The SEC has proposed a rule that would require, to the extent material, companies to provide human capital management disclosure. How should public companies and their counsel approach disclosure in this increasingly important area?

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Outside the area of executive compensation, current law does not require much of a public company in the way of disclosing information concerning its workforce (its human capital) or the philosophies, policies, and practices it implements to select, oversee, and develop that workforce (its human capital management). Under Item 101(c)(xiii) of Regulation S-K, in the “Narrative Description of Business” section, a public company needs to disclose no more than its total number of employees, and common practice is to do no more than that. Someday soon, though, that may not be enough. On August 8, 2019, the SEC proposed amendments to Item 101 of Regulation S-K that would require, to the extent material, enhanced human capital management disclosure.

The Proposed Rule

As proposed by the Securities Exchange Commission (SEC), the new human capital management disclosure rule would require a description of the registrant’s human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the attraction, development, and retention of personnel).

This description would be required only if material to an understanding of the company’s business as a whole; the proposed rule is purely principles-based and leaves it to company management to determine the human capital resources and measures or objectives that are so material that they must be disclosed. Indeed, flexibility is a basic feature of the proposed rule; it requires the disclosure of the “human capital measures or objectives that management focuses on in managing the business,” but the measures or objectives the rule provides (i.e., those that address the attraction, development, and retention of personnel) are, according to the SEC, “non-exclusive examples” that may or may not, in the individual case, be the material human capital measures or objectives that a company must disclose. Recognizing that the materiality of human capital resources and measures or objectives vary by industry, by company, and over time, the SEC proposed a flexible rule that intends to elicit, to the extent material to an understanding of the registrant’s business, disclosures regarding human capital that allow investors to better understand and evaluate this company resource and to see through the eyes of management how this resource is managed.

The Road to the Proposed Rule

The SEC’s justification for this proposed human capital management disclosure rule—providing investors the information they need to see human
capital through the “eyes of management”—echoes SEC Chairman Jay Clayton’s view that a revised human capital disclosure framework “should not attempt to impose rigid standards or metrics for human capital on all public companies” but should instead attempt to elicit the information investors need to understand “the lens through which each company looks at its human capital.” In remarks to the SEC Investor Advisory Committee, Chairman Clayton referred to human capital as, for some companies, a mission-critical asset, explaining that the historical approach of disclosing only the costs of compensation and benefits often is not enough to fully understand the value and impact of human capital on the performance and future prospects of an organization.

Contemporaneously with Chairman Clayton’s remarks, the SEC’s Investor Advisory Committee (IAC) recommended that the SEC recognize the significance of human capital management and “incorporate it as a part of the Commission’s Disclosure Effectiveness Review and the Commission’s approach to modernizing corporate reporting and disclosure.” As explained in the written recommendation, the US economy has transitioned from one based on industrial production and tangible assets to one based on intangible assets and human services, and the current disclosure rules—based on the antiquated view that human capital is a cost rather than a driver of financial performance—have failed to respond. In the view of the IAC, human capital is the “primary source of value” of many of the most dynamic US companies; it therefore encouraged the SEC to engage with investors, issuers and the academic community in an effort to improve and augment existing human capital management disclosure. The proposed rule is the SEC response.

Chairman Clayton’s remarks and the IAC recommendation came from calls for enhanced human capital management disclosure from special interest groups and investors. On July 6, 2017, the Human Capital Management Coalition (HCMC), a cooperative effort of 26 institutional investors representing over $3 trillion in assets, petitioned the SEC for rulemaking seeking enhanced human capital management disclosure. Citing a litany of empirical research and academic work that, in its view, shows that “thoughtful management of human capital is associated with better corporate performance, including risk mitigation,” and highlighting the current lack of, and investor demand for, fulsome disclosure of public company human capital data, the HCMC urged the SEC to consider rules requiring human capital disclosures on workforce demographics, turnover, diversity, culture, and health and safety. The HCMC petition appears to have been influential; the IAC included the petition (and the fact that the HCMC represents a number of large institutional investors) as a finding in support of its recommendation to the SEC. The SEC, in turn, cited the petition in the release proposing rule, explaining that the petition and comment letters the SEC received in support of it “asserted the importance of human capital management in assessing the potential value and performance of a company over the long term.”

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**Human capital management is a critical investment issue.**

BlackRock, the world’s largest asset manager, made a similar call. In 2019, BlackRock, as it had in 2018, identified human capital management as one of its five engagement priorities (along with governance, corporate strategy and capital allocation, compensation that promotes long-termism, and environmental risks and opportunities), explaining that human capital management is a critical investment issue and it is therefore important to investors that companies explain as part of their corporate...
strategy how they establish themselves as the employer of choice for the workers on whom they depend.10

Finally, the Embankment Project for Inclusive Capitalism (EPIC), a project intended “to identify and create new metrics to measure and demonstrate long-term value to financial markets,” spearheaded by the Coalition for Inclusive Capitalism and Ernst & Young, and claiming to represent more than $30 trillion of assets under management, joined the same call.11 In its 2018 report, EPIC identified “talent” as one of the four key “factors that define long-term value” for which company disclosure of consistent and comparable metrics are most needed (along with innovation and consumer trends, society and the environment, and corporate governance). The report therefore proposed a series of metrics to allow investors to measure a company’s management of its “talent” in the areas of human capital deployment, organizational culture and employee health.

The proposed rule is principles-based rather than rules-based, requiring no specific line item disclosures.

Clearly, the SEC found these calls for enhanced human capital management disclosure persuasive. Yet, the step it has taken in the proposed rule is a small one. The proposed rule is principles-based rather than rules-based, requiring no specific line item disclosures and leaving substantial discretion to company management to determine the human capital management resources and measures or objectives that are so material that they must be disclosed. Indeed, in a joint statement, SEC Commissioners Robert Jackson and Allison Lee commended the proposed rule “for adding disclosure on the critical topic of human capital,” but also expressed the concern that, because it favors flexibility over bright-line rules, the proposal may give management too much discretion—sacrificing important comparability—when describing a company’s investments in its workers.12

Noting that, in failing to propose any specific line item disclosures the SEC did not go so far as some stakeholders, including the HCMC and IAC, encouraged it to go, Commissioners Jackson and Lee urged commenters to help the SEC “weigh the degree to which the proposal relies too heavily on principles-based disclosures” and understand “what metrics, if any, would be useful to include in any final rules.”13

The Public Comments

Indeed, whether a revised human capital disclosure framework should be purely principles-based or instead should require specific line item disclosures of human capital metrics is surely the most common single topic discussed in the public comments. In over 70 individual submissions, major public companies, labor unions, pension funds, investment managers, and other firms and groups provided the SEC with comments to the proposed rule.

A relatively small number of commenters solved the problem of whether human capital disclosure requirements should be purely principles-based or at least partly rules-based by positing that there should be no human capital disclosure requirements at all. In the view of three major public companies, UnitedHealth Group (UnitedHealth), General Motors Company (GM), and Chevron Corporation (Chevron), requiring human capital management disclosures is entirely unnecessary, not because human capital is unimportant but because it is in inappropriate subject for mandatory disclosure rules. UnitedHealth explained that the voluntary human capital disclosures already made by many companies (including by UnitedHealth in its proxy statement, 10-K and Website and
by other companies in a wide range of forums) “obviate the need for mandated disclosure.” GM stated that the SEC need not require human capital disclosures because “this information, to the extent necessary to an investor’s understanding of a registrant’s business, would already be required to be disclosed (see Regulation S-K Item 303(a) [MD&A] and Item 105 [Risk Factors]).” Chevron presented both of these arguments, explaining that “[r]etaining human capital management disclosures in voluntary publications” is more appropriate than “including specific metrics in SEC filings” and that under current disclosure rules, any changes or trends in human capital resources that are reasonably likely to materially affect the business environment are already required to be discussed in MD&A.

Both GM and UnitedHealth raised the concern of “timing and operational challenges” and that the proposed rule “could require significant effort and cause companies to incur additional costs in order to be able to track, summarize and review the required human capital information” because

[though much of the information is currently available, companies may need to develop new systems or alter current systems to be able to produce the requested disclosures reliably and timely and such information would then be subject to auditor reviews.]

UnitedHealth concluded its critique with the concern that “the Proposed Rule as written could require companies to disclose competitive or sensitive information.” GM and Chevron concluded their comment with the point that even if the SEC were to adopt a mandatory human capital disclosure rule, the non-exclusive examples of measures or objectives the proposed rule provides should be omitted. As Chevron put it:

providing a list of specific non-exclusive examples of human capital management metrics that may be material creates a risk of encouraging companies to include additional disclosure that is immaterial, fails to take into account the differences and lack of comparability across business sectors and may ultimately obscure or distract from more relevant information about a company’s business.

This final point was echoed in the public comment of the US Chamber of Commerce’s Center for Capital Markets Competitiveness (and, in turn, by a fourth major public company, FedEx Corporation, writing in support of the Chamber of Commerce’s submission), which explained that it was “cautiously supportive” of a principles based human capital disclosure regime but that

[in keeping this disclosure principles base, we do not see a need for the Commission to provide examples of the types of measures or objectives that management should focus on in its disclosure.]

The public company submissions discussed above had their differences, but they all underscored the point that the disclosure regime in the human capital area (if any) should be principles-based and include no line-item requirements. Of course, a number of other commenters wrote to the SEC with precisely the opposite view. Predictably, the HCMC was one of those commenters, explaining that

we do not believe that the substantial move toward a principles-based approach for human capital disclosure contemplated in the [proposed rule] will provide investors with the type of robust, clear and comparable information we require

and suggesting a number of specific line-item requirements to add to the proposed rule, including the
number of people employed by the issuer, the total cost of the issuer’s workforce, and employee turnover and workforce diversity data. In HCMC’s view, these line item requirements would add a measure of comparability to the proposed rule and should be reported by issuers “in addition to material human capital measures or objectives management focuses on in running the business.”

Line item requirements would add a measure of comparability to the proposed rule.

This view of the HCMC, that the final rule should take a dual rules-based and principles-approach, found expression in a number of other public comments. For instance, the New York State Common Retirement Fund, the third largest public pension fund in the United States, wrote to express its “concerns with moving towards completely principles-based disclosure for human capital resources” and view that “a balanced approach between principles-based and prescriptive rules” would be better. The American Federation of Labor and Congress of Industrial Organizations (suggesting a “hybrid system of rules-based and principles-based disclosure requirements” and that the proposed rule “should be strengthened with additional quantitative, bright-line disclosure rules”), the Oregon State Treasury (arguing that a “strictly principles-based disclosure regime is unlikely to result in information that is consistent, comparable, or efficient for investors” and suggesting instead an “approach where the SEC establishes a limited set of well-defined, baseline disclosure standards”), CalPERS (arguing that the purely principles-based approach of the proposed rule will not “provide sufficient comparable disclosure to aid investors” and that certain human capital metrics, including those suggested by the HCMC, EPIC and the IAC should be required), the City of New York Office of the Comptroller (outlining the “shortcomings of a principles-based disclosure regime that does not also require certain line-item disclosures that are consistent and comparable across issuers”), the Service Employees International Union (suggesting “a ‘hybrid’ approach including “a limited set of well-defined, baseline disclosure standards”) and United States Senator Mark R. Warner (encouraging the SEC to take “a principles-based approach that incorporates some prescriptive elements”), all expressed the same view.

In addition to the views discussed above, many of the public comments touched on other topics. Willis Towers Watson argued that the rule would have to define “human capital” (and provided a suggested definition) while Mercer urge[d] the Commission to resist defining what is considered effective human capital management because it is a complex concept and there are many factors that influence [it] that vary with the industry and organization.

Many commenters discussed particular aspects of human capital viewed as important, with gender diversity in the workplace as a leading topic. A number of commenters who were critical of the proposed rule suggested that human capital disclosure issues should be addressed by the SEC with the issuance of interpretive guidance (as it has done with climate change disclosure issues) rather than a mandatory disclosure rule.

Clearly, though, the debate between the purely principles-based approach the SEC took in the proposed rule and an expanded or “hybrid” rule that would include rules-based disclosure requirements was the focus of the public comments. Based on these comments, the SEC would seem to have support for a wide range of options: (1) to not finalize the proposed rule (citing the comments arguing that required human capital disclosures are unnecessary); (2) to adopt the proposed rule as written (citing the comments applauding the SEC for taking a purely principles-based approach); (3) to adopt the proposed rule without making reference to any examples of human capital “measures” or “objectives” (citing...
the comments that critiqued the utility of provided examples); (4) to adopt the proposed rule with the examples of human capital measures or objectives it provided in the proposed rule as well as others provided by the commenters (citing the measures or objectives provided by a large number of public commenters); or (5) move away from the purely principles-based approach of the proposed rule and require line-item disclosures (citing the comments encouraging the SEC to take a “hybrid approach”). Which of these options the SEC will choose, and the possible future of human capital management disclosure, remains an open question.

Preparing for the Proposed Rule

For now, though, public companies and their counsel should focus on the immediate steps necessary to prepare for the potential finalization of the proposed rule. To do so, we recommend public companies and their counsel follow the three steps outlined below.

1. **Start with management’s view.** To prepare for the proposed rule, companies should start by forming a clear picture of human capital resources as seen “through the eyes of management.” Since the SEC’s justification for the proposed rule is its ability to give investors access to this view, we believe that a human capital management disclosure approach that provides a clear picture of human capital management as seen through the eyes of management is likely to meet its requirements. To identify management’s view, companies should consider whether human capital is a primary or ancillary concern of the company, whether it is as an independent item to be focused on or an aspect of a broader field (for instance, culture, or long-termism, or risk), and what aspects of human capital (for instance, diversity, training, or turnover) are most important to the company.

2. **Focus on materiality.** The proposed rule requires disclosure of a company’s human capital resources only to the extent those resources are material to an understanding of the company as a whole. Companies should now take the steps to identify which of its many human capital resources are, in fact, material. Which employees—from the C-suite to the entire labor pool—are a material component of the long-term value of the company? What aspects of the management of those employees—from compensation and training to productivity and retention and engagement—are material to the company’s success? Narrowing the issues by focusing on materiality will allow public companies and their counsel to most efficiently and responsibly meet the requirements of the proposed rule.

3. **Identify measures and objectives.** The proposed rule requires a description, to the extent material, of the “human capital measures or objectives that management focuses on in managing the business.” The company should take the steps to identify those measures or objectives now. Does the board regularly receive a dashboard or other report from management that includes measures or objectives related to human capital? If so, those are likely to be just the material measures or objectives the proposed rule calls to disclose. Who in management is primarily responsible for the oversight of the company’s human capital resources and development, and what measures or objectives does that person or group rely on to complete the job?

What Stakeholders Want to Know

Completing these three steps should allow public companies to adequately and efficiently prepare for the limited requirements of the proposed rule. Preparing for the future, however, (a future in which human capital management disclosure requirements could potentially be exceedingly more expansive than as currently proposed), is a much more challenging task. Though a growing number of stakeholders have joined the call for enhanced human capital management disclosure, a clear, unified
picture of what those stakeholders would like to see disclosed has yet to emerge. The key points these stakeholders have focused on in their calls for enhanced human capital management disclosure, however, present public companies and their counsel the opportunity to glean at least some idea of what human capital management disclosures may in the future be required.

**SEC Suggested Human Capital Management Metrics**

In the proposed rule, the SEC cites measures addressing the attraction, development, and retention of personnel as non-exclusive examples of the “human capital measures or objectives” that must be disclosed. In addition, the SEC requested comment on whether it should include other examples in the final rule, including:

- Number and type of employees, including the number of full-time, part-time, seasonal and temporary workers;
- Measures with respect to the stability of the workforce, such as voluntary and involuntary turnover rates;
- Measures regarding average hours of training per employee per year;
- Information regarding human capital trends, such as competitive conditions and internal rates of hiring and promotion;
- Measures regarding worker productivity; and
- Progress that management has made with respect to any objectives it has set regarding its human capital resources.

These examples serve as a useful guidepost of the type of “human capital measures or objectives” the SEC has in mind as at least potentially required to be disclosed under the proposed rule.

**Stakeholder Suggested Workforce Disclosure**

Stakeholders have suggested the following workforce disclosures.\(^{17}\)

- Demographics (number of full-time, part-time, contingent, subcontracted and outsourced workers);
- Stability (turnover, internal hire rate);
- Composition (diversity, pay equity);
- Skills and capabilities (training, alignment with business strategy, skill gaps);
- Culture and empowerment (engagement, union representation, work-life initiatives);
- Health and safety (injuries, fatalities, lost day rate);
- Productivity (return on cost of workforce, profit/revenue per full-time employee); and
- Compensation and incentives (bonus metrics, measures to counterbalance risks created by incentives).

While engaging with boards on human capital management issues, stakeholders such as BlackRock want to hear about the following.\(^{18}\)

- Oversight of policies meant to protect employees, like whistleblowing, codes of conduct and Equal Employment Opportunity (EEO) policies, and the reporting structures the board relies on to assess their implementation;
- How the human capital management structure ensures a healthy culture and prevents unwanted behaviors;
- Board and employee diversity data;
- Consideration of linking human capital management performance to executive compensation;
- Reporting to the board on the integration of human capital management risks into risk management processes; and
- Board member visits to workplaces to assess the culture and operations of the company.

**Final Thoughts**

If the proposed rule is finalized, public companies must go beyond the disclosure of the total number of employees currently required and instead describe the material human capital
resources and measures or objectives of the company. We think the three steps suggested above will allow public companies to prepare for this relatively easily, especially if the company is already making, as many top public companies are, voluntary human capital disclosures. As reported in the Shearman & Sterling Corporate Governance & Executive Compensation Survey 2019, which reviewed the “corporate social responsibility” (CSR) reports prepared by the 100 largest US public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq, measured by market capitalization and revenue, employee support, diversity, and human capital management were among the topics most often covered in CSR reports.19

But, beyond preparing for the limited requirements of the proposed rule, public companies would do well to use this opportunity to consider what the future of human capital management and human capital management disclosure entails. The investor demand for human capital data has been growing and, we think, is unlikely to cease. Moreover, the group of investors and other stakeholders that have embraced the proposition that human capital resources and human capital management are fundamental aspects of the bottom line is also likely to grow. Indeed, the recent reformulation of the Business Roundtable Purpose of a Corporation, which commits to investing in employees, providing fair compensation, supporting and training employees and fostering workplace diversity, inclusion, dignity and respect is further evidence of the recent entrenchment of human capital in the mainstream (though, to be fair, the fundamental role employees play in the corporate institution is hardly new). For all of these reasons, public companies should consider their human capital resources and human capital management, how that management is communicated to the board, the metrics and objectives that are used, and their human capital management and human capital management disclosure approach for the future.

Notes
2. Id.
4. Id.
5. See Recommendation of the SEC Investor Advisory Committee, Human Capital Management Disclosure (March 28, 2019). The Disclosure Effectiveness Review is a project undertaken by the SEC’s Division of Corporation Finance to review and modernize the form and content of public company reporting.
7. See IAC, supra n.5.
10. See BlackRock Investment Stewardship’s Approach to Engagement on Human Capital Management (Jan. 2019).
11. See Embankment Project for Inclusive Capitalism.
13. Id.
14. GM Submission.
15. United Health submission.
16. The concern that the proposed rule could require the disclosure of competitive or sensitive information was expressed in other public comments, including those of the Financial Executives International’s Committee on Corporate Reporting and the Center on Executive Compensation and HR Policy Association and the Society for Corporate Governance.
17. See HCMC, supra n.3.
18. See BlackRock, supra n.6.