ECONOMY POLITICS COMMENTARY

The Real Reason That Vanguard Settled

Stephen Soukup | Allen Mendenhall March 20, 2026

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When Vanguard Group announced that it would settle its portion of a lawsuit brought by 13 state attorneys general, opponents of "Environmental, Social, and Governance" (ESG) declared victory. And they weren't wrong.

The suit, led by Texas AG Ken Paxton, accused Vanguard, BlackRock, and State Street of conspiring to push green-energy initiatives through their coal-company holdings, allegedly raising electricity prices for consumers.

"A huge win in the fight to stop … ESG," "incredible news"—the celebrations came quickly.

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The damage done to the ESG cause is significant, and the celebration is justified. But it may also be premature—and for reasons that have nothing to do with ESG. The more important question is one that almost nobody is asking: Why, exactly, did Vanguard settle?

The firm says it settled "solely for the purpose of avoiding the burden and expense of litigation"—standard lawyer-speak for "we want you to leave us alone, but we can't admit wrongdoing." While it's almost certainly the case that Vanguard wanted to avoid extended legal action and the associated expenses, the idea that the settlement was reached "solely" for that purpose strains credulity.

After all, the firm agreed not only to pay almost $30 million in fines but also to turn over communications related to its ESG activities—a massive, potentially embarrassing and costly concession. The true "costs" of letting this case reach trial, in other words, must have far exceeded the mere "burden and expense of litigati

English

Vanguard is not the same as the other two members of the Big Three and is *profoundly* different from BlackRock in particular. BlackRock may be the biggest asset manager in the world, with more than $14 trillion in assets under management, but Vanguard is, by far, the biggest manager of *passive* assets. Of its total of $12 trillion in AUM, *almost all* is passively managed. By comparison, only 35%-40% ($5-$6 trillion) of BlackRock's assets are passively managed.

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While State Street is far more passive-focused than BlackRock, it is much smaller than Vanguard and is not entirely passive.

Vanguard is, put bluntly, the undisputed king of passive investing, controlling roughly half of the entire passive investment market that has been growing at a staggering clip. According to Morningstar, passive funds saw nearly 250% growth in AUM between 2014 and 2023, compared to 36% growth for active funds. In the United States, passive AUM surpassed active AUM last year, and growth continues apace.

Passive investing isn't just Vanguard's business model. It *is* Vanguard. That's what was at stake.

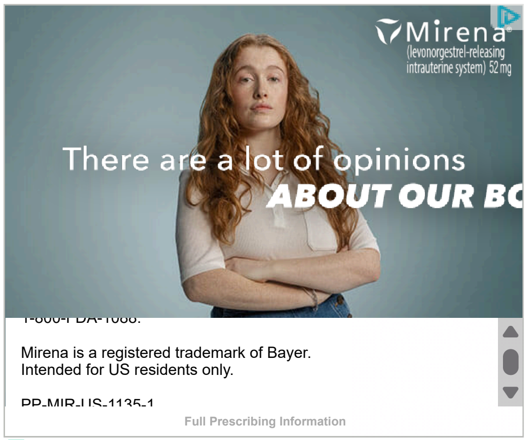
About a year ago, Denise Hearn and Cynthia Hanawalt, two climate investment researchers at Columbia University, published a paper noting that a trial in this case would provide the first legal test of the "common ownership theory," which posits that index investing—in which managers hold multiple companies in the same sector—creates incentives to reduce or eliminate competition between the companies, resulting in a slowdown or stoppage in innovation, artificially inflated prices, reduced output, etc. Hearn and Hanawalt argued that the case against the Big Three was flawed but could, at trial, produce unexpected results that would profoundly disrupt the asset management business.

English

Historically, the common ownership theory has been dismissed as ideologically tinged and is refuted specifically by an appeal to "passivity." Managers take no advantage of the competition-deadening incentives; they are mere inert observers. But that defense may be weaker than it appears, and this is where the story gets genuinely interesting.

We would argue that passivity actually has the opposite effect. Because it dulls the price-discovery mechanism, which traditionally enforces competitive behavior on corporations, passive investing creates the circumstances in which the structural incentives of common ownership—the dampening of competition in the interest of industry-wide profitability—can function without check or intent.

Active collusion between managers becomes unnecessary because the competitive dampening happens by default. As a result, passivity doesn't refute common ownership theory; it operationalizes it.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The implications are potentially staggering. Together, the common ownership theory and the theory that passivity operationalizes competitive dampening could undermine the last quarter-century of capital market growth and consolidation—and destroy the very idea that passive investing is an appropriate process for capitalizing business at all.

No single development in this case would have guaranteed that outcome. But none could have ruled it out, either. And if you happen to run a firm with $12 trillion in assets under management—virtually all of it passive, in a market still growing at breakneck speed—is that a chance you could afford to take?

That, likely, is why Vanguard settled.

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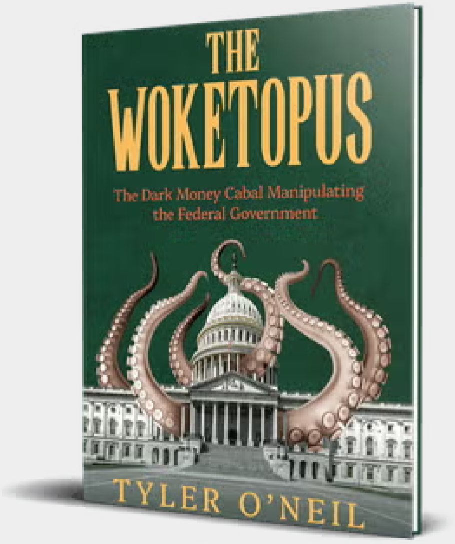
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