Callan Institute

Research

2020 ESG Survey

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Key Findings

Callan's eighth annual *ESG Survey* presents trends on ESG adoption for U.S. institutional investors. The results reflect input from 102 unique organizations and highlight growing adoption of ESG practices.

Manager Implementation: Integration

56% of those that incorporated ESG considered ESG factors with every investment/manager selection

47%

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

33%

of respondents not already incorporating ESG factors into investment decision-making were considering doing so in the near future

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

26%

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

63% endowments

57% foundations

36% public

32% corporate

Stakeholders Matter

60% of respondents that incorporated ESG did so to address concerns of stakeholders such as donors, students, and employees.

Impact investing

has decreased in interest for recent ESG adopters relative to longer-term ESG implementers

Executive Summary

Overview

Callan's *2020 ESG Survey,* conducted from June to July 2020, reflects input from 102 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, impact investing, and other associated terms.

Our *2020 Survey,* the eighth we have conducted, included responses from public and corporate DB and DC plans, as well as from endowments and foundations. Respondents also represented plans of all sizes, ranging from small (<$500mm) to large (>$20bn).

Key Takeaways

The survey found 42% of institutional investors incorporate ESG factors into the investment decision-making process. This mirrors our 2019 survey but is nearly double the 22% result from our first survey in 2013. More revealing of current trends is that over 30% of respondents that are not yet incorporating ESG considerations into investment decision-making are considering doing so. This response is the highest in the survey's history and nearly three times the result from 2019. Public plans have incorporated ESG factors into the investment decision-making process at a higher rate than their corporate counterparts, but this level of incorporation was still dwarfed by that of endowments and foundations. By plan size, mid-sized plans ($500mm to $3bn) had the highest level of ESG incorporation at 55%. Other highlights:

- ESG adoption has been rising steadily over the past five years, with 42% of respondents having started to incorporate ESG into investment decision-making over this time.
- Endowments retained their distinction as the top ESG incorporator and actually increased their ESG adoption rate, reporting incorporation of 63% in 2020 compared to 58% in 2019.
- ESG adoption was highest by plans located in the Northeast and on the West Coast.
- Despite the trends toward adoption, 56% of respondents did not incorporate ESG into investment decision-making, citing unproven or unclear benefits as the main rationale.

Respondent Overview

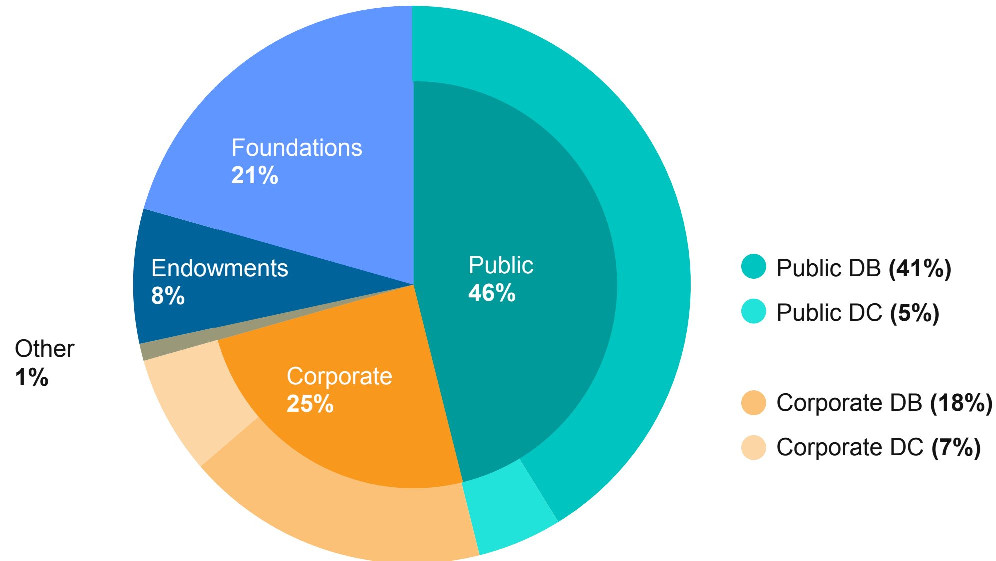
102 institutional investors responded to the survey

46% of respondents were public plans, either pensions or defined contribution plans, making them the largest sector represented

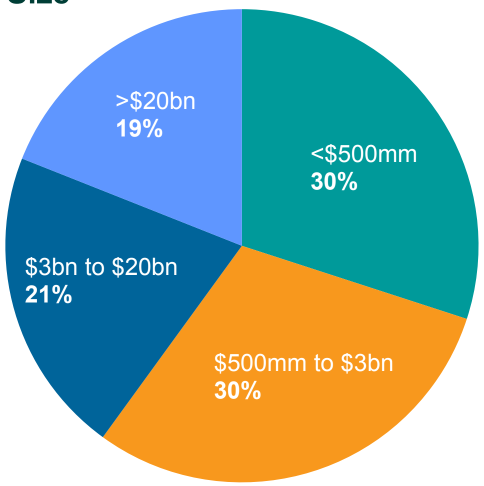
29% of respondents were endowments or foundations

40% of respondents were larger funds with a size of $3 billion or greater. The rest were evenly split between mid-sized ($500mm to $3bn) and smaller funds (<$500mm).

Respondents by Type



Respondents by Size

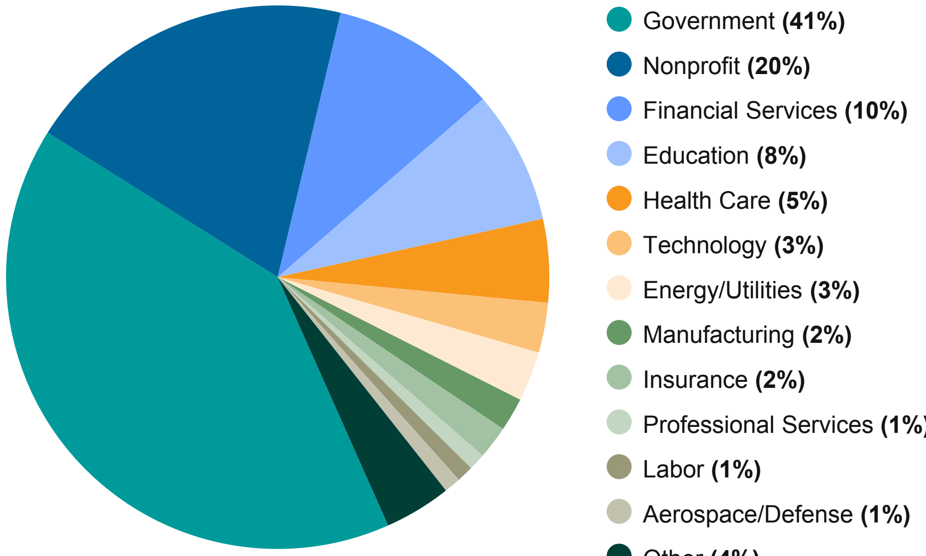


Note: charts in this report may not sum to 100% due to rounding.

Respondent Overview (continued)

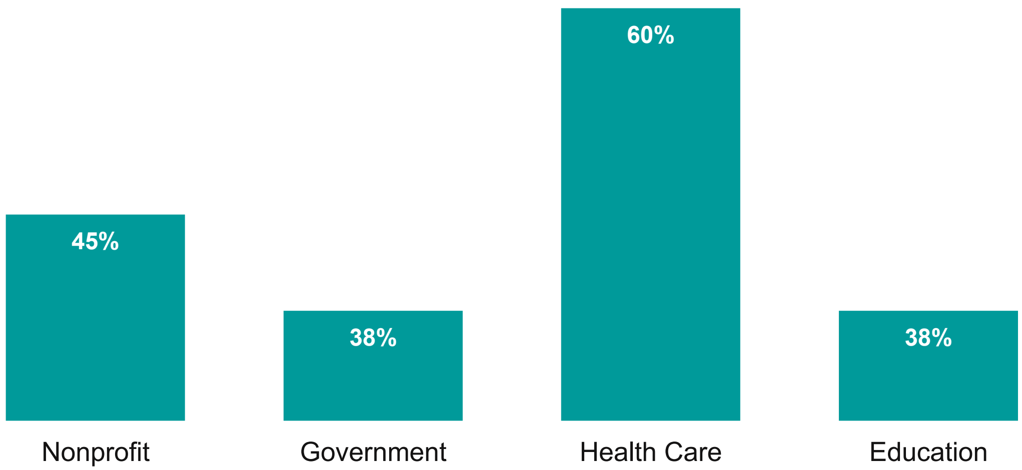
The largest share of respondents were from the government sector (41%), followed by the nonprofit (20%), financial services (10%), education (8%), and health care (5%) sectors.

Respondents by Sector



Looking at ESG incorporation rates by sector, we note that health care and nonprofit respondents had the highest rates of adoption. Note that the sample set for health care was small.

ESG Incorporation by Sector



ESG Adoption Rates: Almost Doubled Since 2013

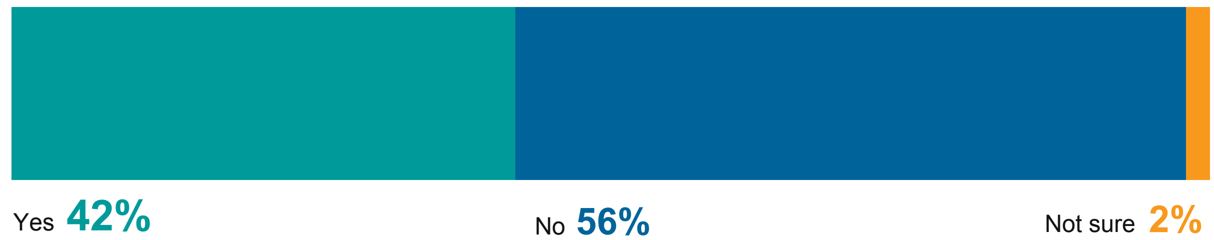
42%

of respondents incorporated ESG factors into investment decisions in 2020, roughly consistent with the past two years. Although adoption rates have leveled off over the past few years, the rate of respondents considering adoption is higher than ever (see pg. 11).

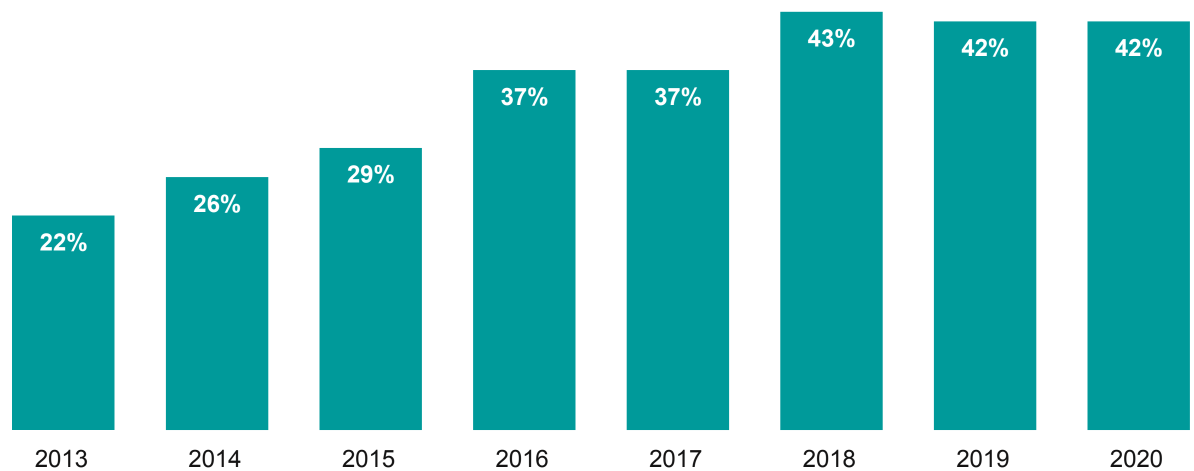
91%

increase in respondents that have incorporated ESG factors into investment decisions from 2013, when Callan first conducted our survey, to 2020.

ESG Incorporation



ESG Adoption Shows Steady Increase



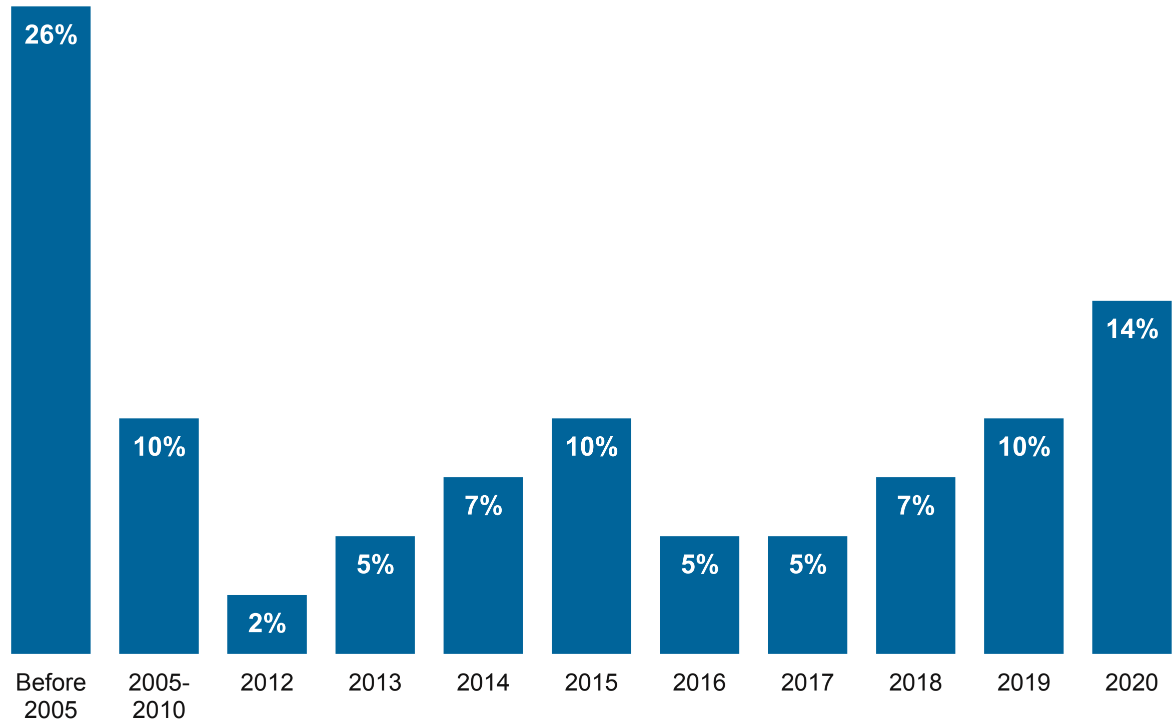
ESG Adoption Over Time

ESG is a relatively new phenomenon for some survey respondents.

41%

of investors that incorporate ESG began doing so in the past five years (2016-2020).

When Respondents First Incorporated ESG Factors into the Investment Decision-making Process*



*No observations for 2011

ESG Incorporation by Investor Type

63%

of endowments incorporated ESG factors into investment decisions, the 2020 survey found, with foundations close behind at 57%. Over time, endowments and foundations have incorporated ESG factors at a higher rate than other institutional investor types.

Establishing and implementing an ESG framework that is consistent with the organization's overall goals and philosophy can typically be more readily accomplished at mission-focused or values-based endowments and foundations than other investor types; public and corporate plans are also subject to different regulatory regimes that can make ESG adoption more complex. Despite that, corporate plans registered their highest rate of adoption this year, at 32%.

ESG Incorporation by Investor Type: 2020

By Investor Type Over Last Seven Years

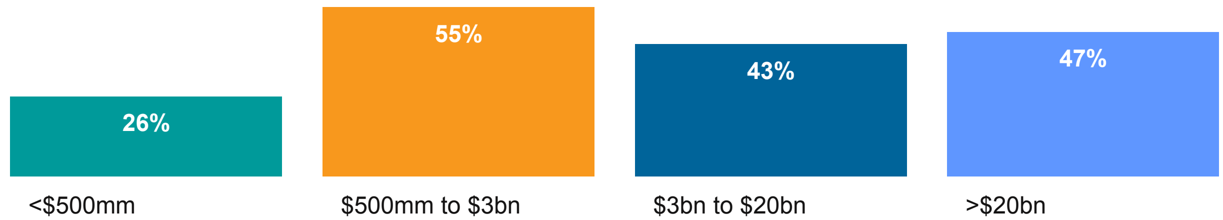
2014	2015	2016	2017	2018	2019	2020
Endowment **34%**	Foundation **39%**	Endowment **53%**	Foundation **56%**	Foundation **64%**	Endowment **58%**	Endowment **63%**
Foundation **31%**	Endowment **37%**	Foundation **48%**	Endowment **39%**	Endowment **56%**	Public **49%**	Foundation **57%**
Public **22%**	Public **27%**	Corporate **30%**	Public **35%**	Public **39%**	Foundation **44%**	Public **36%**
Corporate **16%**	Corporate **15%**	Public **25%**	Corporate **25%**	Corporate **20%**	Corporate **19%**	Corporate **32%**

ESG Incorporation by Size

55%

of mid-sized funds ($500mm to $3bn) incorporated ESG factors into investment decisions in 2020; the highest rate of the four categories.

ESG Incorporation by Investor Size: 2020



Historically, the largest institutional investors (>$20bn) have incorporated ESG factors at the highest rate since the survey's inception in 2013. This year's results suggest a more level playing field than in the past, which is consistent with the greater awareness of ESG and broader availability of information on the topic from a variety of sources, including industry groups, investment consultants, asset managers, and data providers.

By Investor Size Over Last Seven Years

2014	2015	2016	2017	2018	2019	2020
>$20bn **31%**	>$20bn **35%**	>$20bn **71%**	>$20bn **78%**	>$20bn **72%**	>$20bn **50%**	$500mm to $3bn **55%**
$500mm to $3bn **24%**	$3bn to $20bn **31%**	<$500mm **39%**	$500mm to $3bn **42%**	<$500mm **47%**	$500mm to $3bn **50%**	>$20bn **47%**
<$500mm **22%**	<$500mm **26%**	$3bn to $20bn **33%**	<$500mm **30%**	$3bn to $20bn **33%**	<$500mm **38%**	$3bn to $20bn **43%**
$3bn to $20bn **18%**	$500mm to $3bn **26%**	$500mm to $3bn **29%**	$3bn to $20bn **22%**	$500mm to $3bn **28%**	$3bn to $20bn **35%**	<$500mm **26%**

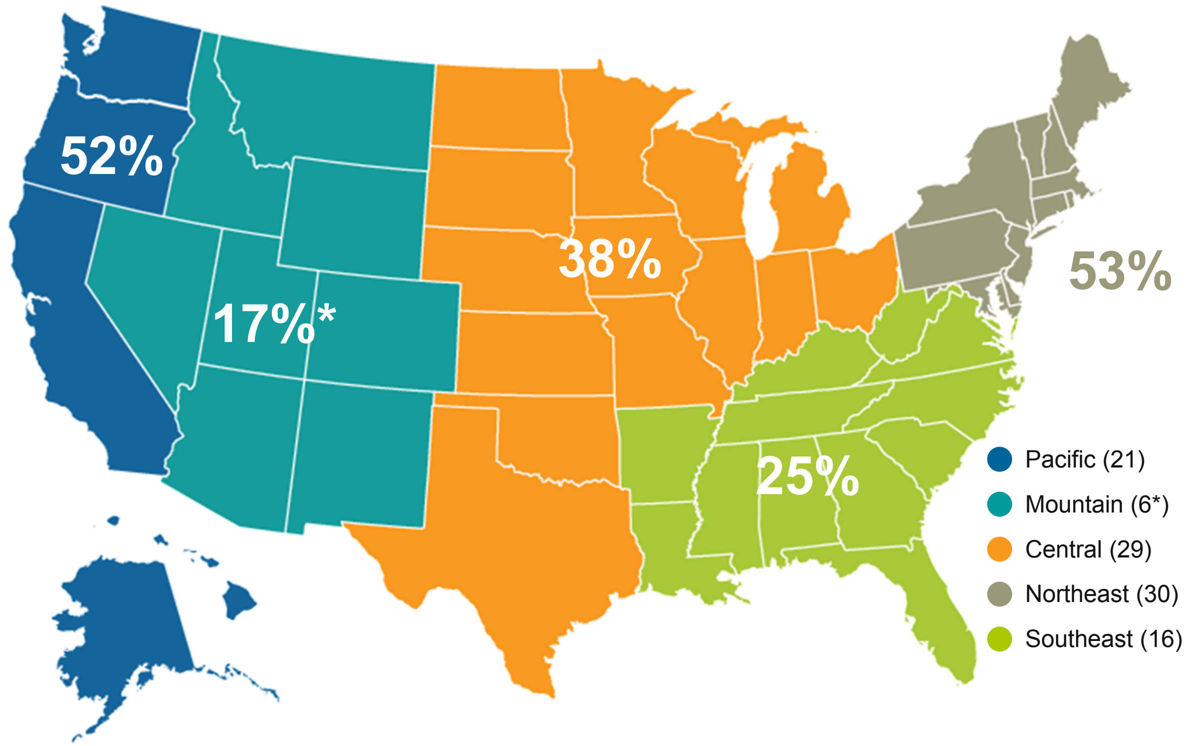
ESG Adoption Rates by Region

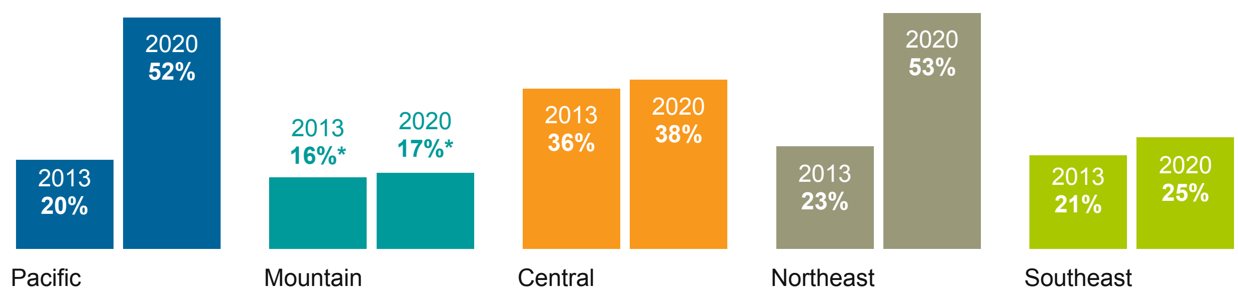
53%

of investors in the **Northeast** region surveyed in 2020 incorporated ESG into investment decisions. Pacific region funds, at 52%, had almost the same rate.

Since 2013, the Pacific and Northeast regions have also seen the largest increase in ESG adoption, with adoption rates more than doubling for both regions.

Regional Breakdown of ESG Incorporation





*Note the small sample size

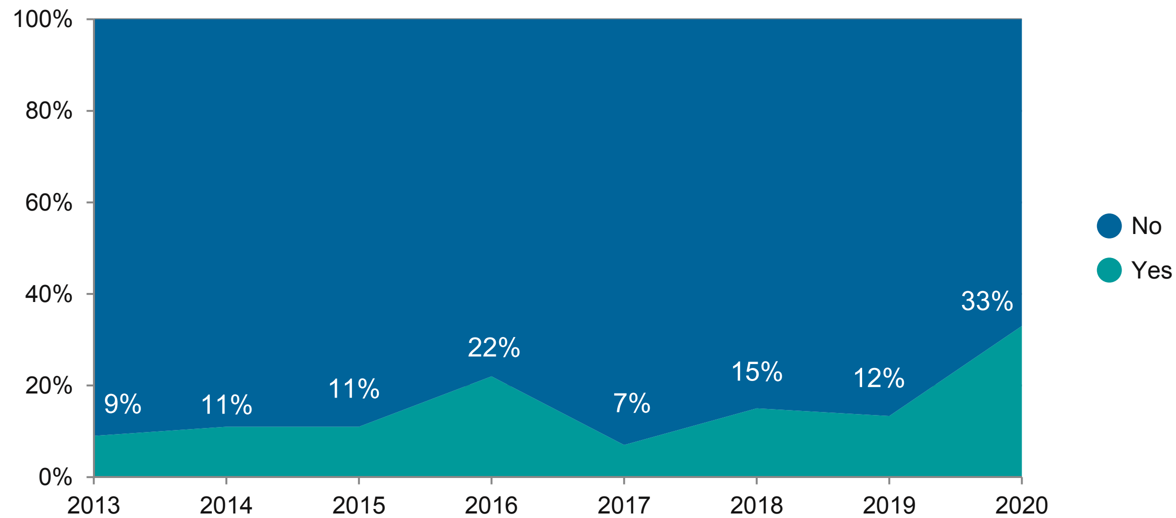
Considering ESG Incorporation

33%

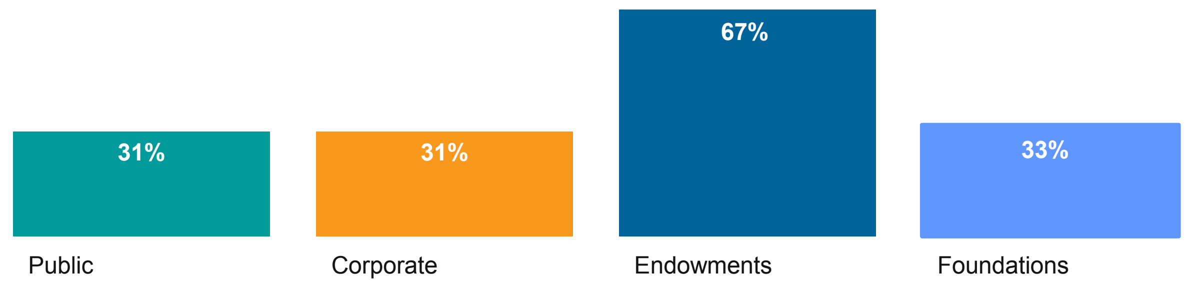
of respondents that have not yet incorporated ESG into investment decisions were considering doing so in the future, a much higher rate than in the past. This figure has fluctuated over time in the roughly 10%-20% range, suggesting that the interest in ESG incorporation is rising these days.

This brings the ratio of those either currently incorporating or thinking about incorporating ESG to over half of the respondent pool of U.S. institutional investors (61%) in 2020.

Share of Respondents Considering ESG Incorporation



Share of Respondents Considering ESG Incorporation by Investor Type



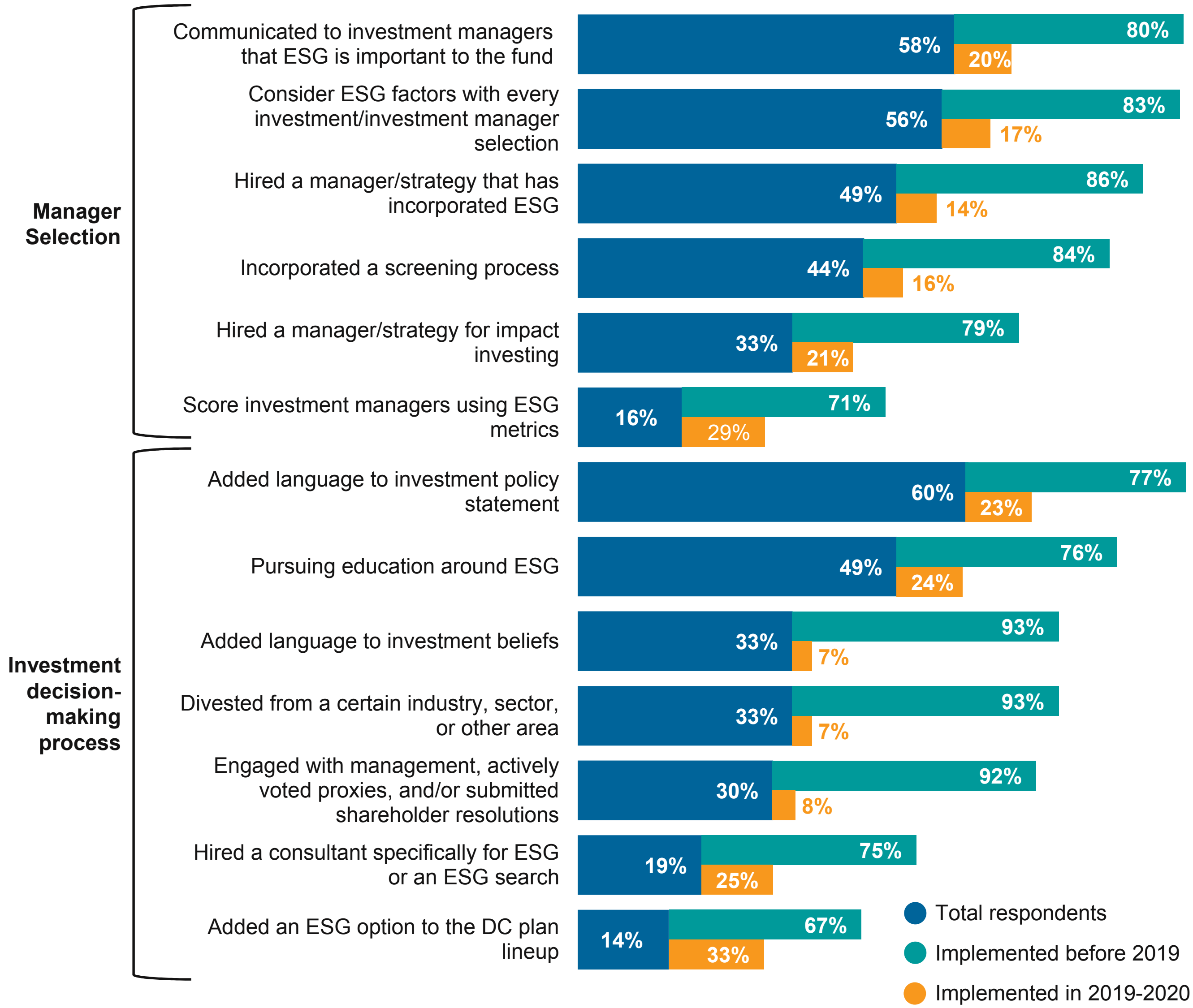
ESG Implementation: Early vs. Recent Adopters

In this year's survey, we delineated 1) ESG adoption into the manager selection process from 2) the investment decision-making process.

Integration is becoming the preferred method of implementation as 56% of all adopters considered ESG factors with every investment/investment manager selection. Even more adopters have communicated ESG's importance to investment managers (58%), indicating that for managers to win mandates with those funds, ESG incorporation is considered table stakes.

In the overall fiduciary decision-making process, the most common form of ESG incorporation was adding language to the IPS (60%). This is consistent with what we see from clients that incorporate ESG, which often believe it is important to formally document their consideration of ESG factors in their investment policy. The second most common form of ESG incorporation was pursuing education (49%), typically by investors that are earlier on in their ESG incorporation path.

How Investors Are Incorporating ESG*



*Multiple responses allowed

Separate ESG Allocation Is Not Common

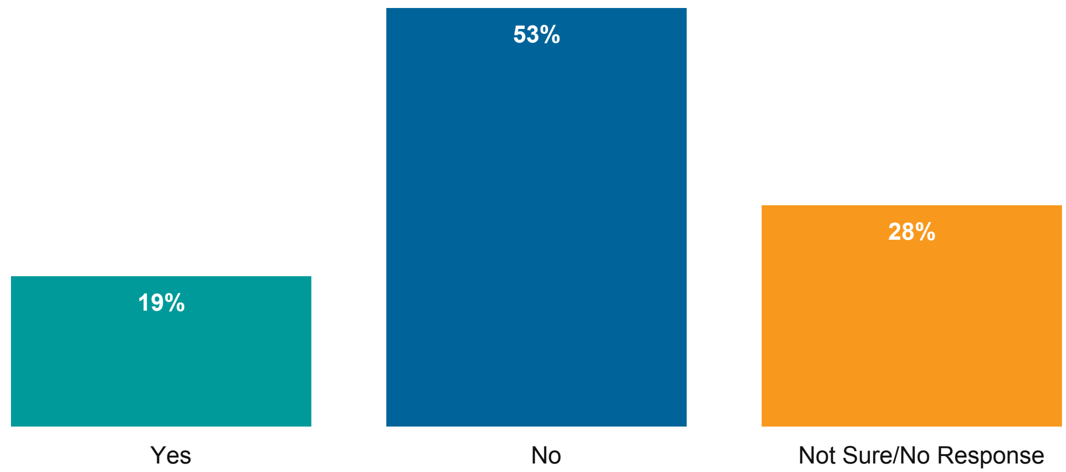
The majority of respondents (53%) incorporating ESG do not do so using a distinct allocation, indicating that ESG incorporation tends to be holistic rather than in a sleeve.

19%

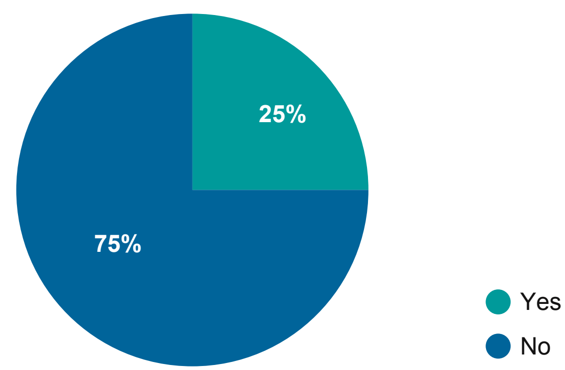
of investors that have incorporated ESG factors into the investment decision-making process made a distinct allocation to ESG investing.

Endowments and foundations may use 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; 25% of E&F respondents noted maintaining a separate sustainable portfolio.

Distinct Allocation Dedicated to ESG Separate From the Traditional Portfolio



Share of E&F Respondents That Maintain a Dedicated ESG Portfolio

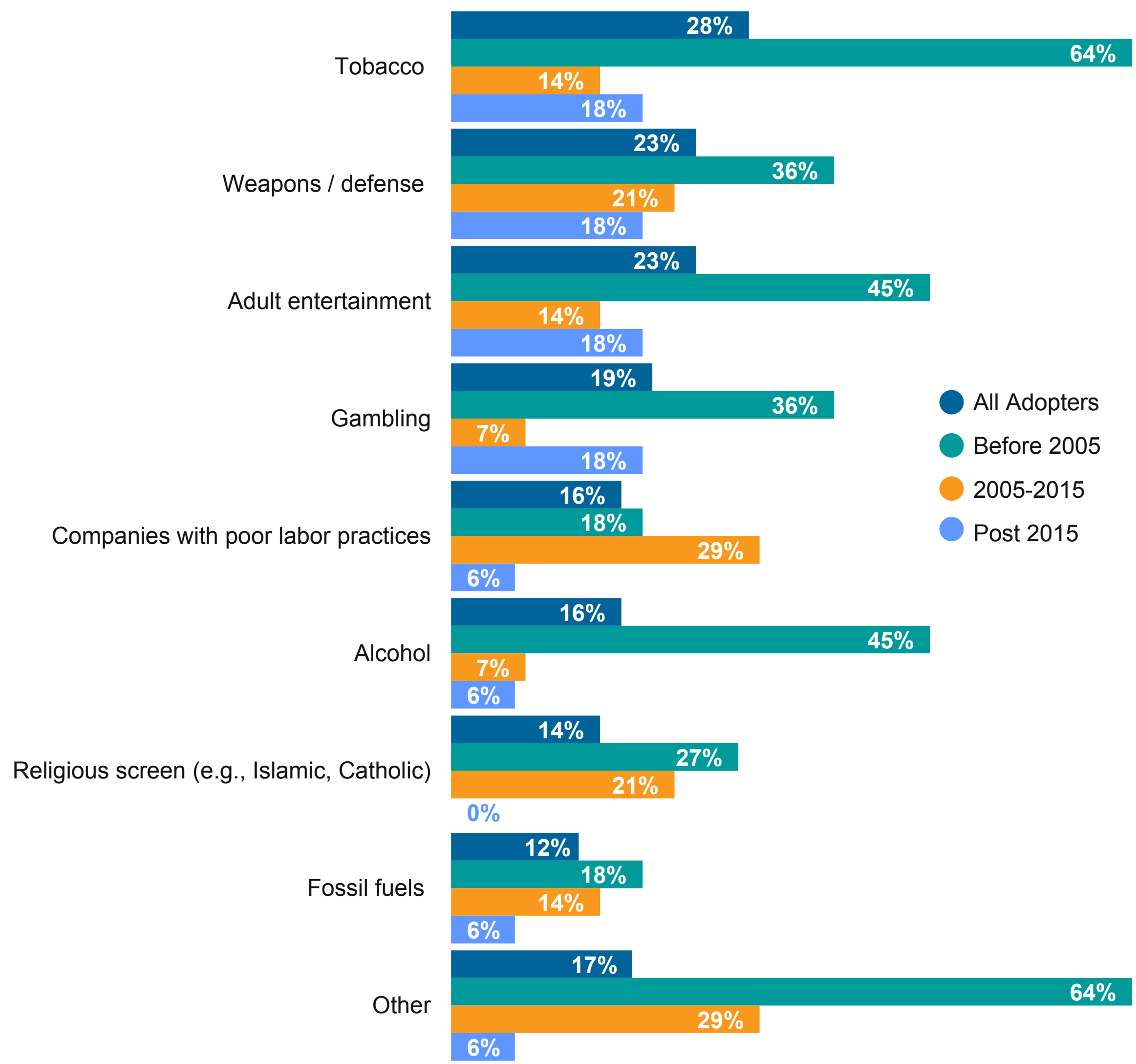


ESG Implementation: To Avoid

While ESG integration into investment decision-making and manager selection is quickly becoming the most common implementation method for ESG, negative screening and divestment still play a role: 44% of all ESG adopters have incorporated a screening process in manager selection and 33% of adopters have divested from an issue.

For all respondents incorporating ESG, tobacco was the most common area to avoid. For early adopters, divestment was spread across many areas, but more recent adopters have focused divestment efforts on tobacco, weapons/defense, adult entertainment, and gambling.

Divestment Criteria*



*Multiple responses allowed

"Other" includes abortion, fetal research, and for-profit education.

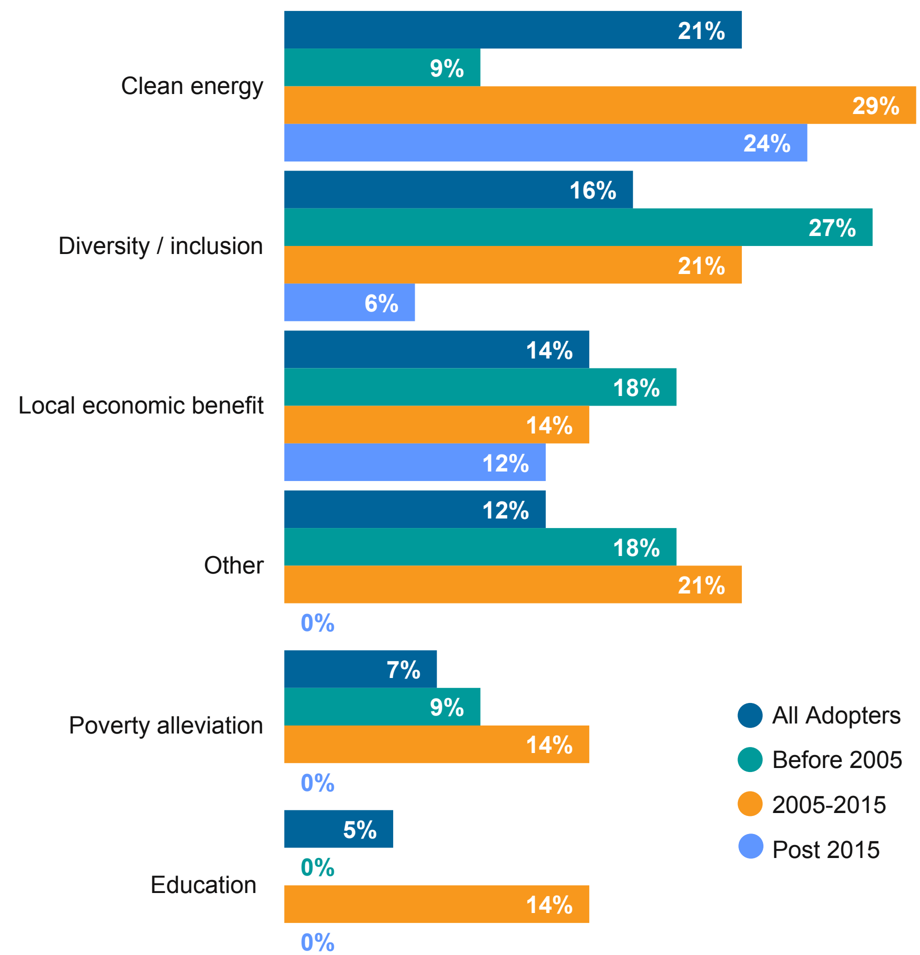
ESG Implementation: To Embrace

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 clean energy, diversity/inclusion, local economic benefit, poverty alleviation, and education. Additional "other" categories included access to clean water, access to health care, and improved governance.

Interestingly, poverty alleviation and education were not areas targeted by recent adopters from the respondents despite these being a focus in the past.

Positive Impact Investments Intentionally Included per ESG Policies*



*Multiple responses allowed

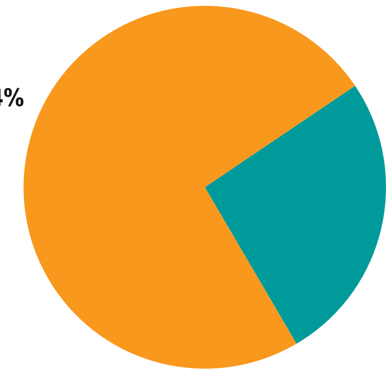
ESG and Defined Contribution Assets

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

26%

of DC plans surveyed (both public and corporate) said there was an ESG option in their plan lineup. For comparison, on the next slide we show the comparable figures from the plans in the Callan DC Index™, which show an even lower level for the number of plans that have an ESG option.

ESG in Defined Contribution 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.)

ESG and Defined Contribution Assets

Despite the growth in ESG interest within the institutional investing community, data from the Callan's DC Index signals that DC plan adoption of dedicated ESG options is still relatively low.

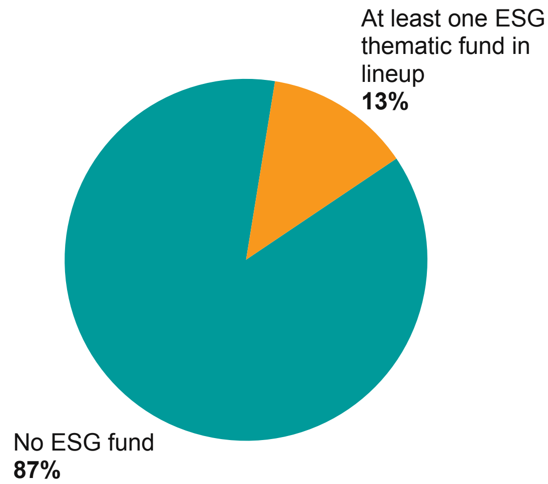
According to Callan's DC Index, around 13% of DC plans offer a dedicated ESG option. However, this number masks a large divide among plan types: only 5% of corporate DC plans offer a standalone option, compared to 43% of public and nonprofit plans.

In addition, utilization for all sponsor types remains low. Allocations range from 0.2% to 3.1% of total plan assets, with an average allocation of 1.2%.

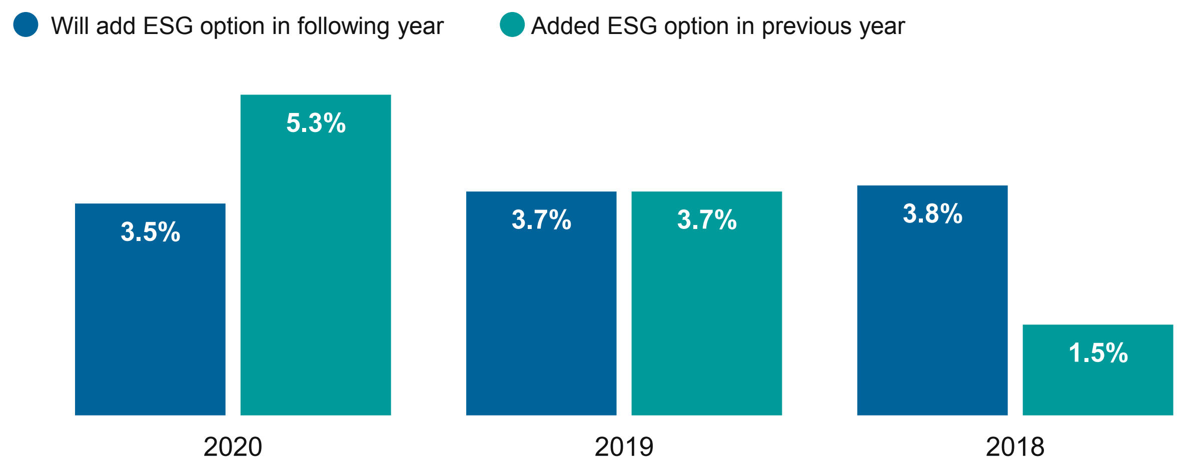
These utilization and prevalence numbers are on par with the figures for emerging market equity, REITs, and global/global ex-U.S. fixed income.

According to Callan's *DC Trends Survey*, there is a slight increase in the percentage of plan sponsors that have added an ESG option to the investment menu in the previous year (1.5% in 2018 vs. 5.3% in 2020).

Callan DC Index: Prevalence of at Least 1 ESG Thematic Fund in Plan Lineup



Callan DC Trends Survey: ESG Option



Sources: Callan 2020 DC Trends Survey, Callan DC Index™, first quarter 2020

Environmental Actions – Investment and Shareholder Advocacy

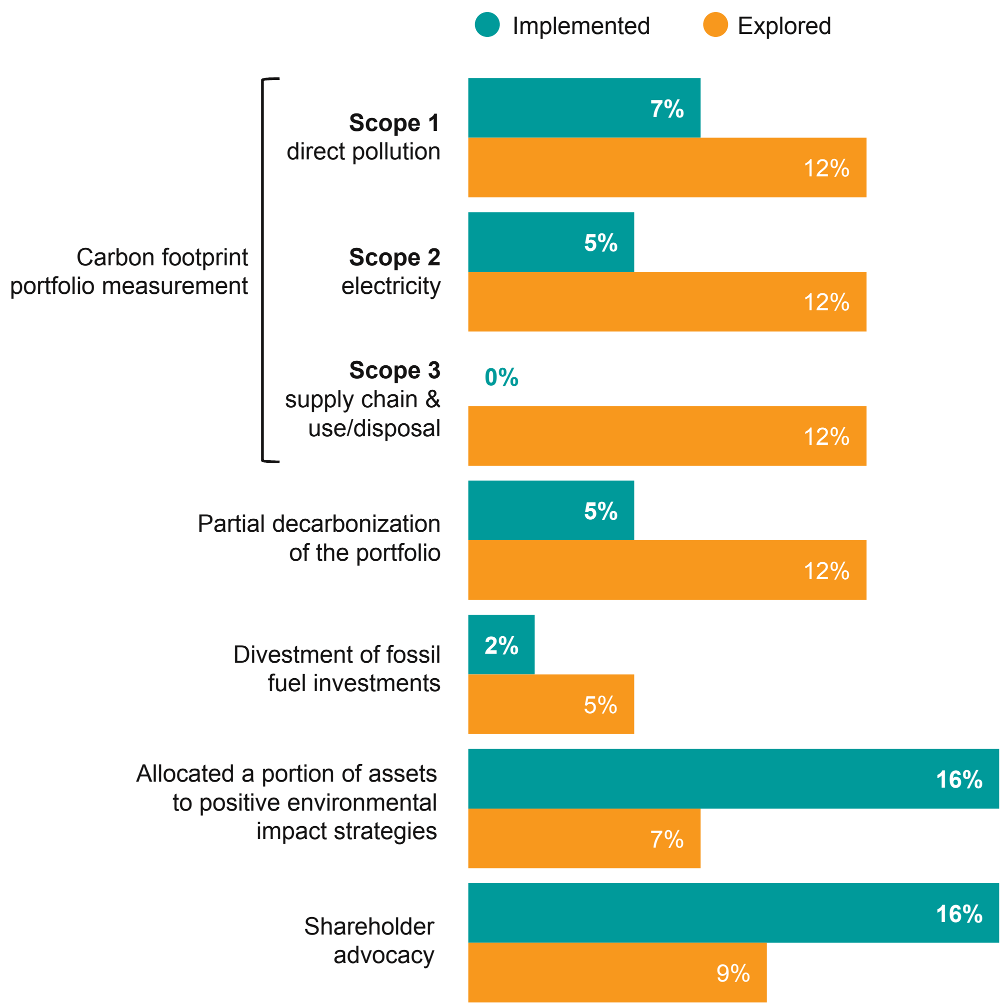
16%

We asked respondents that incorporate ESG what actions they have explored or taken specific to environmental concerns, such as climate change. The two most common environmental actions taken by those that have implemented ESG was to allocate a portion of assets to positive environmental impact strategies and performing shareholder advocacy (16% each).

19%

Carbon footprint portfolio measurement, using one of three scopes, is being explored by 19% of respondents in total, with 12% exploring each of the individual scopes. But actual implementation remains low at 0-7%. Several global reporting initiatives related to climate change, such as the Task Force on Climate Change Financial Disclosures, have created 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

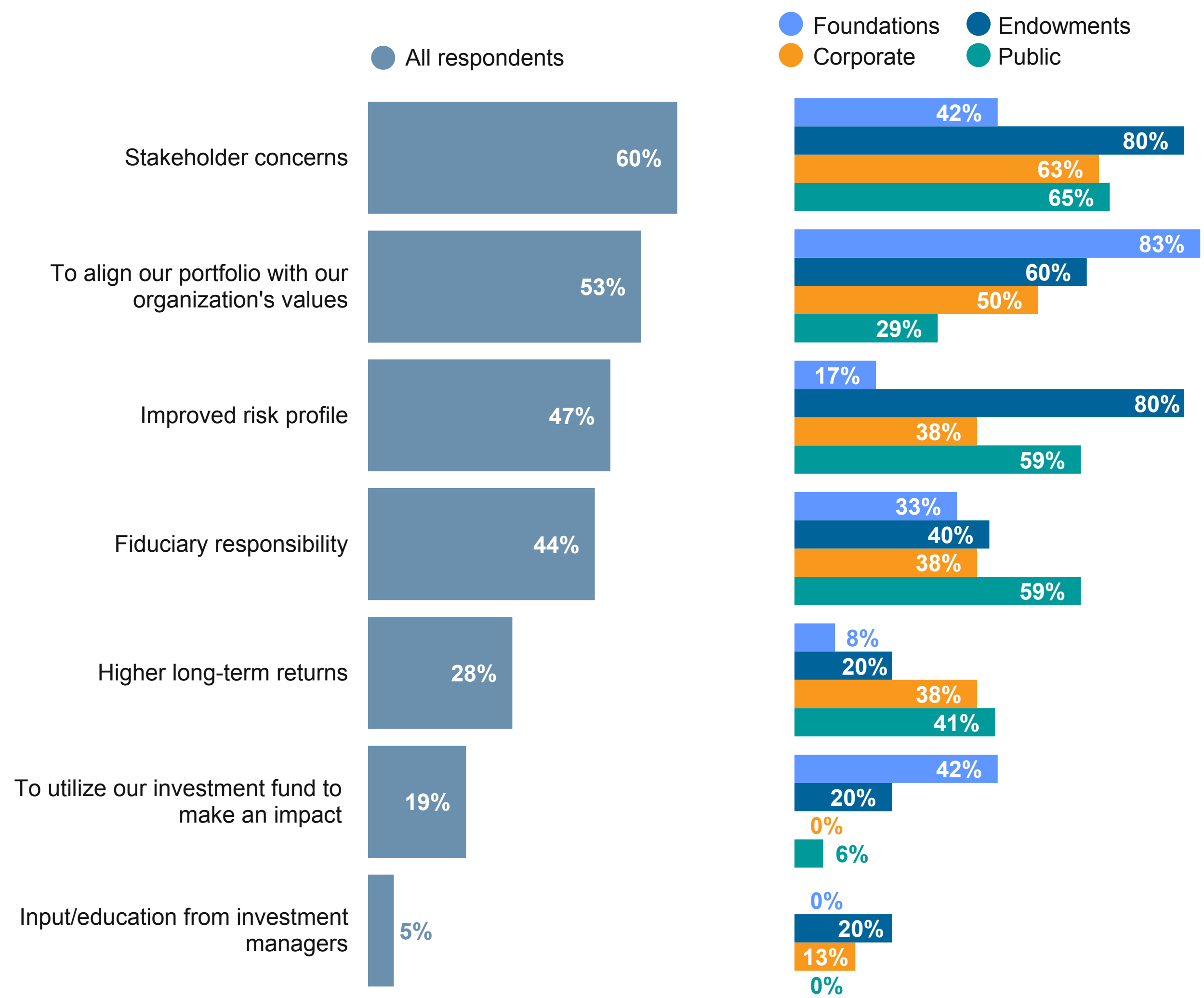
Reasons for Incorporating ESG: Stakeholder Concerns are Primary

60%

of respondents looked to ESG to address stakeholder concerns, up from 54% in the 2019 survey. This was a particularly relevant reason for endowments (80%).

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

Reasons for Incorporating ESG Factors – by Investor Type*

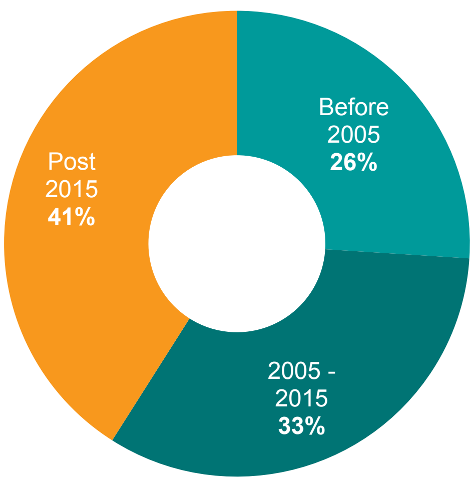


* Multiple responses allowed

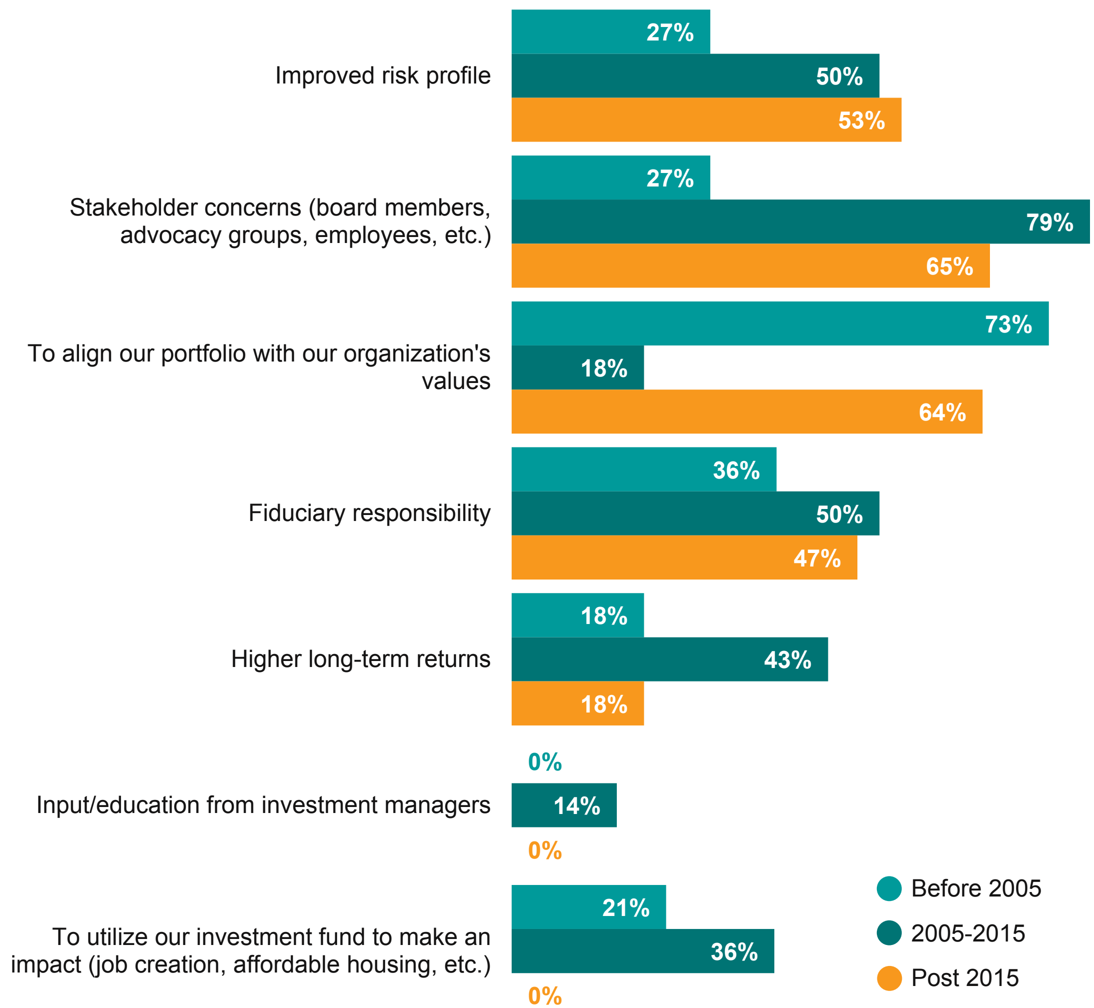
Reasons for Incorporating ESG: Early vs. Recent Adopters

When comparing the early adopters' motivations for incorporating ESG versus 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



Reasons for Incorporating ESG Factors – by Adoption Timeframe*



*Multiple responses allowed

Reasons Against ESG Incorporation – Benefits are Unclear

39%

of investors that are not incorporating ESG indicated that it was because the benefits to their plan are unproven or unclear. Similarly, 30% of respondents said they will not consider any factors that are not purely financial in their decision-making. This response was particularly high across public plans.

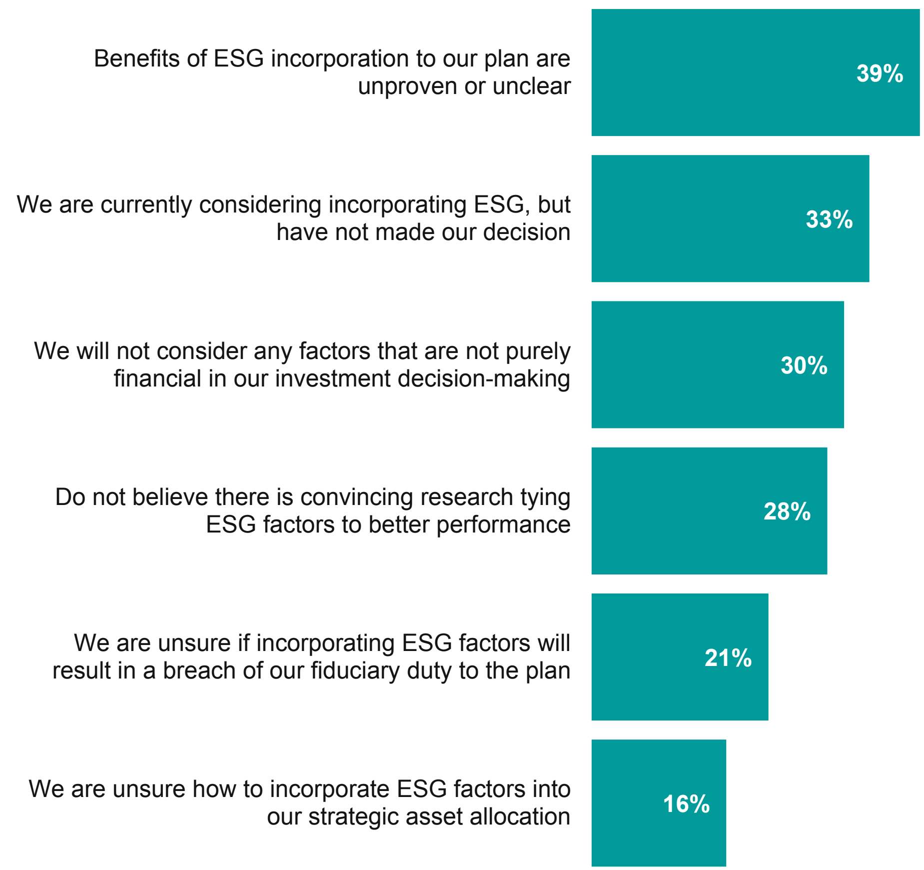
While an increasing body of research supports the belief that ESG issues have material financial impacts in certain investment situations, other reasons for not implementing ESG include:

- 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
- No legal requirement
- Leaving it to managers to integrate
- Haven't yet considered

33%

of those that have not incorporated ESG into investment decision-making are considering doing so (page 11).

Reasons for NOT Incorporating ESG Factors*



*Multiple responses allowed

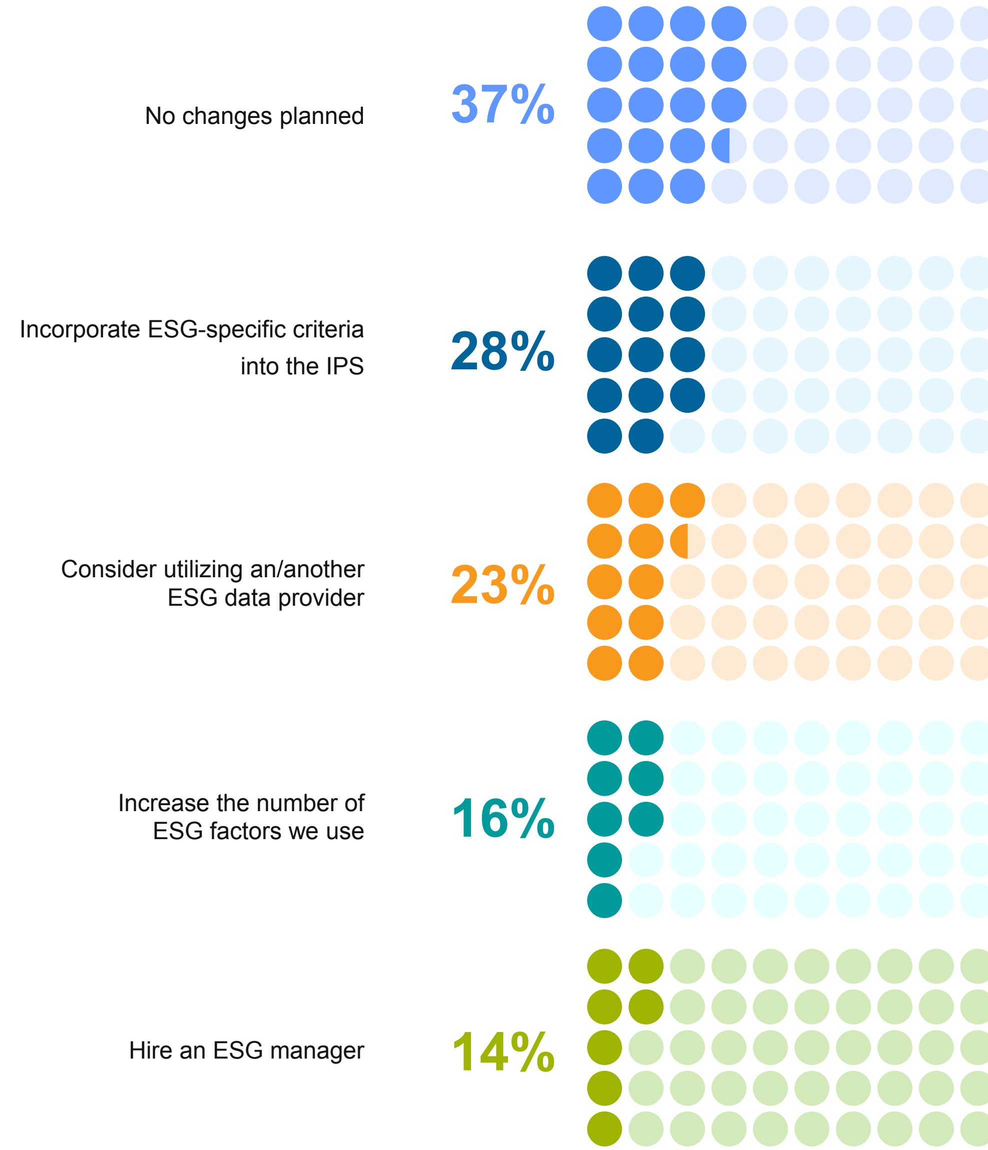
37%

of respondents that have incorporated ESG factors in investment decision-making do not plan to make any changes to their usage of ESG factors in the coming years. This response rate is up from 27% in the 2019 survey as many ESG adopters have made tangible strides to increase ESG implementation in recent years, indicating they have fewer changes to ESG usage to make going forward. This is supported by year-over-year declines in the other responses as ESG factors have made their way into investment policy statements, and data providers and managers have been hired.

To that point, while only 14% of respondents indicated a plan to hire an ESG manager, areas of interest include:

– Adding real assets and fixed income
– Seeking managers with better ESG processes and outcomes
– Impact investing

Planned Changes to Use of ESG Factors Over the Next 1 to 3 Years*



*Multiple responses allowed

Product Offerings – Demand for Active Strategies

We asked all survey respondents where they would like to see more ESG-focused product offerings. Choosing from an array of asset classes, 51% of survey participants responded, including those that had and had not incorporated ESG.

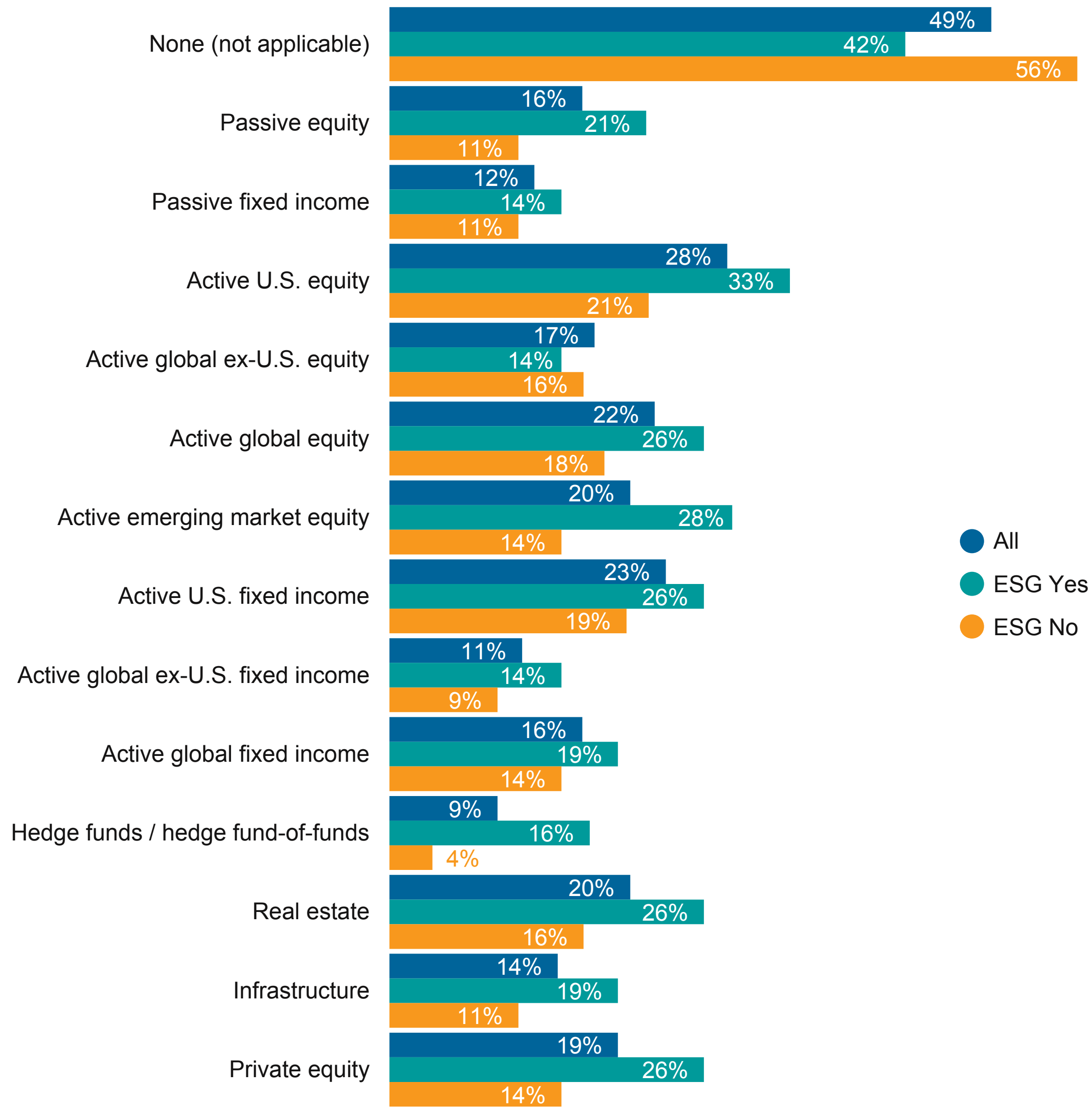
While most respondents not incorporating ESG (“ESG No”) did not have any asset classes where they’d like to see more ESG-focused products (56%), interest across all asset classes was still shown to some degree by these investors.

Those implementing ESG (“ESG Yes”) highlighted several asset classes for more product offerings:

- Active U.S. equity (33%) topped the list, followed by active emerging market equity (28%)
- Broadly, interest in active products matched or far outweighed interest in passive offerings
- Infrastructure only received 19% interest, compared to 35% in 2019’s survey

*Multiple responses allowed

Interest in More ESG-Focused Product Offerings*



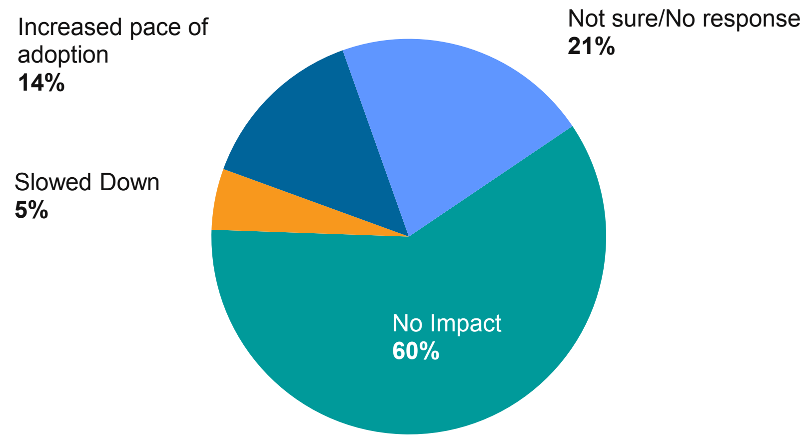
COVID-19 Impact: Respondents Staying the Course

The coronavirus has impacted all aspects of life in 2020, so we asked survey respondents if these impacts extended into their funds' ESG initiatives, especially as many funds adapted to working from home.

60%

of respondents said that COVID-19 has had no impact on their ESG initiatives for the current year. While roughly one-in-five respondents was uncertain of the coronavirus' impact or did not answer, it is notable that almost three times as many institutional investors believe COVID-19 has increased their pace of ESG adoption (14%) as opposed to slowed t down (5%).

COVID-19 Impact on ESG Initiatives



Conclusions

U.S. ESG Adoption Continued: An increasing number of investors incorporated ESG into the investment process in the U.S. in 2020.

- Since 2013, Callan's survey has observed an 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 it has more recently at 42%.
- Noticeably higher than previous surveys, 33% of investors not yet incorporating ESG factors are now actively considering doing so in the future. This brings the ratio of those either currently incorporating or thinking about incorporating ESG to over half of the respondent pool of U.S. institutional investors (61%) in 2020.
- The most frequently cited reason for incorporating ESG among respondents was to address stakeholder concerns. Conversely, the most frequently cited reason for not incorporating ESG among respondents was that the benefits of ESG incorporation were unproven or unclear.

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

- Only 19% of respondents maintain an ESG allocation separate from their traditional portfolio, indicating broader ESG integration is preferred. Over half of respondents who incorporate ESG have communicated ESG's importance to their investment managers, consider ESG with every investment/investment manager selection, and added ESG language to their IPS.

ESG Interest Remains Strong: Despite the recent market environment, investors sought more active equity and fixed income products.

- 60% of respondents claimed the global COVID-19 pandemic has had no impact on their planned ESG initiatives, while 14% actually believe the pandemic will cause them to increase their rate of ESG adoption.
- Active U.S. equity (33%) led the list of strategies current ESG implementers would like to see more of, followed by active emerging market equity (28%).

Survey Methodology

Callan's *2020 ESG Survey* is the eighth 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 an online questionnaire. Callan has conducted this survey annually since 2013; not all respondents to this year's survey have participated each year, which may contribute to some variance in data trends.

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.

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Thomas H. Shingler is a senior vice president and consultant in Callan's New Jersey consulting office. He works with a variety of fund sponsor clients, including public and corporate defined benefit and defined contribution plans, as well as endowments and foundations. His responsibilities include strategic planning, investment implementation, manager evaluation, education, and special projects. Tom is a member of Callan's Manager Search Committee and is the chair of the ESG Committee. He is a shareholder of the firm.

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