



2016 ESG Interest and Implementation Survey

- In September 2016, Callan conducted our fourth annual survey to assess the status of environmental, social, and governance (ESG) factor integration—including responsible and sustainable investment strategies and socially responsible investing—into investment decision making in the U.S. institutional market. The results reflect responses from 84 unique institutional U.S. funds representing approximately \$843 billion in assets.
- The survey reveals a growing trend of incorporation of ESG factors. In 2016, 37% of all survey respondents have “incorporated ESG factors into decision making,” up from 29% in 2015 and 22% in 2013. Some of this increase appears to be driven by funds in the health care sector, which saw particularly high adoption rates (62%). Endowments (53%) and foundations (48%) continue to be the highest adopters relative to other fund types, though corporate funds saw a material uptick in incorporation relative to a year ago, doubling from 15% in 2015 to 30% in 2016.
- By fund size, large funds (greater than \$3 billion in assets) tend to have higher rates of adoption of ESG factors into investment decision making than smaller funds. The largest funds (with more than \$20 billion in assets) had the highest adoption rates at 71%.
- The most common implementation of ESG is to add language to the investment policy statement (cited by 53% of respondents that incorporate ESG). The greatest barrier to funds incorporating ESG into investment decision making continues to be a lack of clarity over the value proposition (cited by 63% of respondents that do not incorporate ESG).

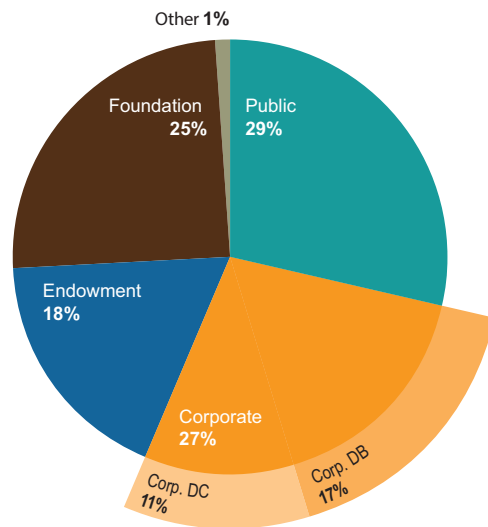
Respondent Overview

Callan surveyed U.S. institutional investors on environmental, social, and governance (ESG) factors, defined for the purposes of the survey as: socially responsible investing (SRI) (including divestment), sustainable investing, responsible investing, and other associated terms. We collected responses from 84 U.S. funds and trusts that collectively represent approximately \$843 billion in assets.

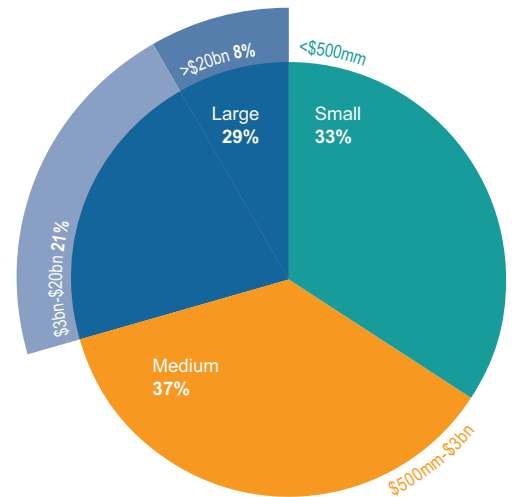
Exhibit 1 details survey respondents by fund type: 27% are corporate funds, 29% public funds, 25% foundations, 18% endowments, and 1% other. Exhibit 1 also shows respondents by fund size. Thirty-three percent have \$500 million or less in assets, 37% have between \$500 million and \$3 billion, and the remaining 29% have greater than \$3 billion. Fifteen percent of respondents are in the health care industry, an area that reflects higher adoption of ESG. While the 2016 respondent pool is smaller than 2015 (242 funds with \$2.4 trillion in assets responded in 2015), the respondent pool makeup is similar by fund size and type. In 2016, a greater percentage of foundations weighed in (25% in 2016 vs. 10% in 2015) while fewer public funds and other fund types responded. By fund size, a greater percentage of medium funds responded in 2016 than 2015, and a smaller portion of large funds weighed in.

Exhibit 1

Respondents by Fund Type



Respondents by Fund Size



Defining ESG

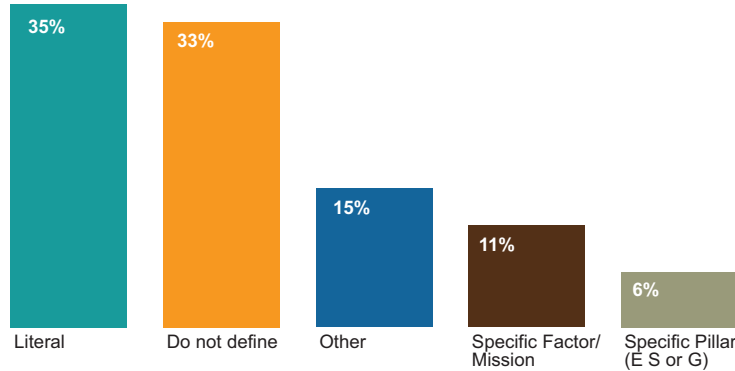
In 2016, Callan sought to determine how respondents define ESG, as we have found that definitions can vary widely in the industry. Logically, defining ESG is often the first step a fund takes in exploring implementation. While just over one-third (35%) of respondents cited a literal definition (i.e., “environmental, social, and governance issues”; or “sustainability related issues”), an almost equal percentage of

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

respondents (33%) do not define it at all (**Exhibit 2**). Nearly every respondent that does not define ESG also does not currently incorporate it into investment decisions. Fewer respondents cited specific factors/missions (e.g., ex-tobacco, religious screens) or highlighted one pillar (e.g., environmental issues only). Some of the “Other” definitions of ESG include: compliant with the PRI principles; applying the Prudent Investor Rule in judging the quality and reasonable diversification of investments; and considering investments based on non-investment criteria.

Exhibit 2
All Respondents

How do you define ESG?

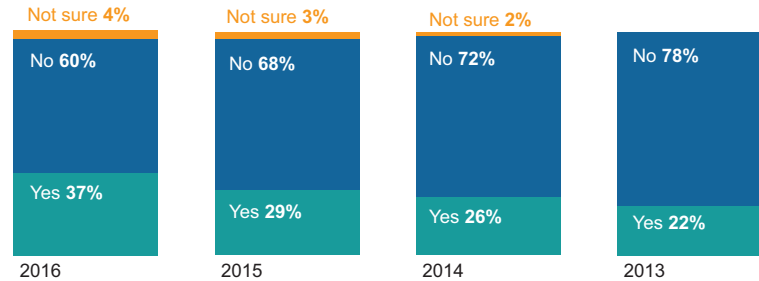


ESG Factor Adoption Rates

Our survey asked whether or not the fund had incorporated ESG factors into investment decision making. The language was intentionally broad in order to capture the prevalence of ESG considerations in the institutional investment arena. The percentage of respondents that have incorporated ESG factors into decision making continues to grow and hit 37% in 2016, up from 29% in 2015 and 22% in 2013 (**Exhibit 3**). Foundations and endowments are the highest adopters relative to other fund types: 48% of

Exhibit 3
All Respondents

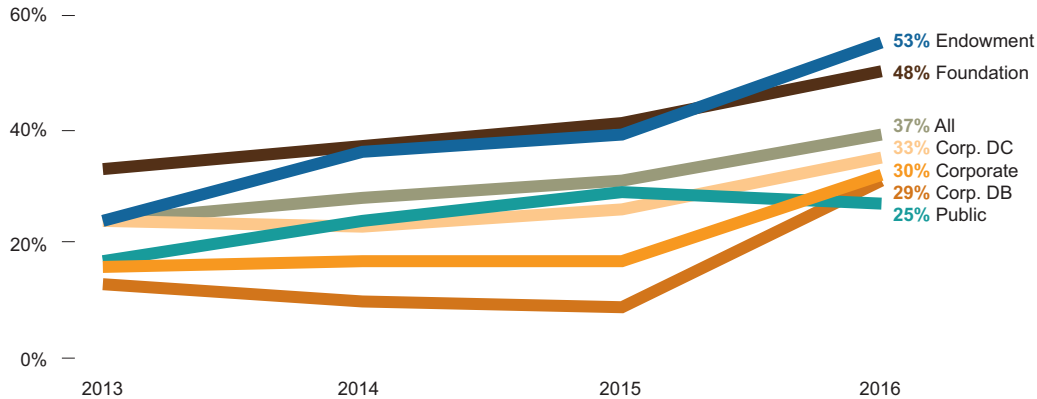
Have you incorporated ESG factors into your investment decisions?



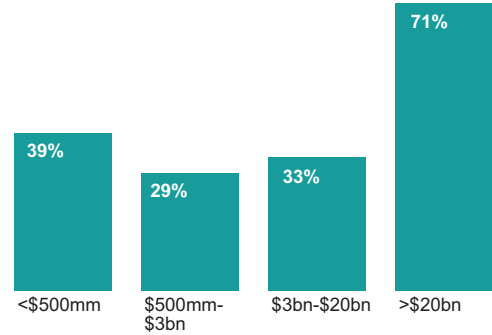
foundations and 53% of endowments indicate they use ESG factors (**Exhibit 4**). Corporate funds saw a material increase in prevalence, from 15% in 2015 to 30% in 2016. Corporate defined benefit plans saw the largest jump, from 7% to 29%, during the same year that followed the Department of Labor’s bulletin clarifying that investment strategies that consider ESG factors can be in compliance with fiduciary duty under ERISA. Public funds now have the lowest rates of ESG incorporation at 25%, a modest decrease from 2015 (27%) that Callan views as a reflection in the survey sample (fewer public funds responded to our survey in 2016 than in 2015).

Exhibit 4
By Fund Type
2013 – 2016

Respondents that have incorporated ESG into investment decisions



By Fund Size
2016



Survey respondents are from across the U.S.: 31% Central, 25% Northeast, 18% Southeast, 14% Pacific, and 12% Mountain. The Pacific region has the highest percentage of funds incorporating ESG factors at 58% (**Exhibit 5**), followed by the Central (46%) and Northeast (33%). Respondents from the Southeast and Mountain regions have the lowest adoption rate at 20% each.

An additional 22% of respondents that have not yet incorporated ESG into investment decision making are currently considering doing so (**Exhibit 6**). This is double the amount considering this decision in 2015 (11%), suggesting the momentum gained in the past few years will continue.

Exhibit 5
All Respondents

Funds that are incorporating ESG factors in investment decisions by region

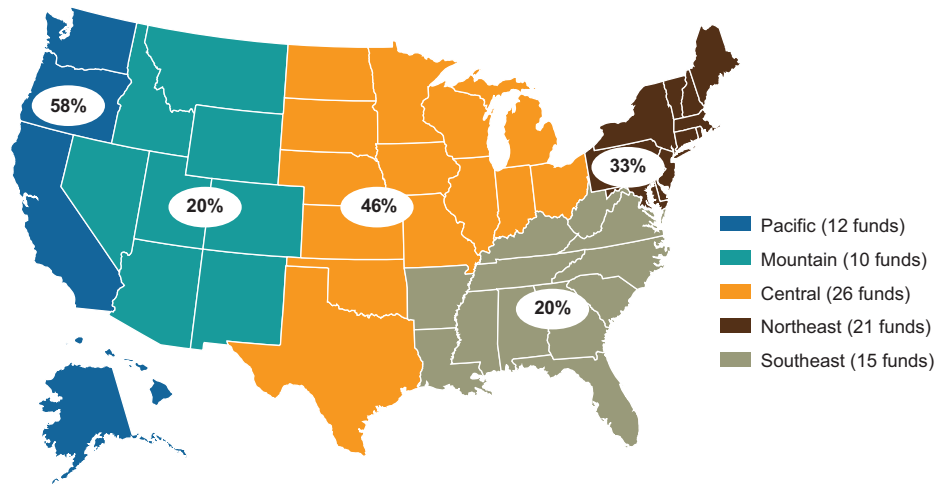


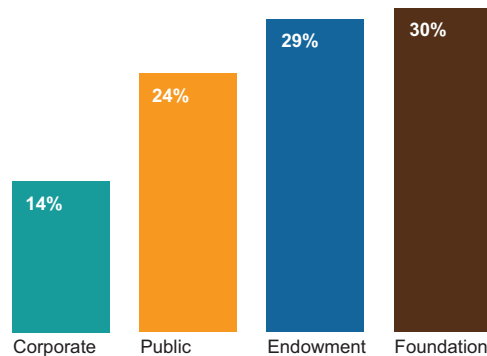
Exhibit 6
All Respondents

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



Exhibit 7
By Fund Type

Respondents that are considering incorporating ESG into investment decisions



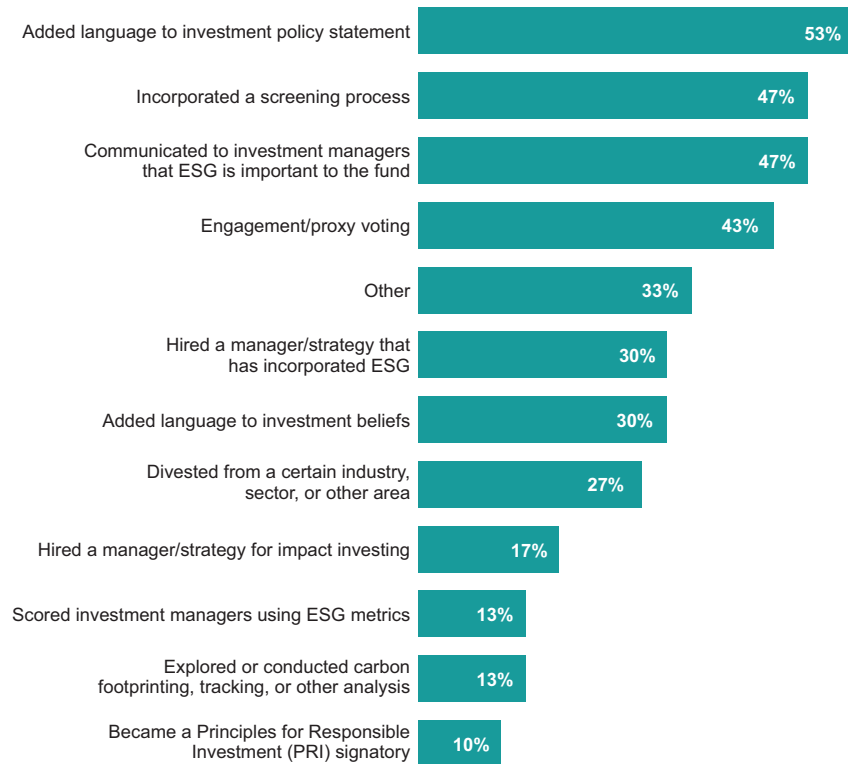
Implementation

In 2016, for the first time Callan asked investors that have incorporated ESG factors into investment decisions specifically how they had done so. The top implementation method for survey respondents was to add language to the investment policy statement (53%). Callan finds that adding language to investment beliefs or policy statements is frequently a first step that many institutional investors take when pursuing an integrated approach to incorporating ESG factors in investment decisions.

The next most prevalent implementations are to incorporate a screening process and to communicate to investment managers that ESG is important to the fund (47% each). A negative screening process can be put into place to address a specific issue (e.g., screen out investments related to tobacco or fossil fuels), but positive screening is also becoming more prevalent (e.g., screen to include only securities that have best practices in a specific sector). Engagement/proxy voting ranked fourth with 43% of investors utilizing this method. Only 10% of respondents indicated they became a Principles for Responsible Investment (PRI) signatory; this global initiative tends to be more prevalent with investment management firms operating in the U.S. Callan's 2016 survey of investment managers revealed 40% had signed the PRI.¹

Exhibit 8

How has your fund implemented the incorporation of ESG factors into the investment decision making process?



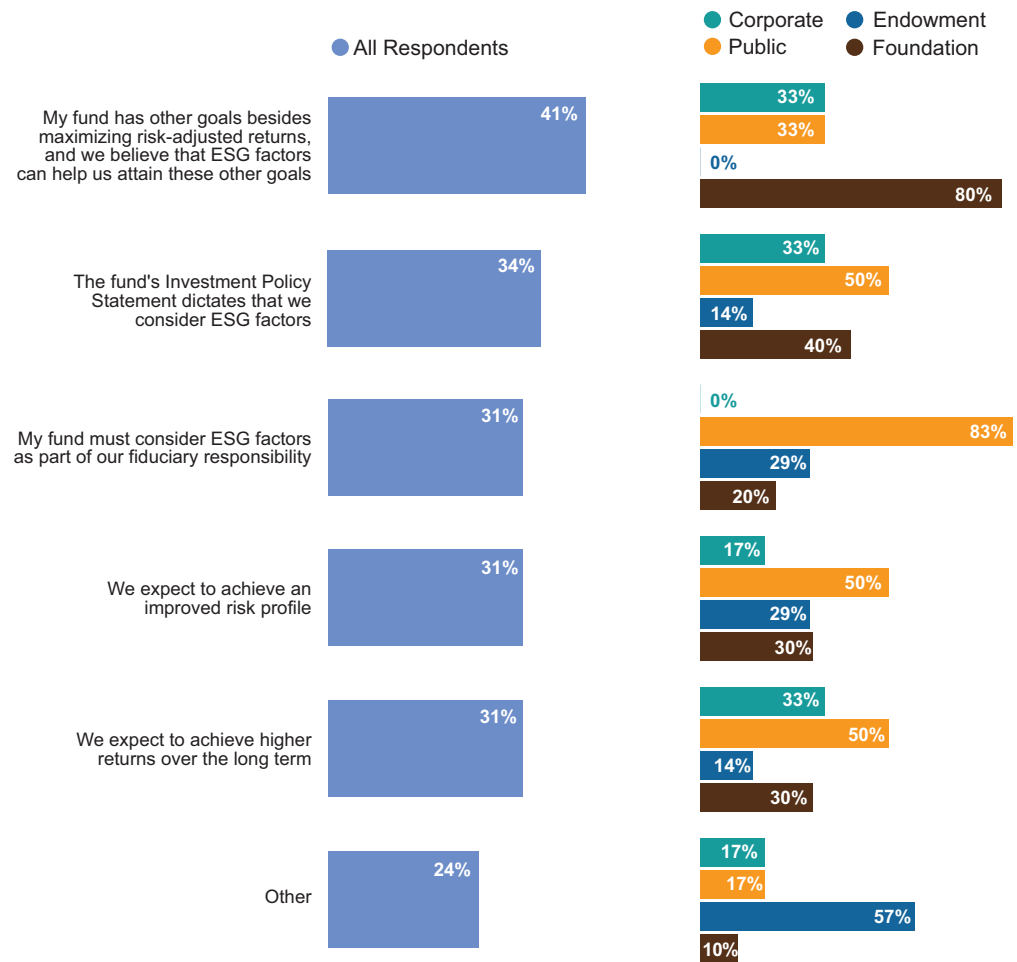
¹ *Asset Managers and ESG: Sensing Opportunity, Bigger Firms Lead the Charge*. Callan. June 2016.

Reasons to Use ESG Factors

Exhibit 9 shows motivations for incorporating ESG into investment decision making. The order of these factors has changed little over the past two years, and the top reasons cited for incorporating ESG factors into investment decisions remain: “My fund has other goals besides maximizing risk-adjusted returns, and we believe that ESG factors can help us attain these other goals” (41%) and “The fund’s Investment Policy Statement dictates that we consider ESG factors” (34%). Nearly one-third of respondents indicate they expect to achieve higher returns (31%) and an improved risk profile (31%), or that their fund must consider ESG factors as part of their fiduciary responsibility (31%).

Exhibit 9

Why has your fund incorporated ESG factors into investment decisions?



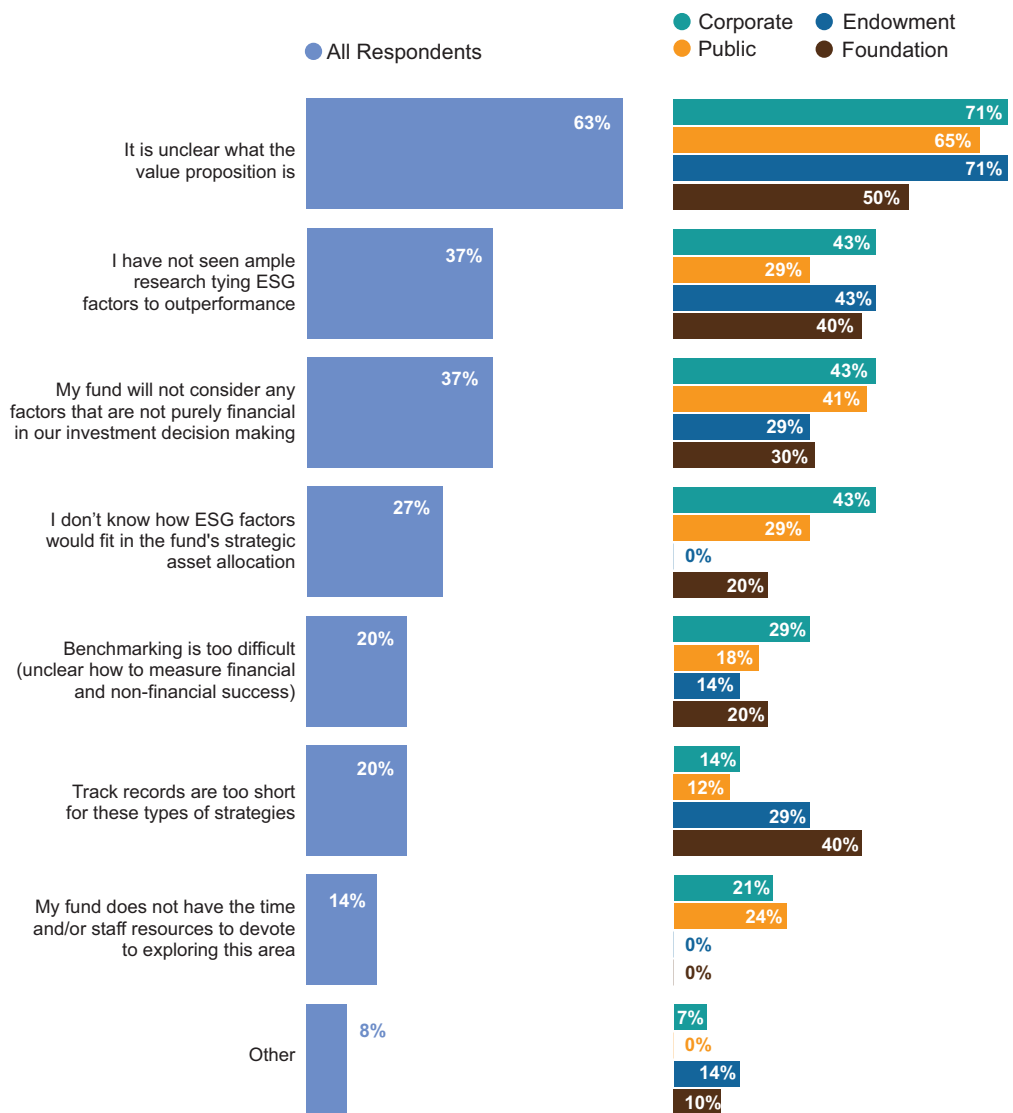
Multiple responses allowed. Other responses include: to maximize endowment contributions; to address political factors/risk; faith-based motivation; sustainability is part of the long-term investor's considerations; and alignment with mission.

Reasons Not to Use ESG Factors

More than half (60%) of U.S. institutional investors that responded to our survey have not incorporated ESG factors into investment decision making, down from 78% in 2013 (Exhibit 3). The main reasons remain unchanged relative to two years ago and include: ESG's value proposition is unclear (63%), a dearth of research tying ESG factors to outperformance (37%), and a perceived disconnect between ESG factors and financial outcomes (37%) (Exhibit 10). Compared to other fund types, fewer foundations cite an unclear value proposition (50%) as a reason to not incorporate ESG factors.

Exhibit 10

Why has your fund NOT incorporated ESG factors into investment decisions?



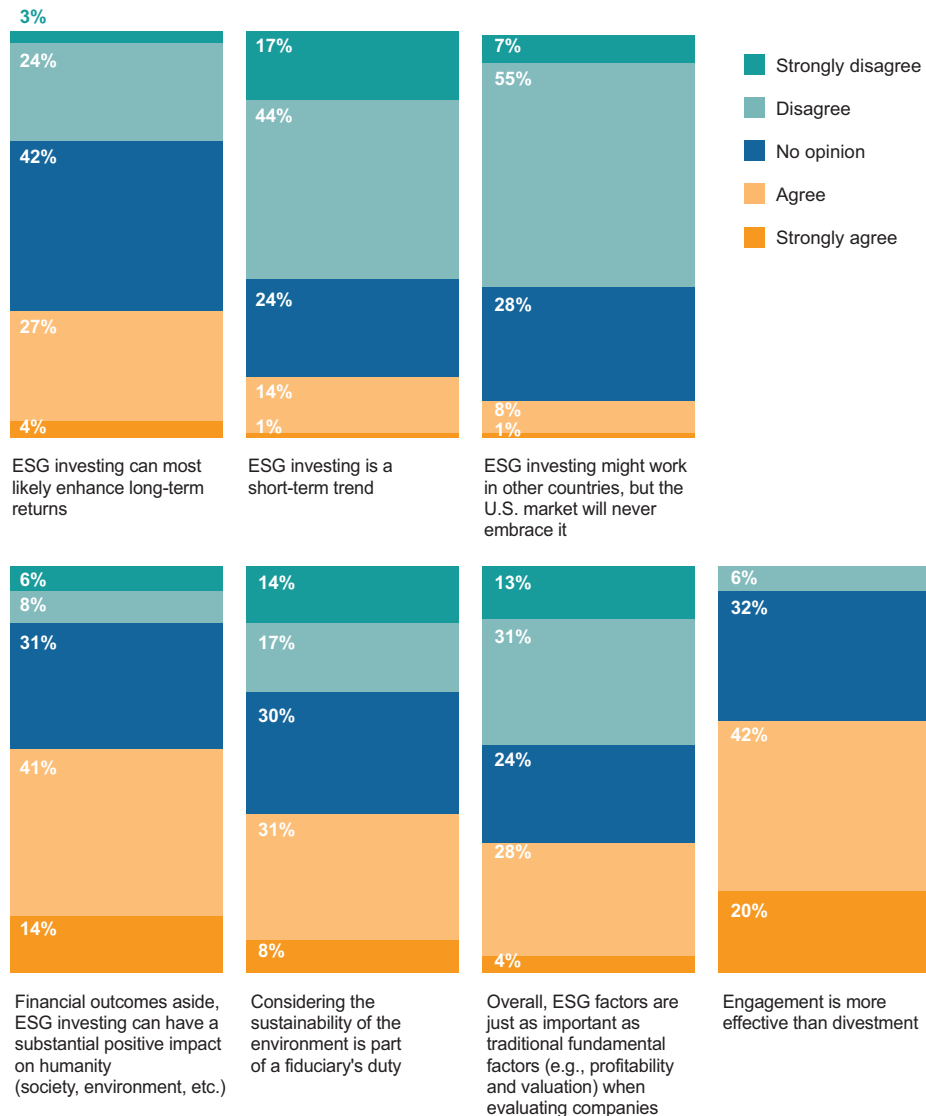
Multiple responses allowed. Other includes: not a board mandate; we consider many factors, but we don't explicitly label/discuss ESG as a separate subject; we found there is no excess performance, and choose not to limit our investment opportunity set; our committee believes their responsibility is to maximize return given an acceptable level of risk.

Personal Views on ESG

Personal views around ESG have changed little over the last several years. Asked to rank a number of statements according to their personal opinions, respondents agree most on the concept that engagement is more effective than divestment (**Exhibit 11**). Just over half of respondents (55%) also support the idea (agree or strongly agree) that ESG investing can have a substantial positive impact on humanity. Respondents are roughly split into thirds around whether considering the sustainability of the environment is part of a fiduciary's duty: a larger percentage agree with this statement (39%) than disagree (31%) and the remaining 30% have no opinion. Respondents most strongly disagree that ESG investing is a short-term trend or that it will never be embraced by the U.S. market. Overall, opinions about ESG appear to be

Exhibit 11
All Respondents

Rank the following statements on a scale of 1 to 5 (1=strongly disagree, 5=strongly agree) to reflect your personal views:



crystallizing; in 2015, 40% or more respondents indicated “no opinion” on three statements while in 2016, the only statement that did not elicit an opinion from more than 40% of respondents was: ESG investing can most likely enhance long-term returns. This suggests that industry educational efforts are helping inform investors about the facts needed to form thoughtful opinions about the issues.

Conclusion

While most U.S.-based institutional investors have not yet incorporated ESG factors into decision making, steadily increasing rates of usage and changing viewpoints suggest the movement to consider ESG is gaining traction. Since Callan began conducting this annual survey in 2013, ESG adoption has been most prevalent in endowments (from 22% in 2013 to 53% in 2016) and foundations (from 31% in 2013 to 48% in 2016). While public funds saw a material increase in usage in 2014 and 2015, adoption leveled off from 2015-2016 at around one-quarter of public funds. Alternately, corporate funds' incorporation rate of ESG factors surged in the past year, doubling from 15% to 30% in 2016, after previously showing little annual change. In October 2015, the Department of Labor issued a bulletin clarifying that investments that consider ESG factors can be in line with a fiduciary's duty provided they meet the same risk and return standards that other investments adhere to.²

ESG issues have received much attention in the last year. Climate change, fossil fuel-free investing, and the Department of Labor's Interpretive Bulletin are a few examples of issues that have occupied investors' minds and been covered by the press. Should trends in Callan's ESG survey continue, we can expect to see more attention to these issues and others related to ESG in the future.

² See Callan's white paper "[The Department of Labor Weighs in on ESG: Key Takeaways from Interpretive Bulletin 2015-01.](#)" November 2015.



About the Author

Anna S. West is a Senior Vice President dedicated to Callan's research and education initiatives. As 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. She also oversees the educational content presented at Callan Investments Institute workshops and conferences. 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 and is chair of the Published Research Committee. Anna joined Callan in August 2006 and is a shareholder of the firm. Prior to Callan, she worked for Vail Resorts, Inc. She is a member of Denver University's Department of Business Information and Analytics Advisory Board, where she aids in maintaining a curriculum that aligns with current industry needs and anticipates future trends. Anna earned an MBA from the University of San Francisco and a BA in International Business and French from Washington University.

For more information about this report, please contact:

Your Callan consultant or institute@callan.com

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 uniquely backed by proprietary research, exclusive data, ongoing education, and decision support. Today, Callan advises on \$2 trillion in total assets, which makes us among the largest independently owned investment consulting firms in the U.S. We use a client-focused consulting model to serve public and private pension plan sponsors, endowments, foundations, operating funds, smaller investment consulting firms, investment managers, and financial intermediaries. For more information, please visit www.callan.com.

About the Callan Investments 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.

© 2016 Callan Associates Inc.

Certain information herein has been compiled by Callan and is based on information provided by a variety of sources believed to be reliable for which Callan has not necessarily verified the accuracy or completeness of or updated. This report is for informational purposes only and should not be construed as legal or tax advice on any matter. Any investment decision you make on the basis of this report is your sole responsibility. You should consult with legal and tax advisers before applying any of this information to your particular situation. Reference in this report to any product, service, or entity should not be construed as a recommendation, approval, affiliation, or endorsement of such product, service or entity by Callan. Past performance is no guarantee of future results. This report may consist of statements of opinion, which are made as of the date they are expressed and are not statements of fact. The Callan Institute (the "Institute") is, and will be, the sole owner and copyright holder of all material prepared or developed by the Institute. No party has the right to reproduce, revise, resell, disseminate externally, disseminate to subsidiaries or parents, or post on internal web sites any part of any material prepared or developed by the Institute, without the Institute's permission. Institute clients only have the right to utilize such material internally in their business.

Callan

Corporate Headquarters

Callan Associates
600 Montgomery Street
Suite 800
San Francisco, CA 94111
800.227.3288
415.974.5060

www.callan.com

Regional Offices

Atlanta
800.522.9782

Chicago
800.999.3536

Denver
855.864.3377

New Jersey
800.274.5878

 @CallanAssoc

 Callan Associates