Biases in Macroprudential Supervision and Their Legal Implications

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Abstract : Given that macro-prudential supervision is a relatively new policy area and its empirical and analytical research are still in their infancy, its theoretical foundations are also lagging behind. This paper contributes to the developing discussion on effective legal and institutional macroprudential supervision frameworks. In the first part of the paper, it is argued that effectiveness as a key benchmark poses some challenges in the context of macroprudential supervision such as the difficulty in proving causality between supervisory actions and the achievement of the supervisor's mission. The paper suggests that effectiveness in the macroprudential context should, therefore, be assessed at the supervisory decision-making process (to be differentiated from the supervisory outcomes). The second part of the essay examines whether insights from behavioural economics can point to biases in the macroprudential decision-making process. These biases include, inter alia, preference bias, groupthink bias and inaction bias. It is argued that these biases are exacerbated in the multilateral setting of the macroprudential supervision framework in the EU. The paper then examines how legal and institutional frameworks should be designed to acknowledge and perhaps contain these identified biases. The paper suggests that the effectiveness of macroprudential policy will largely depend on the existence of clear and robust transparency and accountability arrangements. Accountability arrangements can be used as a vehicle for identifying and addressing potential biases in the macro-prudential framework, in particular, inaction bias. Inclusiveness of the public in the supervisory process in the form of transparency and awareness of the logic behind policy decisions may assist in minimising their potential unpopularity thus promoting their effectiveness. Furthermore, a governance structure which facilitates coordination of the macroprudential supervisor with other policymakers and incorporates outside perspectives and opinions could 'break-down' groupthink bias as well as inaction bias.

Keywords : behavioural economics and biases, effectiveness of macroprudential supervision, legal and institutional macroprudential frameworks, macroprudential decision-making process

Conference Title : ICFSMP 2018 : International Conference on Financial Stability and Macroprudential Policy
Conference Location : Prague, Czechia
Conference Dates : July 09-10, 2018