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Debiasing Macroprudential Policy: Part 2

Designing a New Diversity Criterion for Macroprudential Policy

A Keller

Part 1 of this article explored an evidence-based approach in macroprudential policymaking and critically analysed its challenges and limitations. Although taking an evidence-based approach to inform macroprudential policy decisions appears to be the most natural and intuitive approach to an effective macroprudential supervision, the article contended that this approach is fraught with complexity and inherent biases, such as issue bias, inaction bias and groupthink. The article, therefore, advocated good governance of evidence in the decision-making process of macroprudential supervisors that can be achieved primarily via independence and solid accountability and transparency arrangements. The article concluded with the suggestion that diversity should be a complementary building block in the governance of macroprudential supervisors and used as a key tool to ameliorate identified biases in macroprudential decision-making.

This continuation article delves deeper into the concept of diversity and explores its nature and key dimensions in the macroprudential sphere. It does so by drawing on the burgeoning scholarship on group decision making, *inter alia*, in the organisational behaviour discipline. Where decisions concern complex and ambiguous problems, their quality can be improved through the expression of alternative views and consideration of multiple perspectives.¹ In particular, a key stream in the behavioural strategy field highlights the importance of diverse groups in reducing cognitive biases by fostering information sharing and introducing new perspectives in the decision-making process.²

Following this introduction, section 1 identifies the various dimensions and formulations of diversity within the macroprudential institutional setting and decision-making process. Section 2 uses these dimensions as a benchmark to assess the diversity techniques adopted in the legal and institutional framework of the Financial Policy Committee (FPC)

¹ LR Hoffman, E Harburg and N Maier, 'Differences and Disagreement as Factors in Creative Group Problem Solving' (1962) 64 *Journal of Abnormal and Social Psychology* 206; HC Triandis, ER Hall and RB Ewen, 'Member Homogeneity and Dyadic Creativity' (1965) 18 *Human Relations* 33; C Nemeth, 'Differential Contributions of Majority and Minority Influence' (1986) 93 *Psychological Review* 23.

² RP Larrick, Debiasing in *DJ Koehler and N Harvey* (eds.), *Blackwell Handbook of Judgment and Decision Making* (Oxford: Blackwell Publishing, 2004) 316, in particular pages 326-327. Larrick lists accountability as a debiasing tool which affects the incentives of decision makers (motivational strategy).

For a recent comprehensive overview of behavioural strategy studies on diversity as a debiasing tool see P Meissner and W Torsten, 'The Effect of Cognitive Diversity on the Illusion of Control Bias in Strategic Decisions: An experimental Investigation' (2017) 35 *European Management Journal* 430.

and identifies potential pitfalls and weaknesses. The article concludes with the suggestion that in order to deliver meaningful diversity that encourages genuine deliberation in macroprudential decision-making, a nuanced and non-monolithic approach is needed. This means going beyond the heterogeneous composition of the macroprudential authority and considering a variety of factors such as the decision-rule, the facilitative rather than autocratic role of the chair and the transparency of dissenting viewpoints. By taking this approach, diversity can dissipate inherent biases in the macroprudential decision-making process and in particular, guard against groupthink.³

1. Dimensions of diversity

Evidence is emerging of a clear preference of legislators around the globe to assign macroprudential powers to a multi-agency committee or a board.⁴ This is hardly surprising. Group decision-making is generally thought to be superior to individual decision-making and systemically lead to better decisions.⁵ The preference for a committee or board structure also reflects the pronounced shift towards collective decision-making in monetary policy and the consensus amongst practitioners and scholars that it is international best practice.⁶

Yet, collective decision-making is not without faults. It introduces to the decision-making process a plethora of different biases, such as groupthink,⁷ that can have an unwanted and

³ Part 1 of the article in [].

⁴ According to RM Edge, 'New Financial Stability Governance Structures and Central Banks' (2017) Hutchins Center Working Paper 32, 41 out of 58 countries have a multi-agency financial stability committee (either formal or de facto). 15 of the 17 countries that do not have formal committees, have assigned, at least in practice, macroprudential responsibilities to a single institution (the central bank in 14 of them and the prudential regulator in one).

See also IMF's Annual Macroprudential Policy Survey- Objectives, Design, and Country Responses April 2018 available at <www.imf.org/en/Publications/Policy-Papers/Issues/2018/04/30/pp043018-imf-annual-macroprudential-policy-survey> accessed 10 June 2018.

⁵ For experimental evidence on the superiority of group decision-making over individuals in monetary policy see AS Blinder and K Morgan, 'Leadership in Groups: A Monetary Policy Experiment' (2008) *International Journal of Central Banking* 117; C Lombardelli, J Proudman, J Talbot, 'Committees versus Individuals: An Experimental Analysis of Monetary Policy (2015) 1(1) *International Journal of Central Banking* 181.

See also NRF Maier, 'Assets and Liabilities in Groups Problem Solving: The Need for an Integrative Function' (1967) 74(4) *Psychological Review* 239.

⁶ J Vandenbussche, 'Elements of Optimal Monetary Policy Committee Design' (2006) IMF Working Paper 277; AS Blinder *The Quiet Revolution: Central Banking Goes Modern* (Yale University Press, 2004), Ch 2 views the transition to committees as one of the three changes which constitute revolution in central banking.

⁷ Other inherent tendencies in a group decision-making process include an increased risk of polarisation ('an increase in the extremity of the average response of the subject population') see DG Myers and H Lamm, 'The Group Polarization Phenomenon' (1976) 83(4) *Psychological Bulletin* 602; H Lamm and DG Myers, 'Group Induced Polarization of Attitudes and Behaviours' (1978) 11 *Advances in Experimental Social Psychology* 145. There is also tendency of group members to "loaf" by free-riding on efforts of others but this may not be a serious issue in macroprudential committees. See A Sibert, 'Central Banking by Committee' (De Nederlandsche Bank workshop on 'Central Banking by Committee', Amsterdam, 28 November 2005).

detrimental effect on the performance of the group and the quality of its decisions.⁸ As suggested in ‘Debiasing Macroprudential Policy: Part 1’, these biases remain a strong and perennial force in the decision-making process of the macroprudential authority.⁹ Diversity, alongside accountability arrangements, can be used as a debiasing technique to correct or ameliorate these biases.¹⁰

It is, therefore, imperative to embed diversity techniques within the legal framework and governance of the macroprudential authority and build-in accountability mechanisms to evaluate the effectiveness and genuineness of these techniques. To formulate a nuanced legislative approach to diversity, this section considers its key dimensions, going beyond the obvious concept of diversity in composition and extending it to the nature of deliberation, the decision-rule and the role of the leader in facilitating (rather than dictating) the discussion and the resulting decision.

(a) Heterogeneous composition

Where macroprudential powers are assigned to a committee or a board, diversity in composition would mean the extent of the group’s heterogeneity.¹¹ Empirical evidence suggests that members of macroprudential committees¹² often include representatives from other policy areas such as monetary policy, micro-prudential supervision, conduct-of-business and fiscal policy.¹³ The macroprudential committee could also consist of other external members, from academia, private sector or industry.¹⁴

⁸ IL Janis, *Victims of Groupthink* (Houghton Mifflin, 1972), p 9 explained that “...Groupthink refers to a deterioration of mental efficiency, reality testing, and moral judgment that results from in-group pressures”. For a summary of the negative consequence of groupthink including limiting the discussion to only a few alternatives, avoiding information on the benefits of rejected alternatives and ignoring new information concerning drawbacks and risks of the chosen alternative, see RJ Aldag and S Riggs Fuller, ‘Beyond Fiasco: A Reappraisal of the Groupthink Phenomenon and a New Model of Group Decision Processes’ (1993) 112(3) *Psychological Bulletin* 533, 535.

⁹ Citation of Part 1 to be inserted [].

¹⁰ See n 2. I Janis, Groupthink in *E Griffin (ed.) A First Look at Communication Theory* Ch 18 (McGrawHill, 1991), p 241 lists homogeneity of members' social background and ideology as antecedent condition of groupthink. Janis suggested that “the more cohesive the group. The greater the inner compulsion on the part of each member to avoid creating disunity...” IL Janis, Groupthink (1971) *Psychology Today Magazine* 84,85. For a recent interesting empirical study on the positive impact of diversity on the quality of business decisions published in *Forbes* see *Hacking Diversity with Inclusive Decision Making* (2017) available at Cloverpoop.com accessed 10 June 2018.

¹¹ Heterogeneity can be, for instance, in terms of background and experience of members (who thus differ in the private information they possess) but also in terms of general preferences (such as preference to overshoot (‘better be safe than sorry’ or type 1 error) rather than undershoot (type 2 errors).

¹² These could be members with or without a vote or act solely as observers.

¹³ Edge (2017) (n 4), p 4.

¹⁴ For instance, IMF-FSB-BIS, *Elements of Effective Macroprudential Policies Lessons from International Experience*, 31 August 2016 available at www.imf.org/external/np/g20/pdf/2016/083116.pdf accessed 10 June 2018, pp 6-7. Heterogeneous composition is considered a substantive debiasing tool. DP Francesco PB

(b) Seeking external expertise

Another aspect of diversity is seeking the views of external stakeholders, who are not members of the committee, on a regular or ad-hoc basis.¹⁵ This could take the form of a legal requirement to seek such views as part of the macroprudential supervisor's tasks or an informal framework of deliberation with the relevant stakeholders.

(c) Decision-rule, deliberation and communication of rationales

Whether decisions are made according to a consensus or a majority decision-rule has an impact on the dynamics of the discussion and its outcomes;¹⁶ In addition, the nature of the debate, i.e. whether participants are encouraged to voice their individual views, present the reasons behind these views and challenge other viewpoints may also reflect the degree of genuine deliberation and the effectiveness of the diversity in composition.

(d) The role and behaviour of the chair

The chair of the macroprudential committee has a pivotal role in creating suitable conditions for a deliberative process and ensuring that individual views are voiced freely and considered. For that purpose, a "genuinely-collegial" committee where members argue strenuously for their own (perhaps different) viewpoints but ultimately reach a group decision is preferable to an "autocratically-collegial" committee, where the chair dictates the decision.¹⁷ There is a solid body of empirical literature that suggests that leaders who promote their personal

Luppi, 'Biasing, Debiasing, and the Law' (2008) University of Minnesota Law School Legal Studies Research Paper Series Research Paper No. 13.

¹⁵ In Germany and the Netherlands, for instance, macroprudential supervisors can invite, as required, external experts on an ad-hoc basis. Financial Sector Assessment Program Germany IMF Country Report No. 16/196 June 2016 available at <<https://www.imf.org/external/pubs/ft/scr/2016/cr16196.pdf>> accessed 10 June 2018; FSB Netherlands Peer Review, November 2014 available at <<http://www.fsb.org/wp-content/uploads/Netherlands-peer-review-report.pdf>> accessed 10 June 2018, p 14. In the EU, the European Systemic Risk Board (ESRB)'s internal structure includes an Advisory Scientific Committee (ASC) consisting of 15 experts representing a wide range of skills, experience and expertise. A recent call for expression of interest for members of the ASC included a requirement for background from academic fields or other sectors, in particular in small and medium-sized enterprises or trade unions, or as providers or consumers of financial services. ESRB, Call for Expression of Interest for the ESRB's ASC, 2 May 2018 available at <<https://www.esrb.europa.eu/news/pr/date/2018/html/esrb.pr180502.en.html>> accessed 10 June 2018.

¹⁶ Decision-rule is often used as a factor to empirically test group decision making. See, for instance, M Kaplan and C Miller. 'Group Decision Making and Normative Versus Informational Influence: Effects of Type of Issue and Assigned Decision Rule' *Journal of Personality and Social Psychology* (1987) 53(3) 306; L Thompson, E Mannix and M Bazerman, 'Group Negotiation: Effects of Decision Rule, Agenda and Aspiration' (1988) 54(1) *Journal of Personality and Social Psychology* 86.

¹⁷ AS Blinder and S Alan, 'Monetary Policy by Committee: Why and How?' (2007) 23(1) *European Journal of Political Economy* 106. There are, of course, intermediate cases which may not perfectly fit within these categories.

See also LH Meyer, *A Term at the Fed* (New York: Harper Collins, 2004); H Chappelland and others, *Committee Decisions on Monetary Policy* (Cambridge: MIT Press, 2005).

preferences (promotional leaders), rather than encourage group members to express all possible viewpoints, produce more symptoms of groupthink.¹⁸

The following section assesses the legal framework and institutional setting of the FPC against these identified dimensions of diversity. The FPC provides a useful illustration of a nuanced approach to diversity that embeds a wide spectrum of complementary dimensions to intensify genuine deliberation in the macroprudential decision-making process.

2. Diversity techniques in the FPC governance

The FPC is a committee of the Bank of England¹⁹ and is responsible for identifying, monitoring and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system.²⁰ The FPC has five external members who are selected from outside the Bank of England.²¹ The inclusion of external members was aimed at bringing a different range of knowledge and insights to the FPC, making room for a “creative tension”.²²

The Bank of England Act 1998 (BEA 1998) requires that the person chairing the meeting²³ seek to secure a decision by consensus, wherever possible.²⁴ Where consensus cannot be reached, a vote is taken and in the event of a tied vote, the Chair has a second

¹⁸ NR Ahlfinger and JK Esser, ‘Testing the Groupthink Model: Effects of Promotional Leadership and Conformity Predisposition’ (2001) 29(1) *Social Behaviour and Personality* 31. More specifically, a directive leader is considered an antecedent to groupthink. A directive leader openly expresses his/her views before a discussion takes place and thereafter controls the discussion. This is to be contrasted with a participative leader who encourages members’ participation CR Leana, ‘A Partial Test of Janis’ Groupthink Model: Effects of Group Cohesiveness and Leader Behavior on Defective Decision Making’ (1985) 11(1) *Journal of Management* 5 found that teams with directive leaders discussed fewer alternatives than teams with participative leaders.

¹⁹ 9B(1) of Bank of England Act 1998 (BEA 1998) as amended by s 6 of the Bank of England and Financial Services Act 2016 (c. 14)

²⁰ 9C BEA 1998. The FPC also has a secondary objective to support the Government’s economic policies

²¹ 9B1(e) BEA 1998.

²² HM Treasury, ‘A New Approach to Financial Regulation: Securing Stability, Protecting Consumers’ January 2012 CM 8268, paras B.16-B.17; HM Treasury, ‘A new Approach to Financial Regulation: Judgment, Focus and Stability, July 2010, para 3.19; ‘A new approach to Financial Regulation: Building a Stronger System’ (February 2011) Cm 8012, paras 2.78- 2.79; R Sharp, *The Financial Policy Committee of the Bank of England: an Experiment in Macroprudential Management – The view of an External Member* (London School of Economics, London, 4 June 2014) available at <www.lse.ac.uk/assets/richmedia/channels/publicLecturesAndEvents/transcripts/20140604_1830_boeFinancialPolicyCommittee_tr.pdf> accessed 25 May 2018.

On the contribution of external members to the Monetary Policy Committee, see S Hansen M McMahon, ‘What Do Outside Experts Bring to A Committee? Evidence from the Bank of England’ (2010) *Economics Working Paper Universitat Pompeu Fabra* 1238.

²³ Para 11(3) Schedule 2A BEA 1998. The chair is to be taken by the Governor of the Bank or, if the Governor is not present, by the Bank’s Deputy Governor for financial stability.

²⁴ Para 11 (4) Schedule 2A BEA 1998.

casting vote.²⁵ The UK Parliament did not provide an explanation for its choice of a consensus rule but drawing on research in the organisational behaviour field suggests that - “with unanimous decision schemes, group members often run into difficulty in deciding upon a course of action, forcing a group to move beyond a discussion of preferences to a discussion of the reasons underlying the preferences. In addition, unanimity drives groups toward more systematic processing of information because attention must be paid to all members’ perspectives. In short, unanimity encourages the sharing of minority points of view and the questioning of assumptions than majority rule”.²⁶ Consensus may also be necessary for the successful implementation of the decision,²⁷ and make it easier to project a clear message when addressing the public.²⁸ Nonetheless, the evidence on the impact of a consensus rule on group decision-making is not conclusive. There is a contrary view that suggests that a unanimous rule may foster cohesiveness and that a group guided by it would be particularly at risk of groupthink.²⁹

To minimise the cohesiveness that could result from a consensus decision rule, the FPC is required to publish in the records of its meetings a summary of the deliberations that were considered in reaching any decision.³⁰ Supplementing the BEA 1998, the Chancellor’s Remit and Recommendations to the FPC further clarify that where a vote is taken, the balance of arguments advanced for each position should be reflected in the record of the meeting and that members should be free to explain their differences and will be publicly

²⁵ Para 11 (5) Schedule 2A BEA 1998.

²⁶ S Mohammed and E Ringseis ‘Cognitive Diversity and Consensus in Group Decision Making The Role of Inputs Processes and Outcomes’ (2001) 85(2) *Organisational Behaviour and Human Decision Processes* 310.

²⁷ DR Brodwin and LJ Bourgeois, ‘Five Steps to Strategic Action’ (1984) 26 *California Management Review* 176 show that the amount of time spent in consensual decision-making pays off when taking into account the implementation of that decision.

²⁸ This is particularly important in the macroprudential sphere since certain macroprudential tools may have distributional effects and subject to resistance from the public. Moreover, the implementation of the tools is likely to take place when the danger to financial stability is least apparent, thereby rendering the decision very unpopular. See Part 1 of the article in [].

²⁹ KC Rumison, ‘Unanimity as a Rule for Group Consensus: A Review of the Theoretical and Experimental Literature on the Use of Unanimity in Group Decision Making’ (1998) 6(1) *Modern Psychological Studies* 9, 20; D Frey, S Schulz-Hardt and D Stahlberg, ‘Information Seeking Amongst Individuals and Groups and Possible Consequences for Decision Making in Business and Politics’ Chapter 8 in RH Witte, JH Davis (eds) *Understanding Group Behaviour: Small Group Processes and Interpersonal Relations* Volume 2 (Psychology Press, 2009) 211, 220.

³⁰ To be distinguished from a transcript. 9U(2) BEA 1998; Though without identifying particular members, s 9U(7) BEA 1998. Whilst transparency increases accountability it can also have negative effects on group decision-making, such as herding, conformism and stifling of the discussion. See S Hansen, M McMahon and A Prat, ‘Transparency and Deliberation within the FOMC: A computational Linguistics Approach’ (2017) 133(2) *Quarterly Journal of Economics* 801-870. Although the discussion there relates to monetary policymaking, the potential negative effects of transparency on deliberation is applicable here as well. The records are normally published two weeks after FPC meetings. According to s 9U(8)(b) BEA 1998 there is no requirement for publication where, in the FPC’s opinion, it would be against the public interest.

accountable accordingly.³¹ To date, however, the FPC's decisions have all been reached by consensus.³² One of the external members of the FPC presented a reassuring explanation to this overwhelming uniformity, suggesting that - "Preliminary meetings have been used to narrow options and identify areas for the staff to explore with additional data and analytics. This process has helped to shape a consensus...I have been comfortable that my views have been heard and taken into account...I have not found myself close to dissent on any of our decisions."³³ It may be that this two-stage setting that separates the core deliberative stage and the decision stage creates a safe space for genuine deliberations amongst diverged participants and forms a critical antidote to groupthink.³⁴ In practice, however, the challenge for counteracting inherent biases is considerable. Whilst the records of the FPC meetings reveal differing views that were voiced by its members before a consensus was reached, this does not seem to happen very often. For instance, the record of the FPC meeting on 23 March 2016 suggests that there was initially a disagreement amongst members about the level of the countercyclical buffer rate but that "... the Governor asked whether it was possible for the Committee to reach a consensus around 0.5%. Those members who had initially favoured moving to 0.75% were content to join a consensus". Moreover, the reasons behind the differing views and the reasons why some members were convinced to change their view were not communicated in the record³⁵ impinging on the importance of individual and idiosyncratic points of view during deliberation.

³¹ Treasury's Remit and Recommendations set out by the Chancellor of the Exchequer (March 2017) available at <www.bankofengland.co.uk/-/media/boe/files/letter/2017/chancellor-letter-080317-fpc.pdf> accessed 25 May 2018. This requirement is reflected in the Communications Guidance for FPC members available at <<https://www.bankofengland.co.uk/-/media/boe/files/about/fpc/fpccoc.pdf>> accessed 10 June 2018.

This arrangement is to be differentiated from the Monetary Policy Committee (MPC) where the decisions are made with a simple majority. Schedule 3 BEA 1998, s 11.

In the monetary policy context see Transparency and the Bank of England Monetary Policy Committee Review by Kevin Warsh December 2014 (Warsh Review); Bank of England, Transparency and Accountability at the Bank of England, 11 December 2014 available <www.bankofengland.co.uk/-/media/boe/files/news/2014/december/transparency-and-the-boes-mpc-response> accessed 25 May 2018. The Warsh Review goes to great lengths to emphasise that currently, there should not be a direct read-across from the proposed MPC transparency reforms to the FPC, see in particular pp 46-47.

³² Examination of FPC meetings from September 2011 to July 2018.

³³ Written Evidence submitted by D Kohn responding to a questionnaire from the Treasury Committee, 21 March 2018 available at

<<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/reappointment-of-donald-kohn-to-the-financial-policy-committee/written/81464.pdf>> accessed 10 June 2018.

³⁴ As similarly highlighted with regard to the MPC, Warsh Review (n 31), p 37.

³⁵ On another earlier occasion, the FPC acknowledged that in light of the discrete nature of a decision on a countercyclical buffer, it may not always lend itself to a consensus-based process. Minutes of the FPC meeting December 2015 available at <<https://www.bankofengland.co.uk/-/media/boe/files/record/2015/financial-policy-committee-meeting-december-2015.pdf>> accessed 10 June 2018.

Still, the FPC governance model is in many respects attractive. As a practice, the Treasury Select Committee (Treasury Committee) takes, from time to time, views from the FPC external members without the presence of the FPC internal members and is particularly “keen to take individual views notwithstanding the desire to, as far as possible, to speak in consensus.”³⁶ The Treasury Committee uses these hearings to conduct rigorous and meaningful ‘checks and balances’ on the FPC decision-making process.³⁷ A recurrent theme, advanced in a pertinent manner during those hearings, is whether FPC members feel that they cooperate in the desire to achieve a consensus; are guided by the chair of the meeting or subject to political or other pressure to conform with the majority.³⁸

The role of the Governor of the Bank of England as a facilitator rather than an autocratic chair is another issue that has been assessed during the Treasury Committee hearings. For instance, during the hearing on the 12 July 2016 the Governor was queried (perhaps in quite an adversarial manner) what was his response to the allegation that, following a discussion with the Chancellor of Exchequer, he guided the decision of the FPC in relation to the assessment that Brexit poses risks to financial stability. The Governor replied that – “this is not how the committee works, the Chair does not guide conclusions, the committee is presented with a series of analysis and has robust discussion...”³⁹

The concern that members of the FPC will succumb to the chair, particularly where a consensus is sought is real and live. As one MP simply put it – “The Governor of the Bank, Mr Carney...is one of the most senior central bankers in the entire world. Leaning against him when he says, “Do this or do that,” is difficult.”⁴⁰

Moreover, whilst the rigorousness of this accountability arrangement should be commended, a closer look at the current external members of the FPC suggests that the

³⁶ FPC External members Hearing in the Treasury Select Committee, Tuesday 24 May 2016, attending Richard Sharp, Donald Kohan and Martin Taylor.

³⁷ The FPC is required to publish Financial Stability Reports (FSR) twice a year (9W BEA 1998); It is accountable to Parliament through evidence given to the Treasury Committee and to the Public at large. For an interesting study on the developing role and importance of the Treasury Committee, SM Rombach ‘The Development of the Treasury Select Committee 1995–2015 (2018) 71(2) Parliamentary Affairs’ 324–342

³⁸ This is also a recurrent theme in the Treasury Committee questionnaires to the FPC members prior to their appointment. The answer seems to be invariably negative. See, for instance, the hearing on the 24 May 2016, where the members of the Treasury Committee persistently ask the opinion of the external members on whether their view on Brexit being a risk to financial stability conforms with the Governor of the Bank of England. See, in particular, the question posed 14:35 min into the hearing.

³⁹ Hearing in the Treasury Committee on the 12 July 2016 at 10:24 min into the hearing. Donald Kohan was asked whether he was lead to the decision of the committee (10:23 min into the hearing) and replied negatively.

⁴⁰ George Kerevan, Bank of England and Financial Services Bill Session 2015-16, 9 February 2016 Hansard column 19.

majority of the FPC members have either a central bank background or the private practice.⁴¹ None of the current external members has a background, for instance, in the insurance sector. This somewhat narrow scope of experience and background may be a result of the difficulty to balance between expertise and distance from a homogenised view⁴² and the need to adhere to the FPC Conflicts of Interest Code of Practice⁴³ but the issue has already attracted public scrutiny.⁴⁴ In addition, the length of the term that external members serve on the FPC could also negatively affect their ability to bring to the table a fresh and different view. Indeed, during a hearing in the Treasury Committee, one of the external members confessed, when asked about the effectiveness of external members in diminishing groupthink, that “the trouble is the more time you stay there, the more you become imbued in its atmosphere and tend to agree with it...”⁴⁵ There are therefore strong arguments in favour of restricting the membership of external members to one term.⁴⁶

Probably the most significant limitation of the FPC decision-making framework is the balance of power between external and internal members. Normally, the FPC has thirteen members, six of them are from the Bank of England (the Governor, four Deputy Governors and the Executive Director for Financial Stability Strategy and Risk), five external members

⁴¹ Anil Kashyap – researcher in economics and previously worked at the Fed; Donald Kohn former vice chairman of the Fed; Elisabeth Steeman from supervisory and private practice (largely investment banking); Richard Sharp – from private practice- commercial and investment banking and Martin Taylor- from the financial industry/journalism.

⁴² Before appointing an external member, the Chancellor of Exchequer must be satisfied that the person has knowledge or experience which is likely to be relevant to the FPC's functions and consider whether the person has any financial or other interests that could substantially affect the functions as member that it would be proper for the person to discharge. See Section 9B(3) BEA 1998. Indeed, during the legislative process, Prof Charles Goodhart suggested that it will be difficult to recruit commercial savvy people for the FPC (more than the MPC): House of Lords and house of Commons, Joint Committee on the Draft Financial Services Bill: Session 2010-12, HL Paper 236, HC 1447, paras 323-324.

On a more positive note, external FPC members are not required to hold UK nationality.

⁴³ FPC Conflicts of Interest Code of Conduct available at <<https://www.bankofengland.co.uk/-/media/boe/files/about/fpc/fpcconflictsinterestcodepractice.pdf>> accessed 10 June 2018.

⁴⁴ Letter sent to the Chancellor by the Head of the Treasury Committee, Nicky Morgan, on the 20 October 2017 reported on CityAM available at <<http://www.cityam.com/274250/bank-england-needs-more-diversity-treasury-select-committee>> accessed 10 June 2018.

There is a practice of the Treasury Committee to hold appointment hearings in which candidates are assessed based on personal independence and professional competence. The Treasury Committee's report on the appointment of Dame Clara Furse, for instance, set out several reservations as to her appointment *inter alia*, with regard to her role as a member of the risk and capital committee of Fortis, a Belgian-Dutch bank that was bailed out.

⁴⁵ Evidence given during Treasury Committee hearing on 18 April 2018 at 16:18 min (time) into the hearing. External members of the FPC are appointed for a three-year term but there is the possibility of reappointment up to a maximum of two terms. This means that external members can serve on the FPC for 6 years.

⁴⁶ Similarly, Prof Willem Buiters' open letter to the Chancellor Gordon Brown on the 18 January 2000 argued against a second term on the MPC.

and the Chief executive of the Financial Conduct Authority (FCA).⁴⁷ The external members do not, therefore, have a majority on the FPC even if allied with the FCA Chief Executive who is also a non-Bank member. Whilst the Treasury Committee was concerned during the legislative process that this balance might exacerbate groupthink⁴⁸ the UK government believed that the arrangement provides the best balance between the expertise of the Bank of England and external challenge, mirroring closely the ratio between external and internal members on the MPC.⁴⁹

Naturally, having central banks on board has clear advantages. It allows to utilise their technical expertise and enhances information flow and coordination between macroprudential and monetary policy setters.⁵⁰ Most importantly, it allows for a relatively new policy area to harness the expertise of central banks⁵¹ and benefit from their long-established and hard-won independence and credibility. Notwithstanding these considerations, there are also significant risks involved, such as an increase in institutional overburdening of central banks⁵² and stronger threats to their independence.⁵³ However, in light of the unique features of macroprudential policy-making and its strong inherent biases, as discussed in part 1 of the article, a simple transformation of the monetary policy governance arrangements to the realm of macroprudential policy should be avoided.⁵⁴ Accordingly, a majority of members from the

⁴⁷ 9B(1) BEA 1998. The Bank of England and Financial Services Act 2016 made the Deputy Governor for Markets and Banking a member of the FPC and increased the number of external members to be appointed by the Chancellor from 4 to 5.

⁴⁸ The Joint Committee on the Draft Financial Services Bill Session 2010-12, HC 1447 para 3225 recommended a majority of non-executive members on the FPC. During the consultation, a number of respondents supported the Treasury Committee's view that the FPC's membership may be too heavily weighted towards the Bank of England and that the number of external members should be increased, or the number of Bank members reduced or both. The Treasury White Paper 'A New Approach to Financial Regulation' (June 2011) Cm 8083, para 2.18.

⁴⁹ Parliament House of Commons, Treasury Committee Financial Services Bill: First Report of Session 2012-13, p 25. In its assessment of the macroprudential supervision framework in the UK, the IMF recommended adding a new external member to the FPC, in order to preserve the balance between executive and external members. See IMF Financial Sector Assessment Plan Macroprudential Institutional Framework (2016) IMF Country Report No 160, 7.

⁵⁰ The High-Level Group on Financial Supervision in the EU chaired by J de Larosière Report, Brussels, 25 February 2009, paras 174-178; IMF 2013; S Mckphilmey, 'Integrating Macro-prudential Policy: Central Banks as the 'Third force' in EU Financial Reform' (2016) 39(3) West European Politics 526.

⁵¹ E Nier, 'Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis' (2009) IMF No 70.

⁵² O Issing 'Overburdened Central Banks: Can Independence 'Survive?'' ch 19 in P Hartmann, H Huang and D Schoenmaker (eds) *The Changing Fortunes of Central Banking* (CUP, 2018), 335-340.

⁵³ P Tucker, 'The Design and Governance of Financial Stability Regimes A Common-resource Problem that Challenges Technical Know-How, Democratic Accountability and International Coordination' (2016) 3 Centre for International Governance Innovation Essays on International Finance suggests on p 57 that there should be constraints where a central bank has macroprudential powers so as to prevent "unelected officials from making big distributional choices."

⁵⁴ For a discussion opposing such transformation with regard to the accountability arrangements of macroprudential supervisors. A Keller, 'Independence, Accountability and Transparency: Are the Conventional

central bank⁵⁵ is not a necessary feature of the architecture of macroprudential supervisors and should not be taken as a default rule.⁵⁶

Furthermore, the magnitude of the external members' influence on the decision making within the FPC was further eroded in a 2016 amendment to the BEA 1998.⁵⁷ The Treasury now has the power by order, after consulting with the Governor of the Bank of England, to add or remove a Deputy Governor from the Court of Directors and accordingly, add or remove him/her from membership on the FPC.⁵⁸ The order of the Treasury may also provide for an equal increase in the number of external members who are appointed by the Chancellor.⁵⁹ Unfortunately, it appears that adjusting the number of the FPC external members, and the corresponding balance between internal and external members, is at the discretion of the Treasury, potentially further weakening the role of external members as a debiasing tool.

Another aspect which may contribute to diversity in the decision making of the FPC is the inclusion of a non-voting representative from the Treasury as a member of the FPC.⁶⁰ Rather than being a passive observer, the Treasury representative is expected to contribute to the debate, shape the views of the FPC and where appropriate, challenge the proceedings.⁶¹ In practice, the concern that the presence of the Treasury representative will inhibit the independence of the FPC members and their isolation from political pressure seems to be more of a theoretical one.⁶² The benefits of having the first-hand expertise of the Treasury

Accountability Mechanisms Suitable for the European Systemic Risk Board? (2017) 28(5) International Company and Commercial Law Review 176.

⁵⁵ To be differentiated from involvement to various degrees of central banks.

⁵⁶ Indeed, a recent empirical research suggests that whilst invariably, central banks are involved in the macroprudential settings, their role is far from homogeneous across countries. See D Masciandaro, 'Central Banks and Macroprudential Policies: Economics and Politics' (2018) Bocconi University Working Paper No 78.

⁵⁷ Bank of England and Financial Services Act 2016 c 14.

⁵⁸ Clause 1 subsection 3 of the Bank of England and Financial Services Act 2016 adding s 1A BEA 1998.

⁵⁹ Clause 1 subsection 5 of the Bank of England and Financial Services Act 2016 adding s 1A BEA 1998.

⁶⁰ 9B(1)(f) BEA 1998.

⁶¹ House of Commons Treasury Committee Accountability of the Bank of England, Twenty-First Report of Session 2010-2012 available at

<<https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/874/874.pdf>> accessed 10 June 2018, para 102. See also remarks by Mark Hoban, House of Commons Public Bill Committee; Financial Services Bill, 28 February 2012, column number 206, Hansard.

⁶² Appointments of Andrew Haldane and Donald Kohn, Treasury Select Committee, Second Report of Session 2013-14, Vol 2, Oral and Written evidence available at

<<https://publications.parliament.uk/pa/cm201314/cmselect/cmtreasy/259/259ii.pdf>> accessed 10 June 2018. In response to the question – "Has the Interim FPC operated free of all political interference?" Donald Khan explained that "on one occasion the government, including the Treasury representative at the FPC, have expressed concerns about the effect of our recommendations for more capital on growth and about how the two banks with significant government ownership would meet higher capital standards. We listened and considered but we adhered to the recommendations that arose from our analysis".

during deliberation of financial stability issues and another party to challenge the views of central banks tip the balance in favour of such an arrangement.

Seeking the views of external stakeholders who are not members of the macroprudential authority can also be used to break down groupthink. There is no statutory requirement for the FPC to consult external experts but the Communications Guidance for FPC members encourages members to make contact, subject to certain limitations, with financial market participants.⁶³ This requirement is also aligned with the Treasury Recommendation to the FPC in the 2016 Remit to seek the views of industry participants, academics, other regulators and the public, as appropriate to supplement its own expertise.⁶⁴

Interestingly, the Bank of England and Financial Services Act 2016 introduced the ability for the FPC to make decisions by written procedure.⁶⁵ According to this amendment, the FPC may take decisions without a meeting if a majority of eligible members indicated in writing their agreement to the decision; the eligible members who indicated in writing their agreement to the decision would have constituted a quorum at a meeting of the FPC; and any other requirements determined by the FPC were met. In its meeting on the 20 September 2016, the FPC agreed two additional requirements for decisions taken by written procedure: “First, that the written procedure would only be used for decisions where there had previously been FPC discussion, or decisions that were expected to be straightforward and second, that where any eligible member dissented or stated reservations about taking such a decision, as proposed, by written procedure, the matter would be discussed at an FPC meeting or, if appropriate, an alternative proposal would be circulated.”⁶⁶ These additional requirements, which were self-imposed by the FPC, demonstrate the importance that the FPC attaches to genuine deliberation and consideration of dissenting views in its decision-making process.

⁶³ Communications Guidance for FPC members, 28 April 2018 available at <<https://www.bankofengland.co.uk/-/media/boe/files/about/fpc/fpccoc>> accessed 10 June 2018.

⁶⁴ Recommendations as to engagement with financial sector participants and other external experts, Remit and Recommendations to the FPC, 8 July 2015; This was repeated in the Remit from 16 March 2016 and the 8 March 2017. The recommendation of HM Treasury to the FPC is in accordance with S 9E(1) BEA 1998. Donald Kohn suggested that this is regularly conducted as a way for the members to inform themselves of the concerns and questions of financial market participants, to getting their reactions on the FPC actions and their views on what should be doing. Written Evidence submitted by Donald Kohn in Response to questionnaire from Treasury Committee – 21 March 2018 available at <<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/reappointment-of-donald-kohn-to-the-financial-policy-committee/written/81464.pdf>> accessed 10 June 2018, para 13.

⁶⁵ Bank of England and Financial Services Act 2016 (c. 14) schedule 2 amendment to Part 1 BEA 1998 para 15.

⁶⁶ Record of the FPC Meeting 20 September 2016, paras 52-53.

Finally and most importantly, the Bank of England and Financial Services Act 2016 abolished the Oversight Committee that was a sub-committee of the Court of Directors of the Bank of England consisting exclusively of non-executive directors.⁶⁷ The oversight functions, including the oversight over the duty of the FPC and the procedures it follows, are now the responsibility of the Court of Directors.⁶⁸

What was the rationale for the abolition of the Oversight Committee, only five years after its creation? Whilst the powers of the Oversight Committee were viewed as a successful innovation, its creation introduced an extra and unnecessary layer of governance.⁶⁹ The 2016 amendment simplified this structure and transferred the oversight responsibility to the court as a whole, thus enabling both executive and non-executive directors to be held accountable for the use of the oversight functions.⁷⁰ Nevertheless, the amendment and the effectiveness of the oversight functions in the hands of the whole court proved to be rather controversial during the legislative process.⁷¹ Therefore, to safeguard the prominence and the ability of the non-executive directors to scrutinise the executives' performance, the amendment retains their right to arrange for reviews (including performance reviews) if they consider that this would assist the Court of Directors in the exercise of its oversight functions.⁷² Where necessary, the non-executive directors can act by majority to arrange such a review.⁷³ Furthermore, the non-executive directors are able to meet as a group whenever necessary, in particular, to lead performance reviews that require an assessment of the performance of the executives.⁷⁴ In addition, the commissioning of reviews from expert authorities outside the Bank of England is a legacy of the previous Oversight Committee and was unequivocally

⁶⁷ It was established following the 2011 Treasury Committee Report on the Accountability of the Bank of England that called for considerable strengthening of the Bank of England governance. House of Commons Treasury Committee Accountability of the Bank of England Twenty-first Report of Session 2010–12 available at <<https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/874/874.pdf>> accessed 10 June 2018.

The review highlights the need to ensure the FPC functions and processes are scrutinised given that there is no fixed quantitative objective against which to measure its performance. See, for instance, q 172, Prof Goodhart.

⁶⁸ Article 3A BEA 1998 by article 3 of the Bank of England and Financial Services Act 2016.

⁶⁹ HM Treasury, Bank of England Bill, Technical Consultation, para 4.8 available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/447140/bank_of_england_bill_v3.pdf> accessed on 10 June 2018.

⁷⁰ Bank of England and Financial Services Bill Session 2015-16, 9 February 2016 Hansard Clause 3, Column no 23.

⁷¹ Bank of England and Financial Services Bill Session 2015-16, 9 February 2016 Hansard Clause 3, column no 18.

⁷² 3C(1A) BEA 1998 amended by s 3 of the Bank of England and financial Services Act 2016.

⁷³ *ibid.*

⁷⁴ HM Treasury Bank of England Bill, Technical Consultation available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/447140/bank_of_england_bill_v3.pdf> accessed 10 June 2018, para 4.9.

endorsed by the Bank of England, suggesting that – “... The purpose of such reviews would be to supplement the role of external members of policy committees in bringing outside challenge and ideas in the bank’s financial stability policymaking...”⁷⁵

The inclusion of this safeguard to oversight by the non-executive directors may provide an additional protection against the emergence of groupthink, in line with the stated intention of the legislator⁷⁶ but much depends here on the strength of the non-executive directors to lean, where necessary, against the wind. This concern is particularly acute given that to date, the FPC’s performance reviews in the Bank of England Annual Report⁷⁷ are brief and descriptive rather than critical.⁷⁸ For instance, the 2018 Bank of England Annual Report states that “The external members consider the Committee to be working well, with productive discussions and effective policy interventions”. The oversight of the FPC should include a meaningful assessment of the robustness of the FPC deliberations and in particular, the extent of groupthink,⁷⁹ inaction bias and other biases, to complement the work of the Treasury Committee in that regard.

Conclusion

Adopting effective diversity mechanisms, not solely via heterogeneous composition of the macroprudential authority but also in facilitating genuine deliberation and consideration of individual and different views, would act as a counterbalance to the strong forces of groupthink and other biases. The decision rule, the role of the chair, the balance between external and internal members and their term of office and the transparency of the decision-making process are all factors that have a real impact on the nature and extent of diversity and in turn, on the prevalence (or lack thereof) of biases.

Whilst there is no universal optimal governance setting for macroprudential authorities, the FPC legislative framework provides a useful illustration of a nuanced

⁷⁵ Response from the Court of the Bank of England to the recommendations made by the Treasury Committee and Joint Committee on the Draft Financial Services Bill on the Accountability of the Bank of England, para 14-15 available at <<http://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1769/176905.htm#a9>> accessed 10 June 2018.

⁷⁶ *ibid.*

⁷⁷ Based on the suggestion of the FPC during its meeting on the 24 March 2015, para 48 to include that the Bank of England Annual Report include an assessment relating to the robustness of the FPC’s deliberations.

⁷⁸ IMF Country Report, United Kingdom: Financial Sector Assessment Program-Macroprudential, June 2016, 16/160, para 36. For instance, the 2016 Report of the Oversight Committee briefly observed that – “Court members have noted that the Committee’s deliberations were well-informed and robust.”

⁷⁹ Accountability of the Bank of England, Treasury Select Committee evidence of Prof Bob Garratt, para 100 available at <<https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/874/87407.htm>> accessed 10 June 2018.

approach to diversity that embeds a variety of dimensions to intensify genuine deliberation in the macroprudential decision-making process. Nevertheless, the FPC diversity mechanisms are far from being a perfect ready-made model. The paper identified numerous weaknesses in the FPC legal framework which could potentially mute the power of diversity in debiasing macroprudential policymaking. Whilst the role of the FPC external members in breaking down groupthink is repeatedly reiterated in policy rhetoric, the balance of power is still in the hands of central banks. The article, therefore, emphasised the importance of a rigorous assessment of the deliberation and decision-making process of the FPC to ensure that diversity is not a lip service but rather a meaningful governance mechanism. The assessment should have particular regard to the transparency of the rationales behind diverging opinions and ensure that where consensus is reached it is not dictated by pressure to conform or succumb to the views of the chair or majority of members.

Learning from the case of the FPC, the governance of macroprudential supervisors should reflect the full spectrum of diversity's formulations and dimensions so as to ensure that suitable conditions for a deliberative process emerge and individual views are voiced freely and considered. In addition, a periodic and meaningful oversight of this deliberative process of macroprudential supervisors within clear accountability arrangements would safeguard against groupthink and other inherent biases and ultimately enhance the effectiveness of macroprudential policymaking.

Legislators and policy makers need to be watchful of including diversity in composition without adopting other complementary diversity techniques that can activate the power of external or different viewpoints in challenging existing paradigms. The diversity criterion developed in this article, tailored to local features, could provide guidance for designing or refining diversity techniques in the macroprudential sphere, assist in debiasing inherent biases and ultimately enhance the effectiveness of macroprudential policymaking.