Callan

CALLAN INSTITUTE

Survey

2018 ESG Survey

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Executive Summary

Introduction

Callan's 2018 ESG Survey, conducted in May 2018, reflects input from 89 unique institutional U.S. funds that were asked about their approach to, and opinion on, environmental, social, and governance (ESG) factors when evaluating investments. For the purposes of this survey, ESG factors include socially responsible investing (SRI, including divestment), sustainable investing, responsible investing, impact investing, and other associated terms.

Our 2018 survey, which is the sixth we have conducted, found that U.S.-based institutional investors are increasingly incorporating ESG considerations into their investment decision-making process. Incorporation rates in 2018 were the highest in the survey's history and surpassed 40% for the first time.

ESG factor incorporation increased in 2018, continuing an upward trend

For this survey, ESG factors include socially responsible investing (SRI, including divestment), sustainable investing, responsible investing, impact investing and other associated terms

Overall, incorporation of ESG factors into the investment decision-making process nearly doubled to 43% in 2018 compared to 22% in 2013. Our survey reveals ongoing disparity in ESG adoption rates by fund type and size. Historically, endowments and foundations have consistently had the highest ESG adoption rates. Public funds have incorporated ESG factors into the investment decision-making process at a higher rate than their corporate counterparts.

– Corporate funds saw the most modest rise in ESG adoption rates, from 14% in 2013 to 20% in 2018

– 39% of public funds indicated they incorporate ESG in 2018, up from 15% in 2013

– Foundations reported the highest rate of ESG incorporation at 64% in 2018 (vs. 35% in 2013)

– Endowments incorporated ESG factors at a rate of 56%—more than double the rate in 2013 (22%)

Key Findings

Callan's sixth annual *2018 ESG Survey* presents trends on ESG adoption for U.S. institutional funds. The results reflect input from 89 unique institutional U.S. funds and trusts.

15%

of those who have not yet incorporated ESG factors are considering it

55%

of those who have incorporated ESG consider ESG factors with every investment / manager selection

72%

of large funds have incorporated ESG factors into investment decisions

Risk Matters

Achieving an improved risk profile was the most frequently cited reason for incorporating ESG

43%

Incorporated ESG factors into the investment decision-making process—the highest in the history of our survey

ESG incorporation by region

Pacific	60%
Northeast	54%
Central	42%
Mountain	38%
Southeast	13%

13%

of defined contribution plans feature an ESG option in the plan lineup

64% foundations

56% endowments

39% public funds

20% corporate

41%

of respondents who incorporated ESG plan to broaden the scope of incorporation in the future

Respondent Overview

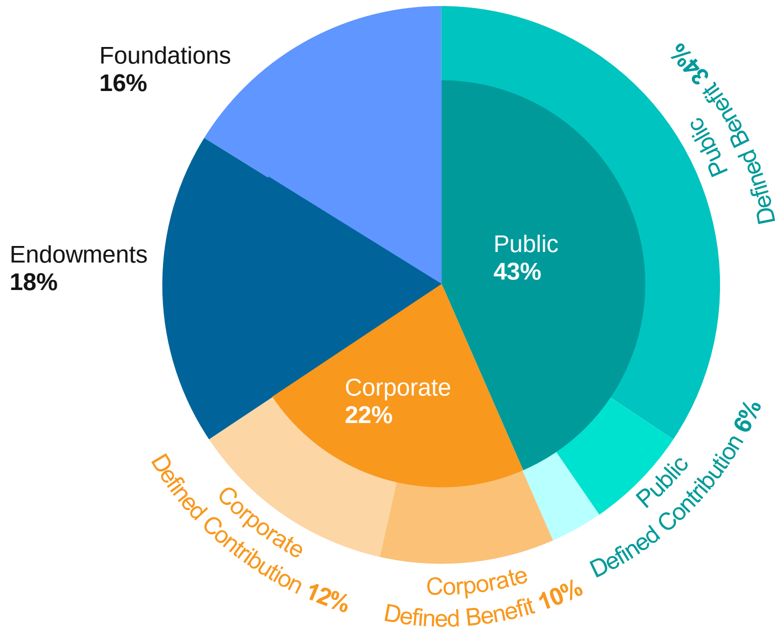
89 funds and trusts responded to the survey

43% of respondents are public funds, making them the largest fund type represented

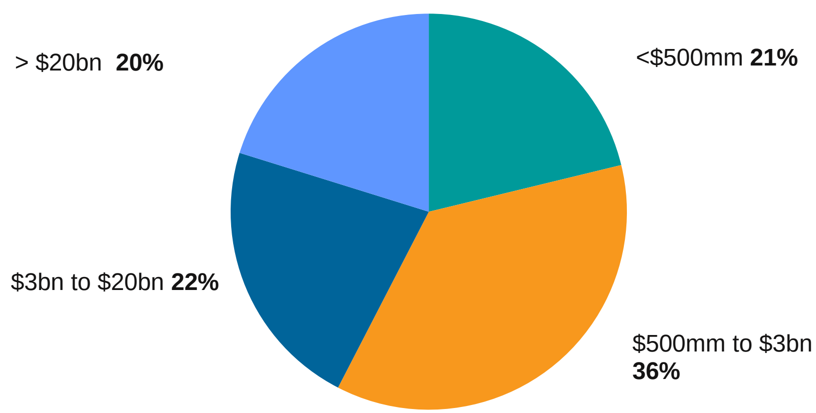
22% of respondents are corporate funds, and more than one-third are endowments or foundations

20% of respondents are "large" funds with $20 billion or more in assets

Respondents by fund type



Respondents by fund size



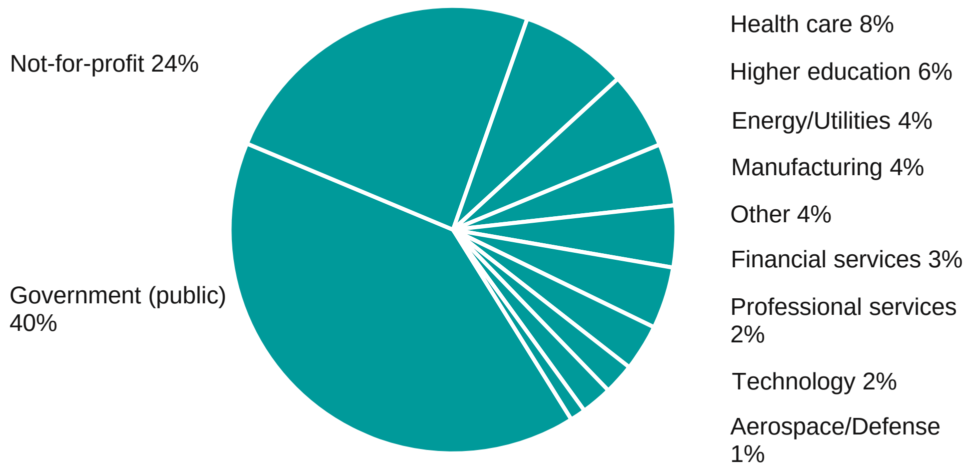
Note: charts in this report may not sum to 100% due to rounding.

Respondent Overview (continued)

40%

of respondent firms are from the government sector, and 24% are not-for-profits

Respondents by industry



"Other" includes:

Retail and Construction

ESG Factor Adoption Rates

Callan asked: "Has your fund incorporated ESG factors into investment decision-making?" This language is intentionally broad in order to capture as many potential types of implementation as possible that reflect the prevalence of ESG considerations in the institutional investment arena.

The percentage of respondents in 2018 that incorporate ESG factors into decision-making rose to 43% from 22% in 2013

Overall: The percentage of respondents in 2018 that had incorporated ESG factors into decision-making rose to 43%, up from 22% in 2013. Another 8% of respondents are considering implementing ESG in the U.S., making it around half of U.S. asset owners that are implementing ESG or considering doing so.

By Fund Type: Foundations and endowments have adopted ESG into investment programs at a greater clip than other fund types over the last six years, a trend that continued in 2018 at 64% and 56%, respectively. Corporate funds saw a decrease in ESG adoption year over year, from 25% in 2017 to 20% in 2018. Most of the decline can be attributed to the adoption rate of corporate defined contribution plans, with only 9% indicating they incorporate ESG into the investment decision-making process. More than one-third of public funds reported incorporating ESG (39%) in the 2018 survey, up from 35% in 2017.

By Fund Size: The majority (72%) of the largest respondents ($20 billion or greater) have incorporated ESG factors into investment decisions. The largest funds have incorporated ESG factors at the highest rate since the inception of the survey in 2013.

By Region: Respondents located in the Pacific (60%) and Northeast (54%) regions of the country are more likely to incorporate ESG factors than their counterparts in the Southeast (13%).

Looking Forward: 15% of respondents that have not yet incorporated ESG into investment decision-making are considering doing so, more than double the rate recorded in 2017 (7%).

ESG Factor Adoption Rates Overall

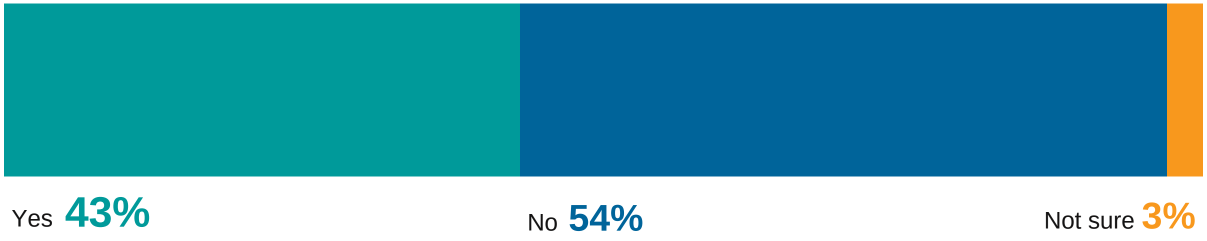
43%

of respondents incorporated ESG factors into investment decisions in 2018, nearly double the 22% we recorded when first conducting this survey in 2013. Adoption of ESG has steadily climbed over time, with the exception of 2017, which was flat with 2016.

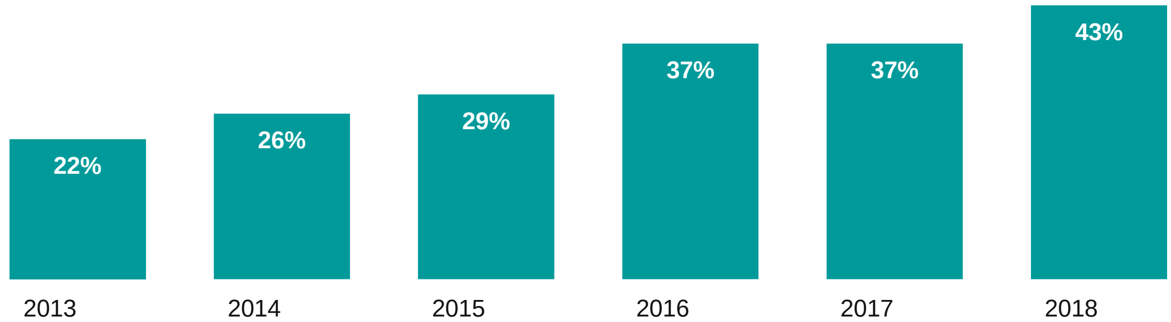
95%

increase in respondents that have incorporated ESG factors into investment decisions from 2013 to 2018

2018: Does your fund incorporate ESG factors into investment decisions?



Funds that have incorporated ESG factors into investment decisions over time



ESG Factor Adoption Rates by Fund Type

64%

of foundations have incorporated ESG factors into investment decisions, the 2018 survey found. Foundations have incorporated ESG factors at a higher rate than all other fund types in four out of the six years that Callan has fielded this survey. Endowments and foundations have consistently led other fund types in ESG implementation over time.

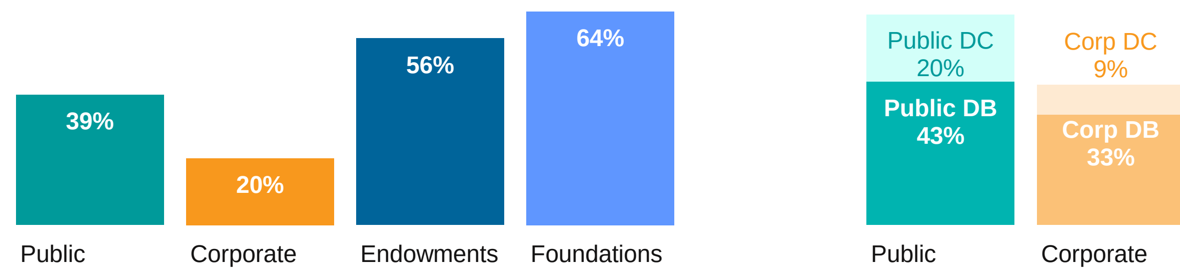
Defined benefit plans are

more than 3x

more likely to incorporate ESG factors into investment decisions than defined contribution plans.

Defined benefit plans, public and corporate combined, incorporated ESG at a rate of **40%** while defined contribution plans only incorporated ESG at a rate of **13%** (not pictured).

2018 funds that are incorporating ESG factors into investment decisions



By fund type over last six years

2013	2014	2015	2016	2017	2018
Foundations **35%**	Endowments **34%**	Foundations **39%**	Endowments **53%**	Foundations **56%**	Foundations **64%**
Endowments **22%**	Foundations **31%**	Endowments **37%**	Foundations **48%**	Endowments **39%**	Endowments **56%**
Public **15%**	Public **22%**	Public **27%**	Corporate **30%**	Public **35%**	Public **39%**
Corporate **14%**	Corporate **16%**	Corporate **15%**	Public **25%**	Corporate **25%**	Corporate **20%**

ESG Factor Adoption Rates by Fund Size

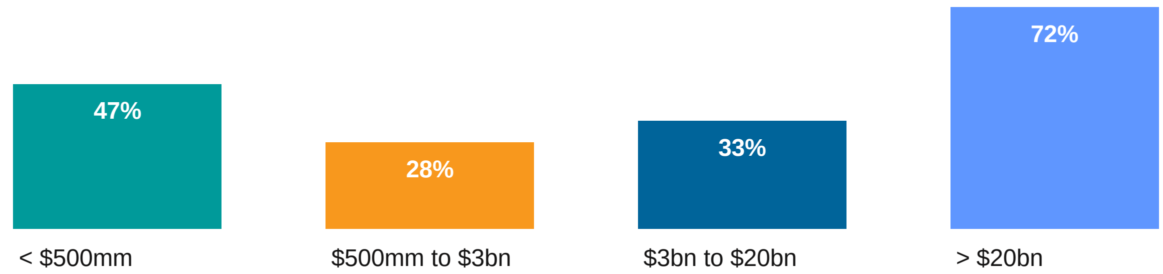
72%

of the largest respondents (>$20 bn) have incorporated ESG factors into investment decisions. The largest funds have incorporated ESG factors at the highest rate since the inception of the survey in 2013.

135%

Small funds are catching up, with a nearly 1.5x increase for the smallest funds (respondents <$500mm) that have incorporated ESG factors into investment decisions since 2013.

2018 funds that are incorporating ESG factors into investment decisions



By fund size over last six years

2013	2014	2015	2016	2017	2018
> $20bn **33%**	> $20bn **31%**	> $20bn **35%**	> $20bn **71%**	> $20bn **78%**	> $20bn **72%**
$3bn to $20bn **29%**	$500mm to $3bn **24%**	$3bn to $20bn **31%**	<$500mm **39%**	$500mm to $3bn **42%**	<$500mm **47%**
$500mm to $3bn **23%**	<$500mm **22%**	<$500mm **26%**	$3bn to $20bn **33%**	<$500mm **30%**	$3bn to $20bn **33%**
<$500mm **20%**	$3bn to $20bn **18%**	$500mm to $3bn **26%**	$500mm to $3bn **29%**	$3bn to $20bn **22%**	$500mm to $3bn **28%**

ESG Factor Adoption Rates by Region

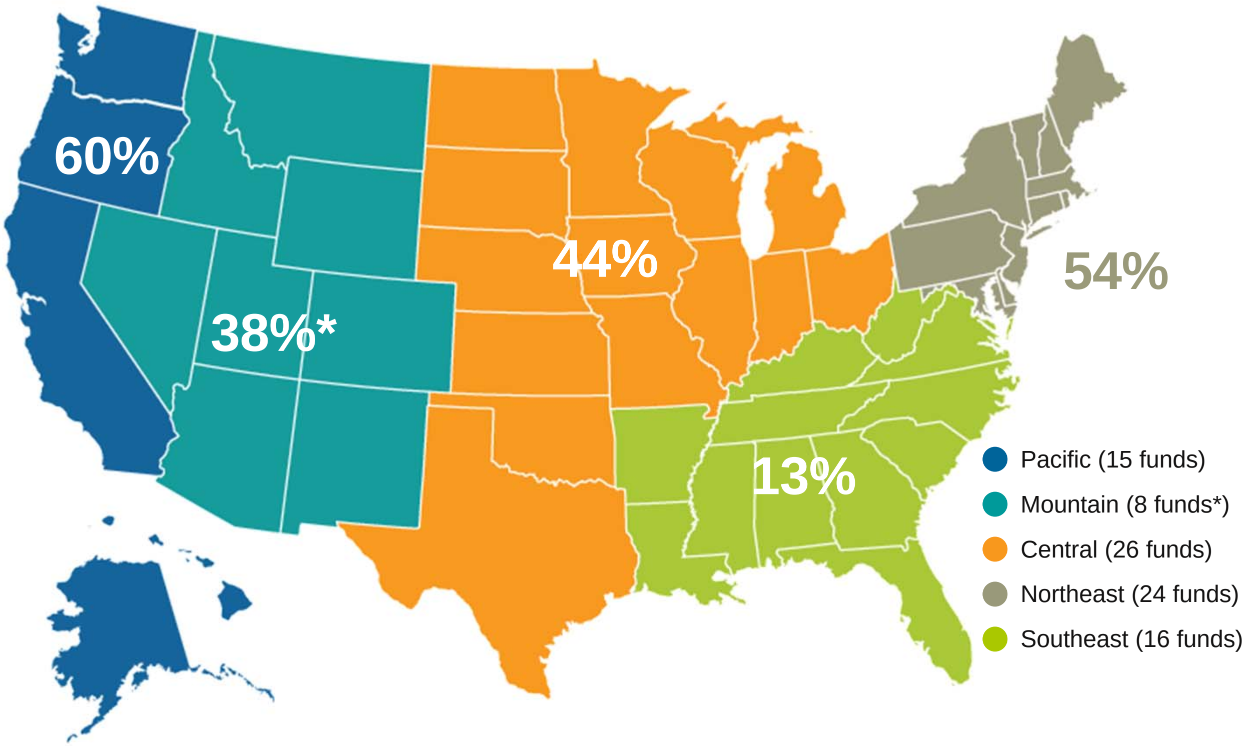
60%

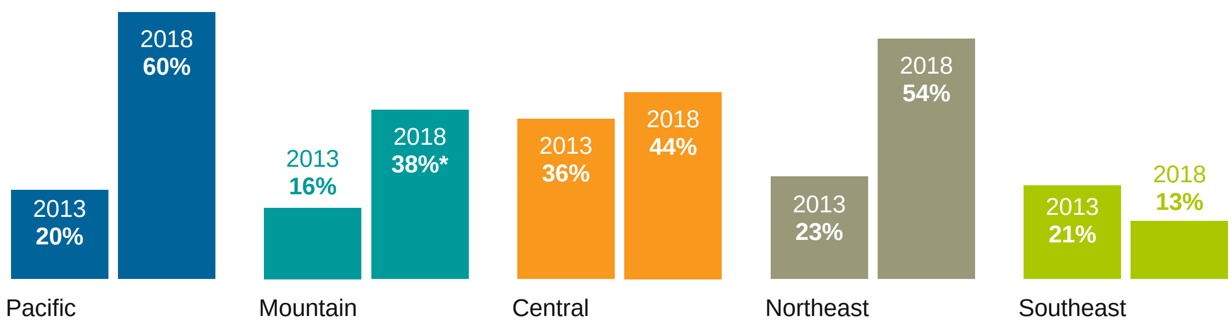
of funds in the **Pacific** region incorporate ESG into investment decisions.

While fund type and size factor more heavily into whether a fund will utilize ESG factors in investment decision-making than region, we note regional differences in our respondents, as well.

The Southeast is the only region where incorporation rates have decreased over the history of the survey.

Regional breakdown of ESG incorporation





*Note the small sample size.

ESG Factor Adoption Rates Looking Forward

Room to grow

15%

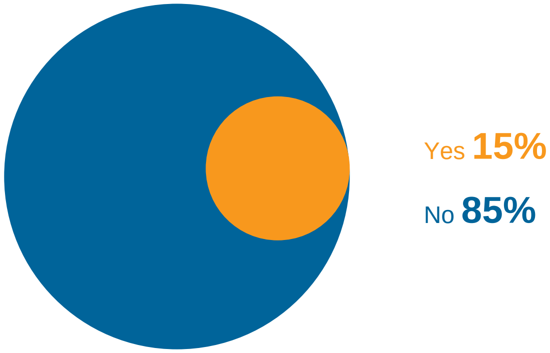
of respondents that have not yet incorporated ESG into investment decisions are considering doing so in the future.

64%

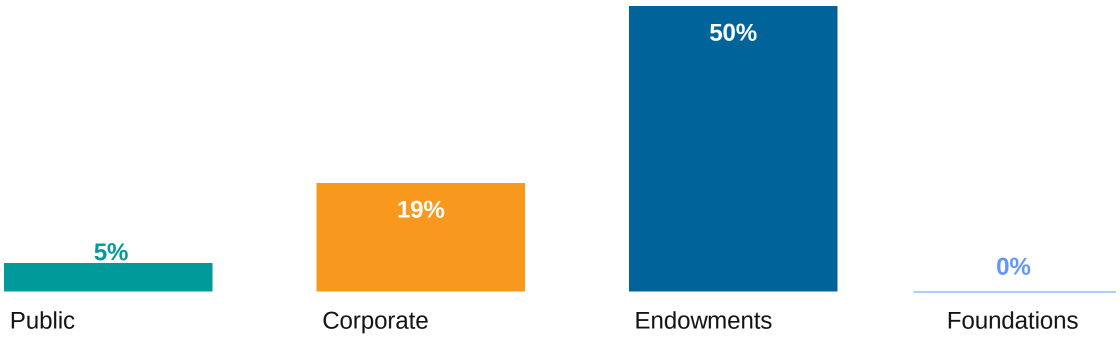
of foundations have already incorporated ESG into investment decisions, and no members of this group that have not yet done so are considering doing so in the future.

For those funds contemplating ESG, the focus is on learning more about it: **57%** of those considering incorporating ESG factors in the future have either received education from their investment adviser or from an ESG-focused investment manager on the topic (not pictured).

If you have not incorporated ESG factors into investment decisions, are you considering it?



Share of respondents that have not incorporated ESG factors into investment decisions but are considering it (by fund type)



ESG Implementation

The term ESG includes a wide swath of implementation options beneath its umbrella

Implementation strategies vary substantially, as investors find the approach that best accomplishes their unique goals

Callan asked survey respondents that have incorporated ESG factors into investment decisions specifically how they had done so to gauge the prevalence of various implementation strategies

The top ESG implementation methods for 2018 focus on the investment management community: to consider ESG factors with every investment/investment manager selection (55%) and to communicate to investment managers that ESG is important to the fund (55%). Callan finds that manager communication and selection are frequently first steps that many institutional investors take when pursuing an integrated approach to incorporating ESG factors in investment decisions.

The next most prevalent implementation actions:

– Engage with management, actively voted proxies, and/or submitted shareholder resolutions (50%)
– Add language to investment policy statement (45%)
– Incorporate a screening process (37%)
– Hire a manager/strategy that has incorporated ESG (37%)

Only 18% of respondents score investment managers using ESG metrics, suggesting the asset owner community is still seeking a standardized and reliable method for measuring success in reference to ESG. Just 13% of respondents said they hired a manager for impact investing specifically.

ESG Implementation

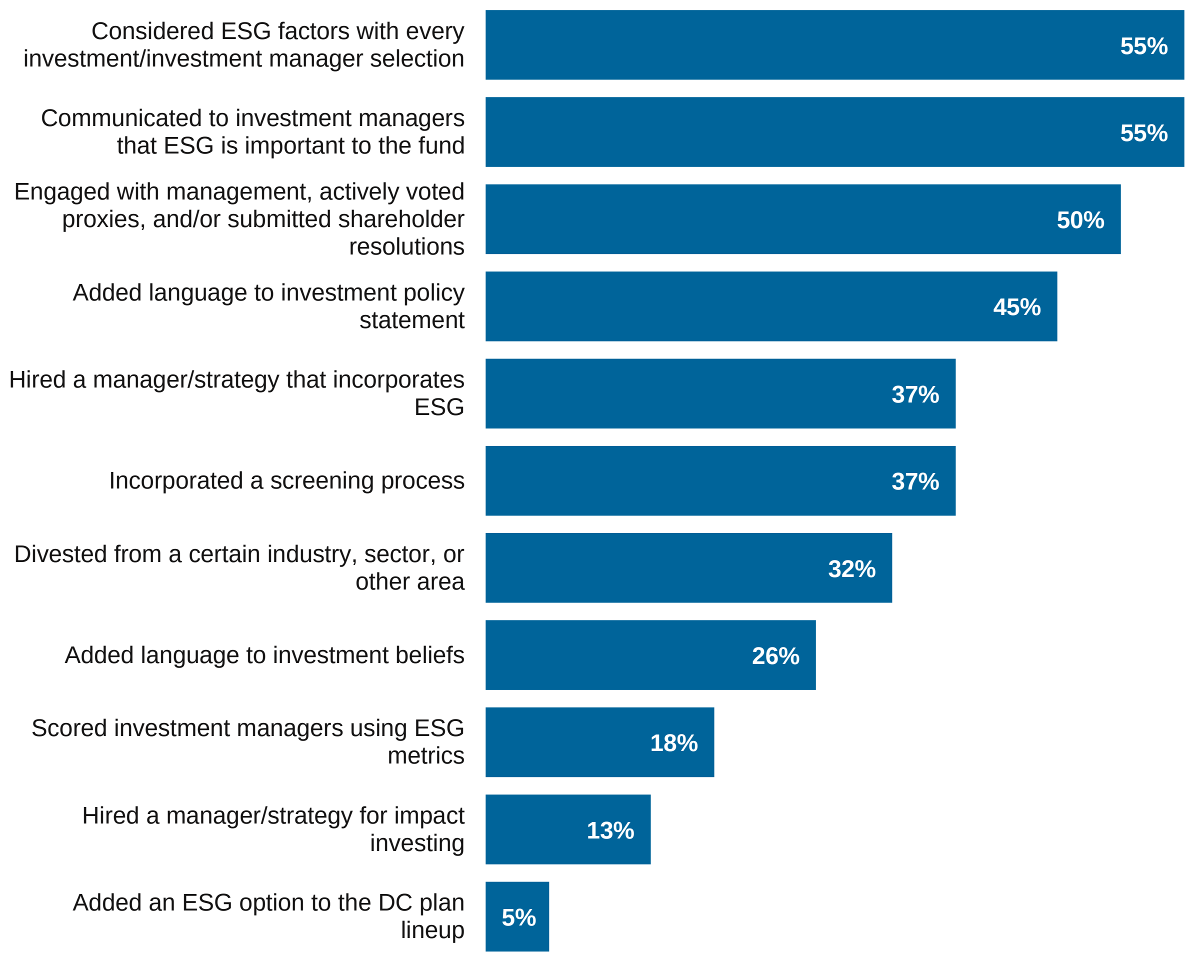
Words becoming action

When Callan inquired about ESG implementation approaches in 2016 and 2017, “added language to the investment policy statement” was the most popular method among survey respondents.

In 2018, the two most popular approaches suggest funds are now taking action on ESG beliefs: considering them in manager selection and communicating them to investment managers.

As ESG research develops and investors become more educated about the issues and implementation options, we’re observing a shift to action, working with others in the investment management community to implement ESG beliefs.

How funds are incorporating ESG*



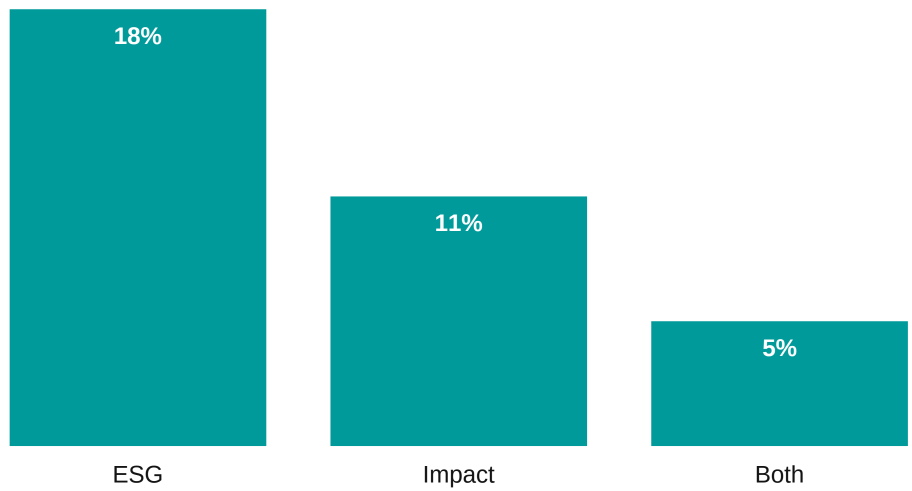
*Multiple responses allowed.

ESG Allocation

18%

of funds that have incorporated ESG factors into the investment decision-making process have made a distinct allocation to ESG investing

Distinct allocation dedicated to ESG or impact investing separate from the traditional portfolio



* Multiple responses were allowed.

Defined Contribution Assets

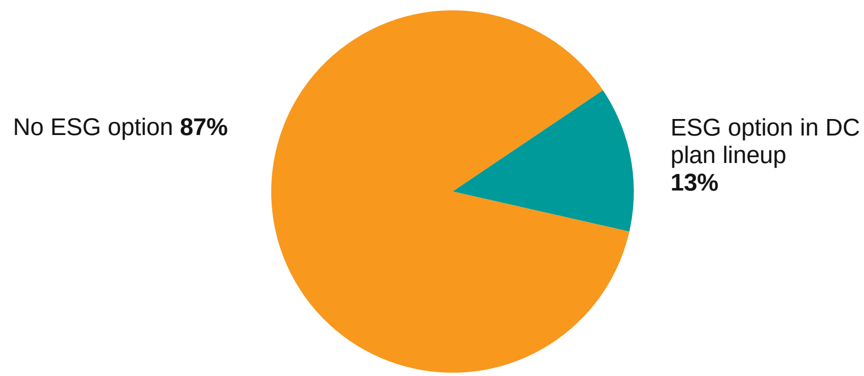
Of the various types of institutional investors in the U.S., defined contribution (DC) plans trail other plan types when it comes to ESG incorporation.

13%

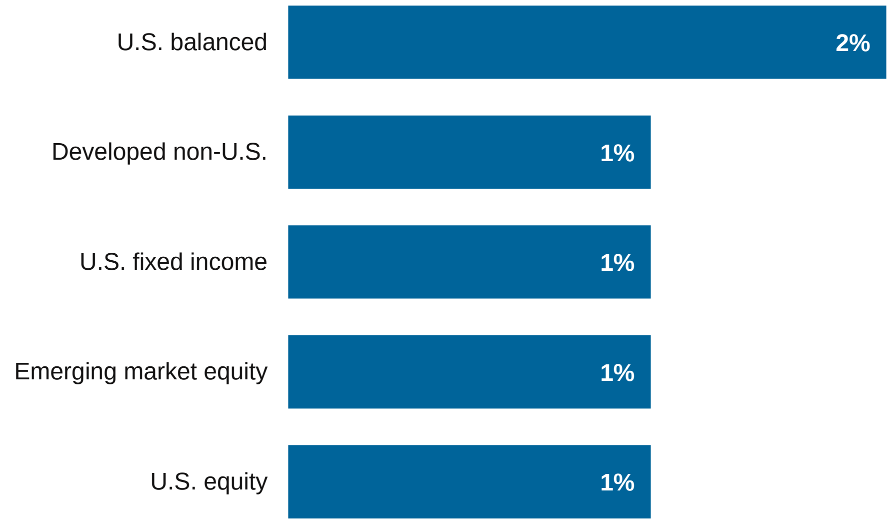
of all DC plans (both public and corporate, and incorporating ESG or not) include an ESG option in their plan lineup, compared to a 40% incorporation rate for defined benefit plans. Similarly, 16% of DC plans in the Callan DC Index™ offer a dedicated ESG option.*

When there is an ESG-focused option in the plan lineup, usage tends to be very low. Respondents indicate an average allocation of just **1%** to the ESG option, when available (based on five observations). Despite the small number of submissions, this average is again in line with the Callan DC Index™, where the average allocation to ESG plan options is 1.2%.*

ESG in defined contribution plans



Assets allocated for those with defined contribution plans featuring ESG-focused option**



*Source: callan.com/esg-dc/

**Note this exhibit is based on just 5 data points, one for each asset class

Environmental Actions

We asked respondents that have incorporated ESG what actions they have explored or taken specific to environmental concerns, such as climate change

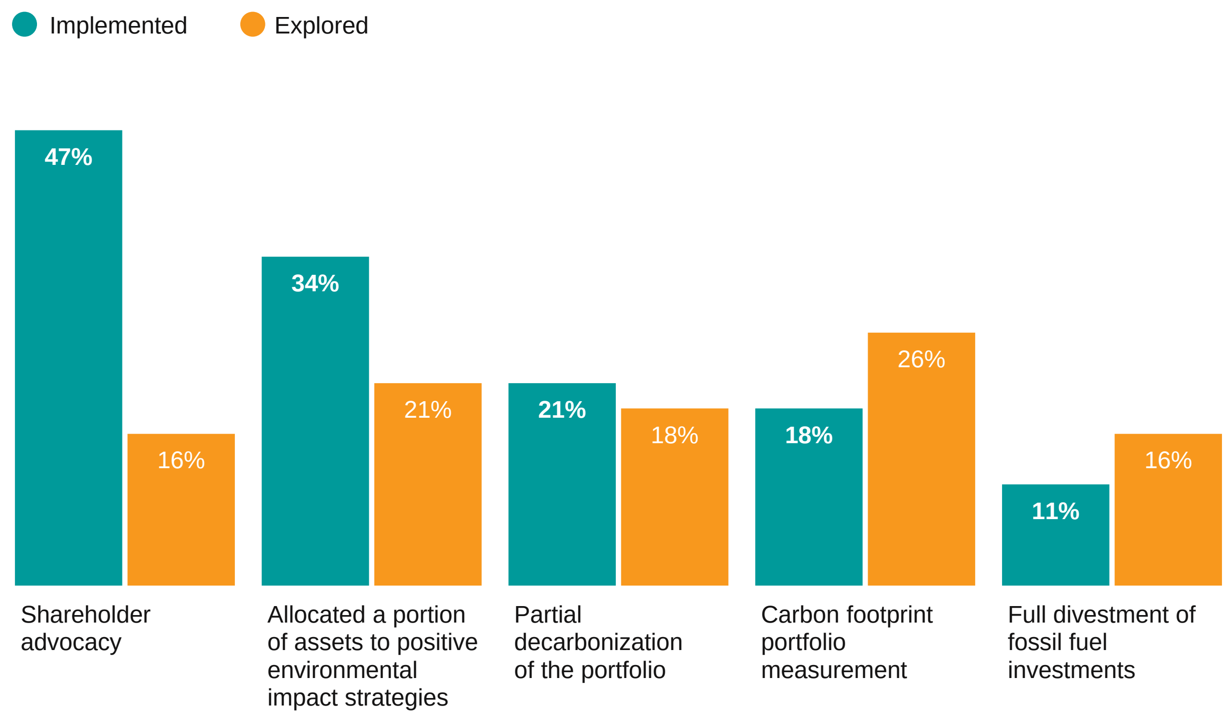
47%

Shareholder advocacy (e.g., proxy voting specific to environmental resolutions) was by far the most popular action taken around “E” (47%), followed by allocating to environmental impact strategies (34%)

Carbon footprint portfolio measurement (26%) was the most popular action explored

One-fifth of respondents that are incorporating ESG are implementing partial portfolio **decarbonization**

Actions taken specific to “E” for those who have incorporated ESG



* Multiple responses were allowed.

Digging Deeper on ESG Pillars

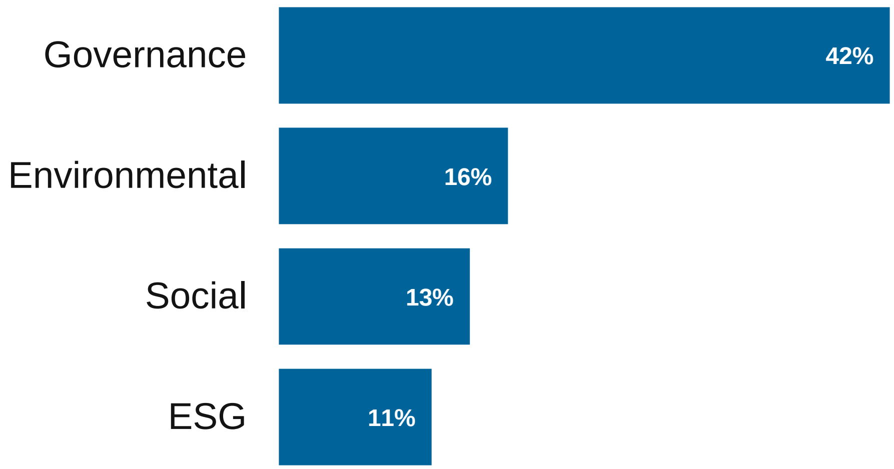
Respondents that incorporate ESG factors into investment decision-making were asked which pillar (E, S, or G) they were most philosophically aligned with

42%
cited governance, overwhelmingly the most popular answer

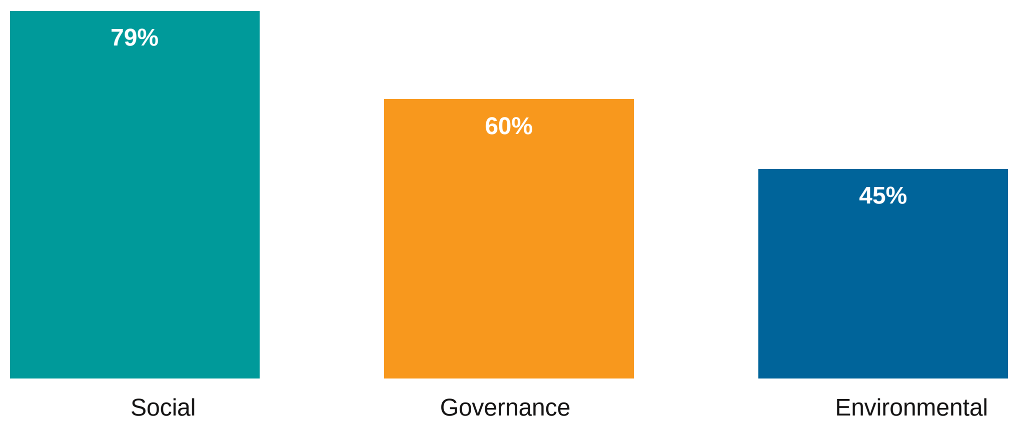
Corporate governance issues have traditionally been part of security analysis, but are getting a fresh look through an ESG lens

We also asked respondents to indicate the percentage of their portfolio that is aligned with each pillar: interestingly, social ranked highest (**79%**) in this case, followed by governance (**60%**) and environmental (**45%**)

Organization's philosophical pillar alignment for those that have incorporated ESG factors into investment decision-making



Portfolio pillar alignment for organizations that have incorporated ESG factors into investment decision-making



ESG Areas of Focus

We asked respondents that are incorporating ESG factors into investment decisions to rank ESG issues from most (5) to least (1) important.

Human capital ranked the highest (3.5) followed closely by financial (3.4), natural (3.3), and civic capital (3.1).

Human capital can be interpreted as a social concern. This aligns with “S” being identified as the most important pillar for portfolio alignment (page 17).

Respondents identified U.S. markets (3.7) as the most important geographically, followed by global (3.4), emerging (3.3), and non-U.S. markets (3.2).

ESG data is more robust and readily available for U.S. publicly traded securities and those in other developed markets, and grows more difficult to attain and verify in the emerging markets.

Importance of ESG Issues

Importance of ESG by Geography

Organization Membership

We asked respondents which organizations, if any, they had joined as part of efforts at education, collaboration, and commitment around ESG issues.

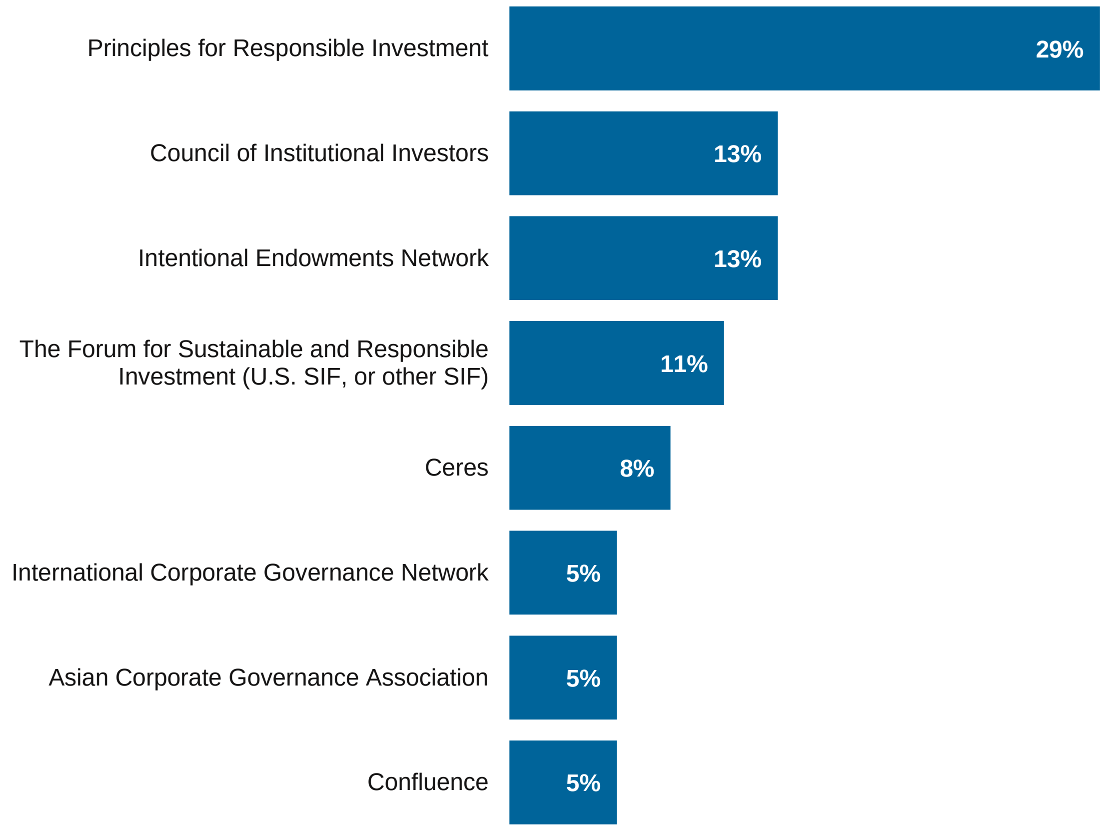
29%

Signing the Principles for Responsible Investment (PRI) was the most popular choice.

The PRI reports that membership has increased from less than 100 signatories in 2006 to more than 1,800 in 2017[1].

The next two most popular organizations for U.S. institutional investors were the Council of Institutional Investors and the Intentional Endowments Network (**13%** each).

Organization membership by those who have incorporated ESG*



*Multiple responses were allowed.

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Reasons For and Against ESG

FOR

Risk, return, and fiduciary responsibility

The motivations for incorporating ESG into investment decision-making were historically tied to moral or other non-financial convictions, but increasingly investors are focused on risk, return, and fiduciary responsibility. The top reasons survey respondents incorporate ESG factors into investment decisions in 2018 include:

- 42% expect to achieve an improved risk profile
- 34% must consider ESG factors as part of the fiduciary responsibility
- 34% have other fund goals besides maximizing risk-adjusted returns

The reasons that funds pursue ESG vary by fund type: endowments and foundations tend to focus on achieving higher long-term returns, while public and corporate funds are more likely to look at ESG through the lens of improving risk. The response “The fund's investment policy statement dictates that we consider ESG factors” fell from one of the most popular reasons for ESG in historical surveys to resonating with less than one-quarter of survey respondents in 2018.

AGAINST

Purely financial and outperformance

Just over half of all respondents have not incorporated ESG factors into investment decision-making (54%) in 2018, down markedly from 2013 (78%).

The most common reason cited in 2018 to not incorporate ESG was that the fund would not consider factors that are not purely financial in the investment decision-making process (52%). This has been one of the top three reasons against incorporating ESG since the inception of the survey.

Nearly half of respondents that are not incorporating ESG cite a dearth of research tying ESG to outperformance. This reason resonated in particular with corporate defined benefit plans (83%) that do not incorporate ESG factors into investment decision-making.

Motivations for Incorporating ESG

50%

of corporate funds incorporating ESG expect to achieve an improved risk profile

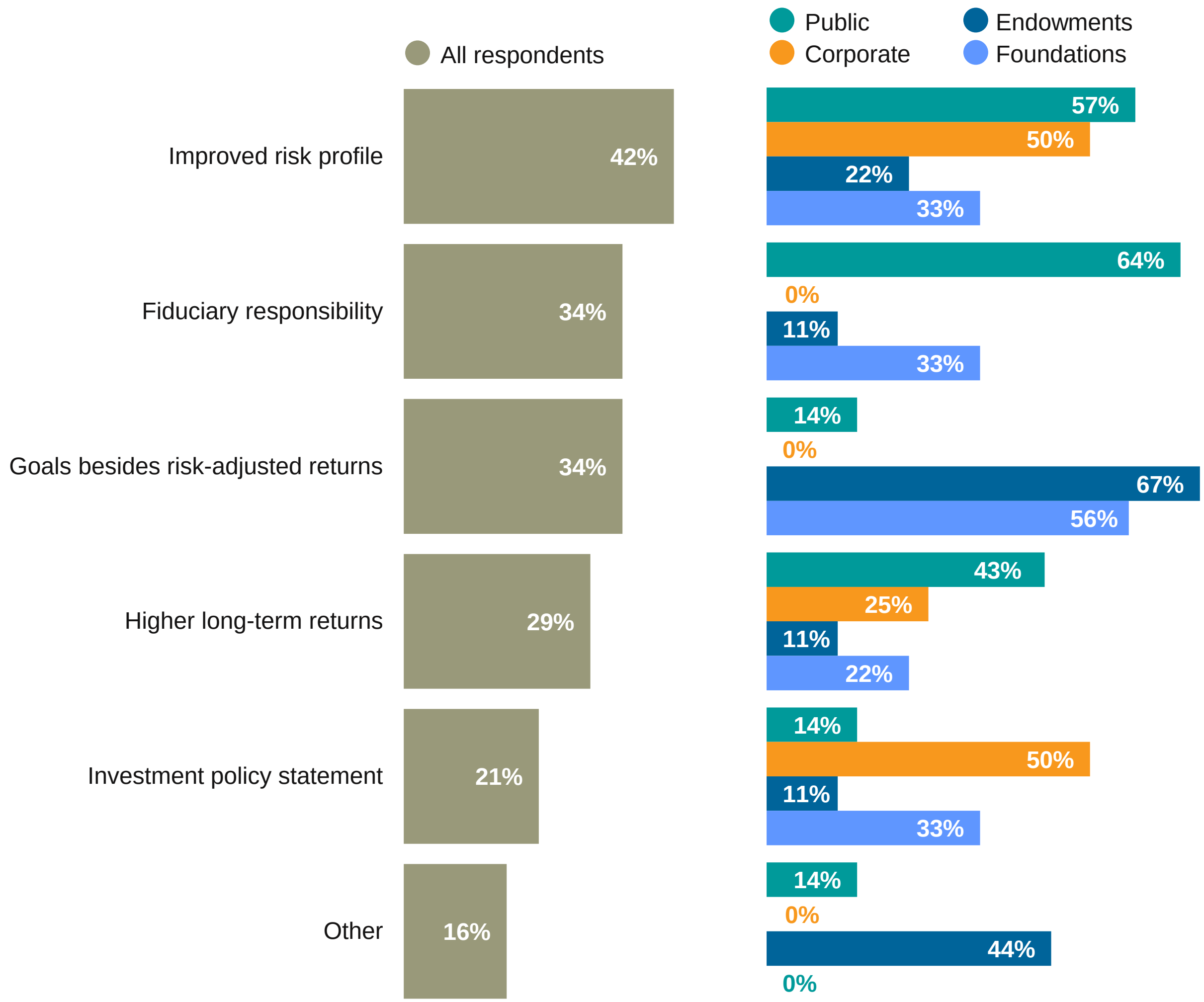
More investors are looking to improve their fund's risk profile by applying an ESG lens in 2018 (**42%**) than in previous years

"Other" responses include:

"Request of faculty"

"We initiated a second portfolio specifically incorporating ESG factors in order to attract endowment contributions"

Reasons for incorporating ESG factors into the investment decision-making process*



* Multiple responses were allowed.

Reasons Against ESG Incorporation

We asked respondents that have not incorporated ESG into investment decision-making to indicate their reasoning

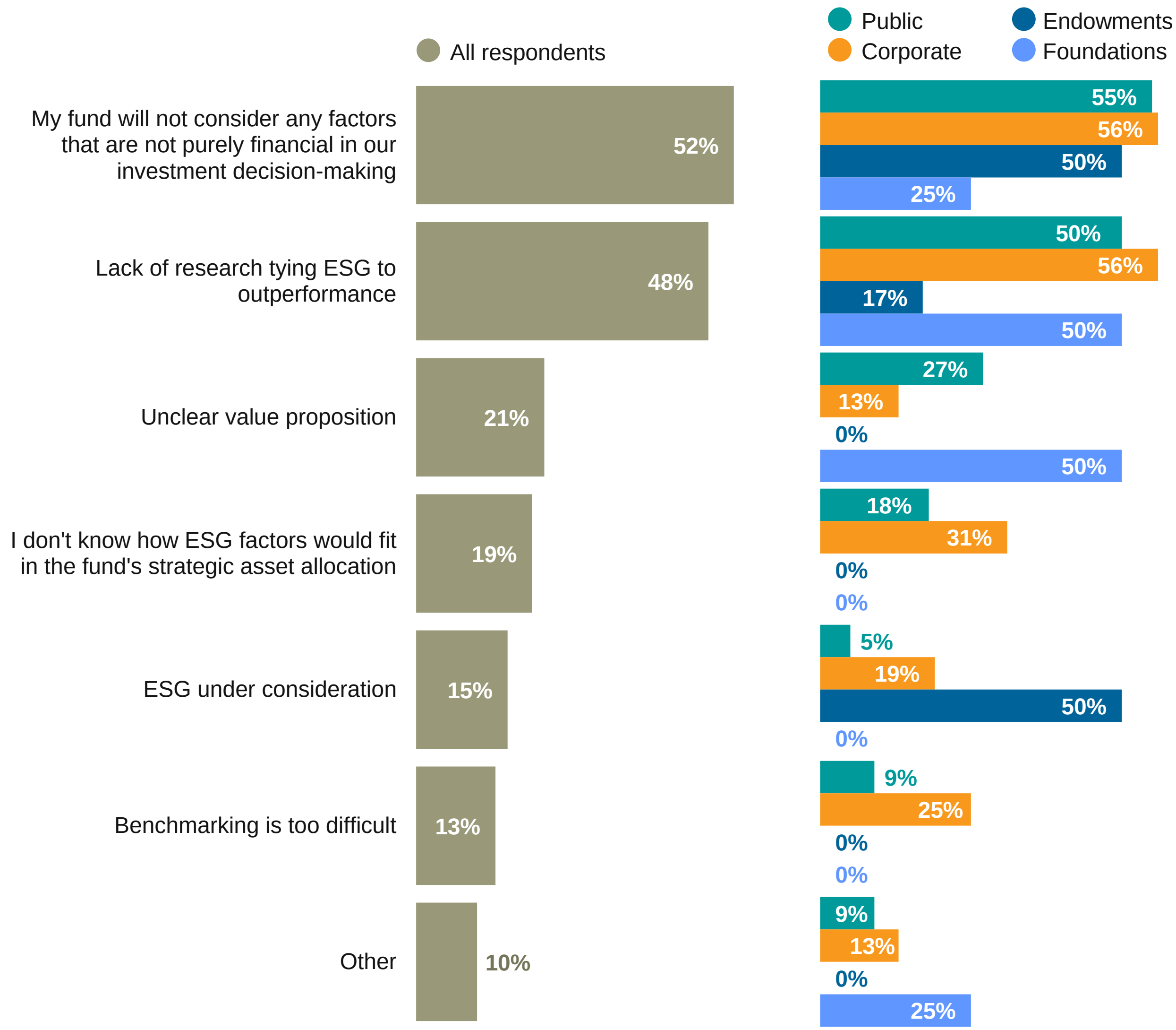
52%

of non-ESG funds indicate they will not consider any factors that are not purely financial –this has been the most popular answer cited for not incorporating ESG factors into investment decision-making for two years

15%

of those who have not incorporated ESG into investment decision-making are considering doing so (page 11), suggesting there is still room for growth in the overall adoption rate of ESG in investment decision making for U.S. institutional investors

Reasons for NOT incorporating ESG factors into the investment decision-making process*



* Multiple responses were allowed.

Looking Forward

39%

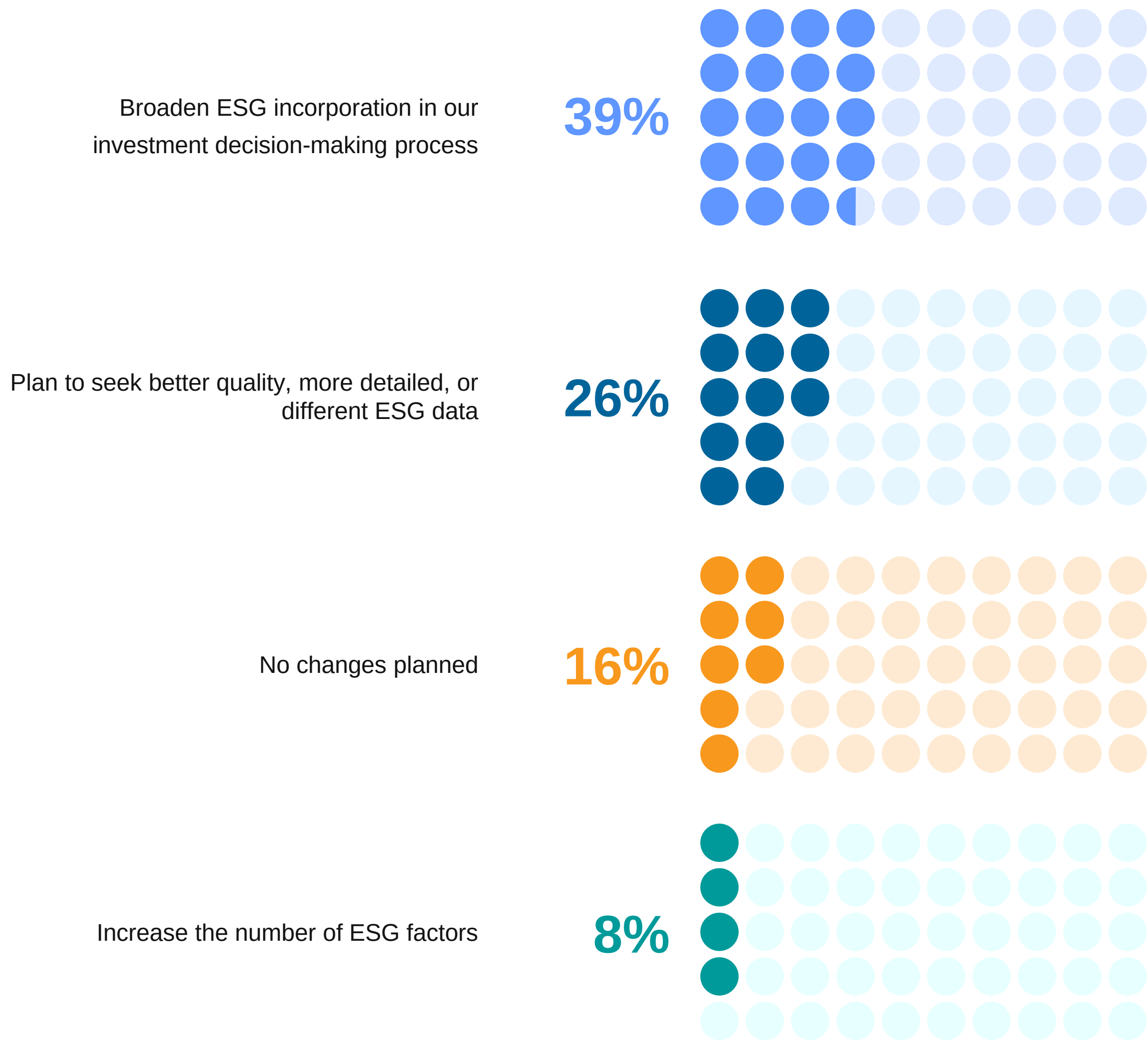
of respondents that have already incorporated ESG factors in investment decision-making plan to broaden the scope going forward, suggesting more activity with investment managers and other industry groups

More than a quarter (**26%**) of respondents that have already incorporated ESG factors in investment decision-making are seeking better quality, more detailed, or different ESG data

Standardization of ESG data and other measurement tools for ESG has not yet occurred, but is well underway

Industry consensus around ESG data reporting will have major implications for asset owners seeking to broaden—and those looking to begin—ESG incorporation

Planned changes to usage of ESG factors over the next 1 to 3 years*



*Multiple responses were allowed.

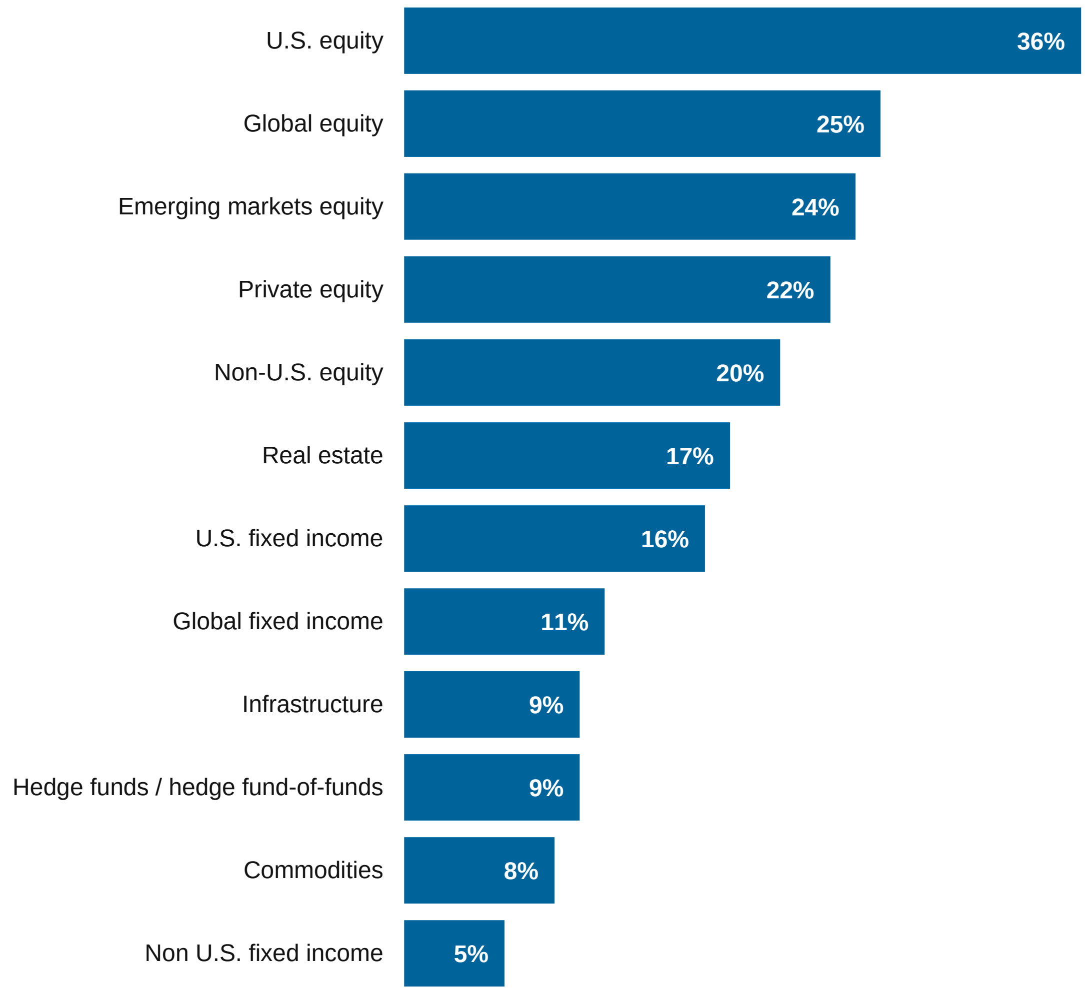
Product Offerings

We asked all survey respondents—organizations that both have and have not incorporated ESG into investment decisions—for which asset classes they would like to see more ESG-focused product offerings.

36%

More than one-third of respondents indicated they would like to see more U.S. equity products, followed by global equity (25%), emerging markets equity (24%), and private equity (22%).

Asset classes for which you'd like to see more ESG-focused product offerings*



*Multiple responses were allowed. 43% responded "none of the above."

Conclusions

The percentage of U.S. investors that have incorporated ESG factors into decision-making has increased to 43% in 2018, the highest percentage recorded in the history of the survey, and up 95% relative to 2013 (22%).

Adoption Growth Continues: After plateauing in 2017 (37%), there was a reemergence of the upward trend in ESG adoption rates seen since the inception of the survey in 2013. 43% of respondents said they have incorporated ESG factors into the investment decision-making process. Additionally, 8% of total respondents are considering incorporating ESG factors in the future, bringing the ratio of those either currently incorporating or thinking about incorporating ESG to just over half of the respondent pool of U.S. institutional investors.

Preparation to Implementation: Previous surveys reflected funds preparing to incorporate ESG factors into the investment decision-making process—by adding language to the investment policy statement and pursuing education around the issue. This year's survey reflects more investors implementing ESG approaches with investment managers: 55% of respondents both communicated to investment managers that ESG is important to the fund and considered ESG factors with every investment/investment manager selection in 2018.

DB vs. DC: Despite a small number of observations recorded, there was a significant difference between ESG adoption rates among defined benefit (DB) and defined contribution (DC) plans. Corporate DB plans incorporated ESG factors into the investment decision-making process at more than three times the rate (33%) of their DC counterparts (9%). Similarly, public DB plans utilized ESG factors at more than twice the rate (43%) of their DC counterparts (20%).

Looking Forward: Respondents that incorporated ESG into the investment decision-making process indicate that they will broaden their approach to ESG (**39%**) in the next 1-3 years, implying a continued progression of implementation. For those funds that have not yet incorporated ESG factors but are considering doing so in the future (15%), education remains the focus of these considerations: **57%** of those considering incorporating ESG factors in the future have either received education from their investment adviser or from an ESG-focused investment manager on the topic.

About the Survey

Survey Methodology

Callan's *2018 ESG Survey* is the sixth edition we have produced to highlight current practices and opinions surrounding environmental, social, and governance (ESG) factors among various types of U.S. institutional investors. Respondents voluntarily provided input via online questionnaires.

We broke respondents into two primary groups for analysis: those that have and have not incorporated ESG factors into the investment decision-making process. Organizations incorporating ESG factors answered different questions than those that were not incorporating ESG factors. In most instances, statistics were calculated using this subset of respondents as the denominator. In a few cases, the denominator was smaller, as a subset of the primary group (e.g., only the defined contribution plans that are implementing ESG). In these situations, we describe the specific respondent group upon which statistics are calculated in the text that accompanies the particular exhibit. Multiple responses were allowed for many questions, as described in relevant footnotes.

About the Authors

Shane Blanton is a Senior Analyst in Callan's Published Research Group covering business analytics. He is responsible for data analysis and visualization to support Callan's research endeavors. In addition, he is responsible for measuring and benchmarking Callan's communications campaigns. Previously Shane was a member of the Analytical Solutions Group for three years, training Callan's clients to use PEP software.

Prior to joining Callan, Shane worked as an Account Manager for an IC packaging manufacturer, and also worked as a trading assistant to a proprietary options firm. Shane attended Carnegie Mellon University, where he earned a B.S. in Business Administration.

Anna West is a Senior Vice President dedicated to Callan's research and education initiatives. As Co-Manager of the Published Research Group, she works with subject matter experts across Callan to produce white papers, surveys, charticles, and other research for investors. As chair of Callan's Environmental, Social, and Corporate Governance (ESG) Committee, Anna covers ESG trends and developments. Anna is also a member of Callan's Emerging and Minority, Women, or Disabled-owned Managers Committee. She is a shareholder of the firm.

Anna joined Callan in August 2006. Prior to Callan, she worked for Vail Resorts, Inc. She earned an MBA from the University of San Francisco and a BA in International Business and French from Washington University.

Disclosure