

International Network for Sustainable Financial Policy Insights, Research and Exchange (INSPIRE)

Third Call for Research Proposals

A Targeted Call on a Cross-Cutting Theme

Assessing the effectiveness and impact of central bank and supervisory policies in greening the financial system

March 23, 2020

This call for research proposals includes:

1. A summary of the goals of INSPIRE
2. A review of the research that INSPIRE has commissioned to date
3. Discussion of emerging research themes for greening the financial system
4. Details of the targeted call on the cross-cutting theme of effectiveness; and
5. Details of the submission process.

1. The goals and background of INSPIRE

The International Network for Sustainable Financial Policy Insights, Research and Exchange (INSPIRE) has three goals: firstly, to commission independent, gold standard research and policy analysis on central bank and supervisory practice to manage climate risks and promote green finance; secondly, to convene researchers, policymakers and practitioners and thirdly, to widely communicate the results.

INSPIRE is a research stakeholder of the Network for Greening the Financial System (NGFS) and commissions research to inform the NGFS's work, as well as encourage the exchange of insights between researchers and central banks. The NGFS is a global network of central banks and supervisors working to "help strengthen the global response required to meet the goals of the Paris Agreement and to enhance the role of the financial system to manage risks and to mobilise capital for green and low-carbon investments in the broader context of environmentally sustainable development."

2. Research commissioned by INSPIRE to date

In 2019, INSPIRE issued two comprehensive calls for proposals responding to the broad range of research topics identified by the NGFS work streams, namely microprudential supervision, macro-financial aspects, scaling up green finance, as well as a number of cross-cutting themes which cross-cut these workstreams.

These calls were launched in March and July 2019 and resulted in 21 INSPIRE research projects clustered in the five main areas below. INSPIRE's commissioned research to date includes:

Theme 1: Microprudential regulation, disclosure and climate change

- Supervision beyond the business cycle: A framework for long-term financial supervision - Ben Caldecott, Jakob Thomä
- Working Group on Banking Supervision and Sustainable Development in the Americas - Kevin P. Gallagher, Daniel Schydrowsky, Janine Ferretti
- How could the U.S. Federal Reserve and other financial market supervisors incorporate climate considerations into their responsibilities? - Adele Morris, Warwick McKibbin
- E&S Risk Management in Brazilian Banking: From an E&S Management Structure to Climate Scenario Analysis Development - Guilherme Teixeira, Gustavo Pimentel, Beatriz Maciel
- Management of Climate Risks in the Financial Industry of a Resource Based Economy: A Canadian Scenario Analysis - Olaf Weber, Adeboye Oyegunle, Truzaar Dord
- Mandatory ESG disclosure and financial stability - Dragon Yongjun Tang, Rui Zhong

Theme 2: Macroprudential regulation, financial instability and climate change

- A risk management framework to address the endogeneity of transition risk - Stefano Battiston, Antoine Mandel, Irene Monasterolo
- Macroprudential instruments to scale up green finance - Paola D'Orazio, Lilit Popoyan
- Low-Carbon Transitions and Systemic Risk – Jason Eis, Rosie Dollman, Giulio Vannicelli, Emanuele Campiglio
- The stochastic impact of extreme weather events - Amit Kara, Ian Hurst, Iana Liadze
- What are the options for sustainable crisis response measures? - Kate Levick, Aziz Durrani, Claire Healy, Ulrich Volz
- Climate-related financial policy in a world of radical uncertainty - Towards a precautionary approach - Joshua Ryan-Collins, Hugues Chenet

Theme 3: Definitions of and risk differentials between 'green' and 'brown'

- Using Credit Risk as an empirical basis for the development of brown taxonomies - Charles Donovan, Bob Buhr, Anastasiya Ostrovnaya, Alexandre Koberl
- Estimating the impact of physical climate risks on the probability of default (PD) of mortgage loans in the coastal cities of China - Ma Jun, Sun Tianyin, David Bresch, Gabriela Aznar Siguan
- Is Credit Risk Lower for Banks' Green Assets? - Rui Zhong, Jing Yu, Xiaoyan Zho

Theme 4: Monetary policy, direct and indirect monetary instruments and climate change

- Greening the Eurosystem collateral framework - Yannis Dafermos, Daniela Gabor, Maria Nikolaidi, Frank van Lerven
- The Role of Monetary Policy Under a Zero-Carbon Transition - Jason Eis, Rosie Dollman, Giulio Vannicelli, Pablo Anton Arnal, Warwick McKibbin

- Central banks' mandates for green credit guidance - Muriuki Muriungi

Theme 5: Sovereign bonds, climate change-related and environmental risk

- Climate Change and Sovereign Credit Ratings - Matthew Agarwala, Patrycja Klusak, Moritz Kramer, Kamiar Mohaddes
- The impact of country SDG performance on sovereign bond spreads - Eline ten Bosch, Dirk Schoenmaker, Mathijs van Dijk
- Sovereign risk and climate change - Ulrich Volz, John Beirne, Emilie Mazzacurat, Jeanne Stampe

3. Emerging future INSPIRE research themes and priorities

These two calls and dialogue with central banks has also identified a rich and expanding international research agenda on central banks, financial regulation and the greening of the financial system. Key elements of this research agenda are set out in the box below.

Emerging priority research themes for greening the financial system

- Assessing firms' exposure to transition risks and the impact of mandatory disclosure on financial institutions, including non-banks
- The limitations of traditional risk management concepts and of backward-looking analysis, and the benefits of forward-looking scenario-based analysis
- The regulatory implications of the adoption and management of sustainable and responsible investment practices
- The design of investment benchmarks aligned to climate goals
- The development of a new asset classes such as long-term, net zero assets
- Reflecting on the concept of market neutrality in the era of climate emergency
- The modelling of systemic climate-related risks and long-term supervision
- The building of common scenarios for assessing the exposure of assets, institutions and systems to climate and wider environmental threats
- The risk effects of environmental factors beyond climate change (biodiversity...)
- Understanding the role of central banks and supervisors in connecting green goals with the need for a just transition to an inclusive and balanced economy
- Financial regulation, supervision and the implications of climate risks and empirical studies on climate risks and stress testing applications
- Mechanisms to link global climate finance and the stability of the international financial and monetary system
- The development of conceptual frameworks to ensure effective coordination among prudential, monetary and fiscal policies
- Comparing scenarios where prudential, monetary and fiscal policies are optimized jointly for climate purposes and scenarios where these diverge
- The implications of the transition to a sustainable economy for core policy tools such as inflation targeting, exchange rate targeting and GDP targeting
- The impact of monetary and financial policies on environmental outcomes even in the absence of green objectives

- Greening monetary policy and accounting for climate risks in central banks' own operations (e.g. greening collateral frameworks)
- The implications for unconventional monetary policies for the environment
- In the context of developing countries, the assessment of financial firms' adaptive capacity to respond to climate-related monetary and financial policies
- Evaluation of the impact of measures to green the financial system in terms of effectiveness, efficiency and equity
- More interdisciplinary research, drawing from political economy/cultural and institutional dynamics/ behavioural economics

This is an ambitious programme of work and INSPIRE will seek to commission research across many of these themes during 2020. With this third call, INSPIRE will focus on a single issue.

4. INSPIRE: 3rd Call for Proposals, March 2020: A Focus on Impact and Effectiveness

INSPIRE's third call targets a key cross-cutting theme that is emerging as a critical issue on the frontier of central bank and financial regulation action to green the financial system, namely the issue of assessing the impact and effectiveness of measures. The topic of this call cuts across all three of the NGFS' workstreams and we encourage proposals on, among other issues outlined in detail below, the impact and effectiveness of microprudential and supervisory aspects, macro-financial topics and the scaling up green finance in the real economy.

The call responds to the rapid growth in actions by central banks and supervisors to respond to climate risks and green the financial system. The nature of the goals, or objectives of central banks and environmental or climate-related policy are thereby of central interest. For some central banks, sustainability-related and environmental goals and objectives may be explicitly or implicitly part of their mandate, while all monetary and supervisory institutions will be affected by the implications for their price and financial stability objectives. The challenge is no longer to make the case for central bank action but to identify interventions that have impact across the three key dimensions of policy performance:

- Effectiveness: Does the policy measure achieve its goals?
- Efficiency: Does the policy measure achieve its goals at reasonable cost?
- Equity: How are the benefits and costs of the measure distributed and who is involved?

Central banks and financial supervisors have a range of policy options to foster the transition to a net zero, resilient and sustainable economy across prudential and

monetary policies. Yet, in spite of the increasing interest of central banks and supervisors in these policy options, the understanding of how instruments impact environmental, financial and economic variables remains at an early stage.

Many policy interventions have focused on improving disclosure of environmental factors, but there remains limited understanding of the effectiveness of disclosure to drive changes in financial market behaviours and what types of disclosure have real economic impact. In addition, some central bankers, for example, have indicated interest in ways to green monetary policy operations, but have also argued that the expected impact would be marginal. These examples illustrate the need for an improved empirical understanding of the impact and effectiveness of measures to green the financial system.

Against this background, INPSIRE would like to commission innovative research on assessing the environmental, financial and economic impacts of central banks' and financial supervisors' policies and operations. The scope of impact includes both the performance of the financial system and changes in the real economy. This focus on impact is set to be increasingly important as central banks and supervisors focus on the contribution they can make to implementing the Paris Agreement goal of making financial flows consistent with the transition to net zero and resilient development pathways.

This call for proposals encourages research submissions that not only focus on the financial impacts of monetary and financial policies, but also investigate their effect on economic and environmental variables. More specifically, INPSIRE welcomes research proposals that identify specific financial and monetary policy options to green the financial system and assess their (intended and unintended) real world impact on (i) environmental outcomes, (ii) financial stability, (iii) financial flows and (iv) the economy (among other possible dimensions).

Within this broad framework, specific research topics could include:

- The development of conceptual frameworks for evaluating policy measures' effectiveness in different dimensions – e.g. environmental outcome, financial stability, financial flows, economic outcome. These frameworks can possibly be focused on a specific region or market.
- The identification of prudential, financial and monetary policies that are the most effective in delivering an orderly transition to a net zero and resilient economy.
- The exploration of how policy measures to green the financial system could be designed or re-designed in order to enhance their effectiveness.
- The evaluation of the data gaps that hold back the assessment of effectiveness of policy options, as well as the identification of ways to overcome them.
- The assessment of the impact that sustainable financial, prudential and monetary policies have on environmental factors, financial flows, the funding of firms and households, and ultimately, on economic activities in the short- and the long-term.

- The investigation of the effect and effectiveness of how climate risks are priced in by financial institutions, the evaluation of risk management techniques (for climate financial risks) and the impacts of supervisory policy on climate risk management by financial institutes.
- The assessment of possible trade-offs and synergies between financial, prudential and monetary policies aimed at fostering the transition to a low-carbon economy and other objectives in the mandate of central banks and financial supervisors.
- The assessment of possible trade-offs and synergies between monetary and fiscal policies, for example in the form of carbon taxes, which are expected to have a significant impact on the economic environment that central banks operate in.
- The assessment of the impacts of a reallocation of the assets in central bank policy portfolios on financial asset prices, funding flows to the real economic activities and on the real economy more broadly. Changes in central bank asset purchases, in their lending policies and in collateral frameworks are examples of such policies. The identification and description of the transmission channels that lead to these impacts is also of interest.

INSPIRE recognises the interdisciplinary nature of sustainable finance research and encourages interdisciplinary teams and the use of interdisciplinary quantitative and qualitative approaches. To further build collaboration, joint projects between policy institutions and academia are also encouraged.

5. INSPIRE: 3rd Call: Details of Submission

In this targeted call, INSPIRE aims to support projects with budgets between \$35,000-\$40,000. Projects should last for up to one year and should aim to produce a working paper or journal article. Priority in the selection will be given to work that is expected to substantially enhance the capacity of central banks and supervisors to manage climate-related financial risks and promote green finance. This call is open to all institutions conducting research, with a particular focus on researchers at academic institutions, non-profit organisations, NGOs and international financial and monetary institutions. All funded research would become publicly available.

Research proposals can be submitted via email to INSPIRE@climateworks.org using [this submission form](#). Due to the expected disruption caused by the CoViD-19 outbreak, the submission period will spans 6 weeks and ends at 23:59 GMT on Friday, 1 May 2020.

About INSPIRE: INSPIRE is a global, philanthropy-supported research platform established to commission independent, gold-standard research on the financial oversight of climate risks and the promotion of green finance. INSPIRE was created to support the members of the Network for Greening the Financial System (NGFS), a network of more than 50 central banks and supervisors, and observer organizations from Africa, the Americas, Asia, Australasia, and Europe, as they work to enhance the financial system's ability to manage climate-related financial risks and mobilize capital for green and low-carbon investments. INSPIRE is hosted by ClimateWorks and the Grantham Research Institute at the London School of Economics, and commissions research guided by an Advisory Committee with domain expertise and close interface with the NGFS and its three workstreams. It operates independently from the NGFS, which has recognized INSPIRE as an official research stakeholder. For more information, please see: <https://www.climateworks.org/inspire/>