S A F E Leibniz Institute for Financial Research SAFE

Dear Marius Luta,

Welcome to the latest edition of SAFE Update, the Leibniz Institute SAFE digital newsletter. Besides informing you about a significant change at SAFE, this issue features projects investigating the relationship between climate change and finance as well as research into asset pricing and machine learning.

We hope you find this newsletter of interest and would welcome your feedback to the editorial team at newsletter@safe-frankfurt.de.

Inside SAFE: Scientific directorship to change hands

Florian Heider will follow Jan Pieter Krahnen

For the first time since it was founded, SAFE will see a change in its academic leadership as, on 1 December 2022, economist Florian Heider takes over from Jan Pieter Krahnen as Scientific Director at the Leibniz Institute. During his tenure, Krahnen was instrumental in building up SAFE; his successor Heider joins the institute from the European

Central Bank (ECB), where he currently leads the financial markets research section.

Prior to this, SAFE's incoming director studied Politics, Philosophy, and Economics (PPE) at the University of Oxford before going on to obtain a Ph.D. in Economics from the Catholic University of Louvain (Belgium). Following research positions at the London School of Economics and the New York University Stern School of Business, in 2004 Florian Heider went to the ECB, working in various functions in the Research, Market Infrastructure & Payments, and Monetary Policy departments, going on to become Head of Section for Financial Markets Research in 2020. His new position as Scientific Director at SAFE is part of a professorship in Economics at the Goethe University Frankfurt.

Heider's academic interests are currently focused on financial intermediaries and on their role in monetary policy, market design, and the capital structure of companies. His work has appeared in a range of international academic journals, including worldwide leading publications in economic and financial research such as *The Review of Economic Studies*, *The Journal of Finance*, and *The Journal of Financial Economics*.

[Reactions to the new director at SAFE](#)

Focus: Research projects into climate change and

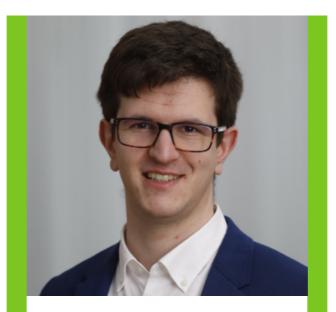**SAFE researchers examine incentives for reducing emissions**

Recently, SAFE research teams led by Christine Laudenbach and Loriana Pelizzon each received a grant from the German Federal Ministry for Education and Research under the climate protection and finance (*Klimaschutz und Finanzwirtschaft*, KlimFi) funding initiative to conduct three-year projects related to the issue of sustainable finance.

The project, called "Transition labels in climate finance (ClimLabels)", is being coordinated by Christine Laudenbach for SAFE and jointly undertaken with researchers from the universities of Bochum and Münster as well as from the Climate & Company think-tank. It aims to develop future-oriented perspectives for products in the financial markets and incentives for emission reductions and green transition. These products need to be built on robust transformation indicators, be aligned with the needs of financial professionals and their expectations in sustainable investment and product design (for instance, in terms of portfolio diversification, easy access to and reliability of forward-looking ESG data), and be relevant for investors. As part of the project,

SAFE is responsible for the design, programming, implementation, and evaluation of field experiments with bank customers. Additionally, in an information experiment with retail investors, the researchers test how updating expectations influences allocation decisions.

Together with her team and in collaboration with the securitization repository European DataWarehouse (EDW), Loriana Pelizzon is coordinating Green Auto Securitisation (GAS), a project to design a framework for a mechanism to support the financing of low-emission vehicles (LEVs) through bank lending. Another aim of the project is to improve data quality and availability by creating a mock-up database for ESG information. While EDW will develop the ESG database as a tool to study the nascent market for green auto loans/leases and for corresponding credit risk models, Pelizzon's team will be responsible for carrying out an in-depth analysis of the probability of default of electric vehicle owners as against drivers using less efficient means of transport across selected countries.

Research Highlight: Merits of machine-learning methods

Asset Pricing and Machine Learning: A Critical Review

by <u>Matteo Bagnara</u>, Junior Researcher in the SAFE Financial Markets Department.

In his paper "Asset Pricing and Machine Learning: A Critical Review", forthcoming in the Journal of Economic Surveys, Matteo Bagnara sets out to demonstrate how research in the field of empirical asset pricing can benefit from the use of machine-learning (ML) methods. Due to their flexibility in high-dimensional settings and their greater prediction accuracy, these techniques have become increasingly popular in financial economics. In his paper, Bagnara investigates whether these advantages translate into the domain of empirical asset pricing – and, if so, how.

To this end, the author conducts a critical review of recent contributions to the relevant academic literature, grouping them into five different categories according to the type of ML approach that is used (regularization, dimension

reduction, regression trees/random forest, neural networks, and comparative analyses). By applying a general framework encompassing the goals pursued by the studies examined, the paper provides a concise overview of the results researchers can achieve by employing ML in asset pricing and assesses their contribution to our understanding of expected returns.

In particular, Bagnara aims to guide his readers to a sound economic interpretation of the latest findings in empirical research, with the intention of freeing ML from skepticism and presenting it as a promising and dynamic alternative to conventional methods. By adding discussion of the econometric challenges which arise in this area and offering guidelines for coordinated future efforts, the paper equips readers with a comprehensive grasp of ML methods imperative for keeping abreast of current advances in asset pricing research.

[Find the research paper here](#)

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Outlook
Papers for the 9th International Conference on Sovereign Bond Markets can be submitted as of now. Hosted by the Carroll

School of Management, Boston College, the event will be held on 27 and 28 April 2023 and focuses on the behavior of Sovereign Bond Markets in Unstable Times. Co-organizers include among others SAFE, the NYU Stern/Volatility and Risk Institute, London Business School/AQR Asset Management Institute, the Bank of Canada, the Deutsche Bundesbank, and the European Central Bank. The deadline for paper submissions is 1 December 2022. Find the submission details here.

Review
Climate change is one of the most pressing issues of our time. In a recent SAFE-CEPR Policy Web Seminar, Paul Hiebert, Stephan Fahr, Katarzyna Budnik, and Michael Grill, all economists at the European Central Bank (ECB), presented the ECB's and European Systemic Risk Board's most recent report titled "The Macroprudential Challenge of Climate Change". Read the follow-up report and rewatch the video of the seminar here.

Handpicked

Michael Kosfeld, Professor of Organization and Management at Goethe University Frankfurt and Coordinator of the SAFE Experiment Center, recommends the book *Why We're Polarized* by Ezra Klein:

"Polarization, the growing divergence in the way we as humans see, interpret, and value

the world around us, has been influencing many aspects of our social, political, and economic life to an ever greater degree. Although perhaps most evident in current U.S. politics, polarization is obviously not a uniquely U.S. problem, and I highly recommend Ezra Klein's recent book *Why We're Polarized* (Avid Reader Press 2021), to anybody interested in this important topic. Drawing on insights from a wide variety of literature in the social sciences, this well-written work provides a convincing examination of the causes, extent, and possible future of polarization. While the focus is on U.S. politics, there is much to learn from a European perspective. The only caveat is that, once you've finished Why We're Polarized, you may well need to find time for many more fascinating contributions on the topic, as, with its broad range of excellent references, the book is a true source of intellectual and academic material on the issue."

[Find the book here](#)

News & Latest

- **News:** Leibniz Institute SAFE establishes Digital Finance Network

- **SAFE Finance Blog:** Corporate-Sovereign Nexus in COVID-19 Times (by Ruggero Jappelli, Loriana Pelizzon, and Alberto Plazzi)

- All upcoming events and SAFE publications

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About SAFE
The Leibniz Institute for Financial Research SAFE ("Sustainable Architecture for Finance in Europe") promotes interdisciplinary research and independent policy advice about the international financial system with a focus on Europe. The institute aims to contribute to a sustainable, crisis-proof financial architecture that stimulates innovation and serves economic and civil needs. Researchers from the fields of economics, law, and political science collaborate at SAFE on questions in the areas of Financial Intermediation, Financial Markets, Household Finance, Macro Finance, Money & Finance, and Law & Finance.

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