
Vanguard cites shunned founder Jack Bogle to deflect criticism after epic ESG flip-flop, extoling the founder's 'whole haystack' investing strategy versus finding the 'needle'

The Malvern, Pa. firm played the Bogle card amid an about-face on NZAM, which it joined 21 months ago with heavy hitters like BlackRock, to 'steward' client assets, but external GOP political pressures may have forced it to cave.

Author [Oisin Breen](#)

January 3, 2023 at 9:02 PM



 **1 Comment**



Scott Fitzpatrick: It's certainly possible that their decision to leave NZAM contributed to ... Vanguard

being excused from the
Texas ESG meeting.

Brooke's Note: Vanguard is the kind of company that used to make the news maybe twice a year. Now it is a man-bites-dog story time and time again. Each time the story's hook differs, but the common denominator stays consistent. The \$7-trillion asset manager is seeking a new identity from perfect but dull to mostly perfect but more exciting. It's a risk, as any kid knows who tries to ditch his nerdy friends for some cooler ones. Landmines lurk. Two hooks grabbed us to this intriguing story. Vanguard's withdrawal from NZAM was a big deal, but then we learned it got immediately excused from a grilling from Texas legislators born to BBQ. When we saw Vanguard reach for late and semi-estranged Jack Bogle's name in its long, convoluted explanation for its actions, we knew that it wished it had never left its nerdy refuge of vanilla index funds.

Vanguard Group's cold calculus to join an ESG group with BlackRock and State Street is now a hot mess after it flip-flopped, threw active management under the bus and perhaps jeopardized its relationships with “blue” states to appease “red” ones.

The Malvern, Pa., asset manager quit the [Net-Zero Asset Managers \(NZAM\) initiative](#), Dec. 7, some 21 months after it joined, causing an uproar in the ESG investing community.

The international group is committed to supporting net zero greenhouse gas emissions by 2050 or sooner.

Vanguard even invoked the wisdom of founder Jack Bogle to explain its decision.



Tim Buckley: Climate change represents a long-term, material risk to our investors' portfolios.

“In the words of our founder, Jack Bogle, rather than searching for the needle in the haystack, buy the whole haystack. It’s an approach that has helped build wealth for tens of millions of everyday investors,” [according to an](#) unsigned corporate statement.

Oddly, the company [quarreled with Bogle for decades](#), up until his death in 2019, as it parted ways with Bogle's “everyman” investment philosophy and plunged deeper into financial advice for wealthier clients. Bogle stepped down as CEO in 1996.

Net zero confusion

Vanguard declined RIABiz's request for further comment. Instead, it let the statement do the talking.

“Such industry initiatives can advance constructive dialogue, but sometimes they can also result in confusion about the views of individual investment firms,” it stated.

“That has been the case in this instance, particularly regarding the applicability of net zero approaches to the broadly diversified index funds favored by many Vanguard investors.”

In other words, you can't beat the market while cherry-picking. See: [After freemium-like beginnings, Vanguard Group is priming its \\$243-billion RIA as a profit engine with high-octane, higher risk, higher-margin proprietary funds, tempered by an 'opt-in' for investors](#)

Vanguard's decision to join NZAM was a strategic blunder from the start, according to Jeff DeMaso, editor of the Independent Vanguard Adviser.

“Whereas BlackRock has been clear and vocal when it comes to ESG, Vanguard [takes] a more neutral stance ... if you want ESG, here are some low-cost options, if you don't, here are some other[s],” he explains, via email.

“NZAM threatened their ability to provide that choice,” he adds.

Indeed, Vanguard's statement assures it still has the warming planet on its front burner.



Jeff DeMaso: NZAM threatened [Vanguard's] ability to provide [investor] choice.

“This change in NZAM membership status will not affect our commitment to helping our investors navigate the risks that climate change can pose to their long-term returns. We will continue to provide investors [with] the information and products they need to make sound investment choices, including products designed to meet net zero objectives.”

Concrete benefit

Indeed, critics say Vanguard's actions speak louder than its words.

At ESG's zenith of popularity in 2021, the company signed onto the NZAM initiative with firms like ESG leader BlackRock and 290 other signatories. Combined they oversee \$66 trillion in AUM.

But Vanguard was one of several firms to come under fire [in Texas](#), which barred state and local agencies in September from doing

business with Wall Street firms that avoided firearms and fossil fuel stocks -- two ESG non-starters.

BlackRock stuck to its ESG principals, but Vanguard dropped out as the growing political furor helped push ESG investing into the gutter in 2022.

“Vanguard got a very concrete benefit from their decision on NZAM,” says Andrew Besheer, director of wealth research at Aite-Novarica, a Boston consulting firm, via email.

By caving to Republican political and economic pressure, Vanguard is in line to pick up red state retirement assets -- and stay out of the dog house BlackRock lives in, sources say. See: [Texas just pronounced BlackRock guilty of pandering to sustainable investing interests -- and BlackRock is having none of it](#)



Wally Okby: Vanguard may become an 'unintentional' ESG champion.

Under stress

Still, the 180-degree shift on NZAM could be short-sighted. See: [Texas just pronounced BlackRock guilty of pandering to sustainable investing interests](#).

"While Vanguard [could] have the upper hand for red state retirement assets, that's likely to come at [the] cost [of] losing out on blue state retirement assets, and more ESG-friendly next generation clients," says Aite-Novarica ESG specialist Wally Okby, via email.

“ESG, as a set of standards, is under considerable stress from legislators ... [and will become] even more deeply embroiled in the culture wars ... regarding which way investor appetites tilt, versus what's politically correct,” he adds.



Bryan Hughes: The committee is encouraged by [Vanguard's] withdrawal.

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Republican-controlled “red” states withdrew at least [\\$3.3 billion](#) from BlackRock retirement funds in the last two months alone, due to the firm's pro-net-zero, anti-fossil-fuel stance. West Virginia was one of the first to do so last [January](#).

Fiduciary decision

Vanguard joined NZAM alongside BlackRock in [March 2021](#), four months after the organization's founding. State Street joined one month later.

Collectively, the three largest asset managers in the world manage an estimated \$18.5 trillion. Vanguard manages roughly \$7.2 trillion, State Street around \$3.3 trillion and BlackRock close to \$8 trillion, according to December figures.

When it joined NZAM, Vanguard chairman and CEO Tim Buckley said membership was a fiduciary decision to protect investors from long-term risk. Buckley also committed to supporting “net-zero emissions by 2050.”

“Climate change represents a long-term, material risk to our investors’ portfolios. As a steward of our clients’ assets, we recognize the crucial role we and others play,” he said in a [statement](#).

Today, ESG investments account for an estimated 13%, or \$8.4 trillion of all domestically managed assets, up from \$7.6 trillion in Jan. 2022, according to ESG research firm US SIF's annual Trends Report, released in December.



Zach Conway: [ESG] index funds face challenges during the construction process.

Drawing praise

Texas state senators last month grilled BlackRock, State Street and Institutional Shareholder Services over their investing practices tied to environmental, social and governance investing.

Vanguard was apparently able to dodge a subpoena for the hearing by dropping its NZAM affiliation -- and it got immediate positive reinforcement.

“It’s a good decision by Vanguard. I’m glad to see an industry leader de-prioritize virtue signaling and re-focus on fiduciary duty,” says Scott Fitzpatrick, the Republican State Treasurer of Missouri, via email.

“It’s certainly possible that their decision to leave NZAM contributed to ... Vanguard being excused from the Texas ESG meeting,” he adds.



John Schroder: [Vanguard] should stay

State Sen. Bryan
Hughes, Chair of the
Texas Senate
Committee on State

in their lane, and we'll
stay in ours.

Affairs, said Texas's decision to excuse the firm from its public ESG hearings was aided by Vanguard's withdrawal from NZAM.

"The committee is encouraged by your withdrawal . . . and by your stated desire to 'make clear that Vanguard speaks independently on matters of importance to [its] investors'," Hughes wrote in a recent letter to Vanguard.

Louisiana State Treasurer John Schroder hinted that the GOP intends to dial down the pressure on firms that steer clear of politics, too.

"I'm pleased to see these companies who want to be the political spokesman for our country take a check on their approach ... They should stay in their lane, and we'll stay in ours," he says, via email.

Trust issues

Republican lawmakers have also argued that by committing to investing only in net zero companies, asset managers could find themselves in antitrust hot-water.

In a [letter](#) released in August, 19 Republican state Attorneys General warned BlackRock that "coordinated conduct with other financial institutions to impose net-zero also raises antitrust concerns ... and runs counter to their fiduciary obligations."



Hortense Bioy:
Vanguard is a laggard in
the ESG space.

"Group boycotts, restraining trade, or concerted refusals to deal, 'clearly run afoul of' Section 1 of the Sherman Act, [which] prohibits '[e]very . . . combination . . . , or conspiracy, in restraint of trade or commerce,'" the Attorneys General wrote.

It's a credible argument, given NZAM, by necessity, involves shared commitment, according to Ari Sonneberg, partner at the Wagner Law Firm in Boston.

"The collusion of the country's major asset managers to essentially boycott certain companies and ... effect the way major corporations behave in order not to be excluded from major investment funds ... there seems to be an antitrust argument to be made there," he explains, via email.



Ari Sonnenberg: An
antitrust argument can
be made.

“Should Vanguard’s funds, [for instance], experience losses that could be attributed to a change in investment strategy focused on a charge to net-zero instead of a focus on returns, you can be sure lawsuits would emerge,” he adds.

'Welcome' news?

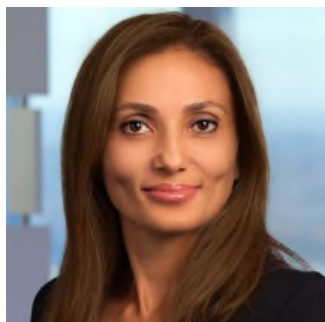
[The Wall Street Journal](#) also lauded Vanguard's NZAM exit, in a December editorial, calling it "welcome news" against a leftist bid to “conscript private capital to drive the left’s climate goals.”

"[NZAM] punish[es] companies that don't adopt the climate lobby's net-zero goals. By its very terms, the initiative would require asset managers to sell their

fossil-fuel holdings," the editorial states.



Kirsten Spalding: It's unfortunate that political pressure is impacting this crucial economic imperative.



Dahlia Blass: We have one bias: to get the best risk-adjusted returns.

Yet, politics ought not trump existential concerns, according to Kirsten Spalding, vice president of NZAM founding partner, Ceres Investor Network.

“It’s unfortunate that political pressure is impacting this crucial economic imperative and attempting to block companies from effectively managing [climate] risks,” she says, via email.

“But until we reach a Star Trek era, self-interest [beats] collectivist fiduciary action,” adds Scott Smith, director of advice relationships at Boston consultancy Cerulli Associates.

“I’m sure [Roman General and conqueror of Britain] Agricola had no doubt that Roman lumber needs took precedent over the future of woodlands,” he quips via email.

Winter chill

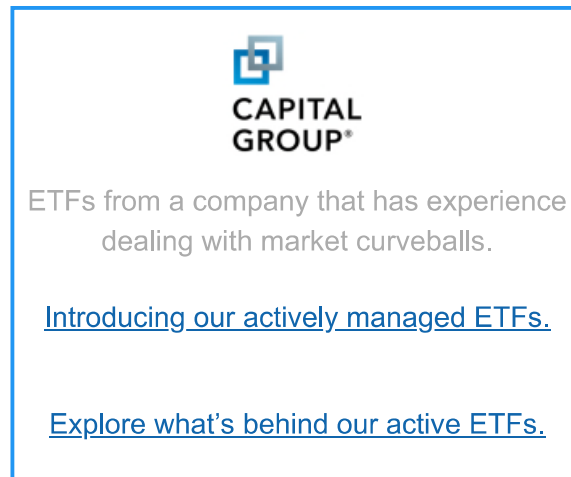
Republican pressure over ESG has also had a chilling effect on the wider asset management industry.

A recent meeting of the International Sustainability Standards Board's Investment Advisory Group, which includes BlackRock and Goldman Sachs, only went ahead after a lawyer formally read out a disclaimer stating the group is not a cartel, Bloomberg [reports](#).

State Street and BlackRock, which declined to comment on the record, also declined to commit to NZAM for the long haul.

“We can’t comment on hypothetical situations ... [but] we are still a member,” says State Street spokesman Randall Jensen, via email.

BlackRock recently dialled back on some of its stronger ESG statements. But its head of external affairs, Dalia Blass, knocked back the suggestion that its judgment was clouded by its “woke” approach of incorporating climate risk as a fiduciary issue. See: [BlackRock to curb ESG proposals](#).



“We have one bias, to get the best risk-adjusted returns for our clients,” she told the Dec. 15 Texas panel.

NZAM founding members The Investor Group on Climate Change, and Wellington Asset Management, which manages approximately \$400 million on behalf of Vanguard, did not respond to a request for comment.

US SIF, and ESG RIA First Affirmative, recently spun out of Goldman Sachs after Goldman's acquisition of Folio Financial, both declined a request for comment.

One voice

Mass market indexing and ESG certainly make strange bedfellows, says Zach Conway, founder and CEO of ESG direct indexing start-up Seeds Investor, via email.

“Index funds face challenges during the construction process when it comes to implementing what are widely considered ESG metrics and data. By design, a traditional oil and gas allocation must be included to track the broad market,” he explains.

Vanguard's decision to curry favour with Republicans by pulling out of NZAM also reflects its general attitude toward ESG -- an approach it has, more often than not, preferred lip service, rather than putting in the hard yards, sources say.



Scott Smith: Agricola



Daniel Wiener:
Vanguard's foray into
the ESG sphere was
marketing driven.

"It's not surprising that Vanguard quit NZAM. Vanguard is a laggard in the ESG space, and Morningstar rates it as such," says Hortense Bioy, director for sustainability research at Morningstar, via email.

had no doubt that Roman lumber needs took precedent.

"Eighteen months after signing the initiative, Vanguard was still unable to commit any of its in-house managed assets, which I believe put the firm in an uncomfortable situation, especially when compared with BlackRock, which committed 77% of its assets," she adds.

Indeed, Vanguard's commitment was only ever a marketing stance, says Daniel Wiener, chairman of Newton, Mass. RIA Adviser Investments, and co-founder of the [Independent Vanguard Adviser](#)

news brief, via email.

"Vanguard's foray into the ESG sphere was marketing driven. As the winds have changed direction, so has [Vanguard]," he argues.

"While [CEO] Larry Fink speaks for BlackRock, Vanguard lacks an ESG spokesperson of any gravitas. They don't even have a quote from anyone [in the NZAM] [statement](#)," he concludes.

Split the difference

As the two largest asset managers in the world, with stakes in a huge number of systemically important global businesses, Vanguard and BlackRock's voices and attitudes matter. See: [Suddenly Vanguard, BlackRock, State Street not only have the assets but the power of ESG mandates.](#)

Fink, and BlackRock spokespeople more generally, have repeatedly explained that the firm views climate risk as a fiduciary issue. Pressuring major polluters to reduce emissions through proxy votes and investment choices is, therefore, an obligation.

"Blackrock's methodology is more forward-looking and aspirational," says Bioy.

Vanguard, however, sees managing climate risk as a personal investment decision that it should facilitate, but not at the expense of investors who want to invest in fossil fuels, according to four industry observers.



Andrew Besheer:
Vanguard got a very
concrete benefit.

Vanguard is also not the first firm to get cold feet over NZAM, according to Bloomberg.

JPMorgan, Bank of America, and Morgan Stanley previously mulled leaving NZAM over its backing of a demand for hard-and-fast reductions in support for coal use as a prerequisite for membership, [Bloomberg reports](#).

Unintentional champion

Ironically, however, Vanguard may one day become the most fervent ESG devotee, whether it wants to be or not, says Okby.

"If or when investor flows turn in favor of sustainable investments, so too will the indices that track them. In these scenarios, Vanguard may become an 'unintentional' ESG champion," he explains.

Between 2020 and July 2022, the leading ESG issue raised by asset managers in proxy votes was fair workplace practices, including efforts to ensure no race, ethnicity, or sex-based discrimination existed in the workplace, according to US SIF data.

Corporate political activity and climate change came a "close" second, the research firm reports.

Texas Comptroller Glenn Hagar, Utah State Treasurer Marlo Oaks, Arkansas Treasurer, Dennis Milligan, and North Carolina State Treasurer, Dale Folwell, all of whose states have withdrawn assets from BlackRock funds, all failed to respond to a request for comment.

Dublin-native and Edinburgh-based Oisín Breen has spent seven years writing about finance, including five whirlwind years diving into the advisor world for RIABiz. A widely published and well regarded poet with two full collections under his belt, Breen is also an academic in English Literature with a deep fondness for his Scottish rabbit, Hessel. [@Breen](#)

Brooke Southall and Keith Girard contributed to the editing of this article.

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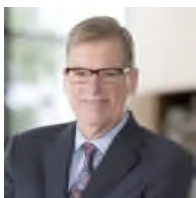
August 8, 2022 at 9:57 PM



Vanguard Group shows up as 'alpha' disciple with two new fixed-income fund launches as it surpasses PIMCO's \$2 trillion with ex-Goldman Sachs partner now calling the shots

The \$8 trillion Malvern, Pa. manager owns beta investing, but RIAs are demanding higher income -- hence market timing and cherry picking -- from their fixed-income allocation.

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RIA recap: Bernie Clark promises to 'be there' for coming TDA-Schwab system snafus; Fidelity gets custody win; Vanguard dishes out big tax bill to investors

Schwab RIA chief petitions for 'patience' for coming merger inconveniences but 'repapering' is no culprit; Carrie Pomerantz gets Schwab board seat; Addepar wins \$65 billion AUM contract.

November 9, 2022 at 10:50 PM



Jason Wenk raises \$50 million from Vanguard Group and others, and Altruist may soon overtake Pershing's No. 3 RIA custodian spot, the Altruist founder asserts

The Los Angeles founder's disruption blitz involves a mobile-first Robinhood feel and a plug-and-play outsourcing one-stop-shop -- a sweet combination, except that it may not lure many big RIAs, analysts say.

May 19, 2021 at 11:22 PM

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 (1) COMMENTS



Brian Murphy

January 4, 2023 — 12:10 AM

As I've previously stated, ESG investing is a "meme", meant to increase profit margins under the guise of "doing good". Like all "meme's" it starts out as a fringe idea or a swell in the ocean, gathers a cult following, then morphs into a "sub-industry" that takes on a life of its own (a tidal wave) - new firms that aim to steer the zeitgeist, analytic providers hell-bent on categorizing ESG-zyness of each publicly traded entity, index providers, etc. Successful investment memes (like indexing) make sense from both the investor and advisor perspective and can be long-lasting and change the industry. But memes that don't work from both the investor and advisor side of things collapse of their own weight. When recognized they fall far quicker than they grew, leaving firms grappling with when to cut the cord. IMO, Vanguard's decision signals the apex.

> POST A COMMENT

Suddenly Vanguard, BlackRock, State Street not only have the assets but the power of ESG mandates, which make them a growing threat to shareholder democracy, critics say

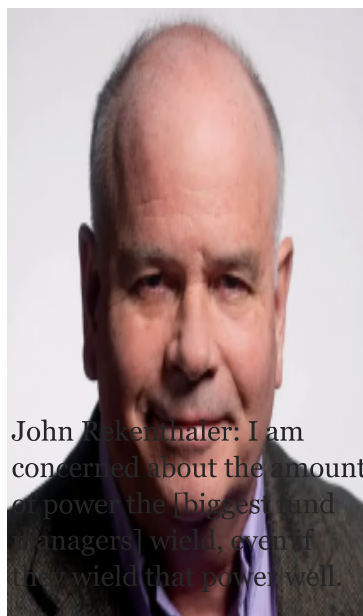
A handful of super-charged fund managers control \$34 trillion of assets and most of the ESG inflows, giving them 'carte blanche' to shape corporate policies.

Author [Oisin Breen](#)

July 28, 2021 at 6:35 PM



 **5 Comments**



John R. Kenenthaler: I am concerned about the amount of power the [biggest and managers] wield, even if they wield that power well.

The embrace of ESG by an ETF power bloc of BlackRock, Vanguard Group, Fidelity Investments, Capital Group and State Street may augur a dark future where they hold the power to sway shareholder votes, according to RIAs, fund trackers, hedge funds and ESG advocates alike.

The rising chorus of critics say the elite exchange-traded-fund producers from Boston, New York, Philly and Los Angeles pose a rising threat to "shareholder democracy" -- albeit because the power has been thrust upon



Vincent Deluard:
Shareholder democracy will
not work as intended.

them.

Investors and advisors have not only funneled their assets to the ETF elite for the past decade but also made them all powerful by giving *carte blanche* to deploy Environmental, Social and Governance (ESG) filters that would freeze out scores of companies.

But now American investors need to be careful about what they asked for, says Vincent Deluard, global macro strategist at New York City brokerage, StoneX.

"It doesn't matter whether it's Vanguard, BlackRock, Fidelity or the California Public Employees Retirement System; if two or three investors control 20% to 40% of the vote of every US company, shareholder democracy will not work as intended," he says, via email.

Between them, the big five manage \$27.7 trillion in client assets globally, and administer over \$34 trillion. In US equities alone, the grouping manages \$15.07 trillion, or 61.89% of all assets held in US equity funds, according to Morningstar Direct.

Kingmakers

Indeed, one veteran Morningstar voice is troubled by the potential implications of placing so much power in the hands of so few, warning that their growing stranglehold on US equity funds will hand them a de-facto veto on all major corporate decisions by 2040.

"I'm concerned about the amount of power they wield, even if they wield that power well. If the sales trend over the past decade continues, then the 35% [cumulative voting] position will occur circa 2040," says Morningstar vice president for research, John Rekenthaler, via email.

"[Then they] truly would be kingmakers. Unless a proposal is so wildly unpopular as not to attract even a 15% vote from remaining shareholders, [they] could ensure the initiative passes."

"Conversely ... they could effectively shut down almost any activist activities," he adds, in a June 7 [Op-ed](#).

BlackRock and SSGA signaled a willingness to comment on these raised concerns but ultimately declined. Vanguard did not respond to a request for comment.



Peter Krull: 'I simply don't trust them, or their motives.'

Rekenthaler says what triggered the alarm was Vanguard, BlackRock and SSGA's early June decision to combine forces to topple a quarter of the Exxon Mobil board.

The trio acted in support of a bid by tiny activist ETF vendor Engine No. 1 to stack the oil giant's board with pro-ESG candidates.

The ETF group surely had a positive motive.

Much of the ESG movement opposes fossil fuel companies that seek to maximize profits based on selling polluting products to customers who pump tons of carbon dioxide-- a greenhouse gas-- into the atmosphere.

"This topic wasn't on my radar when the biggest fund managers ... endorsed the status quo. I paid greater attention after the ExxonMobil vote," says Rekenthaler.

"The issue for me isn't how [this] big three voted, but my belated realization of what power they now possess," he explains.

That's no outlier, [reports The Telegraph](#).

"BlackRock voted against 255 board directors at companies including Warren Buffett's Berkshire Hathaway and oil and gas firm Exxon Mobil in the year to June 30, because they failed to act on climate issues," it wrote. "This is more than four times the 55 executives it rejected the year before."

Double edged sword

ESG advocates are also wary of that the power of big asset managers. They see it as a double-edged sword that, indeed, cuts both ways.

"I personally don't want Blackrock, Vanguard and SSGA to be the ultimate arbiters of proxy proposals, because I simply don't trust them or their motives," says Peter Krull, CEO of Asheville,

N.C., RIA, Earth Equity Advisors, with \$145 million of AUM.

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"Worst case scenario is that the big three suddenly turn their backs on any sort of positive ESG voting," he adds, via email.

Indeed, even today the record of major fund managers in proxy votes shows that more often than not they effectively block pro-ESG initiatives, according to a Morningstar [report](#).

In 2020, BlackRock funds, for instance, voted in favor of just 16% of ESG proposals put forward, and Vanguard backed just one-in-four,

Overall, Vanguard manages \$7.9 trillion globally, BlackRock \$9.5 trillion, SSGA \$3.9 trillion and Capital Group \$2.3 trillion. Fidelity administers \$10.4 trillion and manages \$4.1 trillion.

In US equity funds alone, Vanguard manages \$6.8 trillion, BlackRock \$2.65 trillion, Fidelity \$2.4 trillion, American Funds \$2.2 trillion and SSGA \$970 billion, according to Morningstar Direct.

Inevitable outcome

The rise of a corporate control of millions of proxy votes on behalf of investors in pursuit of their own agendas was inevitable, according to Joshua Levin, co-founder and chief strategy officer of the now JP Morgan-owned direct indexer OpenInvest.

"The problem is not passive managers, active managers, or consumers. The problem is a paper-based legacy system that favored corporatism.

"This system was already heavily consolidated in favor of corporate managers [and] it is largely paid for by corporations ... [who] have enjoyed nearly impenetrable board voting power as a result," he says, via email.

"What's happening now is that indexing consolidation is shifting some of that power from corporations to asset managers, and people are concerned. But I expect that index manager proxy



power is a temporary way point," he adds. See: [As part of sale to J.P. Morgan, OpenInvest is orphaning RIA clients.](#)

Joshua Levin: There are significant concerns around principal engagement, conflicts of interest, and monumental voting blocs

Waypoint, or not, a raft of industry figures now assert that growing pressure to back 'ethical' shareholder resolutions in proxy votes has handed fund giants a license to use their increasingly decisive voting powers as they see fit, albeit wrapped in an ESG mandate.

Significant concerns

In recent years, activist groups including the Sierra Club have lobbied hard to compel asset managers to support shareholder resolutions favoring the aims of the surging "ethical" ESG movement. See: [Sierra Club slams Larry Fink's 'lip-service' to green future.](#)

Fund vendors, as a result, have begun to highlight their ESG credentials. Indeed, BlackRock CEO Larry Fink recently described what he saw as a "[tectonic shift](#)"

toward ESG.

ESG lobbyists also have surging ESG asset growth to boost their ambitions.

In the last year, the value of domestic ESG fund investments more than doubled, up 123% year-over-year, to \$266 billion, as of March, 2021, according to Morningstar Direct.

Indeed, since March, US ESG fund assets jumped another 14%, to \$304 billion, including \$17.5 billion of net inflows, according to the latest July Morningstar [report](#).

An estimated [33% of the roughly \\$51.4 trillion](#) in domestic managed assets are also held in sustainable investments, CNBC reports.

RIAs have also come under pressure from ESG lobbyists to take a more active role in convincing their clients to invest in ESG funds. See: [RIAs are just not that into ESG investing -- at their peril, a new study says.](#)

For years, however, the shoe was on the other foot.

"There are significant concerns around principal engagement, conflicts of interest and monumental voting blocs that historically defaulted to management positions," he explains.

Yet the more asset managers get proactive about pushing an agenda during corporate proxy votes, the more corporate decision-making becomes contingent on the caprice of a small group, according to Levin.

"Rekenthaler [was] right to call out potentially concerning levels of control over shareholder voting

from the big index managers," he says.

Threat to free enterprise

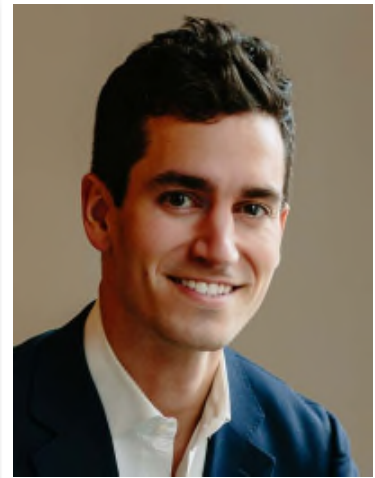
All of the big five fund companies have backed pro-ESG shareholder resolutions in recent years.

In June 2020, Vanguard backed resolutions to cut carbon emissions at

United Parcel Service, J.B. Hunt Transport Services and oil driller Ovintiv. Later in the year, BlackRock [pledged to back](#) an increasing number of ESG resolutions in corporate voting, and

Backing ESG resolutions is increasingly good for business, too, as ESG funds grow in popularity. It also contributes to a company's corporate social responsibility agenda.

Yet Engine No. 1's plucky campaign to put four of its own candidates on Exxon Mobil's board has focused several industry minds on the possibility that the concentrated voting power of halo wearing ETF makers could pose a threat to the free enterprise system.



Michael O'Leary:
[Investors] can't be
expected to cast ten
thousand ballots themselves

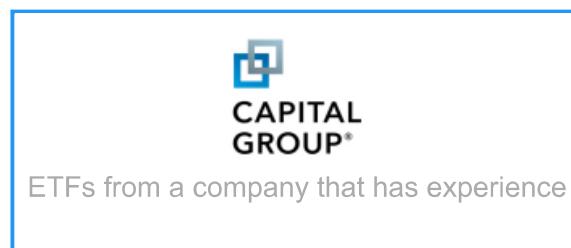
The mouse that roared

Founded last year by a consortium of private equity investors--Goldman Sachs, BlackRock, and Bain Capital alumni--Engine No. 1, began targeting Exxon in Dec. 2020.

Three of its four candidates now sit on the Exxon board, despite the fact that Exxon outspent its campaign by a factor of ten. Indeed, Engine No. 1 only achieved its goal as a result of Vanguard, BlackRock and SSGA's decision to back the company's bid as a bloc.

In doing so, the three firms demonstrated that they hold the balance of power, even at a company as individually powerful as Exxon, which has a market capitalization of \$243.75 billion.

Today, Vanguard, BlackRock and SSGA, alone, control a minimum 43.47% of the domestic fund industry's holdings in US-listed companies, and they have posted the highest net new US equity ETF and mutual fund sales, according to Morningstar Direct.



dealing with market curveballs.

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Engine No.1 launched its first ETF (VOTE), Jun. 22. VOTE tracks the Morningstar US Large Cap index, and the company has pledged to push ESG resolutions across the companies it invests in.

New York City robo-advisor Betterment also just rebalanced its ESG portfolios to include VOTE.

Fifty years out of date

The concentration of corporate voting power among fund vendors hinges specifically on the fact that ETFs and mutual funds disintermediate investors from the stock they hold, leaving the job of buying and selling to expert traders.

Now, as a result of the massive surge in popularity of "set-and-forget" index ETFs in the wake of the last financial crisis, the largest asset managers are responsible for the proxy votes of millions of shareholders.

It's a problem that needs to be solved, says Michael O'Leary, managing director at Engine No. 1, via email.

"Disintermediated voting is a great solution for the way people invested fifty years ago before the advent of index investing. Today, many investors hold hundreds or thousands of stocks through index funds. They can't be expected to cast ten thousand ballots," he explains.

The system worked, when no one paid attention, adds Levin.

"Proxy voting has traditionally been a perfunctory backwater, where large asset managers are mainly concerned with fiduciary compliance and operational ease. The common logic has been to default to management positions for those reasons, and no one looked askance," he explains.

System flaw

The systems built to manage proxy voting also weren't designed to handle the scale of today's fund industry, or the complexity of ESG, says Deluard

This leaves asset managers and the outsourcers they depend on underfunded and understaffed, he explains.

"Practically, BlackRock and Vanguard do not have the staff or the expertise to cover all the votes they are a part of, [so they also] rely on equally

understaffed and unaccountable proxy voting firms," he continues.

"[Proxy advisors] focus on 'low-cost/low-value voting', which doesn't require much research.

"They typically vote for independent directors, splitting the roles of CEO and board chairman, and against poison pills and multiple-class share structure[s] ... [which] may reduce governance risk but is unlikely to move the [ESG] needle," he says.

At one major proxy outsourcer, Institutional Shareholder Service, a team of some 270 global research analysts covers 40,000 shareholder meetings and an estimated 250,000 votes.

BlackRock, which [boasts](#) of having the "largest global stewardship team in the industry," employs roughly 50 staff over 85 voting markets.

It's good to be king

One solution floated by Levin, among others, is to use technology to strip voting power from fund vendors and hand it back to the individual investor, although some say the proposal is pie-in-the-sky.

"Exposing voting rights to individual investors is right around the corner. Rekenthaler points out the sheer volume of ballot measures. Yet to use a metaphor, while there is an overwhelming volume of songs I could choose from, this doesn't stop me from streaming music," Levin explains.

"Once there's sufficient consumer awareness, then there's a market to deploy the curation technologies that can make proxy voting a thrilling experience. I also expect financial advisors, influencers, and other intermediaries will play a big part of that on-platform curation," he adds.

Yet fund companies are unlikely to just hand over the power they've become used to holding, says Deluard.

"Why not develop tools which would allow motivated Gen-Z-ers and Millennials to vote via their Vanguard account or Robinhood app? My guess would be that Larry Fink would resist the idea."

"It's good to be king," he adds.

Dublin-native and Edinburgh-based Oisín Breen has spent seven years writing about finance, including five whirlwind years diving into the advisor world for RIABiz. A widely published and well regarded poet with two full collections under his belt, Breen is also an academic in English Literature with a deep fondness for his Scottish rabbit, Hessel. [@Breen](#)



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May 19, 2021 at 11:22 PM

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Perry E Gibbs

July 29, 2021 — 4:30 PM

Those who make the rules win the game, and the people are pawns of the game, the corporate way. Nothing personal, it's business!



Theguy

July 29, 2021 — 5:50 PM

Seems like every article assumes that ESG only looks at left wing issues... abortion, family values, gambling, porn, etc... never come up. Half of the investors would vote that way.



Karl McGaugh

August 16, 2021 — 10:09 AM

Great article! Yes, something needs to be done to limit this power but what? In my opinion, this began with the changes in the legal definition of a corporation. The limits were removed and now we have corporations owning other corporations. If this was outlawed then flesh & blood individuals would own as much as they want but corporations would be limited to their own stock. Competition would return to the market and individual investors would vote their conscience. This single change would solve every problem in this article and create vast new opportunities for investors. If Buffet wants to invest in a corporation he cannot be a corporation himself. And if he wants to be and private index fund he can not sell shares because he is not a corporation. He could sell his index picks as a research product but the selling of corporate bonds and shares are prohibited unless he is a corporation and if he becomes a corporation he is prohibited from buying shares in the companies in his index. This simple idea of prohibiting corporations from owning other corporations is the best way to limit and prevent multinational corporations (monopoly).



DDearborn

January 22, 2022 — 8:03 PM

Hmmm History is replete with an almost endless cast of some of the vilest, evil, maniacal lunatics that bear a striking resemblance to the latest cast of would-be Kings and Queens. History also teaches us that that simply trying to change our rules imposed by their game never gets you out of the pot because they don't follow any rules. In spite of the fact that History remains a startlingly accurate and consistent guide offering considerable certainty that the latest crop of wannabe totalitarians and/or their seed will

inevitably meet a similar fate, we must strengthen our resolve to resist complacency and indifference by whatever means necessary. Keep firmly in mind that if the outcome was as heavily weighted in their favor as we are being led to believe the seemingly endless machinations, manipulations and lies spewing out of every orifice of their regimes targeting the common man would not be necessary. In short, not only is it abundantly clear that the outcome is still very much in doubt, despite their every effort to convince us otherwise, that fact of the matter is that we still hold most of the hole cards...



Mellisa Rose

February 27, 2022 — 1:15 AM

Those that makes the rules wins the game. I'm curious, wonder what did those that made the rules have to do exactly to get where they are at? They have done the unthinkable, unimaginable, and many dishonest manipulations have they put forth, to be in the position they are at. Just think about a bunch of country folks take control of the world... TN. Way to go, what a disgrace you are, & greed doesn't look good on you !

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