

# Intergenerational Equity and Sustainable Investing

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*Intergenerational equity was defined by economist James Tobin in 1974. He wrote, “The trustees of endowed institutions are the guardians of the future against the claims of the present. Their task in managing the endowment is to preserve equity among generations.” This principle has guided endowment investment policies ever since.<sup>1</sup>*



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— James Tobin, *Economist*

This concept of intergenerational equity is also explored in environmental concerns, including sustainability, global warming, and climate change. The idea of intergenerational equity, the right of future generations to a healthy, vibrant, sustainable planet, are protected by the constitutions of 74 percent of the world's nations. The United Nations Framework Convention on Climate Change (UNFCCC) considers intergenerational equity in Article 3 of its 1992 treaty: "The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities."<sup>2</sup>

The effects of climate change on the world around us are glaring. Hot, dry conditions primed southeastern Australia's forest and fields for the bushfires that ravaged the country in September 2019 and scientists have warned that climate change has likely made the situation much worse. The scale and devastation of these types of wildfires are clear examples of the way that climate change can intensify natural disasters.<sup>3</sup>

According to recent research published in the journal *Nature Climate Change*, in California, a key producer of agricultural products, and other states, the impact of climate change will continue to cause dramatic swings in dry and wet years, causing more frequent droughts and flooding. During hurricane season, more rain, stronger winds, and catastrophic storm surges — byproducts of climate change — will continue to threaten the coastal U.S.<sup>4</sup>

Bob Litterman, founding partner and chairman of the risk committee of Kepos Capital, and chair of the Commonfund

Board, continues to implore states like California to focus on infrastructure and the risks associated with climate change. "This means that electric utilities, in particular, and other businesses more generally have to rethink how they prepare for dangerous fire conditions and other impacts of climate change. These impacts are only growing. The thousand-year flood is now a regular event. The future will also bring further sea level rise, stronger hurricanes, storm surges, droughts, heat waves and wildfires beyond historical precedent."<sup>5</sup>

Rising temperatures, depleting water supplies, and other climate-change consequences have already had seemingly detrimental impact on our world. It will be future generations that inherit the continuing escalation of these and other consequences on the planet.

Climate change experts have cited the problem of "myopia", or short-term thinking, as a barrier to environmental reform and a truly global effort to stave off the effects of climate change.<sup>6</sup> For institutional investors, this sentiment may sound familiar, as tendencies and instincts to focus on what the market is doing in the short term can have negative impacts on the long-term growth of endowments.

As fiduciaries, there is an opportunity and an obligation to fully utilize our investable assets to combat climate change and contribute to a healthy, vibrant, sustainable planet for future generations. Sustainable investing gives investors, investment committees, firms, and institutions the opportunity to expand the definition of intergenerational equity and devote capital to protecting and securing resources for future generations while maintaining their fiduciary duty.



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— *Fiona Reynolds, Chief Executive Officer, PRI*

The risks from climate change are now impacting the financial markets. Recently, Rostin Behnam, who sits on the federal government's five member Commodity Futures Trading Commission, said in an interview "If climate change causes more volatile frequent and extreme weather events, you're going to have a scenario where large providers of financial products — mortgages, home insurance, pensions — cannot shift risk away from their portfolios," he said. "It's abundantly clear that climate change poses financial risk to the stability of the financial system."<sup>7</sup>

Additionally, a report led by Mercer and supported by the International Finance Corporation shows that the adverse effects on returns from climate change are inevitable, and that there are things that investors can invest in now (renewables, sustainable agriculture, clean water technology) to create opportunities and mitigate risk as we, hopefully, begin to transition to a low-carbon economy.<sup>8</sup>

Given the environmental and social challenges that the global community faces — exacerbated by the COVID-19 pandemic — we need to ask ourselves: will our actions today, as stewards of these valuable resources, provide the opportunity for future generations to prosper and take advantage of the legacy and the planet we leave behind? Is there an opportunity to incorporate sustainable investment practices and try to achieve intergenerational equity?

Many institutional investors are implementing ESG strategies that are currently available. Like with any nascent market, there are challenges such as defining standards and terminology and collecting consistent, quality data. With that said, more investors can work with other committed industry leaders to advance sustainable investing.

Fiona Reynolds, Chief Executive Officer of PRI, offers this leadership call to action. "Now is the time for decisive, collective action. It's time to demonstrate that the global financial sector can respond to the immediate crisis while shaping a recovery which prioritizes social and environmental outcomes. The actions we collectively take over the coming weeks, months and perhaps even years will lay the foundations for a more stakeholder-driven and sustainable global economy — one that aligns people, profit and planet."<sup>9</sup>

To be fair, it is human nature to be focused on the short term. Focusing on tangible results today rather than on securing resources and managing risk for the long term is a human instinct that institutional investors and climate scientists both contend with when considering intergenerational equity.

Fundamentally, intergenerational equity is centered on fairness and justice between generations. To go a step further, consider that the term fiduciary — acting on behalf of another or in the best interest of others — could potentially articulate our mandate not only as stewards of capital, but the planet, when thinking of the future and making decisions. For now, we have been presented with an opportunity to consider using the financial resources at our disposal to ensure that future generations have access to an equal share of monetary resources, but more importantly, a sustainable, vibrant, livable planet. It is becoming clearer, and more imperative, that sustainable investing can be a pathway for us to realize both goals.



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### End Notes

- 1 Tobin, James, "What Is Permanent Endowment Income?", *The American Economic Review*, Vol. 64, No. 2, Papers and Proceedings of the Eighty-sixth Annual Meeting of the American Economic Association (May 1974): 427-432, <https://www.jstor.org/stable/1816077?seq=1>.
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- 9 Reynolds, Fiona and Amanda White, "The Power of Collective Investor Action", *Top1000Funds* (March 30, 2020), <https://www.top1000funds.com/2020/03/the-power-of-collective-investor-action/>.

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