Callan Institute

Research

2019 ESG Survey

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Executive Summary

Overview

Callan's *2019 ESG Survey,* conducted from May to July 2019, reflects input from 89 unique U.S. institutional investors that were asked about their approach to environmental, social, and governance (ESG) factors when evaluating investments. For this survey, ESG factors include socially responsible investing (SRI, including divestment), sustainable investing, responsible investing, impact investing, and other associated terms.

Our 2019 survey, the seventh we have conducted, found that U.S.-based institutional investors are increasingly incorporating ESG considerations into their investment decision-making process. The ratio of investors either incorporating or thinking about incorporating ESG was about half of the respondent pool in 2019.

Almost half of U.S. institutional investors currently consider ESG factors when making investment decisions or are considering doing so in the future.

Overall, incorporation of ESG factors into the investment decision-making process nearly doubled to 42% in 2019 compared to 22% in 2013. Our survey revealed an ongoing disparity in ESG adoption rates by investor type and size. Historically, endowments and foundations have consistently had the highest ESG adoption rates. Public plans have incorporated ESG factors into the investment decision-making process at a higher rate than their corporate counterparts.

- ESG was relatively new for most survey respondents: 62% of funds that utilized ESG began doing so in the past five years.
- Foundations reported the highest rate of ESG incorporation in 2018 at 64%, but fell to 44% in 2019. While 22% of foundations that did not utilize ESG are considering it, the top reason for not implementing was a focus on only purely financial factors in investment decision-making.
- 49% of public funds incorporated ESG in 2019, up from 15% in 2013.
- The survey respondents with more diverse boards were more likely to be incorporating ESG into investment decisions than those with less diversity as gauged by differences in gender, race, ethnicity, and age.

Key Findings

Callan's seventh annual *ESG Survey* presents trends on ESG adoption for U.S. institutional investors. The results reflect input from 89 unique organizations, and highlight growing adoption of ESG practices.

Most Common Implementation: Integration

51% of those that incorporated ESG considered ESG factors with every investment/manager selection

50%

of large funds (>$20bn) have incorporated ESG factors into investment decisions

Diversity Effect

Investors with more diverse boards/committees were more likely to incorporate ESG

42% **incorporated ESG factors into the investment decision-making process—up from 22% in 2013**

44% foundations

58% endowments

49% public

19% corporate

49%

of respondents that incorporated ESG plan to seek more, better, or different ESG data in the future

36%

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

Investment managers & general consultants were the most common sources of data to evaluate ESG strategies

Respondent Overview

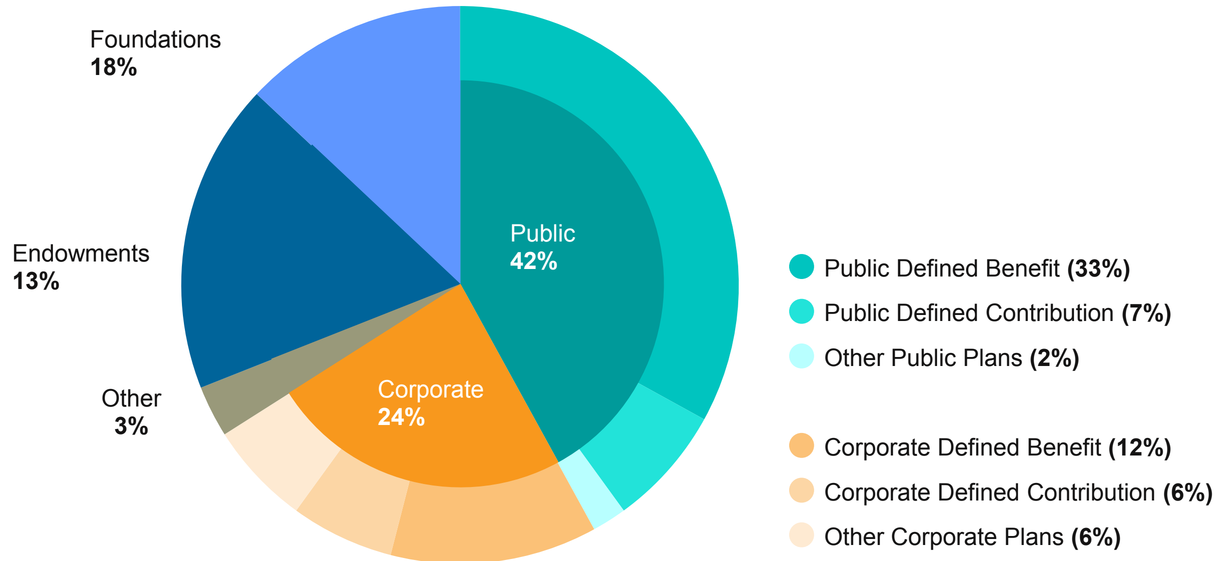
89 institutional investors responded to the survey

42% of respondents were public plans, making them the largest plan type represented

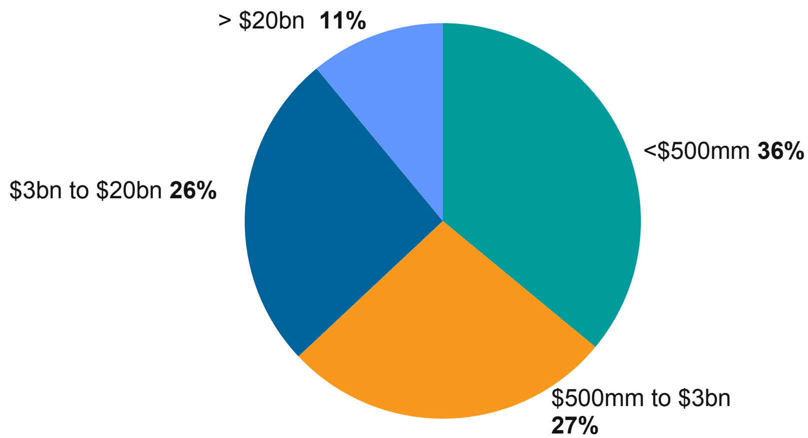
24% of respondents were corporate plans, and around one-third are endowments or foundations

36% of respondents were "small" funds with less than $500 million in assets. The 2019 survey had fewer large funds than in previous years: 11% of 2019 respondents had more than $20 billion in assets, compared to 20% in 2018.

Respondents by type



Respondents by size

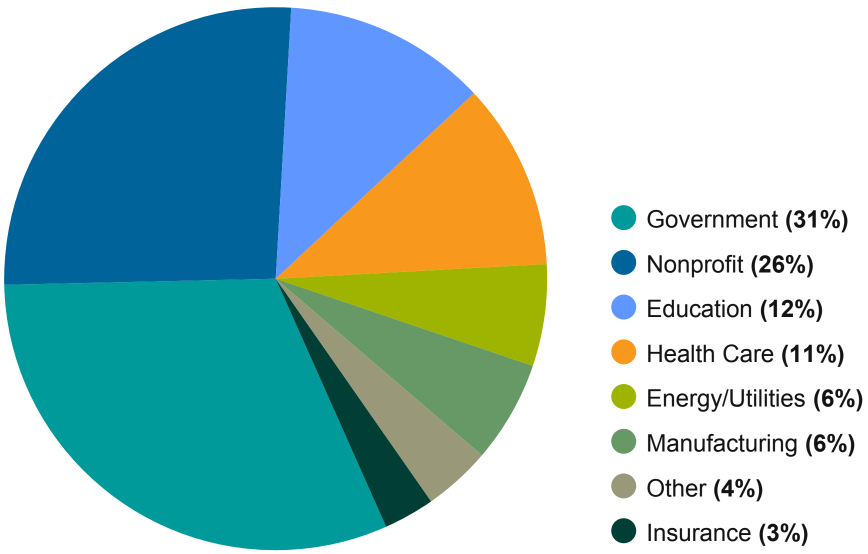


Note: charts in this report may not sum to 100% due to rounding.

Respondent Overview (continued)

Most respondents were from the government (31%), nonprofit (26%), education (12%), and health care (11%) sectors. "Other" includes: aerospace/defense, professional services, technology, and philanthropy.

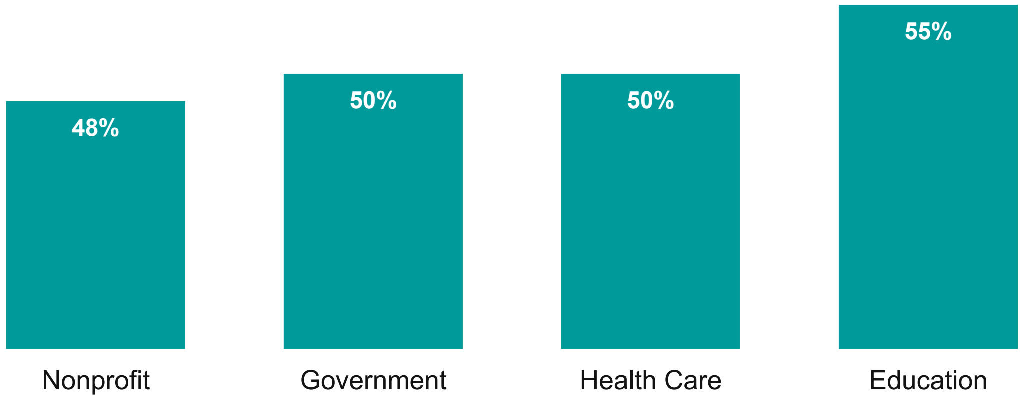
Respondents by sector



Looking at ESG incorporation rates by sector, we note that education tops its peers at **55%**

Government, health care, and nonprofit industries all have higher rates of ESG adoption than other sectors that responded to our survey, including energy/utilities, manufacturing, insurance, and other.

Investors incorporating ESG factors into investment decisions by sector



ESG Adoption Rates

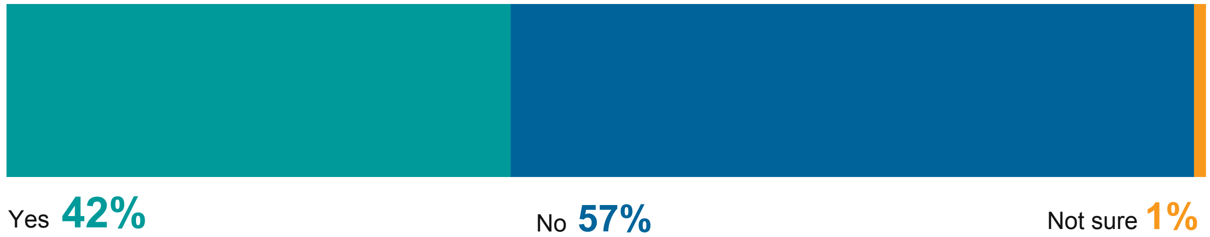
42%

of respondents incorporated ESG factors into investment decisions in 2019, consistent with 2018 and nearly double the 22% we recorded when first conducting this survey in 2013. ESG adoption has steadily climbed in the U.S.

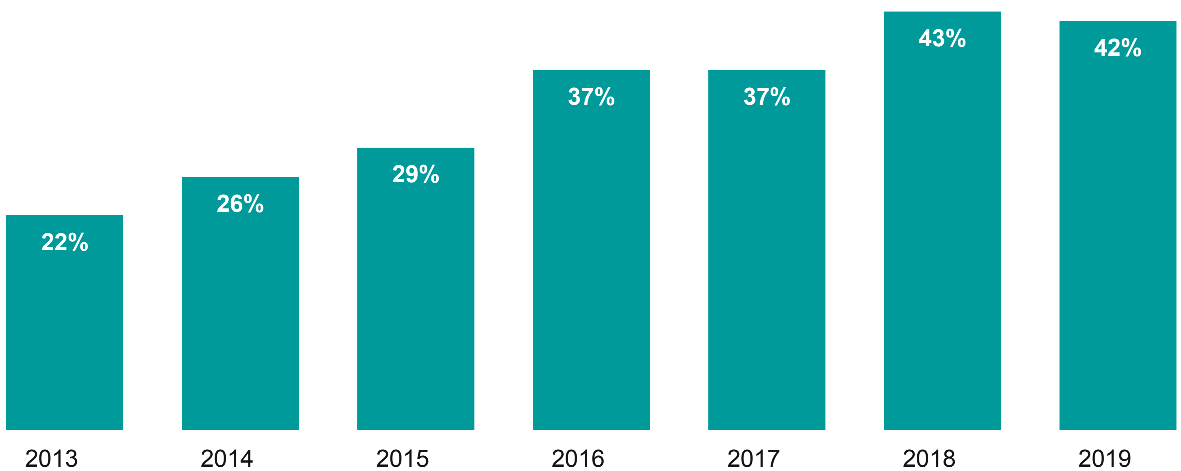
91%

increase in respondents that have incorporated ESG factors into investment decisions from 2013 to 2019

Does your fund incorporate ESG factors into investment decisions?



ESG adoption shows steady increase



ESG Adoption Over Time

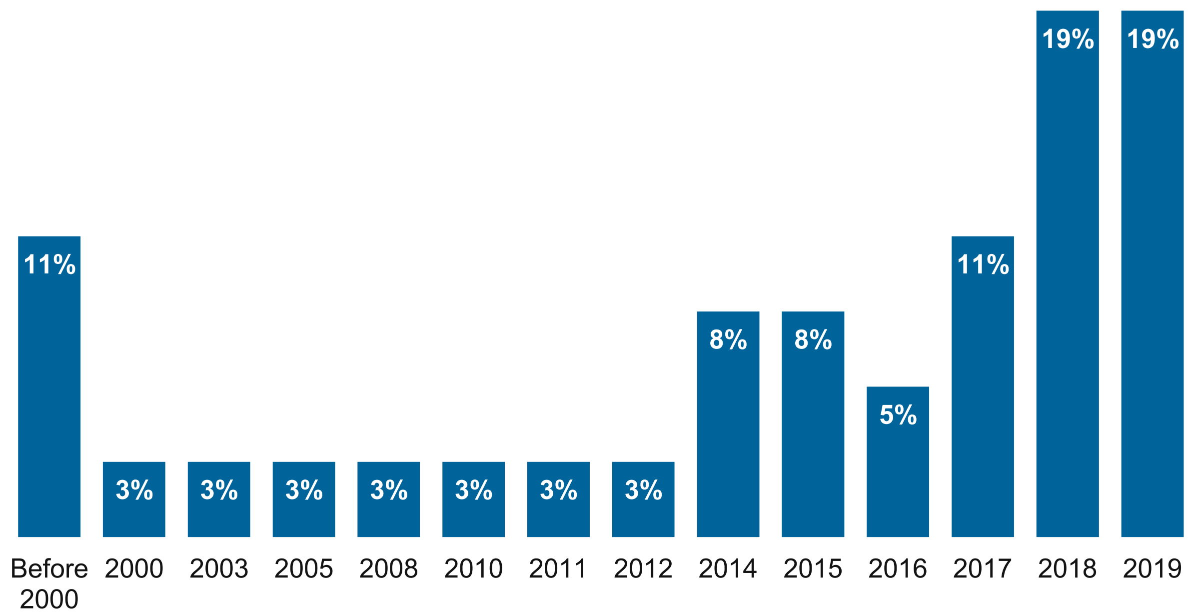
ESG is a relatively new phenomenon for most survey respondents.

62%

of investors that utilize ESG began doing so in the past five years.

Throughout the survey, we note differences in implementation between early adopters of ESG (before 2015) and more recent adopters (2015-19)

When respondents first incorporated ESG factors into the investment decision-making process



ESG Adoption Rates by Investor Type

58%

of endowments incorporated ESG factors into investment decisions, the 2019 survey found. Over time, endowments and foundations have incorporated ESG factors at a higher rate than other institutional investor types Callan has surveyed. Codifying a definition of ESG that is consistent with the organization's overall goals and philosophy is often the first step in implementing ESG into investments; this can be a more straightforward process at mission-focused endowments and foundations than other investor types.

Defined benefit (DB) and defined contribution (DC) plans, both public and corporate combined, incorporated ESG at a rate of **35%** and **36%,** respectively (not pictured). This represents a shift for DC plans, which previously had much lower ESG utilization rates than DB plans.

Investors incorporating ESG factors into investment decisions

By type over last seven years

2013	2014	2015	2016	2017	2018	2019
Foundation **35%**	Endowment **34%**	Foundation **39%**	Endowment **53%**	Foundation **56%**	Foundation **64%**	Endowment **58%**
Endowment **22%**	Foundation **31%**	Endowment **37%**	Foundation **48%**	Endowment **39%**	Endowment **56%**	Public **49%**
Public **15%**	Public **22%**	Public **27%**	Corporate **30%**	Public **35%**	Public **39%**	Foundation **44%**
Corporate **14%**	Corporate **16%**	Corporate **15%**	Public **25%**	Corporate **25%**	Corporate **20%**	Corporate **19%**

ESG Adoption Rates by Investor Size

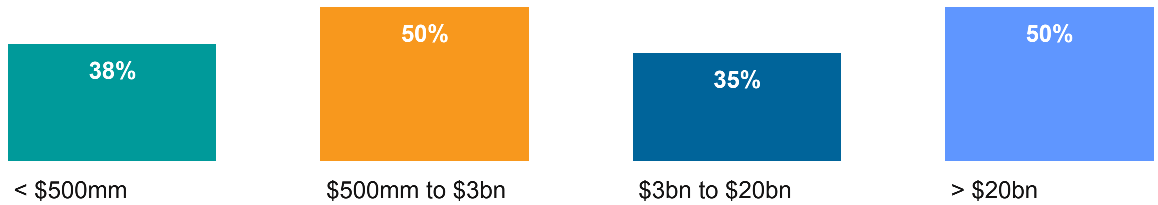
50%

of the largest respondents (>$20 bn) incorporated ESG factors into investment decisions in 2019. The largest institutional investors have incorporated ESG factors at the highest rate since the survey's inception in 2013. Larger organizations tend to have more resources to facilitate ESG adoption. But size and resources are becoming less relevant in predicting ESG adoption.

50%

of investors with between $500 million and $3 billion implemented ESG in 2019. The smallest funds (less than $500 million in assets) were also catching up (38%) as organizations don't have to rely on internal resources to learn about and implement ESG. Most investors relied on third parties—investment managers and consultants—to provide ESG data to evaluate managers/investment strategies (see page 15).

Investors incorporating ESG factors into investment decisions



By fund size over last seven years

2013	2014	2015	2016	2017	2018	2019
> $20bn **33%**	> $20bn **31%**	> $20bn **35%**	> $20bn **71%**	> $20bn **78%**	> $20bn **72%**	> $20bn **50%**
$3bn to $20bn **29%**	$500mm to $3bn **24%**	$3bn to $20bn **31%**	<$500mm **39%**	$500mm to $3bn **42%**	<$500mm **47%**	$500mm to $3bn **50%**
$500mm to $3bn **23%**	<$500mm **22%**	<$500mm **26%**	$3bn to $20bn **33%**	<$500mm **30%**	$3bn to $20bn **33%**	<$500mm **38%**
<$500mm **20%**	$3bn to $20bn **18%**	$500mm to $3bn **26%**	$500mm to $3bn **29%**	$3bn to $20bn **22%**	$500mm to $3bn **28%**	$3bn to $20bn **35%**

ESG Adoption Rates by Region

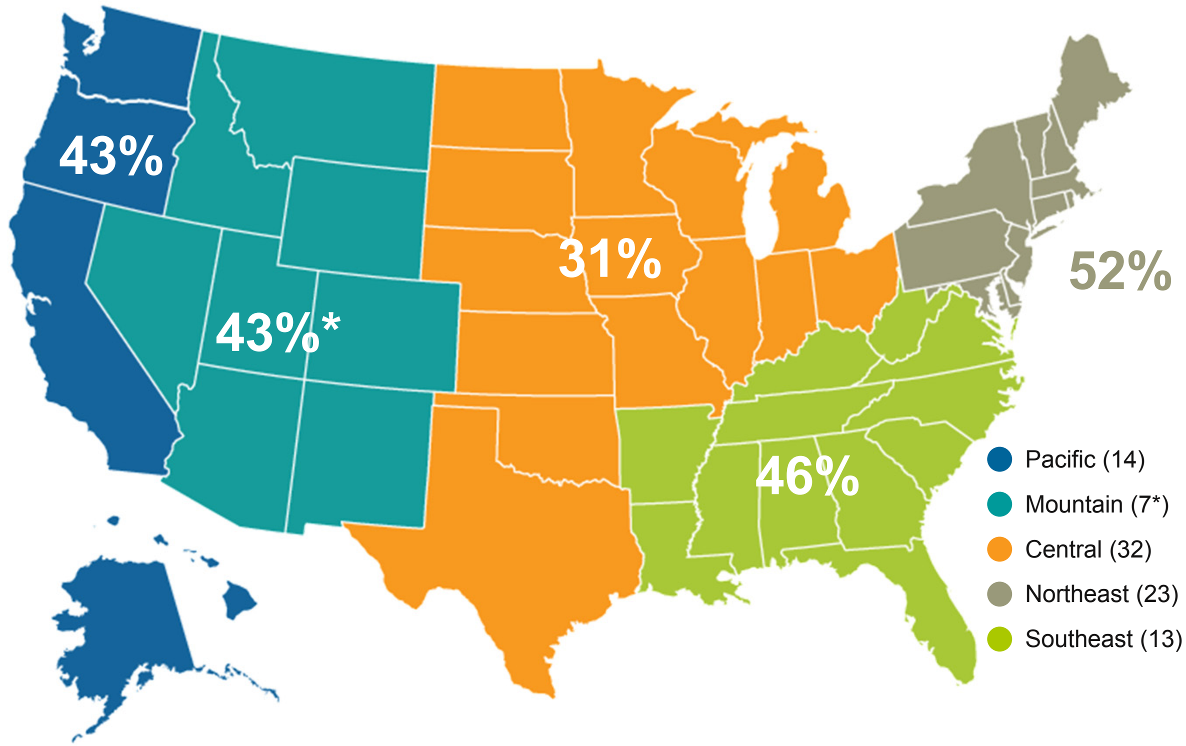
52%

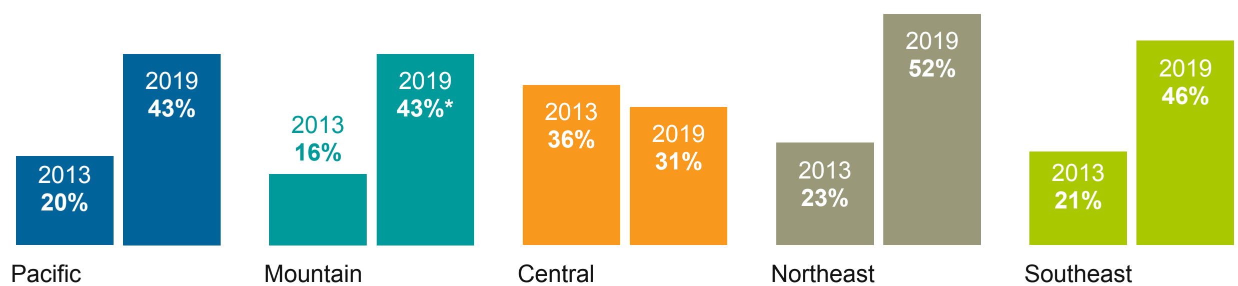
of investors in the **Northeast** region surveyed in 2019 incorporated ESG into investment decisions.

Investor type and size, rather than region, tend to be more consistent factors in whether an investor will use ESG factors in investment decision-making.

In the seven years Callan has produced the ESG survey, we've observed varying regional trends in ESG adoption that suggest location plays little role in whether a fund will implement ESG. Since 2013, all regions have seen an increase in ESG adoption except for the Central U.S.

Regional breakdown of ESG incorporation





*Note the small sample size

ESG and Board Demographics

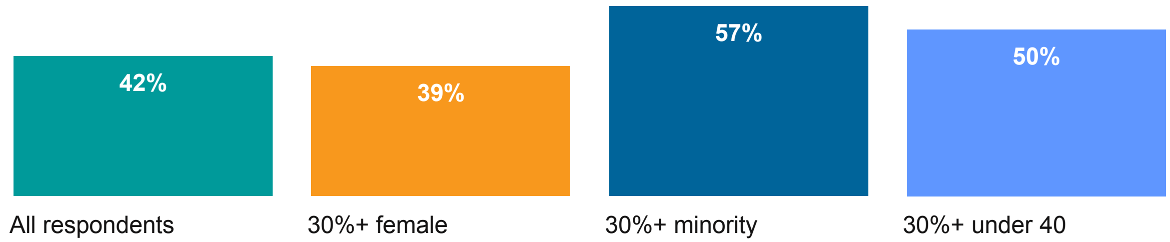
Diversity matters

Survey respondents provided details on the demographics of their investment committees, boards, or other decision-making bodies. Most boards tended to be majority white males over the age of 40.

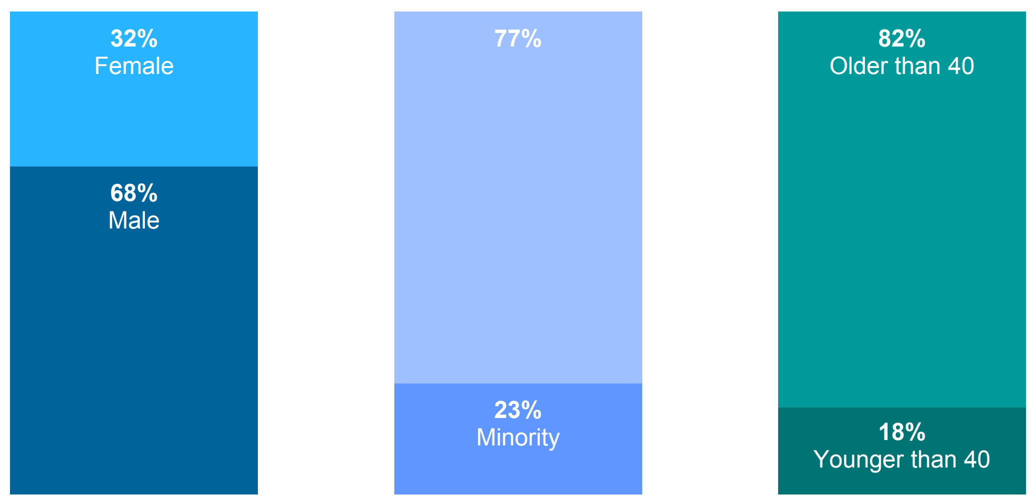
The more diverse boards were more likely to be incorporating ESG into investment decisions:

- Investors with 30% or more minorities (14 total) had an ESG adoption rate of 57%
- Investors with 30% or more of the board under 40 (12 total) had an ESG adoption rate of 50%
- Investors with 30% or more women on the board (44 total) incorporated ESG at a 39% rate, slightly lower than the overall population. But investors with **50% or more women on the board (17) reported an ESG incorporation rate of 53%.**

Investors incorporating ESG factors into investment decisions: variations by board/investment committee makeup



Total respondents: Board/Committee demographic profile*



*Sample size note: all 89 respondent funds reported on percentage male; 55 and 54 responded as to percentage minority and aged under 40, respectively.

Looking Forward

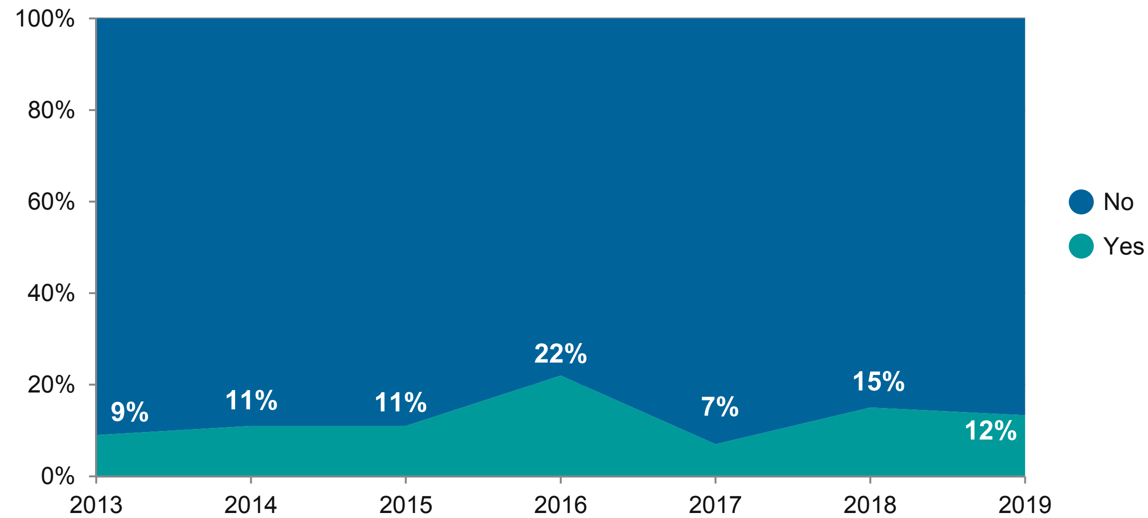
Room to grow

12%

of respondents that have not yet incorporated ESG into investment decisions are considering doing so in the future. This figure has fluctuated from 10-20% over time, suggesting that more investors will explore and implement ESG in the future.

By type, **22% of foundations**, **16% of public plans**, and **6% of corporate plans** that have not incorporated ESG into investment decisions are considering doing so. None of the endowments surveyed that are not incorporating ESG are considering doing so. Endowments have the highest ESG incorporation rates (58%) in 2019's survey.

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 investor type)

ESG Implementation: Early vs. Recent Adopters

Integration is becoming the preferred method of implementation, particularly for early adopters of ESG: 64% of early adopters consider ESG factors with every investment.

The Principles for Responsible Investment defines ESG integration as "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions."

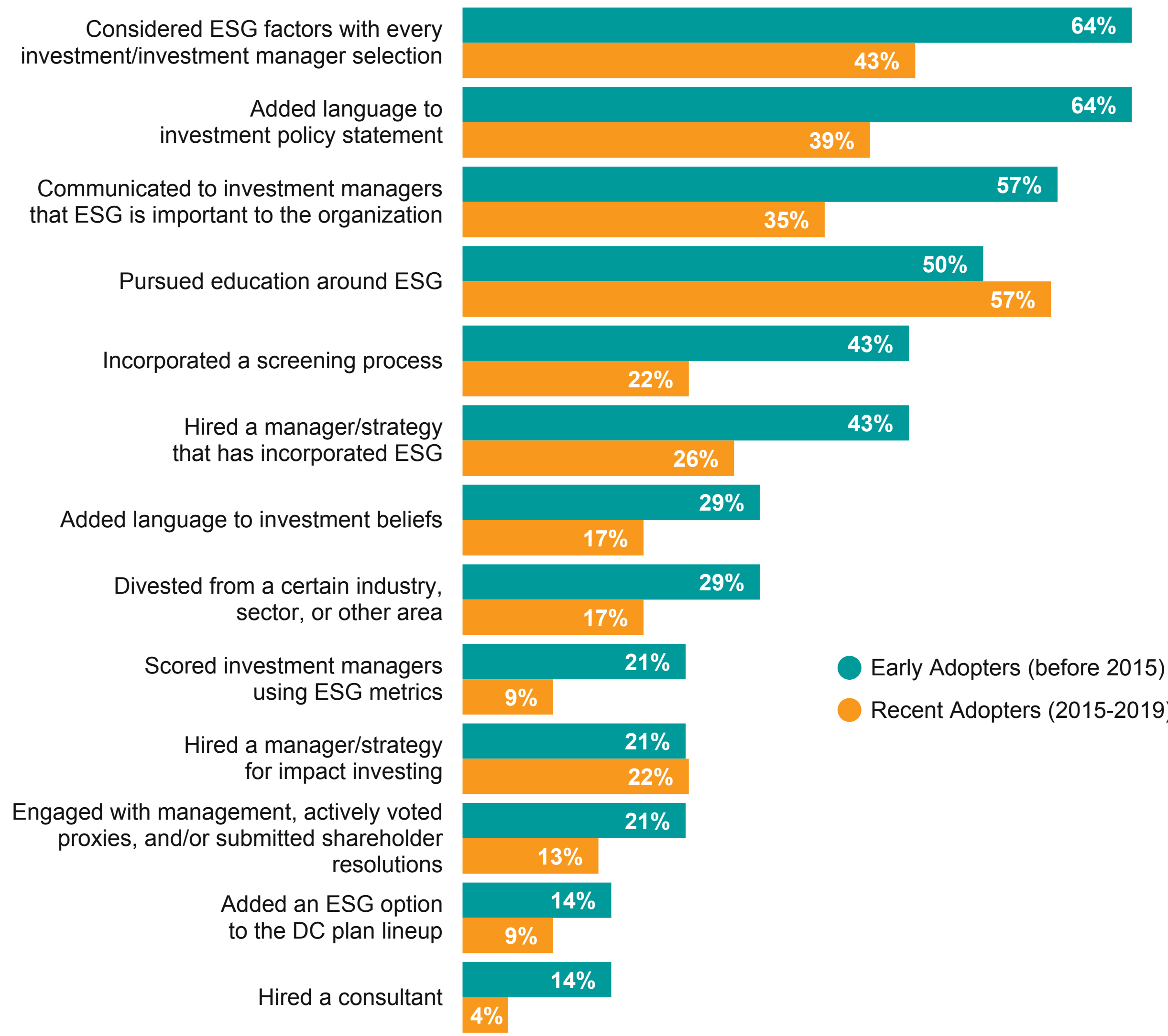
Thematic ESG funds are separate from ESG integration, although they often do integrate ESG criteria into investment decisions. Thematic ESG funds often have a fund name that conveys which tenet of ESG is central to the investment thesis (e.g., Social Equity, Climate Change Aware, etc.)

For recent adopters, ESG education is the most common action (57%). Half of early adopters also pursue ESG education, signaling the importance of ongoing learning to keep up with changes in the field.

On average, early ESG adopters selected 5 implementation strategies to indicate how they are incorporating ESG, compared to 3 for the recent adopters.

*Multiple responses allowed

How investors are incorporating ESG*



Separate ESG Allocation

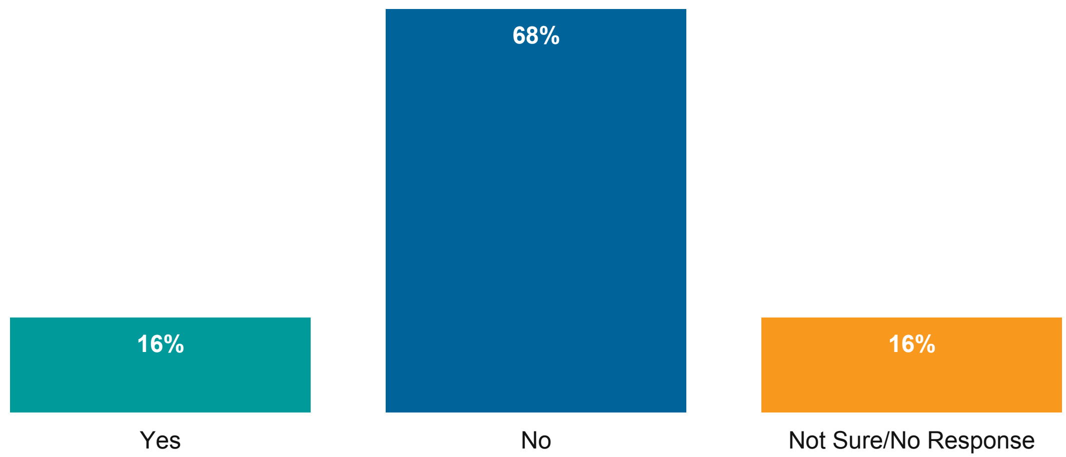
As ESG integration is emerging as the most popular implementation method in the U.S., less than one-fifth of survey respondents separate their ESG investments.

16%

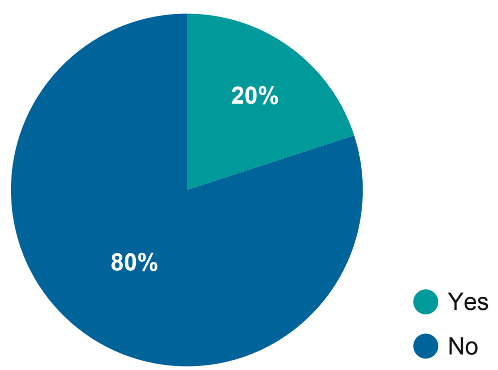
of investors who have incorporated ESG factors into the investment decision-making process made a distinct allocation to ESG investing. This is a common implementation approach for defined contribution plans; adding a standalone ESG option can be a direct way of offering plan participants a sustainable investment choice, for example.

Endowments and foundations also might utilize this approach by creating a carve-out of the main portfolio for targeted ESG investments, or a specific donor pool dedicated to an ESG theme. Out of 10 funds surveyed that responded to this question, only two maintained a separate portfolio 100% dedicated to ESG, reinforcing the notion that ESG integration is likely to be a more widely embraced implementation strategy going forward.

Distinct allocation dedicated to ESG separate from the traditional portfolio



If your endowment or foundation receives new donations, do you maintain a separate portfolio 100% dedicated to ESG for donors that desire this type of investment strategy?



ESG Data Sources

Quantifying ESG

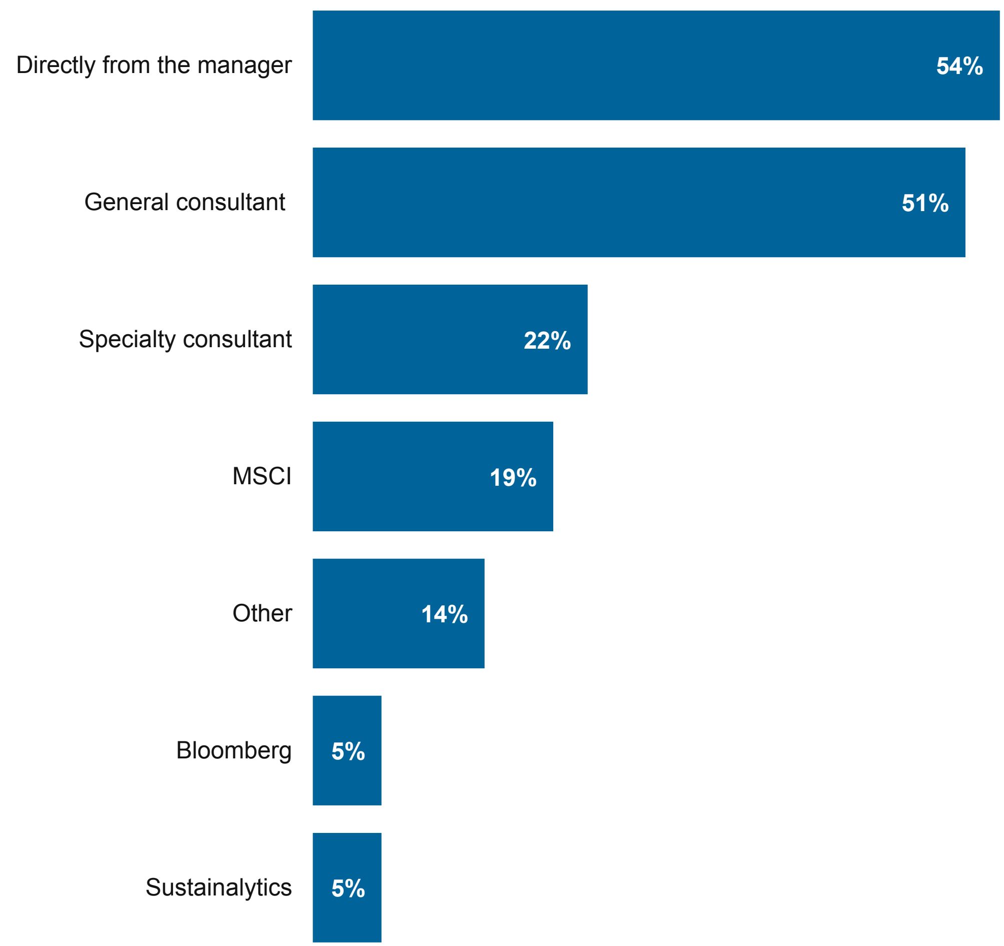
As ESG gains momentum in the investment industry, the issue of how to quantify and measure ESG in investments arises regularly.

Investors tend to use multiple sources for data to evaluate investment managers/strategies on their ESG capabilities and outcomes; 2019 survey respondents used 2 sources, on average. The investment manager and the general consultant were the most prevalent sources of information. Many managers incorporating ESG include strategy-specific metrics, such as carbon footprint, diversity statistics, or progress relative to a UN Sustainable Development Goal.

Early ESG adopters (implemented ESG before 2015) were more likely to use a general or specialty consultant than those recently adopting ESG.

Other ESG data sources included manager proxy voting records, staff, outsourced chief investment officer, and the Principles for Responsible Investment.

ESG data sources to evaluate managers/investment strategies*



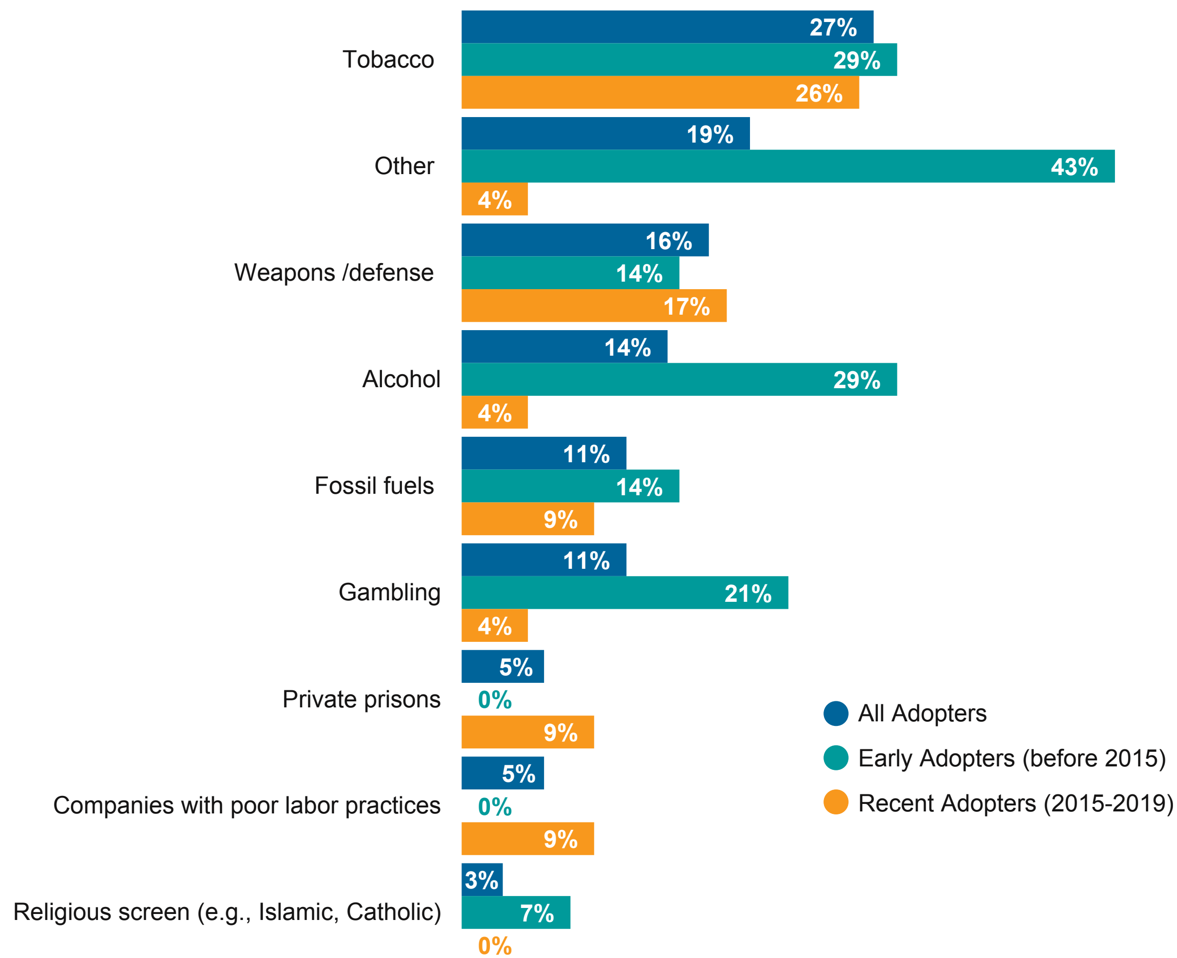
*Multiple responses allowed

ESG Implementation: To Avoid

While ESG integration is quickly becoming the most common implementation method for ESG, negative screening and divestment still play a role: 43% of early ESG adopters and 22% of recent adopters have incorporated a screening process, respectively, and 29% of early adopters and 17% of recent adopters have divested from an issue.

For all respondents incorporating ESG, tobacco was the most common area to divest from. For early adopters, divestment was spread across “other” areas (climate change-related sectors such as thermal coal and oil sands, and recreational cannabis and vaping), but alcohol and gambling were common areas to avoid as well.

Industries/sectors/companies avoided/excluded per ESG policies*



*Multiple responses allowed

“Other” also includes pornography, abortion, fetal research, and for-profit education.

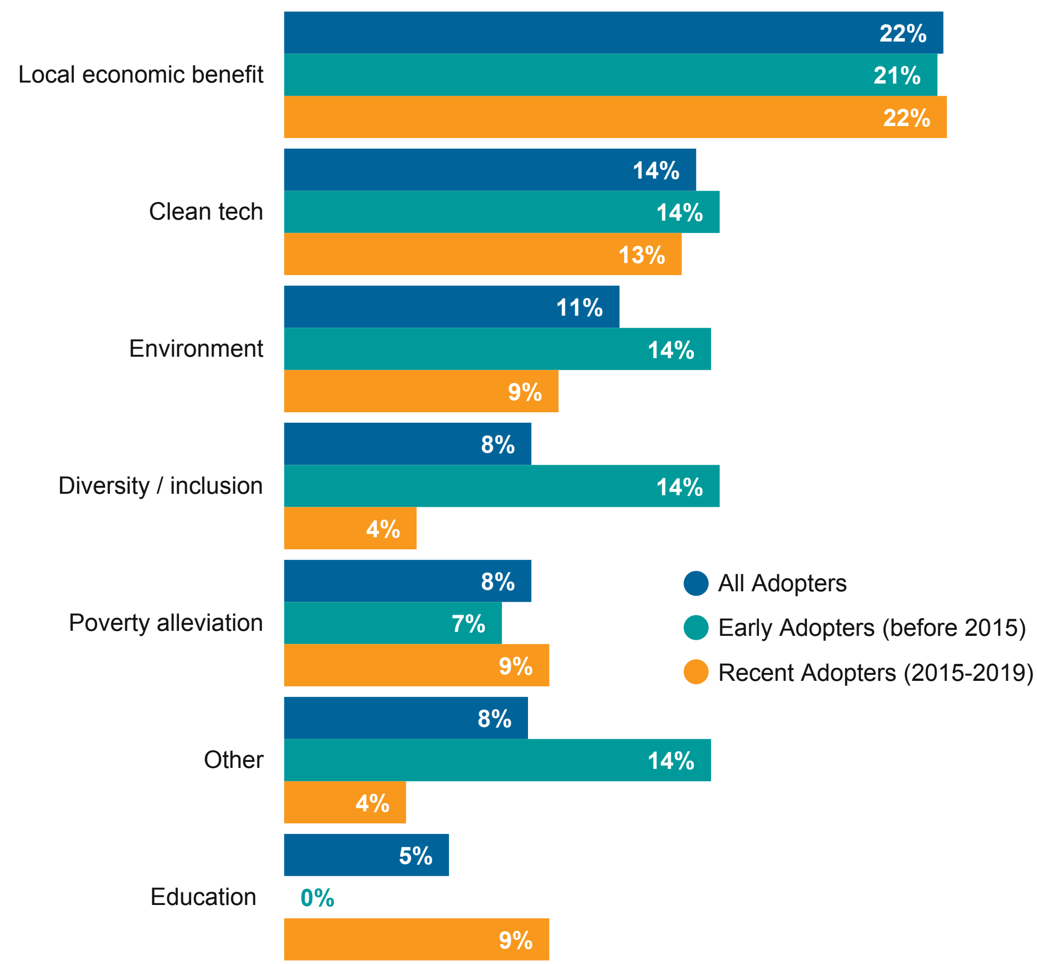
ESG Implementation: To Embrace

Positive impact investments intentionally included per ESG policies*

Impact investing, thematic ESG funds, and ESG integration can all target specific areas for investment that emphasize financial returns in addition to positive societal or environmental change.

Areas targeted for positive change from survey respondents included local economic benefit, the environment, clean tech, diversity/inclusion, poverty alleviation, and education.

"Environment" areas flagged for positive impact include clean energy, sustainable and regenerative agriculture, the transition to a low-carbon economy, water (access to and waste water solutions), and pollution. Additional "other" categories include general impact investing in private equity, ministry support, and church investment.



*Multiple responses allowed

ESG and Defined Contribution Assets

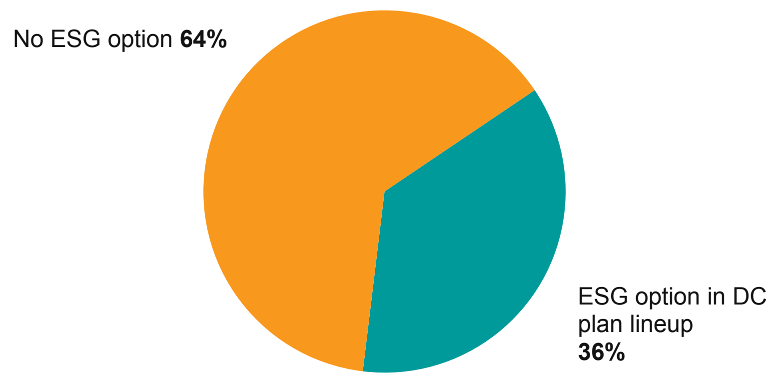
Defined contribution (DC) plan assets are increasingly reflecting ESG incorporation.

36%

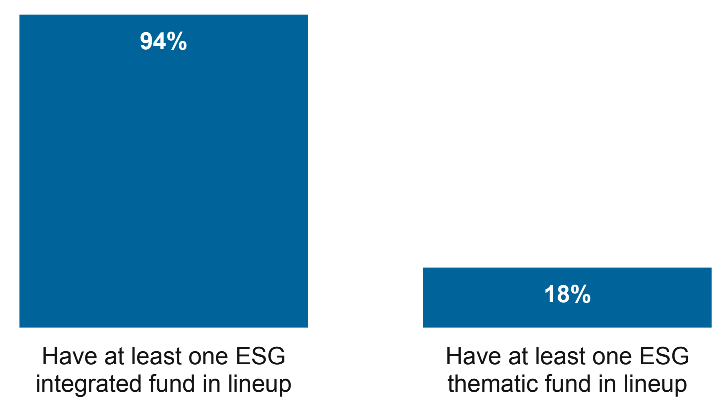
of DC plans surveyed (both public and corporate) said there was an ESG option in their plan lineup. For context, 18% of plans in Callan's DC Index™ offered a thematic ESG fund option (fund name conveys ESG approach), up slightly from 16% in 2018.

While thematic ESG funds are increasing, so is the number of funds using ESG integration (i.e., employing ESG data and considerations in the investment analysis process), and this is a far more prevalent approach. Less than 1% of the 2,400+ fund options in the DC Index were thematic ESG options, but 20% of the funds indicated they integrate ESG into the investment process. And while only 18% of plans have added an ESG-themed fund to the lineup, the vast majority of plans (94%) had exposure to ESG-managed assets (i.e., at least one fund manager indicates they use ESG considerations in the investment process).

ESG in defined contribution plans*



Callan DC Index: Prevalence of ESG thematic vs. integrated funds by plans



*Note the small sample size. Responses from 11 DC plans, 4 of which have an ESG fund in the lineup and one of which is also integrating ESG in other ways (integrated fund; consider ESG with all fund selection, pursuing education, etc.)

**Source: Callan DC Index™, first quarter 2019.

Environmental Actions

27%

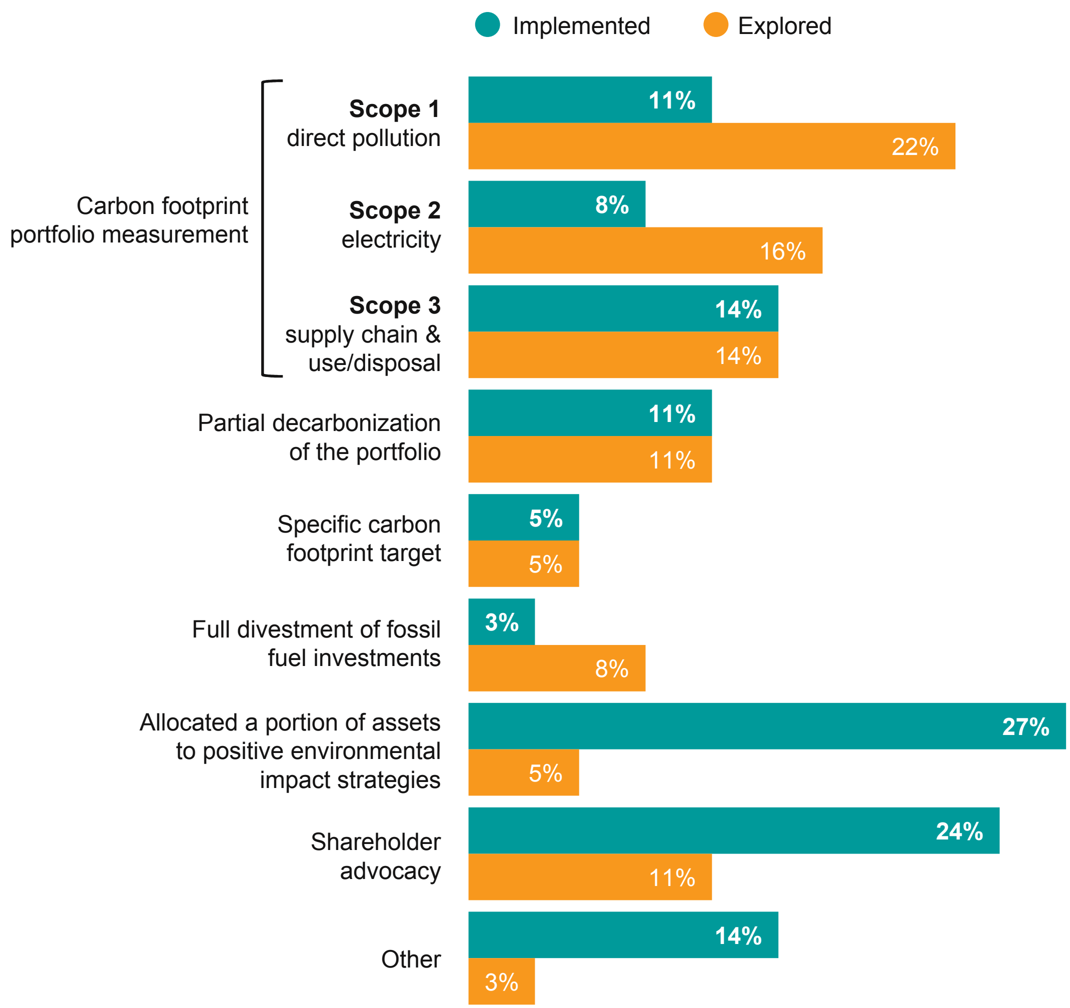
We asked respondents that incorporate ESG what actions they have explored or taken specific to environmental concerns, such as climate change. The most common environmental action taken by those that have implemented ESG was to allocate a portion of assets to positive environmental impact strategies (27%).

24%

Shareholder advocacy was the second most common action taken around "E" (24%). Investors see company engagement—through proxy voting and other measures—as an effective tool to mitigate the worst effects of climate change.

Carbon footprint portfolio measurement is being explored and implemented by around 10-20% of ESG investors. Several global reporting initiatives related to climate change, such as the Task Force on Climate Change Financial Disclosures, are creating frameworks and standards for investors and companies to report on climate-related risks and opportunities.

Actions taken specific to "E" for those incorporating ESG



*Multiple responses allowed

Organization Membership

65%

Most survey respondents implementing ESG have not joined any organization to support efforts at education, collaboration, and commitment around ESG issues (65%) .

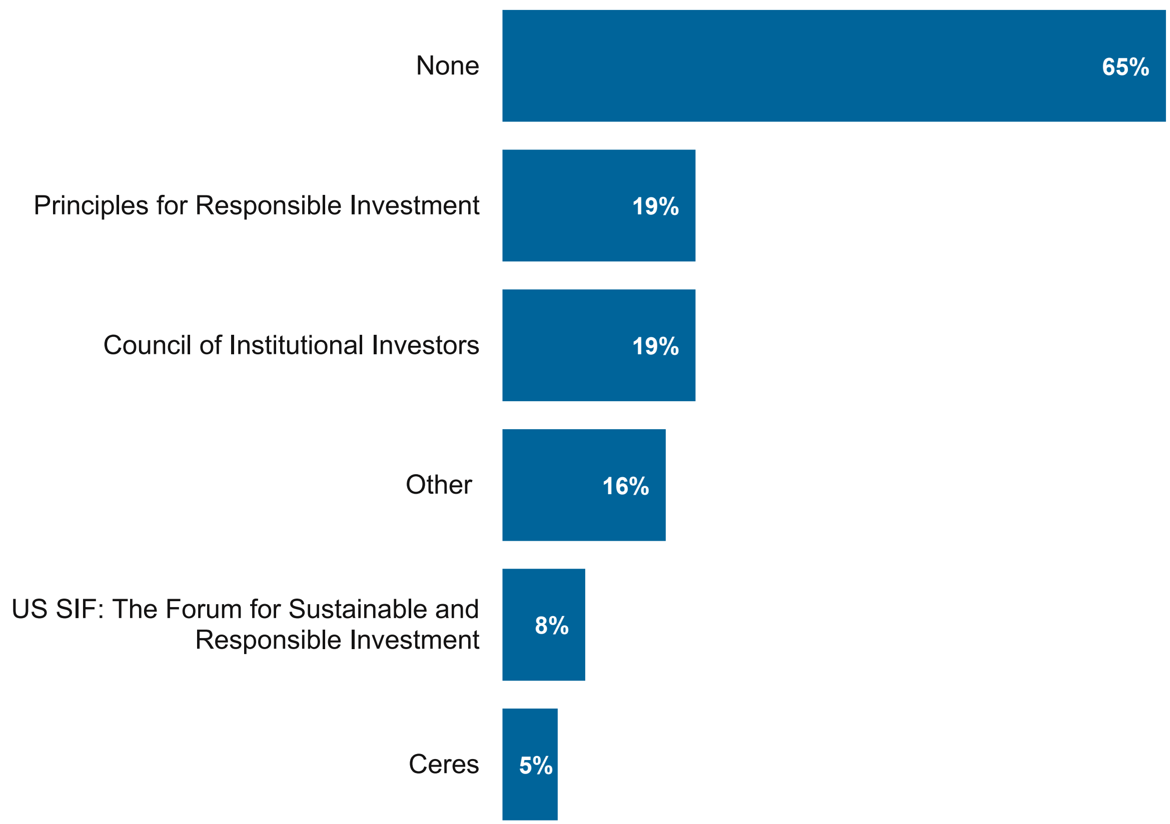
Those that participated with third-party organizations did so with two groups, on average.

19%

The two most prevalent ESG-centric member organizations for survey respondents were the Principles for Responsible Investment and the Council of Institutional Investors (19% each).

Other organizations include Mission Investors Exchange, U.S. Impact Alliance, U.S. Council on Impact Investments, Confluence Philanthropy, Catholic Healthcare Investment Guidelines, Global Impact Investing Network, BALLE, and ICGN.

Organization membership by those incorporating ESG*



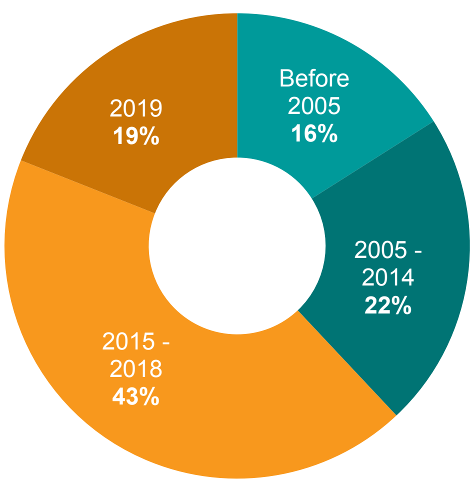
*Multiple responses were allowed

Reasons for Incorporating ESG: Early vs. Recent Adopters

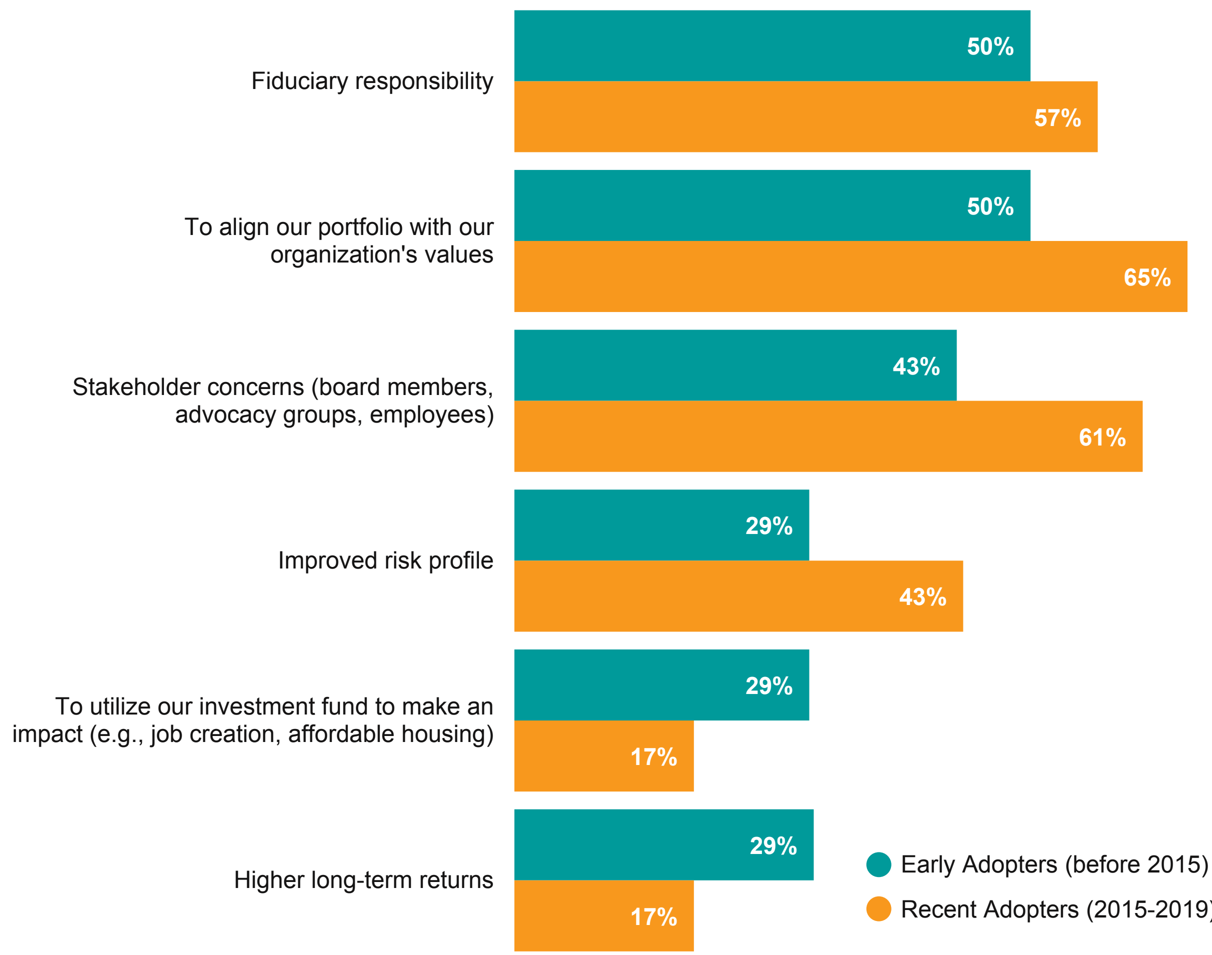
When comparing the early adopters' motivations for incorporating ESG to the recent adopters, we note recent adopters are more likely to be addressing stakeholder concerns and to be focused on an improved risk profile.

Adoption Timeframes

Before 2015 (14) **and after** (23)



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



*Multiple responses allowed

Reasons for Incorporating ESG

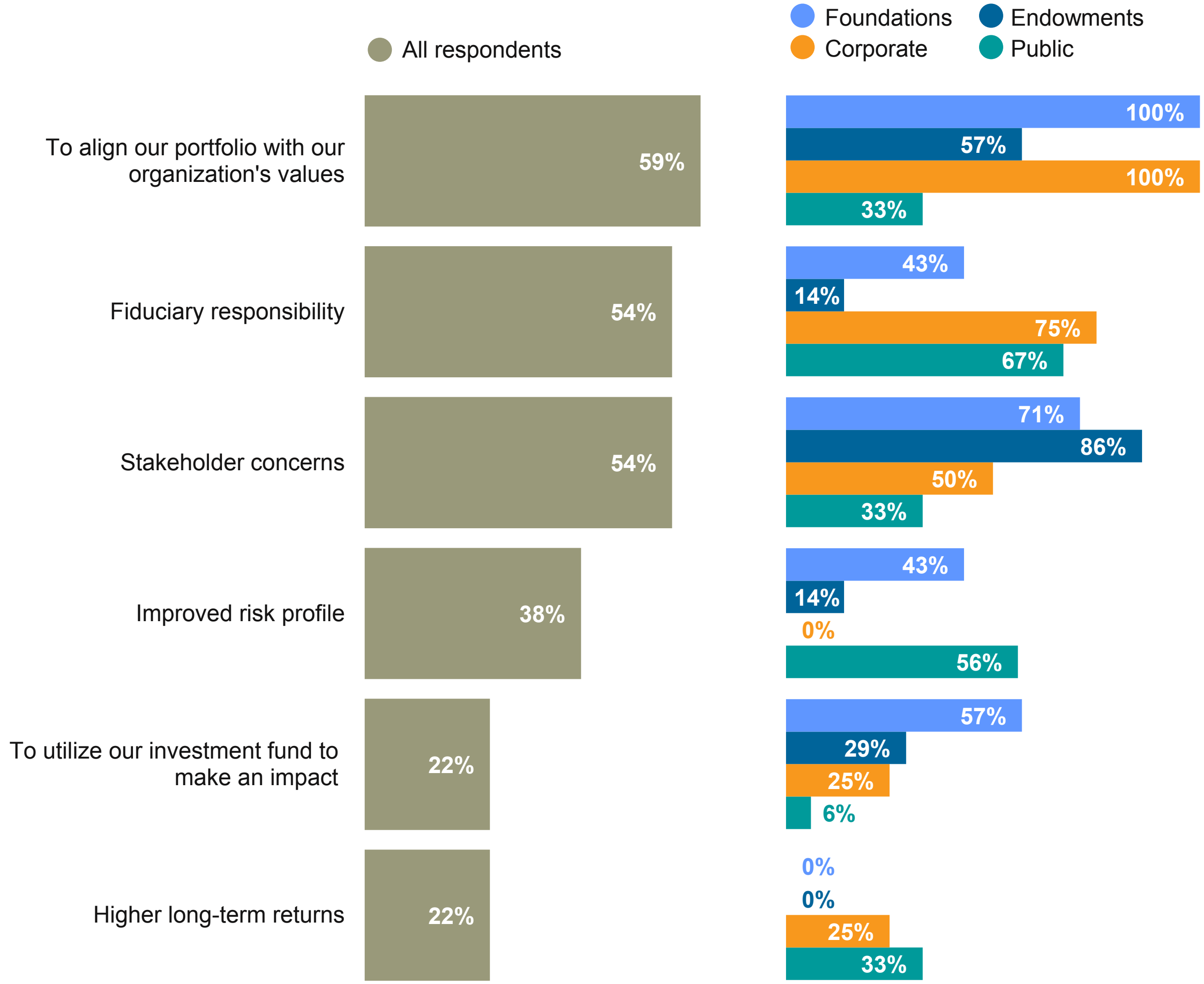
Institutional investors in the U.S. adopted ESG for various reasons. The top reason across fund types was to align the portfolio with the organization's values, which can be easier to achieve at some organizations, such as those with a mission statement that clearly articulates an ESG initiative.

54%

of respondents looked to ESG to fulfill their fiduciary responsibility and to address stakeholder concerns—for endowments this was particularly relevant (86%).

According to respondents, stakeholders included student groups, donors, board members, investment staff, and employees.

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



* Multiple responses allowed

Reasons Against ESG Incorporation

53%

of investors that are not incorporating ESG indicated they will not consider any factors that are not purely financial. Emerging research supports the notion that ESG issues can have material financial impacts in certain investment situations. For example, the CFA Institute "sees value in the incorporation of ESG data into the investment process, but it is agnostic on the value-investing argument more pertinent in the SRI community."

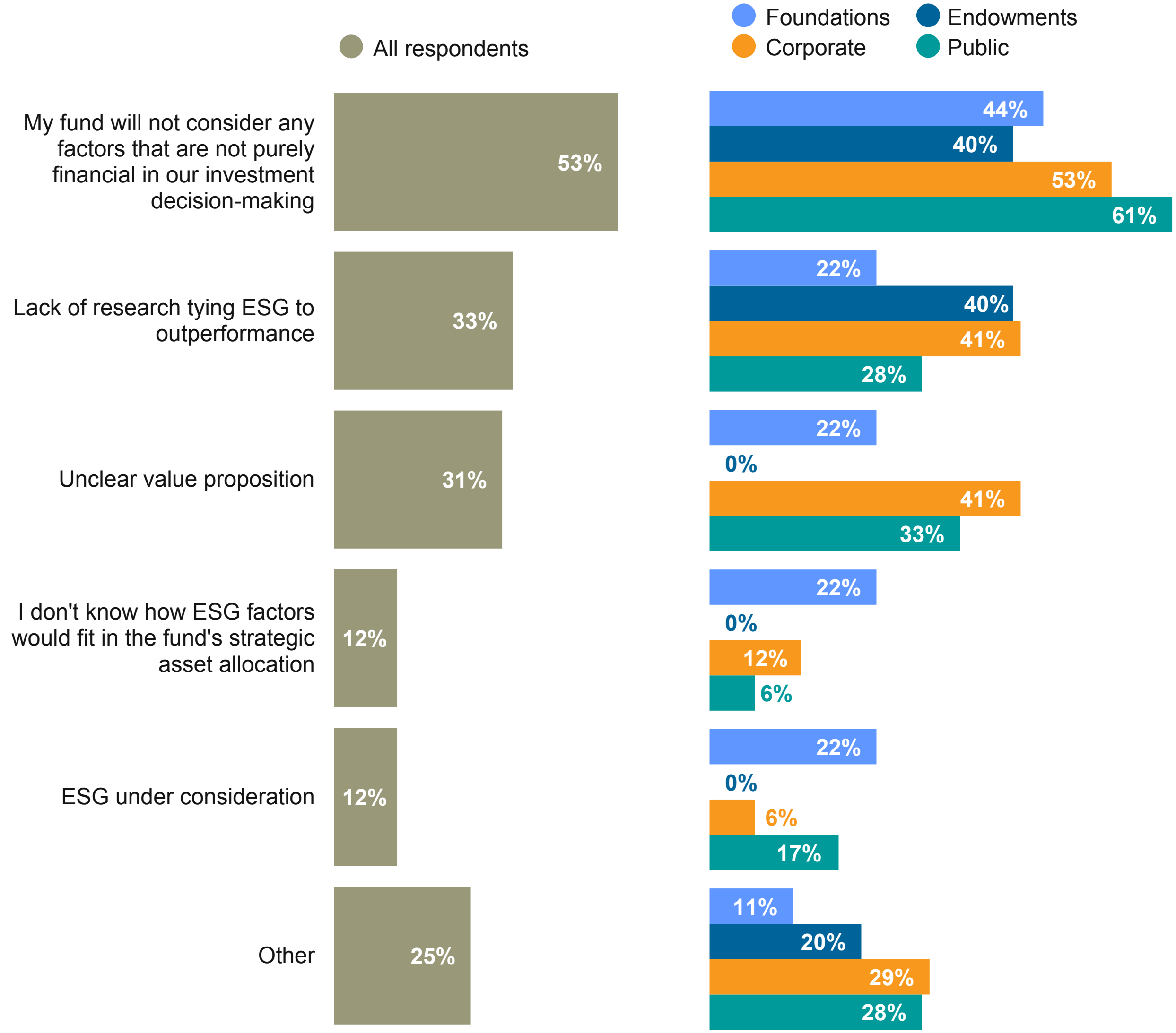
Other reasons for not implementing ESG:

- Limited or no participant interest/demand
- Perceived political activism/unintended political consequences
- Concerns of breach of fiduciary duty
- View that ESG is pushing a moral agenda
- Not legally required
- Leave it to managers to integrate ESG as appropriate
- Haven't yet considered

12%

of those that have not incorporated ESG into investment decision-making are considering doing so (page 12).

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



* Multiple responses allowed

Looking Forward

49%

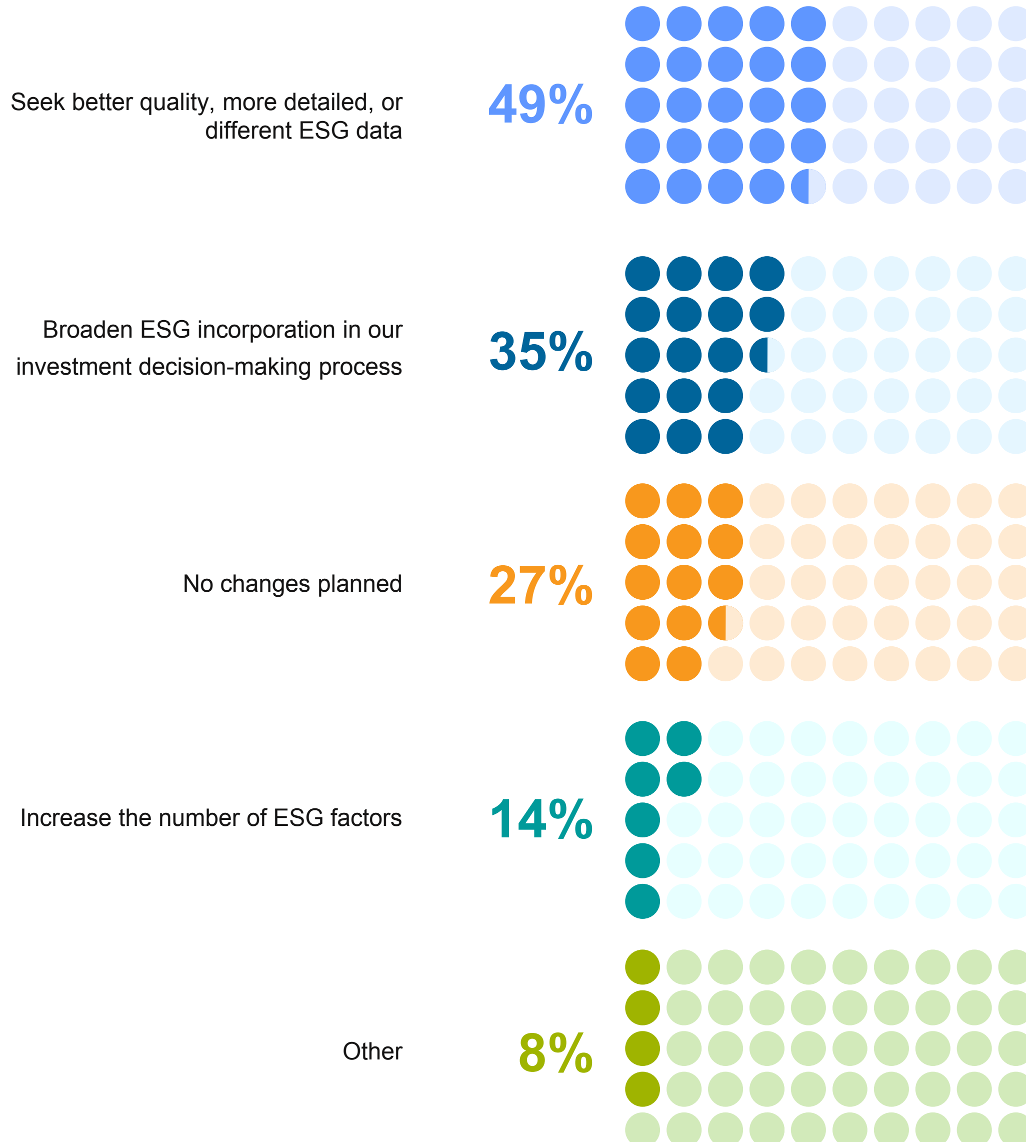
of respondents that have incorporated ESG factors in investment decision-making will seek better quality, more detailed, or different ESG data in the coming years.

More than one-third (35%) will broaden the scope of ESG incorporation. Specifically, respondents indicated they will look to incorporate ESG by:

- Adding real assets and fixed income
- Seeking managers with better ESG processes and outcomes
- Using new or different reporting frameworks
- Including more impact investing
- Enhancing engagement and monitoring
- Developing policies (e.g., investment beliefs, proxy voting)

More than one-quarter (27%) of those incorporating ESG have no changes planned.

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



*Multiple responses allowed

Product Offerings

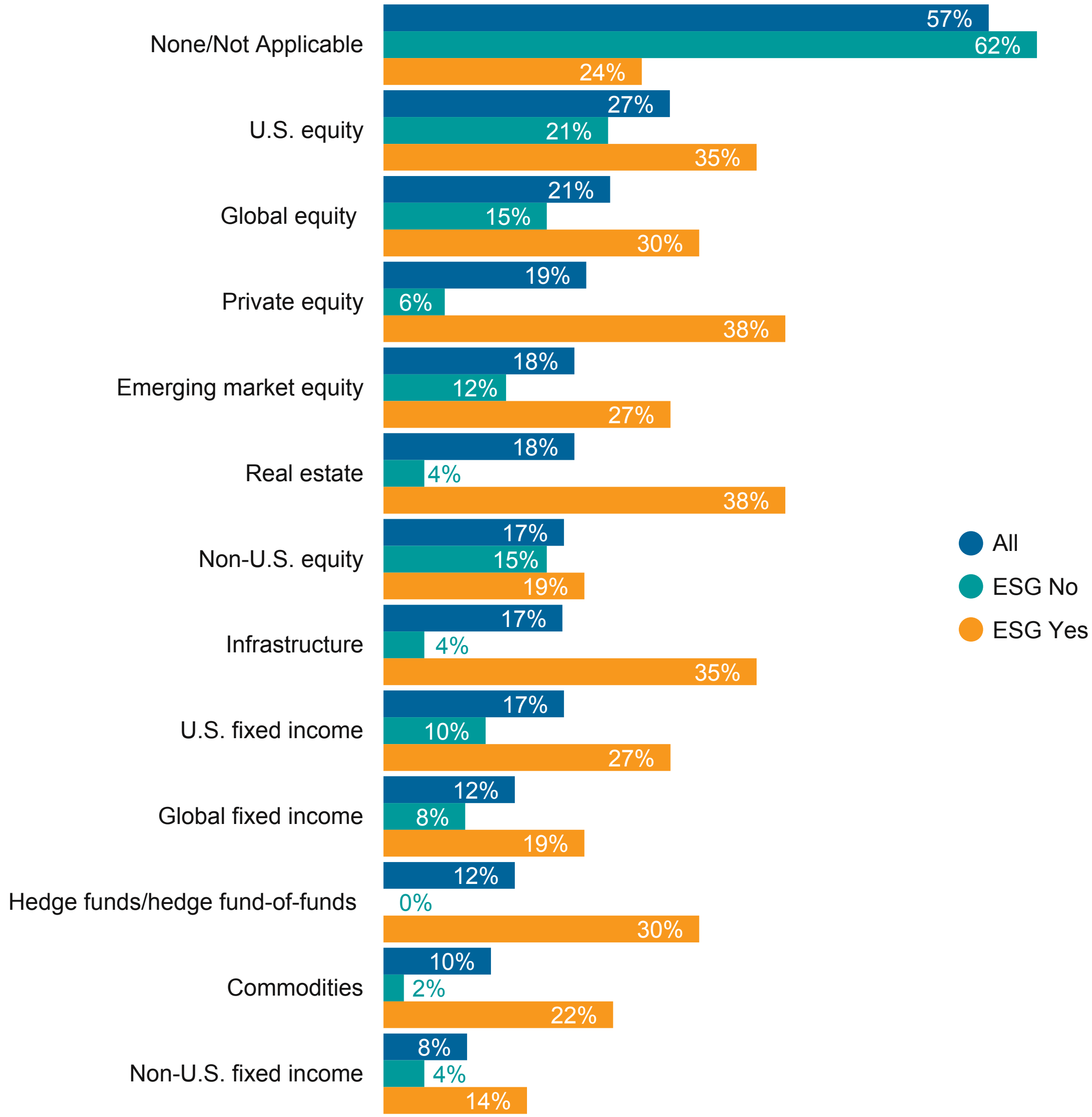
We asked all survey respondents where they would like to see more ESG-focused product offerings. Choosing from an array of asset classes, 43% of survey participants (38 funds) responded, including those that had and had not integrated ESG.

Most respondents (62%) not incorporating ESG did not have any asset classes where they'd like to see more ESG-focused products.

Those implementing ESG highlighted several asset classes for more product offerings:

- Private equity and real estate (38%) topped the list
- U.S. equity and infrastructure (35%) were close behind
- Hedge funds (30%), global equity (30%), emerging market equity (27%), and U.S. fixed income (27%) were all areas of interest

Interest in more ESG-focused product offerings*



*Multiple responses allowed

Conclusions

U.S. ESG Adoption Continued: An increasing number of investors incorporated ESG into the investment process in the U.S. in 2019.

- Since 2013, Callan's survey has observed a steady increase in the portion of funds adopting ESG. This trend varies from year to year, climbing more at times and leveling off in other years (as from 2018 to 2019).
- ESG adoption is relatively new for many U.S. investors—62% of those surveyed in 2019 began implementing ESG in the last five years.
- The most frequently cited reason for incorporating ESG among respondents was to align the portfolio with the organization's values.
- Conversely, the most frequently cited reason for not incorporating ESG among respondents was the fund's decision not to consider any factors that are not purely financial.

ESG Integration Rose as Preferred Implementation: ESG integration is the systematic inclusion of financially material ESG factors in investment analysis and decision-making.

- Callan's surveys consistently find a portion of investors (around 10-20%) not yet incorporating ESG factors, but they are actively considering doing so in the future. This brings the ratio of those either currently incorporating or thinking about incorporating ESG to about half of the respondent pool of U.S. institutional investors (49%) in 2019.
- Thematic ESG funds, divestment, and negative screens play a role in ESG implementation, but a growing percentage of investors—particularly the early ESG adopters—have integrated ESG across investment strategies. Survey respondents considered ESG factors with every investment selection, communicated the importance of ESG to investment managers, and hired managers that incorporate ESG into the investment strategy.

Investors implementing ESG would also like to see more ESG-focused products in alternatives, alongside publicly traded asset classes.

- Private equity and real estate (38%) topped the list of strategies respondents would like to see more of as related to ESG.
- U.S. equity and infrastructure (35%) were close behind.
- Hedge funds (30%), global equity (30%), emerging market equity (27%), and U.S. fixed income (27%) were also areas of interest.

About the Survey

Survey Methodology

Callan's *2019 ESG Survey* is the seventh edition highlighting current practices and opinions surrounding environmental, social, and governance (ESG) factors among various types of U.S. institutional investors. Respondents provided input via online questionnaires.

We broke respondents into two primary groups for analysis: those that had and had not incorporated ESG factors into the investment decision-making process. Organizations incorporating ESG factors answered different questions than those 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 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 Survey

About the Authors

Shane Blanton is an assistant vice president in Callan's Published Research Group, covering business analytics. He is responsible for data analysis and visualization to support Callan's research endeavors. 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 in 2012, Shane worked as an account manager for an integrated circuits packaging manufacturer and as a trading assistant to a proprietary options firm. Shane attended Carnegie Mellon University, where he earned a BS in business administration.

Anna West is a Senior Vice President and the ESG Practice Leader at Callan. She oversees the firm’s efforts to address clients’ educational interests and needs in environmental, social, and governance (ESG) thought leadership, research, education, implementation, and related consulting work. And as chair of Callan’s ESG Committee, she works with colleagues across disciplines to assist clients and implement best practices. Anna is also a member of Callan’s Inclusion and Institute Advisory Committees. She is a shareholder of the firm.

Anna joined Callan in August 2006 and was previously co-manager of its Published Research Group and, until 2018, director of the Callan Institute, the firm’s platform for research, education, and dialogue. Prior to Callan, she worked for Vail Resorts. She earned an MBA from the University of San Francisco and a BA in international business and French from Washington University.

About Callan

Callan was founded as an employee-owned investment consulting firm in 1973. Ever since, we have empowered institutional clients with creative, customized investment solutions that are backed by proprietary research, exclusive data, and ongoing education. Today, Callan advises on more than $2 trillion in total fund sponsor assets, which makes it among the largest independently owned investment consulting firms in the U.S. Callan uses a client-focused consulting model to serve pension and defined contribution plan sponsors, endowments, foundations, independent investment advisors, investment managers, and other asset owners. Callan has six offices throughout the U.S. For more information, please visit www.callan.com.

About the Callan Institute

The Callan Institute, established in 1980, is a source of continuing education for those in the institutional investment community. The Institute conducts conferences and workshops and provides published research, surveys and newsletters. The Institute strives to present the most timely and relevant research and education available so our clients and our associates stay abreast of important trends in the investments industry.

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