of risk. The challenge in managing the Covid-19 response was as much one of defining and communicating a public narrative explaining the risks and decisions made in-response, as it was of harnessing scientific capabilities to combat the virus. Similarly, the war in Ukraine, is, in-part a communications conflict with all sides attempting to define a dominant narrative to support their aims, whilst using disinformation campaigns to undermine their opponents. The narrative wars are also manifested in the conflict between the United States and China, with both seeking to develop a compelling narrative in support of their world view and allowing them to build alliances. In recent years, China has been able to exert a more appealing narrative in the developing world as a business partner that delivers.

The tone and focus of narratives present various threats in the way we address risk and uncertainty. On the one side, a Panglossian world view is unhelpful as it fails to realistically engage with the challenges we face, whilst a lack of humility or hyperbole often surrounds the capabilities we have to deal with them, leading to unrealistic policies and strategies. Conversely, if narratives flip-flop, or are overly negative, this also deters action. Establishing consistent narratives is further complicated by the moral dilemmas corporations and governments face in their decision making. How can the realism of dealing with states or companies whose practices and beliefs are at odds with our own values be reconciled to our own moral positions?

The interconnected nature of the challenges, and the importance of narrative is being played out in many advanced economies. High inflation and interest rates have created a cost-of-living crisis and ongoing fears of recession. Alongside longer-term trends such as deindustrialization, this has contributed to rising economic inequality, which has encouraged strains of populism and fuelled a growing narrative backlash against liberal democracy. In part, this also reflect a rising level of civic inequality, which has seen public debate and discourse severely diminished. This reduces the capacity to understand complex problems and public interest in addressing the realistic trade-offs that need to be made in addressing them. This ultimately leads to poor policy making and the potential for political crises.

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Lack of preparedness

A further key challenge in addressing risk is the lack of preparedness found in both corporate and government settings. Increasingly, questions are being asked as to why large government agencies fail to adequately respond to events.

One of the key problems is the Preparedness Paradox – The level of investment required to allow organizations to adequately prepare and plan for uncertain or unlikely events is hard to justify to stakeholders (shareholders or voters), therefore governments and corporations cut costs related to these activities. This failure to invest leads to obsolescence in both capabilities and mission, as organizations increasingly fail to understand the nature of the risks they face and pivot to adapt to these new realities. This leads to organizations fighting yesterday's wars.

The disinterest in preparation is manifested in the Normalization of Deviance: In various industries, including the airline industry, there is a tendency to overlook near misses to save on costs, kicking the can down the road until a major crisis occurs.

Lessons for managing risk

The interconnected nature of these threats requires a holistic approach to risk management, acknowledging the deep interactions shaping the challenges we face will require us to seek solutions that may require short-term sacrifices for long-term benefits.

1. Overcoming the preparedness paradox

We need to focus on both understanding and preparing for the crisis (boom) and 'extending the runway' to give ourselves more time to mitigate the impact. To do this we need to improve the narratives around risk and uncertainty to gain buy-in for the need to invest in preparation. There needs to be realistic acknowledgement of the challenges at hand, the capabilities we possess, and the gaps that need to be overcome. Organizations must accept that there are many incalculable uncertainties.

Narratives and public debate could be improved by depoliticising critical challenges. Improved engagement and willingness to view the trade-offs needed to make good decisions can be strengthened through education focused on building understanding of the nature of the risks. Similarly, a commitment to good governance, through the reduction of cronyism and clientelism, will strengthen positive narratives and commitments to act. This may also require changing the mentalities of governments, which can get stuck in outdated paradigms.

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2. Strengthening situational awareness and decision-making

There is a need to improve the situational awareness (context) in which decisions are made, and the processes through which this knowledge and information empowers better decision making. In the case of disaster management this should involve the provision of real-time information to individuals who are knowledgeable and empowered to act on it. For example, creating organisational cultures that embraces 'safe-to-fail' principles of learning from mistakes and looking for ways to improve decision making. Near misses are not disregarded but interrogated as crucial pieces of information to improve pattern recognition and preparedness against disastrous outcomes. Clearly articulated organizational values are also important in giving greater clarity to decision makers when responding to situations.

We can also consider other ways in which we strengthen our situation awareness through better understanding of the risks and decision-making environment. For example, taking more nuanced perspectives of conflicting demands and trade-offs in the geo-political arena. By looking to understand the interests and perspective of others, we can better forecast their likely responses and look for common ground. The risks of misunderstanding and miscommunication leading to crises are raised by failure to understand the other actors' interests.

3. Improving the architecture of response

How can organizations improve their responses to these challenges? They need to move beyond the analysis of the situation and immediate decisions, to also focus on managing the consequences. Organizations need to be designed to enable resiliency and adaptability. This is often best achieved through an ability to coordinate and work together.

The success of disaster response and recovery heavily depends on coordination between different levels of government, civil society, business, and community groups. The engagement of all sectors is crucial for effective disaster management. There is increasing recognition that the complexity of the challenges facing organizations today means that no individual company or state can adequately address them. How can government and business coordination be improved? There is a need for new institutions to manage systemic risk and uncertainty. Historical examples of successful coordination during times of crisis, such as the Second World War, potentially offer interesting examples as to how this might be achieved.

4. Listening to the past and learning from history

A long-term perspective can support each element of risk management. A better sense of history (previous events, long-run trends, antecedents to current situations, etc.) can help to overcome the preparedness paradox. History discourages hubris and overconfidence that risks and threats do not manifest themselves. History also helps us to construct more rigorous, fact-based narratives. It shows how previous events have played out and how we have responded to them. This can both improve pattern recognition (strengthening our situational awareness) and allow the construction of positive narratives (the world has changed before and will do so again).

Studying historical policy stances and corporate strategies, such as the supply-side revolution and secular stagnation, or the creation of global supply chains, help us to understand their impact on economic and social dynamics. This understanding emphasizes the need for a more pragmatic and coordinated approach to address current challenges like climate change and economic inequality. Thinking about systemic risks and interdependencies in the long-term helps to create frameworks that allow policy and strategy analysis that considers secondary and tertiary impacts over time which could improve our ability to address long-term challenges.

The past rhymes but does not repeat, there are distinctive differences to today's challenges. As such the insights history should help to provide context and define scenarios rather than create a set of prescribed guardrails.

The importance of leadership

There is a need for leaders to be fully engaged in the management of risk. This may involve the creation and training of specific roles focused on leading preparation and response.

Communication is key: Providing accurate information to the public during a crisis is essential. Leaders should communicate transparently, even if the truth is frightening, and focus on minimizing damage and finding solutions rather than making false promises. Details matter - providing accurate data builds trust with the public.

Instilling hope gives people the sense that tomorrow will be better and motivates them to invest in the future. Leaders can emphasize the potential for positive change through effective cooperation between government, business, and public institutions.

Further readings you may enjoy

- General Stanley McChrystal and Anna Butrico, *Risk: A User's Guide* (Portfolio, 2021)
- Juliette Kayem, *The Devil Never Sleeps: Learning to Live in an Age of Disasters* (Public Affairs, 2022)
- Nouriel Roubini, *MegaThreats: Ten Dangerous Trends That Imperil Our Future, And How to Survive Them* (Little, Brown and Company, 2022)
- John Kay & Mervyn King, *Radical Uncertainty: Decision-making for an unknowable future* (Bridge Street Press, 2021)
- Niall Fergusson, *Doom: The Politics of Catastrophe* (Allen Lane, 2021)

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