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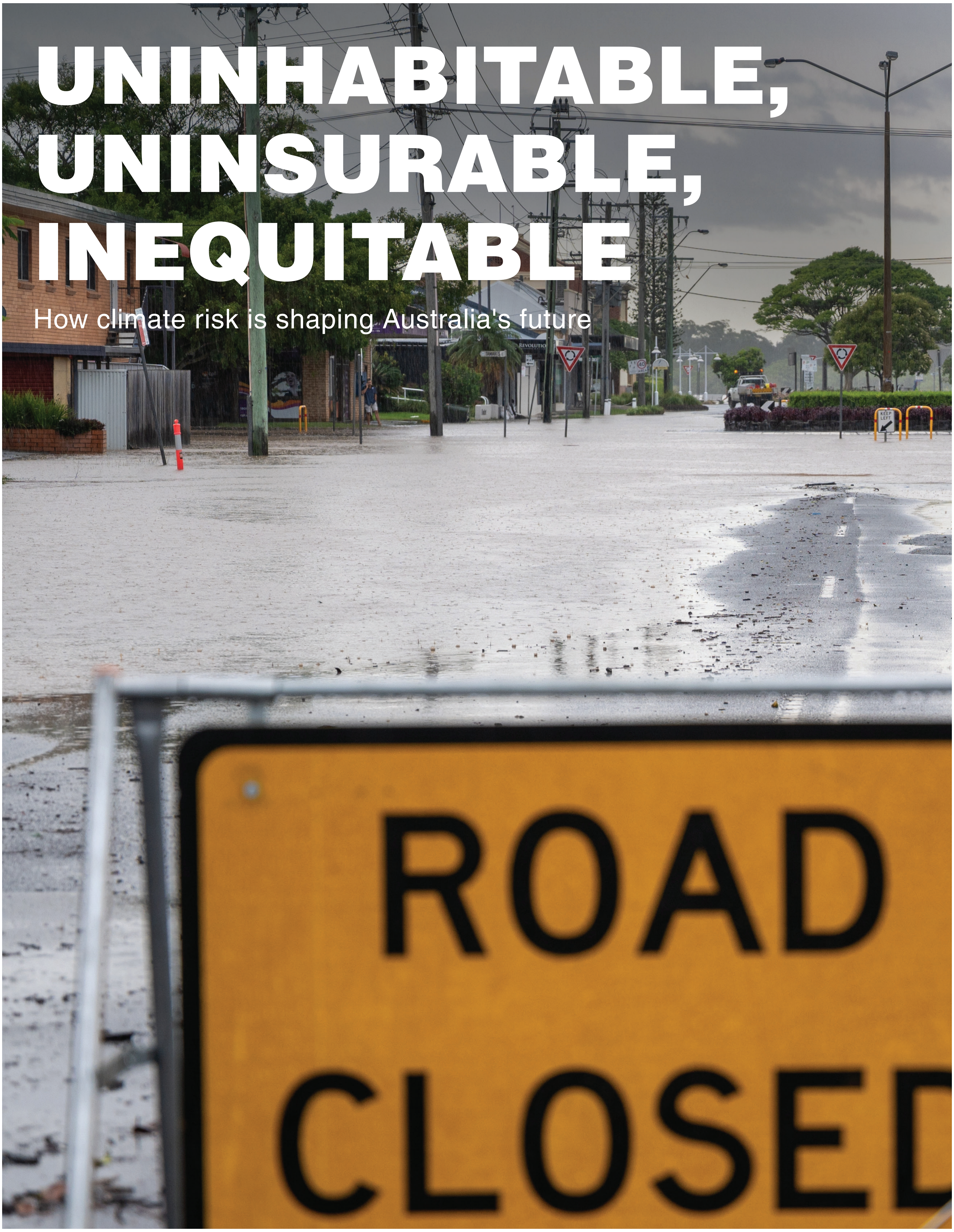
UNINHABITABLE, UNINSURABLE, INEQUITABLE

How climate risk is shaping Australia's future



The Big Green Short

Investors that short a company's stock are never popular, but there is an emerging trend of 'shorting for good'. Based on an investor's perceived performance of so called 'green', 'ethical' or 'sustainable' strategies, short sellers are calling these companies out if they consider action on decarbonisation is too slow, or worse, only window dressing.

Green shorting is a form of short selling. Short selling is a method whereby a ‘short seller’ will borrow shares from another investor. The short seller will then sell the borrowed shares on the market and buy them back prior to returning them. They will pocket any fall in value the borrowed stock might experience in the meantime as profit. Green shorting is when an investor shorts a company based on their sustainability and decarbonisation credentials. Some of these funds, such as the Plato Investment Management Global Net Zero Hedge Fund are designed to outperform broader markets while being exposed only to net zero investments are actively engaged in green shorting. It’s short selling shares in ASX 200 companies with net zero action plans that it thinks might prove difficult to pull off. Essentially, they short stocks that are higher carbon with a poor return outlook and long-stocks with lower carbon with good return averages.

US-based hedge fund AQR which boasts some of Australia's biggest super funds among its clients, has recently suggested that they will consider using short-selling to mitigate climate risks across their portfolios. This comes in the wake of large investor divestment of holdings from major carbon emitters across Australia. Short-selling represents a more aggressive tool with which investors can flex their muscles as green influencers in the market, beyond traditional divestment strategy, which thus far has been at the core of the rapid rise of sustainable investment. Equipped with green shorting, investors are now able to behave in a way that inherently incentivises businesses to clean up their act, or risk getting left behind.

Betting against companies whose stories of helping the environment are stronger than their earnings, or against those that have exaggerated their ethical credentials, has also become increasingly attractive. Sounds sensible really. Financial markets are a fascinating study in belief, sentiment and emotion but sometimes it can create immense change. ESG these days is a must to have not a nice to have and done well brings value to both the investor in a better understanding of the ESG issues that could affect the value of the stock and the business in terms of addressing risks that may not otherwise have been on its radar. Done poorly however, it is worse than not doing it at all. Greenwashing is rife and many companies are jumping on the bandwagon of sustainability with no meaningful commitment ignoring both the benefits and the risk management opportunity. In a world that is changing by the day, where history is no longer any predictor of the future, surely it pays to be prepared and mean what you say. If nothing else, it might stop the short sellers attacking your stock.

If you would like to know more about how ESG, sustainability analysis or climate risk assessment can benefit your business please get in touch with one of our expert team members.

How does short selling a stock work?

Climate Active
Carbon Neutral
ORGANISATION

We are now certified carbon neutral!

Cress Consulting is now a carbon neutral business certified under the Climate Active scheme. The program represents Australia’s collective effort to calculate, reduce, and offset carbon emissions to lessen our negative impact on the environment. Certification is available to organisations, products, services, events, buildings, and precincts.

There are now several credible methods of carbon neutral certification available that require accurate and transparent measurement of emissions and a clearly articulated plan to reduce carbon emissions, purchase offsets to cover those emissions that cannot be reduced and investment in new ways to reduce emissions. As a certified carbon neutral business, Cress consulting is ideally placed to assist our clients to prepare an emissions inventory, establish an emission reduction strategy and investment initiatives, and seek certification against the most relevant scheme.

Uninhabitable, Uninsurable, Inequitable

The recent record-breaking floods across NSW and QLD have devastated homes and businesses alike, and while government disaster relief and recovery packages are pulled together, the immediate community response and nearly 50,000 insurance claims across the region form the backbone of real recovery. As extreme weather events increase in frequency and intensity, the capacity for insurers to offer affordable premiums deteriorates. If prices rise too high many people and businesses will have two options, go under-insured, or leave. Extreme flooding is not the only impact to exacerbate this issue.

In 2016, temperatures in Kuwait City reached 54ºC, the hottest reading on Earth in the last 76 years. According to the Environment Public Authority, parts of Kuwait could get as much as 4.5ºC hotter from 2071 to 2100 compared with the historical average, making large areas of the country uninhabitable. Thanks to its oil endowment, Kuwait's small population enjoys a very high GDP per capita. For this reason, when addressing climate issues such as CO2 emissions, their political system does not lack resources but political will. As Australians, if this sounds all too familiar it's because it is.

Hotter, drier, and more extreme weather conditions across Australia are forcing both residents and businesses to re-evaluate their exposure to climate risk. On January 4th 2020, western Sydney was the hottest place on Earth, reaching an intolerable 49ºC. The 2019-20 Black Summer fire season was the costliest natural disaster in our history, both financially and environmentally. Climate change is no longer looming, it's here, and the insurance market must reconcile the magnitude and complexity of threat posed by climate change with their need to retain customers. The critical threat is that many parts of Australia will be so adversely impacted by climate change, be it heat, floods, fires, or cyclones that residents and businesses will no longer be "actuarially" insurable. That is, it will no longer make financial sense for insurance companies to offer coverage to those people. As the goalposts shift in front of them, insurers are updating their climate models to more accurately price-in true risk, quickly putting the squeeze on some areas of Australia.

The Insurance Council of Australia, the industry representative organisation, states: "At present no region in Australia is uninsurable. However, it is possible some regions may become difficult to insure in the future unless governments invest in appropriate physical mitigation and adaptation strategies."

These mitigation strategies can include stronger building codes to resist storms, improved land-use planning to minimise the urban heat island effect, and permanent physical mitigation infrastructure such as flood barriers. While these measures may indeed diminish some impacts, the only long-term solution to climate change is emissions reduction.

A study published in Science Direct last year found that on Kuwait's extremely hot days, the number of deaths doubles, but it triples for migrants working in low-paid jobs, highlighting the issue of climate change inequality whereby low-paid workers are exposed to the effects of climate change more severely than high-paid workers. Kuwaitis who can afford to do so spend almost the entire summer abroad or have moved away permanently, leaving those unable to with no choice but to stay and suffer the heat.

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Environmental injustice is happening in Australia too. Dust pollution plagues residents living near open-cut coal mines, whose operators rarely pay the consequences. As a result, health insurers must raise premiums to accurately reflect the risk they adopt by insuring residents inhaling coal mine dust. This creates a negative externality of inequality between those able to afford the higher premiums and those unable to do so. As such, the impacts of climate change both create more risk for a population and exacerbate their financial vulnerability to that risk.

The key questions is who is going to pay to provide liveable conditions, and for how long? The challenge for governments is to reconcile the need for short term economic stability with long term economic, social, and environmental prosperity. This balance is not currently being satisfied. A fundamental change in our allocation of resources is required. Australia's Federal and State governments spend 97 percent of disaster-related money on recovery, with the remaining 3 percent left for preparation and mitigation. A study of the aftermath of Lismore's 2017 flood suggested that a levee would have saved hundreds of millions of dollars in smaller floods.

Andrew Gissing, General Manager at Risk Frontiers, estimates that businesses could save up to 80 percent of losses with improved flood mitigation and preparation measures, such as early warning systems. The choice to 'building back better' with more flood-resistant infrastructure should always be weighed against incentivising gradual residential relocation to areas of lower flood risk. It is imperative that in the aftermath of the recent floods a focus is put on building back better to improve community resilience ahead of the inevitable next disaster.

The private sector has historically been ineffective in producing environmentally positive outcomes, choosing instead to maximise profits. However, the newest climate models and reports such as the IPCC AR6 are changing investment patterns and influencing the flow of capital, making climate adaptation and mitigation an absolute imperative for any business interested in long term success. Profit maximisation and climate action are now financially compatible. Climate risk is incentivising markets to change tact and support the prosperity of sustainable businesses.

Understanding the climate impacts communities and businesses face will allow you to pre-empt and mitigate these risks by factoring climate risks into strategic decision-making. This presents an opportunity to increase community resilience and for businesses to attract additional investment by strengthening their environmental, social, and governance (ESG) reporting to better communicate with stakeholders. Help is at hand, specialist consulting firms like Cress Consulting are able to assist in climate risk assessment and the development of mitigation plans that increase community and business resilience.

Why credible decarbonisation matters for your business

Stakeholders are holding businesses accountable with increased scrutiny and action. Expectations continue to increase as businesses everywhere now operate within a high climate-risk context. Awareness of greenwashing and a demand for supply chain transparency pressures businesses across all industries to improve ESG reporting and match peer climate goals.

Access to finance and the cost of capital is becoming more difficult. Asset managers and other financial institutions are under pressure from their stakeholders to align themselves with companies with green initiatives and strong sustainability performance. A higher rate of return is expected when lending to 'brown' industries, essentially functioning as an inbuilt market mechanism to raise the cost of unsustainable operations.

Insurability is under threat in some sectors. Climate change is driving a revaluation of assets, particularly in high-emission industries such as fossil fuels. Along with increased incidence and intensity of extreme weather events, this new context means insurers are scrambling to decrease exposure to risky portfolios. Decarbonisation laggards risk expensive premiums and long term uninsurability in the absence of effective mitigation strategy.

Businesses risk a loss of market share. Supply chain transparency pressures B2B suppliers to offer more sustainable products to their partners. Those incapable of adaptation may lose new or existing clients who choose to instead pursue more responsible sourcing. Consumer facing businesses tacitly face a similar risk through reputational damage.

There is a high risk of operating cost inflation. The likelihood of a future global carbon price mechanism that prices climate risk into the market will materially impact operating cost curves. The degree to which this negatively impacts a firm's competitiveness is largely dependent on their capability to decarbonise operations.

Minimising the potential for greenwashing and litigation. A growing amount of litigation has been brought against firms in a range of industries driving accountability by uncovering false or misleading disclosures touting low/zero carbon products or renewable energy purchasing. The benefits of honest sustainable investment and performance now clearly outweigh the risks of greenwashing.

Risk of failure to adhere to the Paris Agreement. The Paris Agreement is a global treaty designed to protect the climate, and by extension humanity. The risk of not achieving its goals poses a direct threat to business continuity. If you would like to discuss a decarbonization strategy for your business, please contact Cress Consulting.

Cress Consulting is hiring!

If you have a strong background, qualifications, skills, and experience coupled with a desire to make a real impact, please get in touch with us to discuss opportunities to join Cress. You will become a valued member of a vibrant and growing team, collaborating with colleagues and clients to deliver holistic sustainability outcomes across a range of industries.

Contact us here: **info@cress.com.au**

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Cress has the expertise to help identify pathways to a more sustainable, secure future and can help you design and implement strategies to reduce risk and increase self-reliance.

As a Group, our sustainability, risk and water specialists are supported by more than 60 engineers and scientists across the world.

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