E, S, G, AND W: EXAMINING PRIVATE SECTOR DISCLOSURE OF WORKFORCE MANAGEMENT, INVESTMENT, AND DIVERSITY DATA

HYBRID HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

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E, S, G, AND W: EXAMINING PRIVATE SECTOR DISCLOSURE OF WORKFORCE MANAGEMENT, INVESTMENT, AND DIVERSITY DATA

Thursday, December 8, 2022

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTOR PROTECTION,
ENTREPRENEURSHIP, AND CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2128, Rayburn House Office Building, Hon. Brad Sherman [chairman of the subcommittee] presiding.

Members present: Representatives Sherman, Foster, Vargas, Gottheimer, Casten; Huizenga, Wagner, Hill, Mooney, Davidson, and Steil.

Ex officio present: Representative Waters.

Chairman SHERMAN. The Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

This is the last subcommittee hearing that I will chair for at least 2 years. I look forward to working with the Republican side next year.

Today's hearing is entitled, "E, S, G, and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data." And this is a chance for us to look not only at E, S, and G but also, "W," for, "workforce."

I now recognize myself for 4 minutes for an opening statement.

During today's hearing, we will examine a number of important issues regarding the information that is disclosed to investors. While a number of critical topics come in the areas of environmental, social, and governance (ESG), and they will be discussed here, we will also have a chance to look at workforce (W). The lifeblood of any organization is its workforce, and it is something about which investors are concerned.

Since 1988, the European Union has required a report on human capital investment in relation to salaries, bonuses, and other benefits. But these disclosures are not required in the United States and only 15 percent of the [audio malfunction] official standards for defining the terms, determining what is disclosed, tabulating the information, ensuring the internal control of that tabulation, or auditing it.

Meanwhile, the U.S. economy has changed dramatically since accounting standards were designed. It is not all on the balance sheet anymore.

Back in my day, or before my day, if you wanted to look at the book value of a company, you looked at the balance sheet. They have a plant, they have a factory, they have some land; that is their book value. Maybe they are worth 10 percent more than that.

According to the Working Group on Human Capital Accounting Disclosure, while in 1975, intangibles represented 17 percent of the value of an S&P 500 company, today it is 90 percent. So, 90 percent of the value of what investors are looking at isn't on the balance sheet. It is time to have a statement that at least gives investors information about what is the most valuable asset not on the balance sheet of most corporations, and that is their workforce.

For over 5 years, a group of 26 institutional investors, representing $3 trillion in assets, has petitioned the SEC for a framework for disclosing information on human capital. And in August of 2020, the SEC, under the leadership of Jay Clayton, who was appointed by Donald Trump, adopted amendments to Regulation S-K to require public companies to include a description of human capital resources, but not in the kind of form that those familiar with balance sheets and income statements would recognize.

First, we need to define the terms so that it is parallel from one company to another and understood by investors. And we need to determine how that information is going to be presented.

Second, we need to tabulate the information and do so in a method that has internal controls so that we can rely on the tabulation.

And finally, we need to audit adherence to the definitions, the tabulation practices, and the internal control system that leads to that tabulation. We do that for what is now the small part of the balance sheet, the stuff we put on the balance sheet. And we need to give investors information about workforce.

Today, we will also look at the environmental and greenhouse gas issues. And I know our witnesses, most of them, are prepared to discuss that as well.

With regard to environmental disclosures, Scope 1 and Scope 2 being proposed by the SEC, I think make a lot of sense. It is going to be hard to go into Scope 3, and that may be a bridge too far. It may give us effects way beyond what we are trying to achieve.

I look forward to learning more about how we can disclose turnover rates, investment in workforce, and workforce diversity. And we think we have outstanding witnesses who will help us do that.

I now recognize the ranking member of the subcommittee, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Thank you, Chairman Sherman.

And I appreciate the witnesses for being here and for your testimony this morning.

I, frankly, I would be lying if I said I was surprised by today's hearing topic. Sadly, today's hearing isn't about investor protection, entrepreneurship, or capital markets. It is about the Majority's latest attempt to legitimize the last 4 years of failed policy, most of that coming out of the SEC.

Unfortunately, or maybe fortunately for American small businesses, Democrats have been unable to legislate their climate and social policies. Instead, they have relied on unelected regulators and bureaucrats to carry out that agenda.

And you don't have to go far to see this playing out. The Securities and Exchange Commission's pending climate disclosure rule is a primary example of overly-burdensome regulations done by administrative overreach. Requiring the SEC to establish mandatory disclosures on issues outside their expertise would surely result in a complicated and confusing disclosure regime, especially to the extent that information is not material for the company. That is the watchword, "materiality."

Let's for a second focus on the topics at hand, E, S, and G. And for this hearing, the Democrat Majority added, "W," which supposedly stands for, "workforce." I would like to put forward that maybe it stands for, "woke."

Specifically, I want to key in on corporate governance, which refers to how an organization is managed and how leadership performs and how stakeholder expectations are met.

I am also disappointed, frankly, that this committee—and I have to take this moment to say that the committee has not fulfilled its duty, not to mention its pledges, to me and others on this committee and in the public to have SEC Chair Gensler in front of this subcommittee or the Full Committee. It has been over a year since he has appeared.

But under Chair Gensler, the SEC has experienced several operational problems that have eroded public trust in the Commission, preventing it from carrying out its statutory mandate. Instead of meeting those stakeholder expectations, the Agency has focused on pushing a far-left liberal agenda that aims to impact every aspect of our capital markets.

According to an October 2022 inspector general report, staff attrition at the SEC is at its highest rate in over a decade. Not only does this diminish the SEC's ability to protect investors and ensure adequate capital formation, it reduces the quality of the SEC rulemaking being proposed, which has been outsourced to temporary and inexperienced staff.

Coupled with consistent short comment periods, a technical error that disrupted the public comment process, and a complete lack of proposals that will facilitate capital formation, one would have to give the SEC low marks for their corporate governance and workplace management.

Lastly, I would like to provide some commentary on the issue that has been front and center and, frankly, has caused a lot of confusion and concern among marketplace participants. This summer, Chair Gensler gave remarks in which he said, "Retail investors have greater access to markets than at any time in the past," but left open the possibility of promulgating a rule on equity market structure reform, which we learned yesterday will be added to the other 30 rule proposals that he has given in the last 11 months. And that is going to be released next week.

Retail participation in U.S. markets has grown across every demographic, and today, self-directed retail investors make up a specific portion of daily activity in our markets. The current state of equity markets is the product of years of private-sector innovation and prudent, fact-based, and data-driven public-sector rulemakings.

One of the SEC's chief mission objectives is to maintain fair and orderly and efficient markets, which is something that I wholeheartedly support. However, market reform should be developed transparently with input from affected stakeholders and with evidence that the proposed changes will achieve the intended goal. We have yet to be given that evidence.

And without objection, Mr. Chairman, I would like to submit a letter for the record to Chair Gensler from myself and Mr. Gottheimer on market structure reform, outlining our concerns.

Chairman SHERMAN. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you.

And, Mr. Chairman, Republicans on this committee have warned our Democrat colleagues time and time again that there would come a day when they couldn't protect this Administration any longer. Fortunately, for small businesses and investors, that day is coming.

I look forward to hearing from many of the officials who have ignored these warnings and, frankly, ducked Congressional oversight. That is certainly not going to happen anymore.

I look forward to working with all of my colleagues on this subcommittee to achieve our shared objectives, making sure we protect the investors, have fair and orderly markets, and create market opportunity and capital formation. That is our real goal and objective.

With that, I yield back.

Chairman SHERMAN. Thank you.

I now recognize the Chair of the Full Committee, Chairwoman Waters, for one minute.

Chairwoman WATERS. Thank you for holding this important hearing, Chairman Sherman, and for your strong focus on investor protection throughout your tenure as Chair of this subcommittee.

Environmental sustainability and governance metrics, which include human capital disclosures, are increasingly important to investors. Earlier in this Congress, the House passed Mr. Vargas' bill, H.R. 1187, the Corporate Governance Improvement and Investor Protection Act, which would reform the disclosure regime for public companies by requiring standardizing the reporting of several important ESG metrics being discussed today.

The SEC heard this body loud and clear and has moved forward on a disclosure agenda that responds to the needs of our nation's investors and workers. So, I look forward to hearing the testimony today as we look to inform the SEC of its work ahead.

Thank you, and I yield back.

Chairman SHERMAN. Thank you.

I want to thank the witnesses, not only for being here today, especially today, because we had scheduled this hearing for 2 days ago, and then, we had a series of 12 votes on the House Floor. The witnesses rearranged their schedules, and we appreciate their attendance.

We have a panel of distinguished witnesses: Cambria Allen-Ratzlaff, the managing director and head of investor strategies at JUST Capital, and she is particularly focused on the, "W," in today's hearing, "workforce,"; Dr. Colleen Honigsberg, who has a Ph.D. in accounting and is a professor of law at Stanford Law School—I thought I had a good background, being a CPA and a graduate of Harvard Law, but a Ph.D. in accounting and a professorship at Stanford shows me how much more I could have tried to achieve; Dr. Shivaram Rajgopal, a professor of accounting and auditing at Columbia Business School, and while he is prepared to talk about both the, "W," and the, "E," environment and workforce, I should point out that Dr. Honigsberg is more focused here on the workforce; Fran Seegull, the president of the U.S. Impact Investing Alliance, focusing on environmental disclosures; and Andy Vollmer, a senior affiliated scholar at the Mercatus Center at George Mason University.

Witnesses are reminded that their oral testimony will be limited to 5 minutes. You will be able to see a timer which will indicate how much time you have left. I would ask you to be mindful of the timer so that we can be respectful of both your fellow witnesses' time and the time of the committee members.

And without objection, your written statements will be made a part of the record.

Also, without objection, I would like to enter into the record a letter signed by the Working Group on Human Capital Accounting Disclosure, dated June 7th, and signed by the last two witnesses I introduced, since that letter is pretty much the reason we are having this hearing.

Ms. Allen-Ratzlaff, you are now recognized for 5 minutes.

STATEMENT OF CAMBRIA ALLEN-RATZLAFF, MANAGING DIRECTOR AND HEAD OF INVESTOR STRATEGIES, JUST CAPITAL

Ms. ALLEN-RATZLAFF. Thank you. Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, good morning.

My name is Cambria Allen-Ratzlaff, and I am pleased to appear before you today representing JUST Capital, where I am managing director and head of investor strategies.

I also co-chair the Human Capital Management Coalition, now a group of 37 large investors, representing over $8 trillion in assets.

JUST Capital is an independent, nonprofit research organization dedicated to measuring how America's largest public companies create competitive value for their shareholders, while serving their workers, customers, communities, and the environment. Our view is that when companies manage their stakeholder relationships well, shareholders also benefit.

Every year we survey the American public to identify the business issues that matter most to them. We then use publicly-available data to quantify performance of the Russell 1000 Index in meeting those priorities. The vast majority of this data is hand-collected by our research team, taking 10,000 to 15,000 hours on average.

Once we have reviewed the data and assessed company performance, we build our annual rankings. We also leverage the data we collect to understand how performance translates into investment returns. Our work goes where the voice of the American public takes us.

Since 2015, we have engaged more than 160,000 Americans, representative of the U.S. adult population. And we have found that Americans are remarkably united in what they want companies to prioritize: workers; wages; and jobs.

This holds across every single demographic group. Our thesis is that companies that are better at managing their stakeholder relationships tend to generate more returns for their investors, and we have consistently observed this to be true.

For example, if an investor purchased an equally-weighted index of the top 100 companies in our rankings, which we refer to as the JUST 100, the index would have generated over 6 percent in excess returns against the Russell 1000 from March 2019. If you were to invest in an index of companies scoring in the top 10 percent of our worker stakeholder group from the beginning of this year through December 1st, you would have generated in excess of a 9.29 percent return.

As U.S. public companies are born from and an integral part of American society, it is perhaps unsurprising that what is good for workers, is good for investors. Our reporting system, however, has been slow to adapt.

Consider this. The only line item data U.S. public companies are required to disclose on their workforce is head count. This reporting standard was set in 1973 when over 80 percent of the S&P 500 Market Cap was property, plant, and equipment. Fast-forward 50 years to today, and 90 percent of the S&P 500 is based on intangible assets. But it is human capital, the collective knowledge, skills, and experiences of the workforce powering economic growth.

But as our financial reporting standards have lagged, as the Chair noted, this also means that up to 90 percent of company value may not be reflected in companies' disclosed financials, and investors have taken note.

Speaking on behalf of the Human Capital Management Coalition, the Coalition has urged financial and accounting standard-setters to improve access to workforce data through a balanced approach where principles-based disclosures are anchored by four foundational, decision-useful disclosures that apply to all companies: one, the number of full-time, part-time, and contingent or contracted labor directly involved in firm operations; two, labor costs; three, turnover; and four, workforce diversity data sufficient to understand the company's efforts to access and develop new sources of talent, as well at how effective these efforts are.

Without this information, investors are flying blind, unable to understand how well a company manages its work and how it impacts a company's overall business risks and prospects to most efficiently direct their financial capital to its highest-value use.

Today, even attempting to get this information is excessively time-consuming. When JUST Capital assessed workforce disclosure at the 100 largest U.S. employers, it took a team of 2 very skilled data scientists over 130 hours to collect data on a discrete number of human capital metrics or find the data completely unavailable.

If a sophisticated research organization like JUST Capital, or large global institutions with billions of dollar in capital, are unable to access decision-useful, comparable, consistent, and reliable workforce data, small retail investors are at even more of a disadvantage.

Simply put, companies that are best at harnessing the awesome power of their workforces are also best-positioned to generate long-term value for shareholders.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Allen-Ratzlaff can be found on page 34 of the appendix.]

Chairman SHERMAN. Thank you.

Dr. Honigsberg, you are now recognized for 5 minutes.

STATEMENT OF COLLEEN HONIGSBERG, PROFESSOR OF LAW, STANFORD LAW SCHOOL

Ms. HONIGSBERG. Thank you, Chairman Sherman and Ranking Member Huizenga, for the opportunity to testify before you today.

To give you a sense of my background, as Chairman Sherman had noted, I began my career with PricewaterhouseCoopers. While I was there, I became very interested in accounting policy. So, I returned to school, earning a J.D. from Columbia Law School and a Ph.D. in accounting from Columbia Business School. I am now a professor of law at Stanford Law School where I teach classes on securities law, corporate governance, and accounting. My recent scholarship focuses on the empirical study of accounting questions such as human capital disclosure.

This past spring, I was delighted to join forces with my colleague here today, Columbia Business School Professor Shivaram Rajgopal, along with other esteemed academics, including former SEC Commissioners Joe Grundfest and Robert Jackson, to create the Working Group on Human Capital Accounting Disclosure.

In June, our group petitioned the SEC to develop rules requiring public companies to disclose sufficient information for investors to assess the extent to which firms invest in their workforce.

I want to highlight in my testimony today that prompt action on labor cost disclosures is necessary due to two market trends: the growth of human capital firms; and the increasing prominence of net loss firms.

First, consistent with the comments of Chairman Sherman in his opening remarks, let's consider the growth of the so-called human capital firm in the 21st Century.

An increasing proportion of public companies derive much of their value from intangible assets. Yet, only about 15 percent of those firms even disclose information as basic as total labor costs. As the chairman noted, in 1975, intangibles represented 17 percent of the value of firms in the S&P 500. By 2020, intangibles represented 90 percent of those firms' value. Yet, we are using largely the same accounting principles to assess these assets' value.

Indeed, we can see a little legacy of these rules in accounting today as different forms of investment are treated differently. Investments in people receive what I would consider to be the worst quality accounting treatment, as these expenditures are neither capitalized nor disclosed.

This creates real problems for valuation of today's public companies as investors are unable to determine what portion of cash outflows should be considered an investment in the firm's future growth and productivity and what portion of cash outflows merely allow the firm to maintain its current level of productivity.

Second, an increasing number of public companies report a loss for accounting purposes, making analysis of firms' operational costs, the most significant of which is likely to be labor, more important than ever to understanding a firm's value.

In 2020, for the first time, more than half of U.S.-listed companies reported negative earnings. Many of these companies are young, technology-driven firms, and investors are betting on their future profitability. But commonly-used valuation techniques like price-to-earnings ratios cannot be used to value these firms. Instead, investors must project future earnings, an analysis that requires reliable information about costs, margins, and scaleability. But that information is obfuscated under current accounting principles, as investors don't get a sufficiently detailed breakdown of firms' cost structures to identify contribution margins.

As I highlighted in my written testimony, that is why our working group proposed three recommendations. First, managers should be required to disclose what portion of workforce costs they believe to be an investment in the firm's future growth.

Second, workforce costs should be treated in the same way that research and development costs are: expensed but disclosed. That would give investors the information they need to capitalize workforce costs in their own valuation models, should they choose to do so.

Finally, the income statement should be disaggregated to give investors more insight into workforce costs.

As noted above, investors in loss-making firms need information on costs, margins, and scaleability to estimate future profitability. But under current accounting rules, scores of costs are aggregated together under generalized headers such as costs of goods sold or selling, general, and administrative.

Rather than purely generalized categories, investors need detailed information on specific operating costs, the most important of which is labor. Without more detailed cost-level information, it is difficult, if not impossible, to reliably value these firms or to stress test the market's valuation of a firm using fundamental analysis.

Thank you again for the opportunity to testify here before you today, and I would be delighted to answer any questions that you may have.

[The prepared statement of Dr. Honisberg can be found on page 64 of the appendix.]

Chairman SHERMAN. Thank you so much.

Dr. Rajgopal, you are now recognized for 5 minutes.

STATEMENT OF SHIVARAM RAJGOPAL, KESTER AND BYRNES PROFESSOR OF ACCOUNTING AND AUDITING, COLUMBIA BUSINESS SCHOOL

Mr. RAJGOPAL. Thank you.

Thank you, Chairman Sherman, Ranking Member Huizenga, Full Committee Chairwoman Waters, and esteemed members of this subcommittee for inviting me to speak today. It is an honor to be here.

My name is Shivaram Rajgopal and I am the Kester and Byrnes Professor of Accounting and Auditing at Columbia Business School, and I was fortunate enough to be on the Ph.D. committee, so my testimony touches mostly on the, "E," and a bit on the, "W," part of the hearing. In summary, I express support for the SEC's proposed climate risk disclosure rules. But I do have mixed feelings about Scope 3 emissions. I also underscore the need for mandatory disclosure related to compensation, workforce turnover, and tenure on publicly-listed U.S. companies.

Let's start with the SEC's proposed climate rules related to, "E." I support the SEC's attempt to mandate vigorous, comparable, consistent data on greenhouse gas emissions across companies.

My perspective is informed by a research project where my colleagues and I tried to assess whether the so-called net-zero pledges of 57 oil and gas companies are credible. These are just 57 companies, but it took us 6 months to code what these companies were doing. The underlying data is scattered across press releases, websites, 10-Ks, and sustainability reports. There is tremendous variation in the path followed to a net-zero promise, the GHC scope category the promise covered, the reporting framework followed, and the verifiability, if any, of the promised path to this net-zero idea.

Companies routinely follow multiple NGO-sponsored frameworks such as the TCFD, the GRI, the CDP, and the SASB's frameworks. On top of that, the four ESG ratings, ISS, Sustainalytics, Bloomberg, and MSCI provide environmental ratings that don't converge and are all over the map.

Without rigor, consistency, comparability, and verifiability of climate risk disclosures, these companies, I believe, cannot be held accountable for the promises they make to investors in terms of carbon reduction. This concern is even more pressing for the investors of ESG funds that claim to hold publicly-listed stocks that are climate-friendly.

It is also useful to find out that disclosure frameworks suggested by the SEC are agnostic with respect to investors' preference about GHG. Comparable and consistent GHG disclosures can also inform an investigator who wants to bet against, not for, the direction of high-GHG emitters. If an investor wants to buy stocks with high-GHG emissions, so be it.

But I do have mixed feelings about the SEC's requirement to disclose Scope 3 data. Consider a case of a publicly-listed pizza company that sells prepared pizzas to a retail distributor. The retail distributor then uses delivery services to get the pizza to the customers' homes. Asking the publicly-listed pizza company to calculate Scope 3 emissions related to those deliveries can potentially be burdensome.

The other conceptual issue to worry about is the significant double counting of emissions, if one were to add up all of the emissions across companies. So if Chevron sells jet fuel to, say, Delta Airlines, for use in a plane made by Boeing, these are Scope 3 for Chevron and Boeing, and Scope 1 for Delta. And these emissions get counted 3 times, which is problematic for any decent accounting system. Every Scope 2 or Scope 3 emission is someone else's Scope 1 emission.

But having said that, if a company has promised a Scope 3 reduction to investors, we need disclosures to check whether the promise is actually being met.

Let me use the last few minutes I have to touch on and support the petition that Professor Honigsberg and I signed and filed with the SEC. In a typical high school economics class, we teach students that a company creates shareholder value by combining materials, labor, capacity, and some managerial talent. But if you take that high school economics model to a modern-day income statement, it is virtually impossible to get answers to any of these questions. We effectively have a six-line income statement. I don't know where materials are, somewhere in cost of goods sold, but I don't know how much. Labor is everywhere in every line item, except I don't know what the labor costs are and what the composition across the line items in the financial statement might be.

As Chairman Sherman mentioned, barely 15 percent of U.S. companies tell us what labor costs are in their financial statements.

In a sense, the information would help us in four concrete ways: understanding intangibles; understanding the gains shared between labor and capital; understanding substitution of labor for AI, automation outsourcing; and understanding spikes in abnormal turnover.

In summary, I support the SEC's climate risk disclosures with qualified enthusiasm for Scope 3 disclosures. I also want to reiterate support—

Chairman SHERMAN. Thank you.

Mr. RAJGOPAL. —for my joint statement with the—

Chairman SHERMAN. Thank you.

Mr. RAJGOPAL. —on human capital.

Thank you.

[The prepared statement of Dr. Rajgopal can be found on page 73 of the appendix.]

Chairman SHERMAN. Ms. Seegull, you are now recognized for 5 minutes.

STATEMENT OF FRAN SEEGULL, PRESIDENT, U.S. IMPACT INVESTING ALLIANCE

Ms. SEEGULL. Thank you to the subcommittee for convening today's hearing.

And thank you to Full Committee Chairwoman Waters, Subcommittee Chairman Sherman, and Ranking Member Huizenga and the other esteemed members of the subcommittee for your leadership.

Let me start by saying that markets can only exist and operate efficiently when there is a free flow of information. And that is particularly true of our capital markets.

It is core to the mission of the SEC to empower investors by engaging and ensuring they are equipped with clear, comparable, decision-useful data.

As a head of an organization representing a wide range of investor perspectives, and a former chief investment officer, I join you today to share our support for SEC action to create standardized corporate disclosures on human capital management factors.

I serve as president of the U.S. Impact Investing Alliance, a nonpartisan organization committed to catalyzing the growth of impact investing, by which we mean investments that create financial returns alongside measurable and positive social, economic, or environmental impact.

Members of our boards and councils include institutional investors and individuals collectively owning hundreds of billions of invested assets, in addition to asset and fund managers collectively overseeing more than $1 trillion in assets.

Impact investors are motivated by a range of objectives, both financial and values-based. Some impact investors seek to create economic opportunity in historically-underinvested communities. Others look to foster the technology and innovation that will drive a sustainable 21st Century economy. But what unites all investors is the need for access to corporate information that is material, reliable, and comparable in order to express their individual or institutional priorities and invest their assets accordingly.

With that context in mind, I would like to make five key points for the subcommittee's consideration.

First, the U.S. Impact Investing Alliance and the investors we work with strongly urge the SEC to pursue rulemaking on corporate disclosures for human capital management factors. This should include, among other things, the total number of employees by type, and the total cost of a company's workforce, turnover rates, and employee diversity demographics at each level of the company.

Second, we support these standardized disclosures because a company's workforce is one of its greatest assets, and the success of all companies is dependent on its workers. As such, investors are eager to understand how a company attracts, manages, invests in, and retains its talent, factors that relate directly to business performance.

Third, such a rulemaking is clearly consistent with the SEC's mandate to protect investors. Transparency and accountability are the hallmarks of efficient markets. But the current lack of information creates market inefficiencies, harming investors and weakening the financial system. It is in the long-term interest of both individual companies and the wider economy to be responsive in disclosing human capital management factors to investors.

Fourth, such disclosures would improve market efficiency and would not impose significant burdens on issuers. Corporate leaders currently navigate a complex web of private disclosure standards in order to meet investor demands. The SEC should standardize these disclosures and thereby create clarity and benefits for issuers, investors, and the broader markets alike.

Lastly, SEC action on human capital management disclosure is a matter of American economic leadership and competitiveness.

Global regulators are moving forward with their own disclosure frameworks, placing U.S. investors and corporations at an information disadvantage if the U.S. does not pave its own path forward.

We believe the clear and consistent disclosure of human capital management factors will make existing U.S. issuers stronger. It will also attract more capital into businesses and industries that will, in turn, create pathways to economic opportunity for American workers.

Collectively, these five points show how a streamlined and standardized corporate disclosure framework on human capital management factors from the SEC will fortify the transparency, accountability, and efficiency of our capital markets and, in doing so, enhance the competitiveness of the U.S. economy for many years to come.

Thank you to the subcommittee for this opportunity to speak on such an important topic for U.S. investors.

[The prepared statement of Ms. Seegull can be found on page 77 of the appendix.]

Chairman SHERMAN. Thank you.

Mr. Vollmer, you are now recognized for 5 minutes.

STATEMENT OF ANDREW N. VOLLMER, SENIOR AFFILIATED SCHOLAR, MERCATUS CENTER AT GEORGE MASON UNIVERSITY

Mr. VOLLMER. Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, thank you for inviting me.

My written statement addresses three topics and provides some information about my background. In these oral remarks, I would like to summarize a few main points.

As noted in my written statement, my comments are solely my own and are not on behalf of the Mercatus Center or any other person or organization.

The subcommittee is considering a possibility of requiring additional disclosures on workforce management. The question about new areas of disclosure by public companies comes up regularly. When Congress or the SEC is considering the possibility of adding to the already-extensive list of disclosures required of reporting companies, it should be guided by a set of basic principles. My written statement lists several principles.

For example, Congress or the SEC should impose new disclosure obligations only when it has data or evidence of a strong need or a serious continuing harm that the private markets will not solve and that a law could solve.

Congress should evaluate the costs and benefits of possible new disclosure areas. One cost, of course, is compliance. Another cost is that investors, even sophisticated investors, find that disclosure documents under the current system are already long, complicated, and difficult to understand. New disclosure areas with detailed information make the problem worse.

A further cost is that new required disclosures restrict personal freedom. Congress should always bear in mind that new laws can reduce liberty. That is a genuine cost to take into account.

The bills and proposals for more disclosures in the workforce or human capital management area raise questions under these criteria. In particular, the need for more disclosure is open to doubt. The SEC expanded required human capital disclosures in 2020 and obliged companies to provide additional quantitative and qualitative information.

It also deliberately decided not to require extra metrics and statistical information so that each company could discuss the workforce issues relevant to its own business.

Additional disclosures in the area would certainly raise costs, especially costs of compliance, but would not necessarily produce benefits greater than those produced by the 2020 SEC rule.

My written statement also covers two other topics. I encourage the subcommittee to make progress on reforming the statutes and rules on capital formation. Congress could reduce obstacles set up by the public offering process, a complicated set of exemptions from that process, and the lengthy and burdensome set of disclosures that reporting companies must make.

The final topic I touch on in my written statement concerns the way the current SEC is managing and administering its work. A majority of the Commission has proposed a long list of major rules in quick succession, in ways that have disserved the rulemaking process and the public. The accelerated schedule has prevented the SEC staff from adequately developing and preparing draft rules and has denied reasonable amounts of time for the public to comment. That has diminished the quality of the proposed rules, and has lowered staff morale and increased staff departures.

Congress should consider systems to address these problems.

Those are the main points in my written statement. I would be happy to answer questions.

[The prepared statement of Dr. Vollmer can be found on page 83 of the appendix.]

Chairman SHERMAN. Thank you.

I now recognize the Chair of the Full Committee, Chairwoman Waters, for 5 minutes for questions.

Chairwoman WATERS. Thank you very much.

I want to address this question to Ms. Seegull.

According to surveys of public company executives, a majority of the CEOs identified human capital as one of the most valuable assets within their companies. Although many companies have taken the initiative to disclose human capital-related information on their own, including diversity statistics, others have not.

Further, there are widespread differences regarding how companies disclose investments in their workforce. For example, firms in the European Union are required to report human capital investments and salaries, bonuses, and other benefits, as well as board diversity information. But because similar disclosures are not required in the United States, only 15 percent of S&P 500 firms voluntarily do so.

According to the Embankment Project for Inclusive Capitalism, however, those U.S. companies that do voluntarily disclose this information outperform those that do not.

As your organization interacts with many investors, can you please discuss why workforce, or human capital metrics, particularly diversity-related information, is important to investors?

Ms. SEEGULL. Thank you for the question, Chairwoman Waters.

In terms of investor demand among the network of investors that we work with, in June of this year the U.S. Impact Investing Alliance joined nearly 50 investor and business organizations in writing to SEC Chair Gensler, encouraging the Agency to prioritize standardized disclosures on human capital management specifically. And that includes diversity data, which it is worth noting, is already collected by companies in their EEO-1 data. I think what we are asking here on diversity in particular is the disclosure of data that is already being disclosed.

I was reading and enjoying a Harvard Law School and IARS Institute report on materiality that specifically talks about human capital disclosure. It effectively is a metastudy of 92 empirical studies that examine the relationship between HR policies and financial outcomes, including return on equity, return on investment, and profit margins. And this metastudy effectively concluded that there is sufficient evidence of human capital materiality to financial performance to warrant inclusion in standard investment analysis.

Specifically, as it relates to diversity across corporate boards, senior management, and overall workforce, we know, according to studies, that diversity corresponds with better financial performance and resiliency, as well as a company's ability to attract and retain talent.

And I will also mention on the diversity piece the investors that we work with disclose workforce disclosure by race, gender, and LGBTQ+ and disability status so that investors can understand the diversity and the strength of workforce as a way of assessing a company's strength and allocating capital thereof.

Chairwoman WATERS. Thank you very much.

I have a little time left, and I would like to direct this question to Professor Rajgopal.

As you know, the SEC's proposed disclosure rule applies only to publicly-listed companies. Would you comment on the benefits of extending these disclosure requirements to similarly-situated but privately-held operating companies that issue unregistered securities, or operating companies that are wholly and substantially owned by private equity funds, such as Staples, which is owned by Sycamore Partners, and PetSmart, which is owned by BC Partners?

Mr. RAJGOPAL. Thank you, Chairwoman.

Part of the problem with this ESG disclosure idea is that if you mandate something for the publicly-listed companies, there is always a possibility of transparency arbitrage. So, if the rules become harder for public companies, you create incentives for these people to go private. And then, the exact problem that you were trying to solve in the public space just migrates to a different area.

One has to be careful about this information arbitrage idea, and this has been going on in other domains for a long time. That is my concern.

Chairwoman WATERS. Thank you.

I yield back.

Chairman SHERMAN. Thank you.

And I now recognize the ranking member of the subcommittee, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Thank you.

Mr. Vollmer, is it a correct assertion that any of the workforce management or diversity data items being considered here today would already have been disclosed if they were material to investors?

Mr. VOLLMER. I think that is true, since the 2020 SEC expansion of the rule.

Mr. HUIZENGA. Okay. And has the materiality standard, which has been the recognized standard for decades, served the American investors well?

Mr. VOLLMER. It has served American investors extremely well.

Mr. HUIZENGA. Okay. Is there a good reason to deviate from that standard, as each of these bills do?

Mr. VOLLMER. I think a materiality qualifier needs to be included in any additional disclosures that Congress adopts or the SEC adopts.

Mr. HUIZENGA. Just a short while ago, Ms. Seegull actually—and I wrote this down—was talking about workforce disclosures. And she said really what we are asking for is, “the disclosure of data that is already disclosed.” That didn’t make a whole lot of sense to me, other than maybe mandating it in a certain form through the SEC. And, obviously, there are costs when you are forcing companies to disclose information that is not material to investors. Correct?

Mr. VOLLMER. The cost can be extremely high.

If you go back to the very beginning when Justice Marshall adopted the materiality standard for proxy statements in a case called, *TSC,* he warned that a corporation and its management could be subject to liability for insignificant statements or misstatements and that shareholders could be buried in an avalanche of trivial information.

Mr. HUIZENGA. Yes. And an expansion of that is lately, we have seen some Democrat SEC Commissioners, in their speeches, call for ESG disclosure mandates on private companies. And the climate disclosure proposal would impose disclosure requirements indirectly on private companies through the Scope 3 requirements—Professor Rajgopal had mentioned a pizza delivery company.

I have Gerber Baby Food in my district, which is owned by Nestle, a publicly-traded company. So, you are now going to go and effectively require family-owned small farms that supply the peas, the carrots, and the corn that is steamed and put in a jar to now do a Scope 3 disclosure.

And as I talked to one of the farmers, he said, “I am the guy who does all the reports.” They are struggling to make sure they hit the organic versus the nonorganic, much less having a compliance department. There is none. It is completely unworkable, as has been discussed.

But a lot of these ESG mandates that are being discussed are for publicly-traded, because that is who the SEC regulates. But wouldn’t these direct, much less these indirect disclosure requirements on privately-held companies be concerning to you as well?

Mr. VOLLMER. I think trying to impose some of these broad and extensive disclosure obligations on private companies would be extremely unwise. Not only would you deter people from using the securities systems to raise capital, but you are talking about a group of investors for private companies that are extremely sophisticated and know what information they need to make investment decisions.

That is how the system operates at the moment. There is really no need to require large sets of additional disclosures.

Mr. HUIZENGA. They are sophisticated investors apparently until it comes to FTX, but that is another hearing that is going to be coming up.

And I question, frankly, whether it is legal. How do you have the legal ability to go in and force a privately-traded, privately-held company to do these types of disclosures that are not material?

I do want to also quickly touch on, in my last remaining seconds here, Professor Honigsberg, you had talked about what I viewed as accounting principles. That is very different than SEC-mandated disclosures. And as we were chatting up here, I think that is an area that we can and should discuss. But a 10-K or a 10-Q is very different than having the SEC come in on an ESG mandate.

But we ultimately need to know how these mandates help shareholders and how we make sure that we don't add additional regulatory burdens on those returns, thus harming mom-and-pop investors, as well as those institutional investors.

My time has expired, and I yield back.

Chairman SHERMAN. Thank you.

I would like to comment that I believe our ranking member is more woke than he may realize.

He tells us that the, "W," for today's hearing is for, "woke," and the, "W," for today's hearing is providing workforce metrics. So, if it is woke to want workforce metrics, an investor tries to evaluate a company, we here have to evaluate the SEC. The gentleman does that, and he focused on turnover and attrition at the SEC.

If he uses workforce metrics to evaluate entities that he has to evaluate, why shouldn't investors have workforce metrics to evaluate companies? And if it is woke to care about workforce attrition, then I thank the—yes?

Mr. HUIZENGA. Will the gentleman yield?

I am just trying to fit in.

Chairman SHERMAN. Good.

Mr. HUIZENGA. So—

Chairman SHERMAN. And the fact is that workforce is material to investors. My fear as an old accountant is that we are doing a great job of reporting a tiny portion of the information that is needed.

As the witnesses have pointed out, back in 1975 and before—and keep in mind, the balance sheet, the income statement we disclosed is 100-years-old. Back then, even in 1975, 90 percent of the value of the company was the stuff that is on the balance sheet today. Now, it is 20 percent or less of the value of the company is what is the balance sheet today. We need a supplemental statement.

Mr. Vollmer tells us that investors have perhaps been overwhelmed by too much information but, obviously, workforce metrics ought to be included, and if you watch CNBC, you will see that investors want more information.

The ranking member is concerned about our power to require disclosures from public companies. I say we clearly have that power under the Commerce Clause. And I would point out that we ought to provide—that when we are talking about large companies, we ought to require such disclosures just to keep things even between the companies that investors are allowed to invest in and the ones that are privately—that they can't invest in.

Ms. Allen-Ratzlaff, studies have shown—and these studies are impressive, at least to some investors—that companies make better decisions when their decision-making group is diverse. Should we disclose the diversity of the board, the executive group, or the diversity of, say, the top 5 percent in compensation at a company?

Ms. ALLEN-RATZLAFF. Thank you, Chairman Sherman, for that question.

Looking at the totality of disclosures that we have currently today, when you are talking about, for example, board diversity, that is something that right now, some companies disclose. Some do not. But investors certainly are looking for that information. And right now what we have is a situation where investors essentially are guesstimating more or less the diversity of boards, even though to your point there is research showing time and time again that diverse boards—and I would say diversity across the board—are better at making decisions. They create more value for shareholders. Period. That is what shareholders care about.

And I would also point out that we were talking about the S-K rules which went into effect in November 2020. And JUST Capital's data shows that 32 percent of companies at the beginning of 2021 disclosed some type of demographic data.

As of September 2021—

Chairman SHERMAN. I am going to interrupt. I have limited time.

Ms. ALLEN-RATZLAFF. Yes.

Mr. SHERMAN. But, yes, all of these companies are telling us things without universal definitions, tabular displays, internal control, or auditing; they are just doing it on their own.

And I would point out that Mr. Vollmer says that accounting standards diminish liberty. We don't give companies the liberty to decide what is on the balance sheet. We tell them at the Financial Accounting Standards Board (FASB). And we should have standards for disclosing other information.

I want to thank Professor Rajgopal for pointing out some of the accounting difficulties of dealing with Scope 3. I know a lot of environmentalists—I am always the only accountant in the room—and they don't know how tough it is.

I want to thank one of the witnesses for pointing out that if we in the U.S. don't provide information that at least some investors want, we will lose out to other investment markets.

And, finally, I want to point out that the SEC has been badgered in this room for the 26 years I have been here for not getting their job done. Thank God, they are working hard. They are getting their job done.

And I will now recognize Mrs. Wagner.

Mrs. WAGNER. Thank you, Mr. Chairman.

I have been, along with many others, very troubled that the SEC is deviating from its core mission of protecting investors and facilitating capital formation. It is as simple as that.

In fact, I, too, sent a letter last Monday to Chair Gensler, expressing my concerns with this proposed rule to reform U.S. equity market structures. This soon-to-be proposed rule appears to have been hastily developed without any empirical evidence that there is a problem with the current quality of U.S. equity markets for retail investors.

At a time when our equity markets remain the deepest, the most-liquid in the world, and provide retail investors with historically-high access to low-cost investment opportunities, the SEC's recommendations will have negative consequences on millions of mom-and-pop retail investors working to simply secure their financial future.

And I would like to enter, Mr. Chairman, this letter into the record.

Chairman SHERMAN. Without objection, it is so ordered.

Mrs. WAGNER. And I so look forward to finally questioning Chair Gensler on this matter in the next Congress. It is long overdue.

I am further concerned that the SEC is attempting to implement a partisan policy agenda through additional government mandates.

Mr. Vollmer, you touched on this some. But would requiring the SEC to establish mandatory disclosures on issues outside of its expertise and its mission, such as the proposals before us, result in a complicated and confusing disclosure regime for investors and businesses?

Mr. VOLLMER. Yes. It already has, and it will continue to do so if they continue on the same path.

Mrs. WAGNER. In your opinion, is the SEC the appropriate entity for determining reporting metrics and industry standards when it comes to workforce management and diversity?

Mr. VOLLMER. I am not aware that they have that kind of expertise. In particular, I think that some of the bills and the proposals would require very detailed disclosures in many different areas where I am quite sure the SEC lacks the expertise. But certainly, there are some employee and workforce areas where the SEC is competent.

Mrs. WAGNER. Does piling on additional disclosure requirements help increase capital formation and encourage companies to go public?

Mr. VOLLMER. Oh, I think there is a major concern with raising the cost of compliance with the disclosures that the SEC administers. It deters companies from going public.

Mrs. WAGNER. Yes, it does.

Mr. VOLLMER. And that deprives lots of retail investors of opportunities, because the private market offerings exclude a great many retail investors.

Mrs. WAGNER. It is a huge problem currently.

Mr. VOLLMER. I agree.

Mrs. WAGNER. Mr. Vollmer, can you describe to us how the SEC lacks statutory authority to adopt the rules in its climate disclosure proposal?

Mr. VOLLMER. I would be delighted, but I don't think you have enough time. I wrote two separate submissions and filed them with the SEC about their proposed climate change rules. The first one is a rather lengthy legal analysis of their lack of statutory authority. And the core of the point is, if you go back to 1933, the Securities Act of 1933 set the disclosure framework that has remained in place. It focuses on certain subjects, and those subjects all relate to the valuation of the company: financial performance; financial statements; the business; and what securities are being offered. Congress was very precise about these different categories of information. And that approach has carried forward to today, and the SEC is not permitted to vary it without Congress' consent.

Congress has not authorized—

Mrs. WAGNER. And what kind of regulatory precedent would that set for the SEC and for other Federal agencies if it would do so?

Mr. VOLLMER. We have already seen that the courts are very concerned about agencies exceeding their statutory boundaries.

Mrs. WAGNER. Right.

Mr. VOLLMER. Because then you have regulation by a very small group of unelected people, rather than having policies set by this Congress.

Mrs. WAGNER. Unelected bureaucrats. I thank you for your testimony.

I am out of time, and I yield back.

Chairman SHERMAN. Thank you.

The gentleman from Illinois, Mr. Foster, who is also the Chair of our Task Force on Artificial Intelligence, is now recognized for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

Our first 2 witnesses commented on the 90percent fraction of intangibles in the valuation of companies. To me, this raises questions or worries about whether there may be a valuation bubble that may at some point be on the verge of systemic collapse, perhaps triggering a financial crisis if it is 90 percent of valuations.

I think it was back, roughly, in 2018 that a paper came out of UC London called, "Capitalism Without Capital," that got play in The Economist magazine and elsewhere, and it described the sudden collapse of an English construction firm, I think, called Carillion, which had 40,000 employees, but apparently very few tangible assets and very badly-mispriced intangibles.

A recent example of what might trigger this sort of collapse is the incredible recent breakthroughs in GPT chatbots, which you may be aware of, where these look like they are very close to being able to replace computer coders, Harvard lawyers, and a wide range of people who spend their days staring at screens.

And this would immediately cause a massive revaluation of the human capital part of the valuation of firms. There are thoughtful commentators looking at the performance of these who think that within a couple of years, Google is going to be obsolete, that instead of searching the internet, you will simply ask your chatbot to summarize the total content available on the internet, and it will give you a nicely-formatted, concise summary of what you want to know. And this will immediately—Google has all sorts of intellectual property and intangibles and a great workforce around its search business that will be vaporized.

So, how do you view this, and how worried should we be in Financial Services about the potentially-volatile nature of the valuation of human capital as AI accelerates its disruption of the workforce?

I guess I will go in the order that you were called, since you both mentioned the 90 percent.

Ms. ALLEN-RATZLAFF. Sure. Thank you so much for that question. I think we absolutely should be concerned. I think the 90 percent is huge. And the SEC's job is to make sure that investors have the information they need to make decisions or get out of the way. There is nothing more free market than that. And investors have been raising the same issues that you have, that we simply have no idea how well companies are managing their workforces.

It is interesting—I know several years ago, there was a rule adopted by the SEC on CEO-to-worker pay ratio, and regardless of your personal or political views across the board on that, we actually looked through a few of the disclosures. And in 2 hours, we found 14 companies that said that they actually have no idea and they cannot tell you what they spend on their workforce.

Labor cost is a basic part of the income statement on which every single financial statement is based. So, if there is something wrong with that, it's the same with the balance sheet.

Mr. FOSTER. Before I go on to the next witness, do you have trouble untangling the cause and effect between profitable companies and companies that treat their workforce well? Because you can imagine that a company with a good line of products is very profitable and is in a position to treat its workers well, whereas one that is forcing external competition simply may not be able to. And how do you deal with that?

I am getting nods from our second witness, so if you could try to answer both of those?

Ms. HONIGSBERG. Congressman, those are both great questions. And I think, consistent with my colleague here, I would say this is all the more reason why we need to provide this type of information.

For example, there is a recent study that I think is relevant to your second question. And this study looked at both capital expenditures and labor cost as a percentage of sales over the period from 1991 to 2018. They found out capital expenditures as a percentage of sales remained roughly constant at about 10 percent. Whereas, labor expenses as a percentage of sales increased from about 28 percent to close to 50 percent.

Now, this was done with European data. We wouldn't be able to run this type of study in the U.S., but presumably we would have a similar trend here.

And so for us, I think we really want to be able to identify this information. How much are they spending on human capital? If we see erosion because of AI, we would see that number actually being able to decrease in a way that we can see with European data but that we wouldn't be able to see right now using our U.S. data.

Mr. FOSTER. Yes. Thank you. And if any of you have a reading list for a Member of Congress that is sort of at the level of the UC

London paper, and you can submit it for the record, I would very much appreciate it.

Thank you. I yield back.

Chairman SHERMAN. Thank you.

I now recognize the gentleman from Ohio, Mr. Davidson, for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman. And thank you to everyone for being here. I greatly appreciate you being here, but I think you have heard from us before, we really feel the panel would be rounded out with Chairman Gensler here since he is driving an awful lot of this or attempting to.

We are thankful, or at least I am, that not every sector of the government was able to get someone in place. I am glad that Sarah Bloom Raskin is not at the Federal Reserve. I hope the Federal Reserve stays focused on its own lane.

But this whole idea of ESG dominating our capital markets instead of fiduciary duty, I think is rightly troubling. I have had constituents frustrated because they feel like their pension fund isn't pursuing the best returns. I have had financial advisors frustrated, and I have jhad ust had ordinary people in business asking, why are my bigger customers pushing us to do these things for disclosures net of mandates from capital markets.

People want to run the business that they built. And if you look at, say, the most alarmist predictions on sea level rise or something like that, the idea that you couldn't possibly make a loan that is for 5 years and understand the risk of default is hard for people to comprehend.

Mr. Vollmer, when you look at fiduciary duty, has there been a statutory change that we all missed somehow, that says, no, ESG is now more important than a fiduciary duty?

Mr. VOLLMER. No. There has not been a change. And I think the foremost consideration of both fiduciaries, asset managers but also corporate boards, is to produce the maximum returns for shareholders.

Mr. DAVIDSON. Yes. And as has been discussed already, a materiality standard there, which could include some other impacts. But in your testimony, you discussed the accelerated rulemaking agenda within the SEC, which has led to all kinds of problems there and problems potentially for our capital markets. In light of *West Virginia* v. *EPA,* there are also clearly problems for the fact that it is not legal.

Do you believe that an agency with the kind of morale, staff retention, and leadership problems that the SEC has under Gary Gensler adequately promotes capital markets in our country?

Mr. VOLLMER. I think that we need to return much more attention to capital formation and capital access.

Mr. DAVIDSON. Yes. Almost like we could focus on the mission, not necessarily this other agenda. So yes, I really appreciate that. I think that is a sentiment broadly shared, but it's troubling that it is not shared by most of the positions that the Biden Administration has appointed.

One of the important things is that the Biden Administration has appointed people whose mean years of private-sector experience is zero. They are all academia, thought leaders down this movement.

And speaking of that, Ms. Honigsberg, earlier this year you participated in a podcast with Joe Bankman, your colleague at Stanford Law and the father of Sam Bankman-Fried, the now disgraced and former CEO of FTX. In that podcast, you spent time with Mr. Bankman trying to outline the importance of ESG reporting requirements, and you even discussed an example where a small group of investors was able to force a vote on ExxonMobil to push for cleaner energy.

Speaking of Exxon and FTX, the FTX case poses some interesting ESG questions. An analysis by TruG Labs gave FTX a higher ESG rating than Exxon. As you know, it was largely due to Mr. Bankman-Fried's approach to what he claimed was, "effective altruism." Perhaps like Robin Hood. I don't know. I don't know what his logic was.

But, Ms. Honigsberg, do you really feel that a higher rating for a company like FTX is more merited than Exxon? And if not, what is this ESG metric missing?

Ms. HONIGSBERG. That is a great question. And, first and foremost, I really hope all the victims of FTX get the fullest extent of justice that they can get under the law. I think we all think that.

And in hindsight, clearly, it doesn't make sense that a crypto company would have a higher rating than many other companies. My understanding of the issue with that was that Exxon was largely unreceptive to feedback and consideration. And it also comes down to how we measure ESG, which is terrible.

For example, Professor Rajgopal and I went through 4 different issuers, and we found that those 4 different issuers disclosed 70 different metrics just on human capital alone. Only one of them was disclosing comments. You just don't have the information to where you can evaluate and companies are able to cherry-pick.

Mr. DAVIDSON. Yes. I agree that the way you do an ESG is terrible. So, thank you.

Chairman SHERMAN. I look forward to next year when I am sure the then-Majority will have Mr. Gensler here. It will make my life more interesting and it will boost our ratings on C-SPAN3.

I now recognize Mr. Vargas from California.

Mr. VARGAS. Thank you very much, Mr. Chairman. I appreciate it. I want to thank Chairwoman Waters, of course, and you as Chair, and the ranking member, for this hearing. I think it is very, very important.

Before I get into my prepared remarks, I do want to ask Ms. Seegull, you were quoted, and I think correctly, that disclosed information is already disclosed. Within the context of what you were saying, I thought what you meant to say was that information is already collected, but maybe it wasn't. I do want to give you a few seconds to clarify that.

Ms. SEEGULL. Thank you, Congressman Vargas. Yes. I apologize if I misspoke.

What I meant to say, if I didn't say it, is that EEO-1 data on workforce diversity is already collected by large companies but not disclosed currently to investors. My point was: one, that it should be disclosed to investors; and two, because the information is already being collected, it would not impose significant additional costs on issuers to disclose vital information to investors.

Thank you.

Mr. VARGAS. Thank you. That is what I understood. I think you misspoke.

It's funny, if you were 80-years-old, they would say you were senile, because that is what the other side says about the President. But obviously, you are incredibly intelligent, and you just misspoke a word, and that happens all the time. But again, unfairness sometimes. You should have been given the courtesy to correct that, and I am glad you did correct that.

With that being said, I know this hearing is focused on workforce management, but Iwould like to look at the totality of ESG-related disclosures. ESG disclosures are market-driven initiatives to increase investor education and corporate transparency information from ESG disclosures, help investors gain greater insight into what companies are doing to reduce their carbon footprint, and address important issues like climate change, diversity, and labor rights, which I do think are material.

Investors understand that ESG issues are material and need to be accounted for when accessing market opportunities and risks. In market economies, it is called complete information when investors have all the needed metrics to make well-informed, ethical, and sustainable financial decisions. As a matter a fact, the data shows, and today we heard testimony, that corporations that implement sustainability strategies, I should say, have experienced better financial information, such as more innovation, higher operational efficiency, and better risk management.

Additionally, a recent Ernst & Young survey states that a majority of companies saw higher than expected financial gains from their ESG initiatives. And companies that incorporate financial metrics, employee well-being, and customer benefits in holistic ESG programs saw increased environmental gains as well.

Just to be clear, it is profitable to be in the business of sustainability, root stewardship, environment, diversifying the boardroom, limiting corruption, and taking care of your workers. These factors materially impact companies' performance communities and the lives of our constituents. And I applaud Chairman Gensler and the SEC for their proposed ESG disclosure. In addition, I am proud to announce that next year, I will be working on the Congressional Sustainable Investment Caucus. I look forward to working with Chairwoman Waters, and my colleagues, hopefully on a bipartisan basis, to highlight the role ESG plays in our economy.

Ten years ago when I got elected, my good friends on the other side—and I do have some very good friends on the other side; I shouldn't be beating then up so much—were all about beating up the Dodd-Frank Act. Then, when the CEOs of the banking industry came, they said Dodd-Frank was actually very helpful. And when we heard from the academics, they said that Dodd-Frank was very helpful, especially the capital standard. So, they don't beat up on it anymore.

They used to beat up on the SEC, saying they were too hard on crypto. In fact, it is kind of interesting, I saw a little bit of backsliding here today. Because they said, why do they have to have so many disclosures? Well, now we see why they should have more disclosures.

But, anyway, all that being said, I do want to ask Professor Ratzlaff, do you believe that ESG is material information?

Ms. ALLEN-RATZLAFF. Thank you so much. And I would love to say that I am a professor, but I am not. But I do believe that factors which might be considered ESG—the definition is a little bit difficult—are already being taken into account by investors. And I also would like to state that materiality is not necessarily a requirement. I know I have heard that from colleagues many times on this panel, but it is simply not the case.

If we used a materiality standard, we would never know about executive compensation, for example. There are materiality standards that are based on a certain percentage of revenue. There are standards that are based off of just information that investors have been saying is important. I just wanted to be very, very clear that investors are looking for this data.

And to your point, you mentioned FTX. We all saw the leaked picture of their income statement, and what we don't want to see is, "Uh, I am not sure if this is accurate or not."

Mr. VARGAS. Thank you.

Chairman SHERMAN. The gentleman's time has expired.

I now recognize the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman. And thanks to the panel, a very informed, smart, good panel, and helpful to the committee's operation.

Like all laws, there are good things and bad things in those laws. So, there are plenty of things that House Republicans still object to that were contained in Dodd-Frank, and I could go into those in great detail, but we are not going to do that today.

Professor Rajgopal, I thought you made a really good, thoughtful statement about information arbitrage, which is a classic in economics, and the Ph.D. in accounting even learns about it. So, you have this perverse incentive of raising agency costs and sending people from the public markets to the private markets. But also, there is the issue of building up a cost structure that is so high, that even if one's objective to be a public enterprise is still number one, you are raising the market cap to justify going public, reducing capital choice to small and midsized and emerging growth companies, which is why this Congress and this committee, on a bipartisan basis, has passed two versions of the JOBS Act in order to drop those agency costs and those burdens.

In this debate about whether it is the, "E," in ESG or the, "S," a lot of this is about doing it in the right way rather than the wrong way to diminish agency costs and not deter capital formation. There is no use in here of people calling people names about climate denier, nah, nah nah, blah, blah, blah. So, I want to thank you for that comment. I thought it was helpful.

Have you read the 2017 so-called Mark Carney-Bloomberg Commission Task Force on Climate Disclosure?

Mr. RAJGOPAL. It is a long document, as I recall.

Mr. HILL. It is a long document. And it requires that those disclosures be timely, accurate, comparable within industries, measurable across industries, and not too costly. It has a whole list of things that they say, and then they end up saying, while these are great goals, it is going to be very hard to do this. And, in fact, they say, don't do Scope 1, Scope 2, or Scope 3. They have a whole metric in that 2017 report suggesting a different emissions-type definition

I think that is why we are not skeptics about doing disclosure. We want to do it in the right way, in the least-costly way that brings the most benefit. Let me stop there and, again, thank you for your comment.

And, Dr. Honigsberg, excellent comments as well. I share those with the ranking member about accounting standards and would love to get a memo from you on—a GAAP memo that addresses workforce-related issues that I assume—do you know that GAAP or FASB is entertaining working on that? And, really, I don't want to say it has nothing to do with this committee, but it is in a KQ disclosure per se, and we were both intrigued by that.

What is the working group zone out in FASB land on that topic?

Ms. HONIGSBERG. First, I would be delighted to work with your staff on any of these issues.

Mr. HILL. Yes.

Ms. HONIGSBERG. Now, we have had conversations with FASB about this. My understanding is that they are more focused and are actually considering income statement desegregation.

Mr. HILL. Okay.

Ms. HONIGSBERG. They would look at, for example, breaking out cost of goods sold into what portion is labor, and what portion is other elements, but that is FASB. They have a relatively slow timeline.

Mr. HILL. Yes, they do. We remember it when it was just a suggestion.

Ms. HONIGSBERG. Exactly. So to the degree that we can help them better focus on what would be helpful in valuation, I think that would be great.

Mr. HILL. Thank you. I think in academics and also in the coalition-type work, this is not a one-size-fits-all topic in any way, shape, or form. And, Mr. Vollmer, you have made that point. So, for industry groups making industry recommendations to standard-setters is the way to go. It shouldn't be mandated by Congress. It shouldn't be mandated by Gary Gensler. It really shouldn't. That is not the way, over the years, that we have developed this.

Mr. Vollmer, you were the Deputy General Counsel of the SEC when Chair Clayton created this principles-based approach on Reg S-K basing it on material information. In your view, has there been a demonstrated need or market failure that necessitates a more-prescriptive approach to this topic?

Mr. VOLLMER. I think that the SEC's new rule in 2020, which tried to balance some enhanced disclosures, including quantitative disclosures but with flexibility, was reasonable and we ought to give it some time to work.

Mr. HILL. Because people are now studying that. I just read an Aon study—I would like to insert that into the record, Mr. Chairman, if I could—the Aon study comparing the first 2 years.

Chairman SHERMAN. The time of the gentleman—

Mr. HILL. I have a motion. I am asking for your permission to insert in the record an Aon study on the—

Chairman SHERMAN. Without objection, it is so ordered.

Mr. HILL. Thank you. I yield back, and I appreciate the time.

Chairman SHERMAN. A vote has been called. We will adjourn this hearing when 300 of our colleagues have completed voting.

And I will now recognize Mr. Casten for 5 minutes, and note that he is the Vice Chair of this subcommittee.

I also want to note that we do have jurisdiction in this subcommittee over FASB and PCAOB.

Mr. CASTEN. Thank you, Mr. Chairman. I will try not to talk for 300 votes.

I want to focus on the, "E," part of ESG. A 2020 CFTC report said that climate change poses a major risk to the stability of our financial system. In 2021, FSOC said basically the same thing. The IPCC has recently said that if we stay on the current trajectory, losses from climate change could approach $23 trillion per year.

I see you nodding, Mr. Rajgopal.

That risk or any risk, if I am an investor and I am concerned about that risk, I would like to know: number one, who is contributing to the risk; number two, how do I hedge the risk; and number three, who is most exposed to the risk, so I can move my capital around appropriately.

Now, I think your answer is going to be yes. If you say no, I am going to have to pivot to a friendlier witness, but in general, Mr. Rajgopal, do you agree that, provided they have sufficient information, that markets are actually a very efficient way to allocate risk?

Mr. RAJGOPAL. Absolutely.

Mr. CASTEN. Okay. Good. We can move on then.

Going to who is the hedge against that risk. And I was just sitting here Googling on my phone as of the close of last week. First Solar is trading at a price earnings ratio of 189. NextEra is trading at a price earnings ratio of 30. Tesla, as much as their CEO is going crazy right now and tanking their stock, they are still trading at a price earnings ratio of 55. ExxonMobil is trading at 8. Chevron is trading at 10.

Given our agreement about capital markets, would you say that capital markets are efficiently allocating market capital in response to hedging out these climate risks or are they just woke?

Mr. RAJGOPAL. My read of Exxon is probably similar to yours in the sense that maybe they see that, in the future, eventually, for all kinds of reasons, the demand for oil, especially from transportation, will maybe stabilize, if not abateeventually, and maybe that is what the markets are looking at.

Mr. CASTEN. Yes. And I am not asking you to opine, but we are actually seeing movements of capital, which is positive, right? But every time we have seen an industry transition, some companies have pivoted and adapted and some have whined. And we know what happens when the markets pivot.

Now, I put this caveat on the front of, if we have complete information—and this is all about markets moving to hedge the risk and look at where it goes—when we look at the losses from climate change, do you think we have sufficiently transparent information now to make sure that investors can rationally allocate their capital?

Mr. RAJGOPAL. Absolutely not.

Mr. CASTEN. Neither do I. And I ask that because this, according to me, is about financial stability. It is not about wokeness. It is about, if we don't have the information, of course, there isn't an industry in the world that has ever come to Washington and said, dear Members of Congress, would you please make our industry more competitive and efficient. It never happens. So, it is understandable that there is—and please don't be woke, please don't stop our capital from going—meanwhile, these losses are coming.

There is a recent study—and I am just picking on one State. I am intentionally picking a State that we don't think about in terms of flooding. We have sea level rise, you have losses. West Virginia is not a State that you think about as a super flood-prone risk. First Street Foundation recently estimated that more than 400,000 properties in West Virginia are at risk of being severely flooded in the next 30 years, which represents more than one-third of all of the properties in the State.

If I am an insurer, a mortgage provider, someone who is holding the residual equity in those, do you think I actually have enough information to understand and to hedge that risk right now?

Mr. RAJGOPAL. Are you asking me if investors have the information or do the insurers have the information?

Mr. CASTEN. Let me maybe reframe that.

If there is a lack of complete information—and we had this conversation a few months ago with Jay Powell when I talked about flood risk, and I asked, "Do you think the sophisticated players will spot this sooner and offload the risk onto the unsophisticated players?" And he said, yes—I am paraphrasing—that would probably happen. That is a risk, I think, to the stability of the financial system.

Do you see risks to the stability of the financial system if we don't get this transparency of information? And we could talk about floods. We could talk about fires. We could talk about any number of climate risks.

Do we have complete information? If we don't, is there a stability problem there?

Mr. RAJGOPAL. Let me, in 30 seconds, try to do the best I can with that question. That is a very complicated question.

In my view, insurers, especially the property and casualty (P&C) insurers, write 1-year policies. So, they have to worry about risk for 1 year. If you are an equity investor or an insurance company, you probably have a longer horizon. They are completely different problems.

Mr. CASTEN. Of course.

Mr. RAJGOPAL. Like I said, a life insurance policy, where I have to forecast whether the person I am writing the policy on will live for 20 years or 30 years or 40 years, is a fundamentally different kind of contract. Life insurance and P&C are different, which makes this quite hard.

Mr. CASTEN. And the CFTC report I mentioned actually observed that they saw an offloading risk onto Fannie Mae and Freddie Mac in flood-prone areas.

Thank you.

Mr. RAJGOPAL. Thank you.

Mr. CASTEN. Professor Honigsberg, I was hoping to follow up on this with you. If you would like to follow up offline, I would love to connect with you.

But thank you, and I yield back.

Chairman SHERMAN. I thank the gentleman from Illinois.

I would point out that some 368 Members have not voted yet, so we do have enough time.

We look forward to hearing the questions of the gentleman from West Virginia for 5 minutes.

Mr. MOONEY. Thank you, Mr. Chairman.

There has never been an Administration more hostile to the fossil fuel industry and, by extension, my beloved State of West Virginia, than the Biden Administration. When the Obama-Biden war on fossil fuels began in 2009, coal mining employed nearly 28,000 West Virginians. Today, that number has shrunk to half, about 14,000. And just last month, President Biden said, referencing coal, that, "we are going to be shutting these plants down all across America."

President Biden is putting West Virginians out of work and suffocating our economy. Biden and his allies here in Congress have not been able to pass many of their climate change, climate priorities in Congress through the democratic process. Instead, Biden is turning to his financial regulators to abuse their authority and bypass Congress to enact them on his behalf.

Despite businesses and these job-creating businesses that are important to my State and all across the country saying it would be costly and unworkable, the Securities and Exchange Commission is pushing forward with a rule to require public companies to disclose all of their emissions, including from their upstream and downstream suppliers.

My question is for Mr. Vollmer: How is information about climate emissions actually material to an investors' investment decisions? In other words, is this just a way to name and shame fossil fuel companies?

Mr. VOLLMER. It is difficult to answer that question generally because climate change information covers such a broad range. But I think the better way to think about this and the short version of the answer is, there are already extensive required disclosures in the Federal securities laws. They go on for pages in the Code of Federal Regulations, and they cover all aspects of the financial performance and operations in business of reporting companies. And they touch on all of the matters that would be relevant or important to investors. So, there is no need for a whole separate second set of disclosures aimed at climate change risks.

Mr. MOONEY. Thank you. Well put.

As a follow up to that, activists contend that ESG investing is somehow the morally-responsible and more-profitable thing to do.

Mr. Vollmer, how do the returns for the families who invest in ESG funds compare to non-ESG funds?

Mr. VOLLMER. I am not current with all the recent research, but the last time I looked at it, it is a highly controversial and debatable point. The evidence is mixed, and it often depends on how the questions are asked, how the studies are done. I think we need to be careful of people who assert that extensive disclosures in these various areas produce benefits for investors or tell us more about the returns of some of the reporting companies, because I am not sure that in the end, that is really solid.

Mr. MOONEY. Okay. Thank you.

I just want to state that under the strong leadership of our State Treasurer in West Virginia, Riley Moore, we have led the way in divesting from asset managers who focused on appeasing woke activists rather than maximizing returns for American families and retirees who depend on these returns to pay their bills, their mortgages, their children's college tution, and to put food on the table.

State Treasurers have a fiduciary responsibility to maximize returns on investments. At a time when the number of companies going public has dropped dramatically, the SEC and congressional—my colleagues on the other side of the aisle here, the Democrats, would be wise to focus on actions that encourage business growth rather than pushing for irresponsible environmental policies.

Thank you, Mr. Chairman. And I yield back.

Chairman SHERMAN. Thank you.

I want to thank the 320 Members of Congress who have not voted yet because they give me an opportunity to recognize the gentleman from New Jersey for 5 minutes.

Mr. GOTTHEIMER. Thank you, Chairman Sherman. I am also grateful. And thank you to all of our witnesses for being here today.

A recent scandal uncovered that Sustainalytics, ESG research, a subsidiary of Morningstar, has published ESG ratings of companies based on information from the biased United Nations Human Rights Council that has long promoted anti-Semitism, undermined U.S. allies, including Israel and Taiwan, and selectively ignored human rights abuses around the world. Just this past October, the biased council refused to even debate the treatment of the Uyghur population in China.

Americans choosing to invest in ESG-focused financial products expect firms to provide unbiased and relevant data about how their money is supporting specific ESG goals. Morningstar's use of the biased United Nations' data is completely unacceptable.

Ms. Allen-Ratzlaff, if I can ask you a question, please, does JUST Capital use the United Nations' biased Human Rights Council as a source for human rights-related ratings?

Ms. ALLEN-RATZLAFF. Not to my knowledge, no. Our ratings—I should say that their relative rankings are based solely on what we hear from the American people are their priorities.

Mr. GOTTHEIMER. Good. It sounds like that is a, no. I am happy to hear that.

Do you feel it is appropriate for ESG ratings firms to use potentially-biased information from international organizations to develop their scores?

Ms. ALLEN-RATZLAFF. I actually think that you point to an important problem and issue within ESG in and of itself, that there is no definition for it. We know that, "E," stands for environment, "S," stands for social, and, "G," stands for governance, and that is about it.

That is a private company that has decided to use certain metrics. Again, we use a relative ranking. I wouldn't view us, JUST Capital, as a ratings firm. I would view us as looking at how well companies satisfy the expectations of American workers, and, again, that translates into value.

Mr. GOTTHEIMER. Right. You have to be careful, because it could be misleading to investors?

Ms. ALLEN-RATZLAFF. Actually, yes. Yes. Without any definition, yes. Absolutely. And I think that is why 90 percent of Americans, including 86 percent of Republicans, 98 percent of Democrats, and 88 percent of Independents say it is important that there are common standardized reporting structures for companies. I think what we are seeing right now is that, we start with the free market. That is great. But right now, we are just not getting high-quality information.

I push back a little bit on the idea that what we are looking at right now is not of use to investors. It absolutely is. And to make sure that we are able to create value for, for example, a beneficiary at a pension fund by telling that pension fund, I am sorry, you can't consider factors that you would have considered 30 years ago to understand how well, for example, your companies that you have bought debt from are able to pay back that debt. It just concerns me.

Mr. GOTTHEIMER. Thank you.

Ms. Seegull, in your work with Impact Investors Alliance, how do you help them evaluate ESG research to ensure that their decisions are not inadvertently supporting outside efforts, like the anti-Semitic Boycott, Divestment, and Sanctions, or BDS movement, which the U.S. Congress has overwhelmingly condemned, or other efforts that can undermine our allies?

Ms. SEEGULL. Cambria and others have brought up the rating agencies and the methodologies that these rating agencies use. The data comes from sustainability reports that are voluntarily offered with the data points cherry-picked. And so,a what we have in these ratings is publicly-available information, unverified, and cherry-picked.

And what we encourage our investors to do is to take ratings under advisement, to look at underlying methodology, and to do their own primary research. The problem is that without standardized, comparable data, which I think we are all calling for from the SEC on material ESG factors, we are reliant on these imperfect rating metrics we talked about.

Mr. GOTTHEIMER. Right. And these metrics can be misleading, and mislead investors and actually get them to support things that are counter to their values. That is my concern.

And I yield back. Thank you so much.

Chairman SHERMAN. Thank you.

Mr. HUIZENGA. Mr. Chairman, I have a letter to submit for the record that was sent to Chairwoman Waters and Ranking Member McHenry from the Small Business Investor Alliance concerning the negative impact increased disclosures could have on small businesses.

Chairman SHERMAN. Without objection, it will be entered into the record.

I want to thank our witnesses today and, again, for changing their schedule so they could be here today even though we were going to do this 2 days ago.

The Chair notes that some Members may have additional questions for these witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is adjourned.

[Whereupon, at 10:46 a.m., the hearing was adjourned.]

A P P E N D I X

December 8, 2022

Testimony of

Cambria Allen-Ratzlaff
Managing Director and Head of Investor Strategies
JUST Capital

Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets

E, S, G and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data

December 6, 2022

Full Text of Statement

Chairman Sherman, Ranking Member Huizenga, and other Members of the Subcommittee:

Good afternoon, and thank you for the opportunity to testify at today's hearing. My name is Cambria Allen Ratzlaff, and I am Managing Director and Head of Investor Strategies for JUST Capital.

I am pleased to appear before you today on behalf of JUST Capital, and to share with you our data and research.

My written testimony includes a brief overview of JUST Capital, an independent nonprofit that works at the intersection of business, finance, and civil society to build and support a stronger, fairer, and more just market system that reflects the values of the American people.

We know that investors are seeking more decision-useful information to understand and assess a company's business risks and prospects in order to make critical decisions about how and where to direct capital. We have spent over five years investigating how companies that do best on the American people's priorities perform financially and in the marketplace, and we have found that our company performance data, investable indexes, and in-depth financial analysis demonstrate a powerful business and investor case for just business behavior. In other words, companies that perform best on the things Americans prioritize also do better for their investors.

One of things we do know is that Americans want more trusted and reliable information on how companies are actually performing on the issues they care about, especially "kitchen table" factors such as how companies are investing in their workers, creating good jobs, and supporting stronger and healthier communities, as well a number of issues that relate to environmental factors, including climate risk. They want this information so they can make more informed choices as workers, consumers, and investors. A poll we fielded earlier this year also suggests Americans would like to see more standardized disclosure on key issues relating to their business practices and impact on American society.[1]

We also know that, based on our assessments, the current data landscape does not meet these different needs (because of the dearth of data and the frequent lack of meaning and veracity), increasing risks for those stakeholders and their use cases.

Introduction to JUST Capital

JUST Capital is an independent, nonpartisan nonprofit dedicated to building an economy that works for all Americans by measuring and improving how America's largest public companies do right by their workers, their customers, the communities they operate in, and more. Every year we ask the American people what their priorities are, map how well Russell 1000 companies perform against these priorities through our Rankings, assess how well this performance translates into investment returns, and work with companies to help them improve performance. While our survey research is not framed in ESG language or context, Americans understand the core issues and have a clear, common sense picture of what they think is important. Therefore, our data incorporates metrics some may view as "ESG" only to the extent the American public tells us they are relevant. We are not an advocacy group, but rather we go where the polling and data take us. We have consistently observed that companies that best serve the needs of key stakeholders also tend to outperform in the U.S. capital markets.

Our process begins with an annual poll of the American public to identify the issues that matter most to them in defining business behavior today. Since 2015, we've engaged more than 160,000 respondents broadly representative of the U.S. adult population. We observe that these issues fall into five key stakeholder groups: Workers, Communities, Customers, Shareholders and Governance, and the Environment. Issues prioritized by the public become the foundation by which we track, analyze, and incentivize corporate behavior change, including our Rankings of America's Most JUST Companies and our investable indexes.

Building our 2023 Annual Survey to identify Americans' priorities for large U.S. public companies

As in previous years, we began our 2023 Annual Survey process by facilitating a series of group conversations with a diverse mix of Americans across the U.S. to help us broadly understand the business behaviors and actions they view as most important.[2] These focus groups enable our research team to hear the unvarnished voice of the public speak to what issues matter most, and whether their opinions have changed over time. The polling team then distills the focus groups' major themes into statements that capture these concepts, which we call "Issues." This years' survey – which will form the basis of our 2023 Rankings – yielded 20 Issues, which is consistent with the number of Issues identified last year.

Since the public initially tells us that all of these Issues are of high importance, we then conduct a choice modeling exercise to understand the *relative* importance of each Issue. From here, we extract a "weight" per Issue that we use to power our Rankings of America's Most JUST Companies.[3]

This year's survey covered 3,002 Americans and was conducted from June 22 to July 11, 2022 in partnership with SSRS, a non-partisan research institution that provides scientifically rigorous statistical surveys of the U.S. population.

Results were weighted to U.S. Census parameters for age, gender, education, race/Hispanic ethnicity, and Census Division to ensure representativeness of the U.S. population (Figure 1).

Figure 1

2022 Demographics

AGE	
18-29	19%
30-44	26%
45-54	14%
55-64	19%
65+	21%

EDUCATION	
Less than high school	8%
High school grad/equivalent	30%
Some college/Associate's degree	27%
Bachelor's degree+ (some post grad schooling)	23%
Graduate degree	12%

HOUSEHOLD INCOME	
Less than $40,000	36%
$40,000 to $74,999	24%
$75,000 to $249,999	31%
$250,000+	3%

EMPLOYMENT	
Hourly, low wage workers	22%
Previously worked for a large company	58%

POLITICAL IDEOLOGY	
Conservative	31%
Moderate	37%
Liberal	31%

RACE/ETHNICITY	
Asian/Non-Hispanic	5%
Black/Non-Hispanic	12%
Hispanic	17%
White/Non-Hispanic	63%
Other/Mixed race	3%

GENDER	
Female	53%
Male	45%
Non-binary	1%

Each year, Americans have identified the American worker as the highest priority group

Consistent with each of the six years we have conducted our polling, the resounding refrain from the public in 2022 is that America's largest companies should put workers squarely at the heart of just business practices.

Four of the top five Issues of relative import relate directly to various aspects of working life, from wages and job creation to advancement and health and safety:

1. Pays a fair, living wage. (21.2%)
2. Creates jobs in the U.S. (11.1%)
3. Acts ethically at the leadership level. (7.6%)
4. Protects worker health and safety. (7.3%)
5. Supports workforce retention, advancement, and training. (7.1%)

This year's top Issue, "Pays a fair, living wage," takes that spot for the third consecutive year, and more than doubled in importance over the last two years (from 9% in 2020 to 21% in 2022). Additionally, more than three-quarters of Americans say that this Issue is "more important" (including 50% saying it is "much more" important) than last year.

Collectively, Issues most directly impacting Workers will comprise 44% of a company's score in our upcoming 2023 Rankings of America's Most JUST Companies, followed by Communities (18%), Customers (14%), Shareholders and Governance (12%), and the Environment (12%).[4]

Americans are clear, consistent, and united what they want companies to prioritize: workers and wages

Despite increasing media attention and political rhetoric that the country is incredibly polarized, we are not divided as a country when it comes to expectations regarding business behavior.

There is broad consensus across all demographic and political cohorts that Workers should be corporate America's top priority.

Specifically, among every demographic group – liberal, conservative, high-income, low-income, men, women, young generations, older generations, and white, Black, and Hispanic Americans – the Workers stakeholder is the top priority (Figure 2). And for every one of these demographic groups, the most important Issue is "Pays workers fairly and offers a living wage that covers the cost of basic needs at the local level."

Figure 2

Overall	Stakeholders	Black	Hispanic	White	Republican	Democrat	Low-wage	Women	Under 30	65 plus	Active Investors
1	Workers	1	1	1	1	1	1	1	1	1	1
2	Communities	2	2	2	2	2	2	2	2	3	2
3	Customers	3	3	3	3	4	3	3	4	4	3
4	Shareholders	4	5	4	4	5	5	5	5	2	4
5	Environment	5	4	5	5	3	4	4	3	5	5

Overall	Top 5 Issues	Black	Hispanic	White	Republican	Democrat	Low-wage	Women	Under 30	65 plus	Active Investors
1	Pays a fair, living wage	1	1	1	1	1	1	1	1	1	1
2	Creates jobs in the U.S.	2	2	2	2	2	2	2	3	3	2
3	Acts ethically at the leadership level	4	8	3	4	4	5	5	5	2	3
4	Protects worker health and safety	3	4	4	5	3	3	3	2	5	5
5	Supports workforce retention, advancement, and training	5	3	5	3	6	4	4	6	4	4

(For a more comprehensive look at our polling process and results, see Appendix 1.)

There is a strong case for investment in America's Most JUST Companies

The corporate data from our Rankings are a tool for investors as much as they are for the C-suites and boards running the companies we track. We know that investors are seeking more decision-useful information to understand and assess a company's business risks and prospects in order to make critical decisions about how and where to direct capital. We have spent over five years investigating how companies that do best on the American people's priorities perform financially and in the marketplace, and we have found that our company performance data, investable indexes, and in-depth financial analysis demonstrate a powerful business and investor case for just business behavior. In other words, companies that perform best on the things ordinary Americans prioritize also do better for their investors.

As of September 30, 2022, our flagship JUST U.S. Large Cap Diversified Index (JULCD), which tracks the top half of ranked companies in the Russell 1000 by industry, has outperformed the R1000 by 6.55% since inception. Our JUST 100 Index (JUONE) shows similar results, with the top 100 companies in our Rankings outperforming the R1000 by 6.76% since inception. Looking deeper into the Rankings, the top 10% of companies in our Rankings outperformed the bottom 10% by almost 43.45% since January 1, 2018.

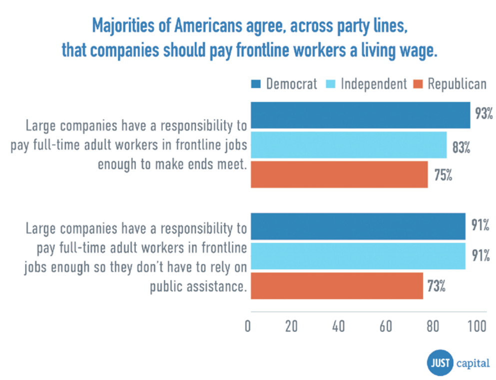
Our partnerships with some of the largest U.S. asset managers and owners have resulted in stakeholder-centered investment products that leverage our data to drive capital and capture returns based on the performance of companies leading on the American public's priorities. JUST data currently supports 10 different financial products with over $400 million in assets under influence.

Across Political Divides, Americans Agree Companies Should Prioritize Workers

Understanding issues relating to workers' wages continually rise to the top in regard to prioritization in our Annual Survey, JUST Capital and its polling partner, SSRS, conducted an additional survey in June 2022 to explore deeper insights into what Americans want from companies when it comes to wages and benefits.[5]

Overall, Americans want companies to take greater responsibility for their workers' economic security: 84% of Americans believe large companies have a responsibility to pay full-time adult workers in frontline jobs enough to make ends meet, and, moreso, that companies should pay enough so these workers don't rely on public assistance (87%). This holds true across political ideologies (Figure 3).

Figure 3



Americans also want more wage transparency: 93% of Americans favor large companies releasing the wage ranges for different types of jobs at their company, and 89% favor the release of minimum wage rates for frontline and entry-level workers.

Americans agree a living wage can drive competitive advantage: When comparing two companies – one that pays its frontline workers a living wage to another that minimizes costs by paying lower wages – 90% agree that the first company will provide better customer service, 71% agree it will be more competitive in its industry, 78% agree it will be more profitable in the long term, and 59% agree it will provide greater value to shareholders.

Americans are also more united than we may think when it comes to wages: Despite divisive rhetoric, Republicans, Independents, and Democrats alike agree that it's a company's responsibility to raise wages in line with cost of living increases; and provide affordable health insurance, opportunities for advancement, and more (Appendix 2).

Americans across party lines support increased corporate disclosure

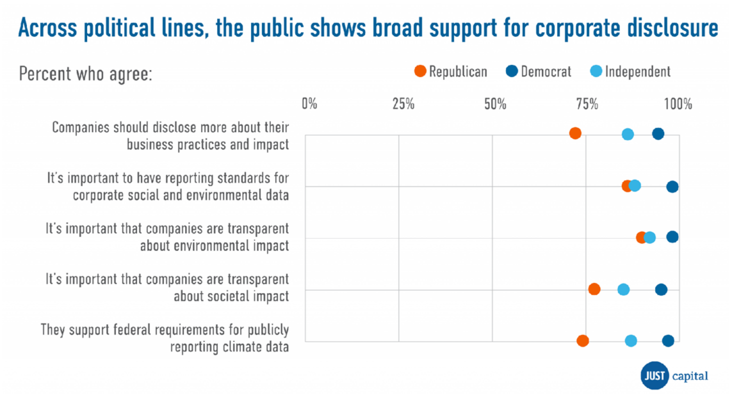
In February 2022 JUST Capital and its polling partner, SSRS, conducted a survey to understand how the American public felt about corporate disclosure and reporting standards (Figure 4).[6] Specifically Americans believe:

- More disclosure is needed: 85% of Americans agree, including across political affiliations, that companies need to disclose more about their business practices and impact on society.

- Standardization is key: 90% of Americans – including 86% of Republicans, 98% of Democrats, and 88% of Independents – say it is important to have standards for reporting corporate social and environmental data.

- Americans support federal action: Nearly 90% look to the federal government – including 74% of Republicans, 97% of Democrats, 87% of Independents – to support greater corporate disclosure on business-relevant issues such as workforce compensation and climate data.

Figure 4



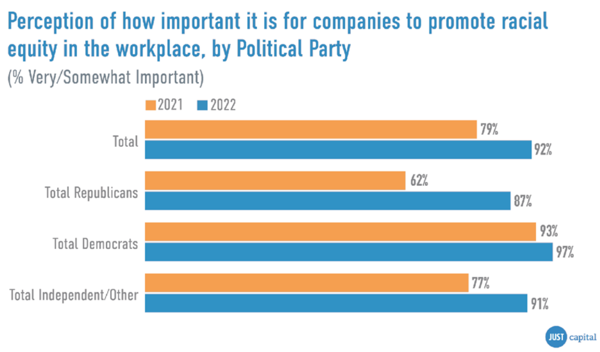
Americans across political ideologies think it's important for corporate America to promote racial diversity in the workplace

In order to understand how the American public views corporate efforts to advance racial equity – specifically, what concrete actions corporate leaders can prioritize – we worked with our polling partner SSRS in April 2022 to survey a representative sample of 1,202 U.S. adults.

The survey showed that over 90% of Americans (up from 80% last year) believe it is important for companies to promote racial diversity and equity in the workplace. However, 68% of Americans (up from 64% last year) say companies have more work to do to achieve racial equity in the workplace.

Across party lines, we see strong percentages of respondents who agree that workplace equity is important (Figure 5).

Figure 5



When looking at a range of policies that companies can implement – including pay equity analyses, demographic disclosure, and training opportunities – three-quarters or more say every policy is important in advancing racial equity. Across all demographics, Americans universally agree that wages are key: 77% say that racial equity cannot be achieved without all workers being paid a living wage (Appendix 3).

The public wants transparency, but data is limited

As JUST Capital's polling research demonstrates, the American public expects companies to share data on worker issues. But measuring the state of disclosure on these issues remains challenging given the absence of reporting standardization. While there has been progress made on voluntary disclosure on human capital data, it remains limited and non-standardized.

And while it is clear what Americans care most about, identifying quantifiable performance measurements that meaningfully capture these concerns and are applicable across industries remains challenging in the absence of standardized reporting requirements. In November 2020, the Securities and Exchange Commission (SEC) amended Item 101(c) under Regulation S-K, calling on employers to disclose human capital measures or objectives that a company deems material to its business, a step beyond the previous requirement to only disclose the number of employees.[6] Even with this amendment, the new human capital reporting requirements lack detailed and specific requirements which leaves it to the discretion of companies themselves to determine what data to disclose. As such, the inconsistency in disclosure across some of the most salient and frequently analyzed worker metrics is high.

Many investors, including members of the $8 trillion Human Capital Management Coalition, recognized the new disclosure standards as a step in the right direction, but also voiced their concerns that the absence of standardized reporting metrics permits an overreliance of management discretion in what is reported and does not require a uniform set of baseline information which is consistent, comparable, and concise to allow investors to gain a clear and effective understanding of a company's skill in managing its workforce.

Companies are struggling with the myriad of frameworks

One of the core elements of JUST Capital's work is working directly with the largest publicly-traded companies headquartered in the United States, in this case, those in the Russell 1000 on their transparency and performance on the issues that matter most to the American public. To date, we have some degree of relationship with over 500 of the 1,000 companies, and active engagement with around 350 of those companies. In 2022, 54% of them told us that they made some change around their transparency or performance because of JUST Capital's work. We hear consistent themes from corporate leaders, including:

- Corporate leadership believes that investing in their workforce, their relationship with their consumers, managing climate risk, and more is good for business and good for competition. Specifically, they increasingly see workers as a source of value creation, and are looking for support in measuring their success and areas of improvement around good jobs.

- They struggle to navigate the myriad of frameworks that exist, and because there hasn't been a clear set of metrics to measure and disclose, they see the need for continued leadership across sectors in ensuring there is forthcoming clarity on those topics.

- They appreciate efforts like the recent one by the Families and Workers Fund and the Aspen Institute, which JUST Capital supported in its conversations with companies, around measuring what a good job actually is, so that there is a consistent baseline for workers, consumers, and, importantly, investors.

- On the downside, companies are very familiar with the cost of compliance, trade secret risk, and potential liabilities that some disclosures can raise. A process needs to include those challenges, and also be driven by the market to ensure that disclosures that do exist are related to utility, performance, and business impact.

The state of disclosure and standardization of human capital metrics is poor, making data collection labor intensive

To develop a foundational understanding of the size of the gap between the American public's and the investor community's desire for transparency around human capital and workforce data and the actual availability of these metrics, JUST Capital began collecting publicly disclosed data from the 100 largest U.S. employers in the Russell 1000 Index between July and August 2021.[7]

We first identified a set of core human capital metrics based on the overlaps in recommendations from standards setters and other stakeholders, including the Human Capital Metrics Coalition, Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), the World Economic Forum International Business Council's report "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation" (WEF IBC), and the Embankment Project for Inclusive Capital's report (EPIC), among others. [8] [9] [10] [11] [12] From this preliminary landscape analysis, we found a total of 35 performance-focused human capital metrics, grouped into six key themes: Employment and Labor Type; Job Stability; Wages, Compensation, and Benefits; Workforce Diversity, Equity, and Inclusion; Occupational Health and Safety; and Training and Education (Appendix 4).

We then manually searched through company websites, corporate social responsibility reports, diversity and inclusion reports, annual filings, and other company-reported sources among the 100 largest U.S. employers within the Russell 1000 – those that based on JUST Capital's other research are disproportionately more likely to disclose any ESG data – to find voluntarily disclosed data on 28 of the 35 identified metrics.[13] In addition to recording data (or lack thereof) associated with each metric, we also collected excerpts, source type, collection time, and other metadata that could help quantify its standardization and document the complexity of finding it.

The analysis revealed four trends about the state of human capital disclosure:

(1) Disclosure on recommended performance-based human capital metrics is low across the board, with less than 20% of companies disclosing data for the majority of the metrics.

We found that 23 out of the 28 metrics evaluated have a disclosure rate below 20% – meaning that less than 20 of the 100 companies assessed report data on them (Appendix 5). Five metrics have a disclosure rate between 20 and 40%, and just one metric – the total value of salaries, benefits, and pensions for the workforce – has a disclosure rate of 42%. On average, disclosure is 11% across all metrics, and no company has disclosure on every single metric.

The results underscore that even the companies that generally have more robust ESG disclosures lag behind when it comes to voluntarily reporting on performance-based human capital measures.

(2) Data on human capital is mostly disclosed in Corporate Social Responsibility or Sustainability Reports, which are not audited or subject to metric standardization.

We list the average distribution of source types in which human capital metrics are found in Appendix 6. On average, 56% of metrics were disclosed in Corporate Social Responsibility or Sustainability Reports. Notably, these are mostly informal documents prepared by marketing or communications teams that are not subject to auditing and are not required to meet standardization requirements. Annual Reports and 10-K Filings, the next most common source, do have more standardization, but the lack of specific requirements in Regulation S-K largely leaves it to the discretion of companies to determine what human capital, workforce, or diversity data is disclosed.[14]

A working paper published in September 2022 supports these findings.[15] The researchers examined manually collected human capital disclosures among 2,393 firms and found that the richest human capital data was found in ESG Reports (inclusive of Corporate Social Responsibility and Sustainability Reports), not 10-Ks. Regulation S-K helped shift some information, particularly on diversity and turnover data, into 10-K Filings, but overall the amendment was insufficient in broadly increasing reporting on human capital metrics.[16]

(3) Metrics that have the most disclosure are more likely to be found in Annual Reports or 10-K Filings.

Annual Reports and 10-K Filings were the most common source among data points that had the highest rate of disclosure (Appendix 7). For example, among the 42 companies that disclosed the total value of salaries and benefits and 38 companies that disclosed the total cost of pensions for the workforce, 98% and 97%, respectively, were found in Annual Reports or 10-K Filings.

This may suggest that formal, required, or more structured reporting formats can serve as easy vehicles for reporting, but it also indicates that disclosure in these sources are more focused on workforce size and labor costs and less on outcomes of human capital investments, in line with observations from other research.[17]

(4) Data collection for human capital metrics is highly labor intensive, requiring significant time and resources given non-standardized reporting.[18]

To collect 28 human capital metrics across 100 companies, it took a team of two full-time workers over 130 hours, more than three weeks, indicating the complexity of finding this information. Figure 6 shows the breakdown of collection time by thematic area, but it is also worth noting that the majority of the time that analysts spent searching for data resulted in finding no disclosure on a given human capital metric.

Figure 6

HUMAN CAPITAL METRICS DATA COLLECTION TIME

	Number of Metrics	Total Collection Time (In Hours)	Average Minutes per Company	Average Minutes per Metric	Average Minutes per Metric per Company
Employment and Labor Type	6	36.1	21.7	361.0	3.6
Job Stability	12	30.2	18.1	150.8	1.5
Wages, Compensation, and Benefits	7	35.1	21.1	300.9	3.0
Occupational Health and Safety	1	8.0	4.8	480.0	4.8
Training and Education	3	17.4	10.4	347.0	3.5
TOTAL	29*	130.7	78.4	270.4	2.7

Note: This chart reflects data for the 100 largest U.S. companies, determined by U.S. employment size. *While our report looks at 28 metrics across the six human capital themes, we collected data on 29 metrics (one of which was a metadata year field and not usable in broader analyses) across five human capital themes.

Source: JUST Capital's Human Capital Metrics research project, with data collected between July and August 2021.

In cases where analysts did find disclosure, Annual Reports and 10-K Filings were the most time-consuming source type. While they may be an easy vehicle for reporting, intensive data collection time from this source type might be caused by their poor searchability, extreme length, information buried in technical language, footnotes, and tables, and insufficient standardization in human capital metrics data included or referenced.

Across Russell 1000 companies, voluntary reporting on policies and practices supporting workers is also low

Bridging from the foundational research on the state of disclosure around performance-based human capital metrics, we used data from our 2022 Rankings of America's Most JUST Companies – which examined 954 of the Russell 1000 companies – to assess the scope of low disclosure on a broader set of workers issues. These findings largely corroborate our previous exploratory research and are summarized below.[19]

(1) State of disclosure is poor across all Russell 1000 companies and across worker issues.

In 2022, JUST Capital completed a comprehensive overview of 23 policy and performance metrics that represent the top issues most relevant to workers, as defined by the American public, and found that with few exceptions, disclosure in public company materials – such as

Annual Reports, 10-K Filings, and Corporate Social Responsibility (CSR) reports – is low across the board.

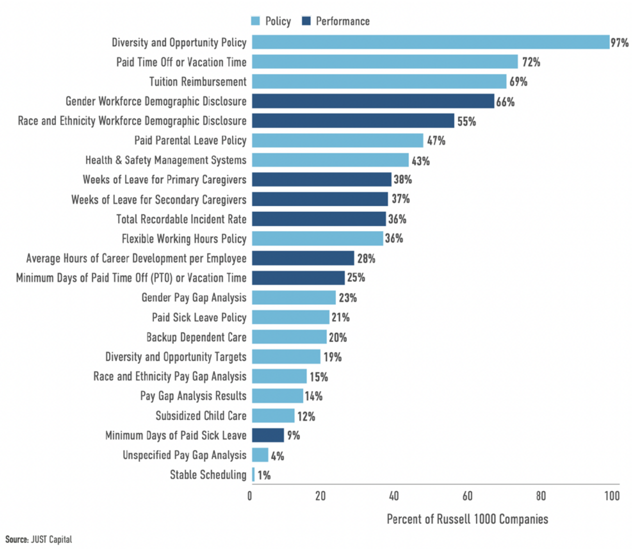
An average Russell 1000 company discloses only eight data points out of a possible 21 (some disclosures are mutually exclusive), and not a single company discloses all 21 data points (Appendix 8). This wide range exemplifies the extreme variation in disclosure and the lack of a unified approach to disclosing this information. Looking at industry trends, we found that while disclosure overall is low across industries, Utilities and Oil & Gas have higher worker disclosures, while Basic Resources companies lag.

(2) <u>Companies tend to disclose more policies than performance metrics on worker issues.</u>

We separated the workers metrics that we analyzed into policy and performance type to distinguish between disclosures on the existence of a policy versus disclosure on the company's actual performance on an issue (Appendix 9).

Looking at the disclosure level by metric, we found that it ranges from 1% to 97%, with almost all performance data points having less than 40% disclosure (Figure 7). Meanwhile, the metrics with high disclosure rates across America's largest companies tend to be policy metrics, which do not necessarily speak to performance on a given issue or reflect their accessibility or the lived experiences of workers. The one exception to this finding is workforce demographic data by gender and race and ethnicity, which is discussed in detail in the next section.

Figure 7



Even our newer data on minimum wage disclosure across the Russell 1000 yielded similar results, though, as recent polling shows, transparency around this issue received bipartisan support.[20] Our data revealed that only 13% of America's largest companies disclose some data about their employees' lowest hourly wages, and even fewer, 9%, disclose the exact value of the minimum wage paid to their U.S. workforce.

Workforce data on diversity and representation is an example of how existing standardized reporting frameworks and increased investor focus have rapidly grown disclosure

Because it is one of the issues identified by the American people as relevant to just business behavior, JUST Capital developed a workstream in 2019 to track diversity, equity, and inclusion (DEI) data, with a particular focus on collecting 23 metrics on workforce demographic data, comprising a range of highly generalized to highly detailed counts or percentages of workers by gender, racial, or ethnic identity.[21] Over time, this research has revealed that:

(1) Data disclosure on workforce demographics is highly non-standardized, aside from voluntarily disclosed EEO-1 Reports, which are annually submitted to the Equal Employment Opportunity Commission (EEOC).

Among Russell 1000 companies, there is significant variation in *how* gender, racial, and ethnic workforce demographic data is disclosed. First, there is little consistency in which racial or ethnic categories are reported out. In some instances, companies follow the U.S. Census Bureau's grouping while others may choose to aggregate or disaggregate certain groups.[22] Second, the unit of measurement or calculation method employed differs across companies: Companies may either report the count of workers identifying as a member of a group or the percentage of the global or U.S. workforce.

Though gender data is still largely reported in binary terms (Men and Women), JUST Capital has observed that there are generally four broad ways in which companies report racial and ethnic demographic data, ranging from least to most granular:

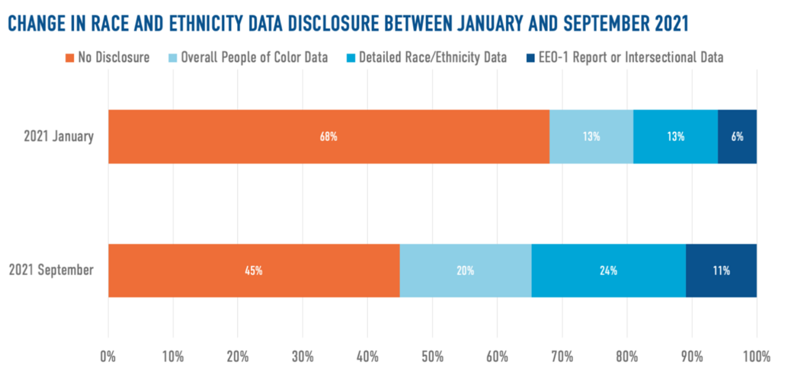
- *No Disclosure:* Companies report neither numbers or percentages of workers broken down by racial or ethnic identity.
- *Overall People of Color:* Companies report an aggregate number or percentage of workers who identify as people of color, which is often termed "minority" or "non-white."
- *Detailed Race/Ethnicity:* Companies at least report the number or percentage of workers who identify as Asian, Black or African American, and Hispanic or Latino.
- *EEO-1 Report or Intersectional Gender and Race Ethnicity:* Companies report the number (and to a lesser degree percentage) of employees by 14 intersectional identities of gender by race or ethnicity, further disaggregated by 10 standardized job categories. Employers that have at least 100 employees are required to submit an EEO-1 Report that includes this data in Component 1 annually to the EEOC.[23] While EEO-1 Reports

are highly standardized vehicles for reporting racial and ethnic workforce data, companies are not required to disclose them publicly.[24]

(2) <u>Across Russell 1000 companies, a growing majority voluntarily disclose some type of racial or ethnic data.</u>[25]

JUST Capital's data from January 2021 revealed that 32% of companies we tracked within the Russell 1000 Index disclosed some type of demographic data (Figure 8). Our updated data collection as of September 2021 found that this share had grown to 55%, a 23 percentage point increase since January of that same year. As of September 2021, detailed racial/ethnic data were the most common type of racial/ethnic disclosure reported by Russell 1000 companies.

Figure 8



Note: This chart is based on JUST Capital's evaluation of 954 companies from the Russell 1000 Index featured in our 2022 Ranking of America's Most JUST Companies. "EEO-1 Report or Intersectional Data" denotes that a company has disclosed highly detailed race/ethnicity data disaggregated by gender. "Detailed Data" denotes that a company has disclosed race/ethnicity data for at least three standard groups: Asian, Black or African American, and Hispanic or Latino.

Source: JUST Capital's corporate demographic datasets, with data as of September 2021.

(3) <u>Disclosure of highly-standardized intersectional demographic data like EEO-1 Reports is low but has grown rapidly over the last four years thanks to investor advocacy efforts.</u>[26]

When JUST Capital initially began tracking it in 2019, it became clear that EEO-1 Reports were a low-lift public disclosure framework for companies to use when sharing demographic data because of their high degree of standardization and submission requirement to the EEOC.[27] However, at the time, just 3% of Russell 1000 companies voluntarily disclosed this rich, intersectional gender, race, and ethnicity data. Since 2019, investor advocacy efforts – like those from the New York City Comptroller and shareholder proposals during proxy seasons – have pressed for large public companies to voluntarily disclose EEO-1 Reports, and, correlationally, we have seen rapid growth in the disclosure rate among Russell 1000 companies despite the fact that overall disclosure is still low.[28]

Between November 2019 and September 2021, EEO-1 Report or intersectional data disclosure grew from 3% to 10.9%, close to an 8 percentage point increase which is equivalent to nearly a 250% increase (Appendix 10).

When surveying a broader array of DEI-related data we see areas that received rising pressure from investors have greater disclosures that those that have not

For the past two years, JUST Capital has been tracking the specific steps that companies have taken to cultivate diversity – one of the issues identified by the American people as relevant to JUST business behavior – via our Corporate Racial Equity Tracker, which offers an in-depth accounting of the state of disclosure by the 100 largest U.S. employers in the Russell 1000, through 23 metrics across six specific dimensions of racial equity: (1) Pay Equity, (2) Racial/Ethnic Diversity Data, (3) Education and Training Programs, (4) Response to Mass Incarceration, (5) Community Investments, and (6) Anti-Discrimination Policies.[29] Analyzing the results, it is clear that corporate America is making progress in some areas, but is still not matching its commitments with actions to implement meaningful change.

Across the 85 companies JUST Capital tracked in both 2021 and 2022, the greatest increases in disclosure are seen in workforce and board diversity data, as well as pay equity – areas where there has also been rising pressure from investors:

- Workforce diversity data disclosure increased by 6% from 86% to 91%.
- Board diversity data disclosure increased by 13% from 84% to 95%.
- Racial/Ethnic Pay equity analysis disclosure increased by 33% from 34% to 45%.
- Disclosure of pay ratios by race/ethnicity increased by 71% from 14% to 24%.

Metrics that have low levels of meaningful disclosures among the 100 companies currently tracked include the following. Only:

- 7% disclose their internal hire (or promotion) rate by race/ethnicity.
- 11% report re-entry or second chance policies.
- 21% report providing anti-harassment training, compared to 98% of companies that disclose an anti-harassment policy.
- 22% disclose the actual results of the pay equity analysis, i.e. pay ratios by race/ethnicity.
- 23% disclose diversity targets for hiring, workforce composition, promotion, or retention by race/ethnicity.
- 42% disclose a supplier diversity spend amount, and 9% disclose a local supplier/small business spend amount.

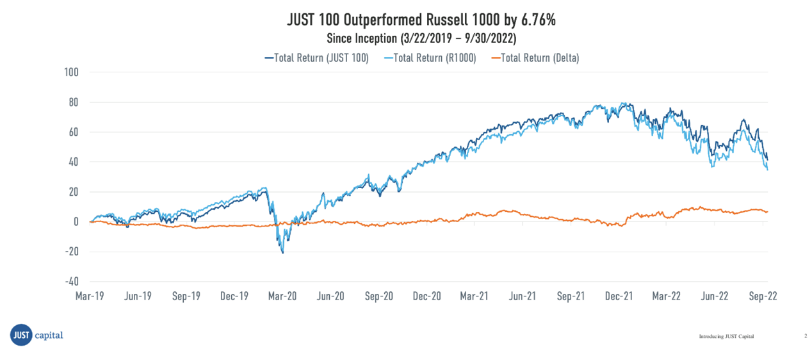
It is clear to us that more availability of data would only benefit investors and other stakeholders.

Stakeholder Capitalism Is Good for Business

One of the foundations of the stakeholder model of business is that by taking into account how companies perform in creating value for all their stakeholders – their workers, their customers, the communities they operate in, the planet, and of course, shareholders – we can grow the pie for everyone, and create a race to the top for business in America today. We have seen evidence of this in our assessment of companies.

When comparing the index of our JUST 100 companies to the Russell 1000 since inception through the end of September (March 22, 2019 - September 30, 2022), we have found outperformance of 6.7% (Figure 9).

Figure 9



We are not guaranteeing that companies that manage according to the priorities of the American public will consistently generate alpha, but we are at least confident in the JUST 100 Index's general ability to generate market beta, given the data. And, given the nature of our metrics, these companies also generate tangible value across all stakeholders. For example, the average JUST 100 company compared to the average Russell 1000 company created 7.8 times more jobs in the U.S. from 2016 to 2020, had a 4.4% higher return on equity and paid 19.2% more in dividends, were 7.6 times more likely to disclose workforce demographic data by race and ethnicity, and used 19.8% more renewable energy.

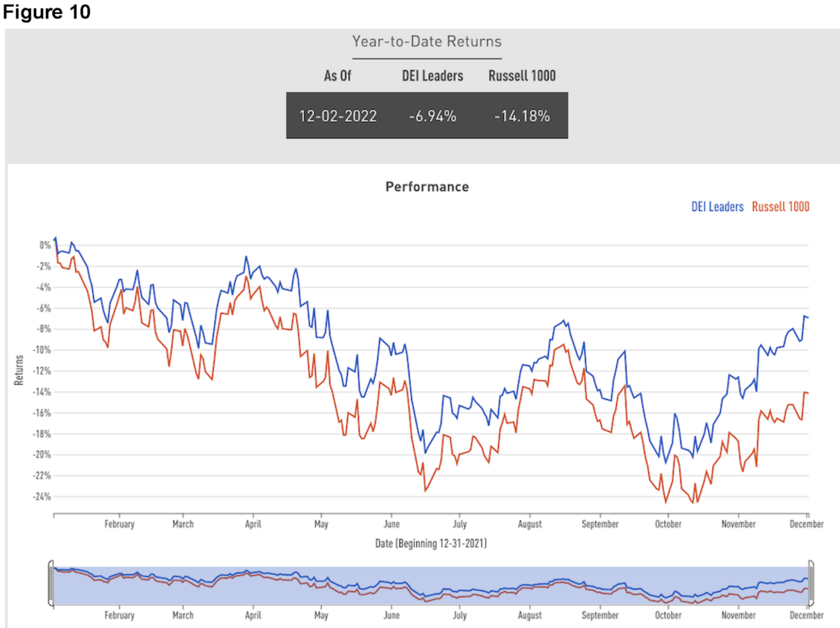
The case for investing in workers

As we have discussed above, the American public prioritizes worker issues when it comes to their expectations of the country's largest companies, and that is why JUST spends as much time as it does on matters of human capital. These are issues that have only increased in importance in a tight labor market with high inflation, and we have found that companies that are investing in their workers are finding an edge.

We found that in Q3 of 2022, of the companies we track, those in the top 10% of the Workers score outperformed the bottom 10% by 2.09%.[30] Further, when we created an index concept of our Top Quintile of Workers, we found it outperformed the Russell 1000 by 9.29% across 2022 (Appendix 11). We found that the average company in this quintile, as compared to the average Russell 1000 company, was 18.1% more likely to pay a living wage, 125.1% more likely to have conducted a pay gap analysis, and 37.2% more likely to disclose workforce demographics.

There is also evidence that taking DEI policies seriously within corporations – namely, being transparent and providing paths of opportunity and mobility for all employees – is smart business. When comparing the top quintile of companies according to their DEI score against the Russell 1000 through the beginning of December, we found an outperformance of 7.24% (Figure 10).

Figure 10



These data points do not exist in a vacuum.

There is a wealth of research that finds a link between wages and employee satisfaction and retention (e.g. research from the Oxford Saïd Business School) and higher productivity (e.g. research from thePeterson Institute for International Economics).[31] [32] We have also discussed with leaders of companies scoring well in JUST's DEI metric how policies of opportunity and mobility have improved productivity, as well as recruitment and retention in a competitive marketplace for talent.[33] [34] [35]

A tool for investors

As mentioned above, we know that investors want to see relevant stakeholder metrics to get as thorough a picture as possible about the companies they choose to invest in, and we can see from our data and work with corporations that these metrics are material.

There are many different kinds of organizations in the ESG and stakeholder capitalism space, but JUST is focused on the priorities of the public as a North Star. We are against any disingenuous hijacking of these terms to "greenwash" or otherwise use marketing to gain political favor; to us, measuring these metrics and then managing and investing according to them is simply smart business.

Academic Usage

JUST Capital's Rankings and underlying raw data have also been used across the academic community as a valued source of research and insights. Spanning topics from workers and performance to the COVID-19 pandemic and CSR, engagement and interest from the academic community continues to increase. Following more than 50 academic data requests booked for the year 2022, JUST has worked alongside, just to name a few, New York University, Harvard Business School, the Darden School of Business at the University of Virginia, and MIT.

Conclusion

As you have seen, JUST Capital focuses on the business issues that matter most to the American public, and they are clear about what they want companies to prioritize – and that's workers, wages, and jobs. A majority of survey respondents tell us that the economy is not currently working for everyday Americans. They expect companies to do more to help deliver on the promise of the American dream. We know from our research that companies that do right by their workers do well for their shareholders, but that we still have a long way to go to provide relevant, meaningful data that can help build and support a stronger, fairer, and more just market system that reflects the values of the American people.

Thank you for this opportunity, and I look forward to your questions.

APPENDICES

Appendix 1

Every year we begin our Annual Survey process by facilitating a series of group conversations with a diverse mix of Americans across the U.S., to help us broadly understand the business behaviors and actions that they consider to be most "just." These focus groups enable our research team to hear the unvarnished voice of the public speak to what issues matter most, and whether their opinions have changed over time. The polling team then distills the focus groups' major themes into statements that capture these concepts, which we call "Issues." In 2022, this work yielded 20 Issues, which is consistent with the number of Issues last year.

Since the public initially tells us that all of these Issues are of high importance, we then conduct a choice modeling exercise as part of our Annual Survey work, allowing us to derive the relative importance of these 20 Issues. From here, we extract a "weight" per Issue that we use as the foundation for our Rankings of America's Most JUST Companies. The weights below reflect the probability that an individual would choose that Issue as most important to defining a just company, based on a representative sample of 3,002 Americans. These weights power our analysis of corporate stakeholder performance at the country's largest companies, including JUST's annual Rankings. The 20 Issues, according to those surveyed, that will power our 2023 Rankings are as follows:

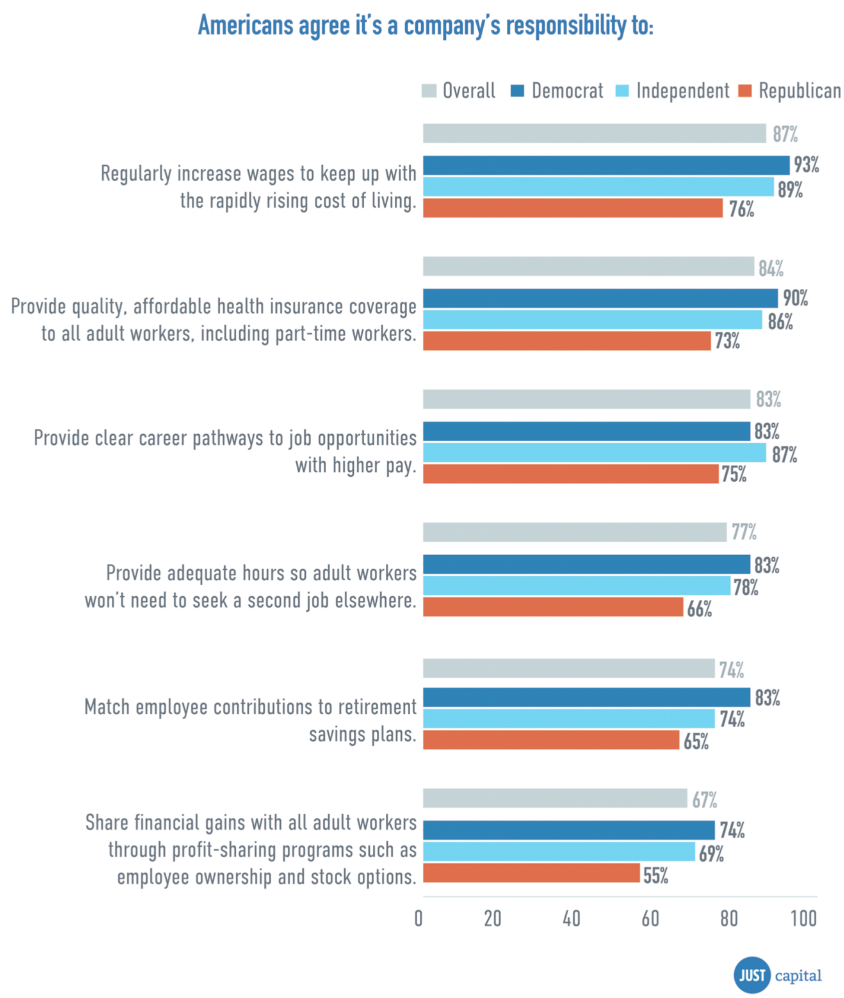
1. Pays a fair, living wage. (21.2%)
2. Creates jobs in the U.S. (11.1%)
3. Acts ethically at the leadership level. (7.6%)
4. Protects worker health and safety. (7.3%)
5. Supports workforce retention, advancement, and training. (7.1%)
6. Provides benefits and work-life balance. (6.2%)
7. Protects customer privacy. (4.3%)
8. Minimizes pollution. (4.2%)
9. Addresses human rights issues in the supply chain. (3.8%)
10. Treats customers fairly. (3.6%)
11. Uses sustainable materials. (3.4%)
12. Communicates transparently. (3.4%)
13. Combats climate change. (2.6%)
14. Makes beneficial products. (2.5%)
15. Cultivates a diverse, inclusive workplace. (2.4%)
16. Contributes to community development. (2.3%)
17. Generates returns for investors. (2.2%)
18. Prioritizes accountability to all stakeholders. (2.1%)
19. Uses resources efficiently. (1.5%)
20. Gives back to local communities. (1.1%)

Organizing the 20 Issues into stakeholder groups, the survey research provides a roadmap for how Americans want companies to prioritize its their stakeholders, including how a company:

- Invests in its Workers. (44%)
- Supports Communities. (18%)
- Treats its Customers. (14%)
- Impacts the Environment. (12%)
- Serves its Shareholders through good Governance. (12%)

For the past two years, JUST has partnered with SSRS, an objective, non-partisan research institution that provides scientifically rigorous statistical surveys of the U.S. population, to survey more than 3,000 Americans on their perspectives. This year's annual survey was conducted from June 22 to July 11, 2022 among a general population sample of 3,000. Results were weighted to U.S. Census parameters for age, gender, education, race/Hispanic ethnicity, and Census Division to ensure representativeness of the U.S. population.

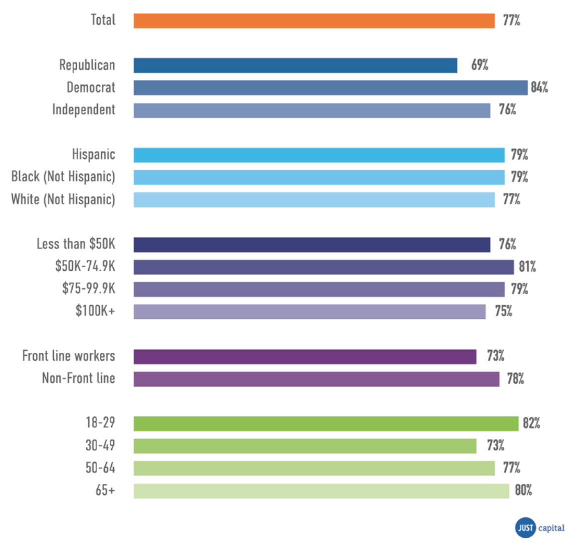
Appendix 2



Americans agree it's a company's responsibility to:
Overall
Democrat
Independent
Republican
Regularly increase wages to keep up with the rapidly rising cost of living.
87%
93%
89%
76%
Provide quality, affordable health insurance coverage to all adult workers, including part-time workers.
84%
90%
86%
73%
Provide clear career pathways to job opportunities with higher pay.
83%
83%
87%
75%
Provide adequate hours so adult workers won't need to seek a second job elsewhere.
77%
83%
78%
66%
Match employee contributions to retirement savings plans.
74%
83%
74%
65%
Share financial gains with all adult workers through profit-sharing programs such as employee ownership and stock options.
67%
74%
69%
55%
0
20
40
60
80
100
JUST capital

Appendix 3

Percentage agree: Racial equity in the workplace cannot be achieved without all workers being paid a living wage



Appendix 4

HUMAN CAPITAL METRICS BY THEME

Employment and Labor Type	Job Stability	Wages, Compensation, and Benefits	Workforce Diversity, Equity, and Inclusion	Occupational Health and Safety	Training and Education
▪ Full-Time Employees ▪ Part-Time Employees ▪ Salaried Employees ▪ Hourly Employees ▪ On-Site Contractors and Vendors ▪ On-Site Temporary or Seasonal Workers	▪ New Hires ▪ Total Female New Hires ▪ Total Male New Hires ▪ Total Minority New Hires ▪ Turnover ▪ Voluntary Turnover ▪ Voluntary Turnover by Gender or Race/Ethnicity ▪ Involuntary Turnover ▪ Involuntary Turnover by Gender or Race/Ethnicity ▪ Retention Rate ▪ Retention Rate by Gender ▪ Retention Rate by Ethnicity	▪ Minimum Wage Lowest Pay Threshold ▪ Share of Local Minimum Wage Earners ▪ Minimum Wage to Local Minimum Wage Ratio ▪ Total Value of salaries, bonuses, and pension benefits for the workforce ▪ Total Value of Salaries and Benefits for the Workforce ▪ Total Value of Pensions for the Workforce	▪ Workforce demographic composition by Gender or Race/Ethnicity* ▪ Board demographic composition by Gender or Race/Ethnicity* ▪ Ratio of basic salary and remuneration by Gender or Race/Ethnicity* ▪ Adjusted pay gap by Gender or Race/Ethnicity*	▪ Absenteeism Rate ▪ Total Recordable Incident Rate (TRIR)*	▪ Internal Hiring Rate ▪ Internal Hiring Gender Disclosure ▪ Internal Hiring Race Ethnicity ▪ Average hours of training per employee per year* ▪ Program for tuition or education assistance*

Note: Metrics marked with an asterisk* were not collected as part of JUST Capital's Human Capital Metrics research project, and instead follow our typical rankings data collection procedure. For this reason, they have not been analyzed in this report.

Source: JUST Capital's Human Capital Metrics research project, with data collected between July and August 2021.

Appendix 5

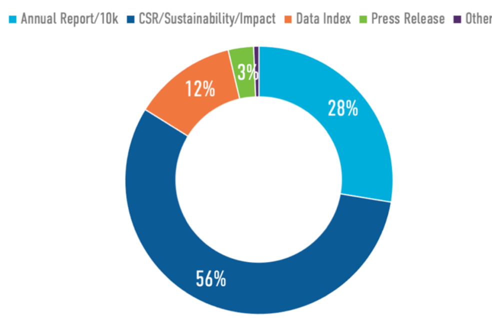
HEAT MAP OF DISCLOSURE RATES FOR HUMAN CAPITAL METRICS

		Disclosure Rate	0-20%	20-40%	40-60%	60-80%	80-100%
Employment and Labor Type	Full-Time Employees	38%		●			
Employment and Labor Type	Part-Time Employees	31%		●			
Employment and Labor Type	Salaried Employees	4%	●				
Employment and Labor Type	Hourly Employees	6%	●				
Employment and Labor Type	On-Site Contractors and Vendors	1%	●				
Employment and Labor Type	On-Site Temporary or Seasonal Workers	4%	●				
Job Stability	New Hires	16%	●				
Job Stability	Total Female New Hires	24%		●			
Job Stability	Total Male New Hires	11%	●				
Job Stability	Total Minority New Hires	13%	●				
Job Stability	Turnover	15%	●				
Job Stability	Voluntary Turnover	15%	●				
Job Stability	Voluntary Turnover by Gender or Race/Ethnicity	2%	●				
Job Stability	Involuntary Turnover	5%	●				
Job Stability	Involuntary Turnover by Gender or Race/Ethnicity	2%	●				
Job Stability	Retention Rate	4%	●				
Job Stability	Retention Rate by Gender	1%	●				
Job Stability	Retention Rate by Ethnicity	0%	●				
Wages, Compensation, and Benefits	Minimum Wage/Lowest Pay Threshold	20%		●			
Wages, Compensation, and Benefits	Share of Local Minimum Wage Earners	1%	●				
Wages, Compensation, and Benefits	Minimum Wage to Local Minimum Wage Data Ratio	0%	●				
Wages, Compensation, and Benefits	Total Value of Salaries, Benefits, and Pensions for the Workforce	0%	●				
Wages, Compensation, and Benefits	Total value of Salaries and Benefits for the Workforce	42%			●		
Wages, Compensation, and Benefits	Total value of Pensions for the Workforce	38%		●			
*	Absenteeism Rate	1%	●				
Training and Education	Internal Hiring Rate	3%	●				
Training and Education	Internal Hiring Rate by Gender	3%	●				
Training and Education	Internal Hiring by Race/Ethnicity	1%	●				

Note: This chart reflects data for the 100 largest U.S. companies, determined by U.S. employment size. Asterisk * indicates Occupational Health and Safety theme.
Source: JUST Capital's Human Capital Metrics research project, with data collected between July and August 2021.

Appendix 6

AVERAGE DISTRIBUTION OF SOURCES ACROSS DISCLOSED HUMAN CAPITAL METRICS



Note: This chart reflects data for the 100 largest U.S. companies, determined by U.S. employment size.
Source: JUST Capital's Human Capital Metrics research project, with data collected between July and August 2021.

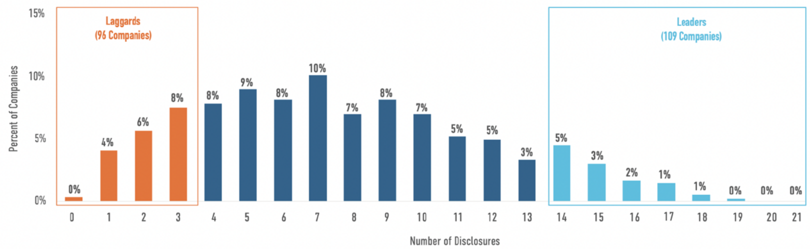
Appendix 7

HEAT MAP OF SOURCES FOR METRICS WITH 20% OR HIGHER DISCLOSURE RATE

	Disclosure Rate	Annual Reports or 10-K Filings	CSR, Sustainability, or Impact Reports	Data Index	Press Release	Other
Total Value of Salaries and Benefits for the Workforce	42%	98%	2%	0%	0%	0%
Total Value of Pensions for the Workforce	38%	97%	0%	3%	0%	0%
Full-Time Employees	38%	61%	34%	5%	0%	0%
Part-Time Employees	31%	57%	37%	7%	0%	0%
Total Female New Hires	24%	8%	83%	8%	0%	0%
Minimum Wage/Lowest Pay Threshold	20%	5%	11%	5%	68%	11%

Note: This chart reflects data for the 100 largest U.S. companies, determined by U.S. employment size.
Source: JUST Capital's Human Capital Metrics research project, with data collected between July and August 2021.

Appendix 8



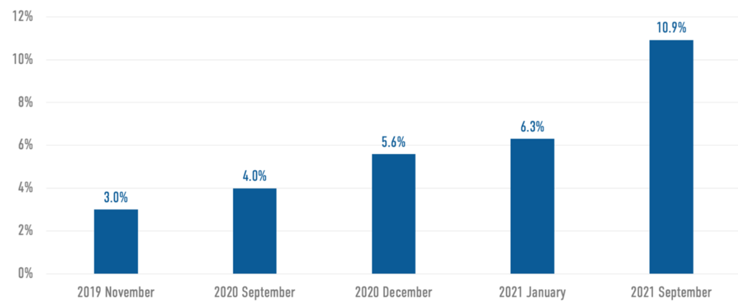
Source: JUST Capital

Appendix 9

Issue	Data Point	Performance or Policy
Benefits & Work-Life Balance	Paid Time Off or Vacation Time for Exempt Employees	Policy
	Minimum Days of Paid Time Off (PTO) or Vacation Time for Exempt Employees	Performance
	Paid Sick Leave Policy for Exempt Employees	Policy
	Minimum Days of Paid Sick Leave for Exempt Employees	Performance
	Paid Parental Leave Policy	Policy
	Weeks of Leave for Primary Caregivers or Maternity Leave	Performance
	Weeks of Leave for Secondary Caregivers or Paternity Leave	Performance
	Subsidized Child Care	Policy
	Backup Dependent Care	Policy
	Flexible Working Hours Policy	Policy
	Stable Scheduling	Policy
Diversity, Equity, & Inclusion	Diversity and Opportunity Policy	Policy
	Diversity and Opportunity Targets	Policy
	Gender Pay Gap Analysis	Policy
	Race and Ethnicity Pay Gap Analysis	Policy
	Unspecified Pay Gap Analysis	Policy
	Pay Gap Analysis Results	Policy
	Gender Workforce Demographic Disclosure**	Performance
	Race and Ethnicity Workforce Demographic Disclosure**	Performance
Workforce Investment & Training	Tuition Reimbursement	Policy
	Average Hours of Training or Career Development per Employee	Performance
Worker Health & Safety	Total Recordable Incident Rate (TRIR)	Performance
	Health & Safety Management Systems	Policy

Appendix 10

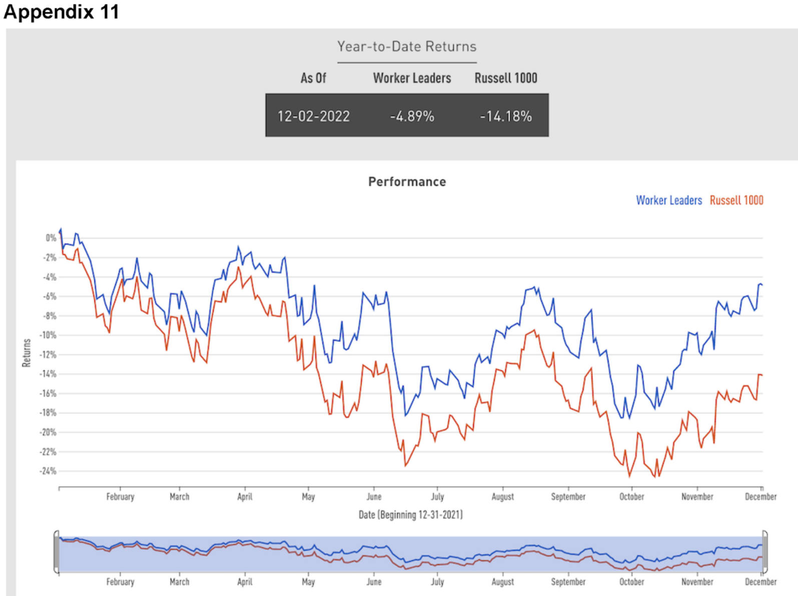
GROWTH IN EEO-1 REPORT OR INTERSECTIONAL DATA DISCLOSURE SHARE



Note: This chart is based on JUST Capital's evaluation of companies Russell 1000 Index featured in our 2020, 2021, and 2022 Rankings of America's Most JUST Companies. Companies are required to submit (though not publicly disclose) EEO-1 Component 1 reports to the EEOC, featuring data by gender by race/ethnicity by 10 standardized job categories. Intersectional data includes workforce demographics by gender by race (and sometimes select job categories).

Source: JUST Capital's corporate demographic datasets, with data as of September 2021.

Appendix 11



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Testimony of Dr. Colleen Honigsberg
Professor of Law
Stanford Law School

Before the
Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Of the
United States House of Representatives

Hearing on
E, S, G and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data

Tuesday December 6, 2022

Thank you, Chairman Sherman and Ranking Member Huizenga, for the opportunity to testify before you today. To give you a sense for my background, I began my career as a Certified Public Accountant with PricewaterhouseCoopers. I became interested in how accounting standards are set, so I returned to school, earning a law degree from Columbia Law School and a Ph.D.in Accounting from Columbia Business School. I am now a Professor of Law at Stanford Law School, where I teach classes on securities law, corporate governance, and accounting. While at Stanford, I have served as an Economic Research Fellow at the Public Company Accounting Oversight Board, and I currently sit on the Securities and Exchange Commission's Investor Advisory Committee. My recent scholarship has focused on the incentive structure for auditors and human capital disclosure.

This past spring, I was delighted to join forces with my colleague here today, Columbia Business School Professor Shiva Rajgopal, along with other esteemed academics, including former SEC Commissioners Joe Grundfest and Robert Jackson, to create the Working Group on Human Capital Accounting Disclosure. In June, the working group petitioned the Securities and Exchange Commission to develop rules requiring public companies to disclose sufficient information for investors to assess the extent to which firms invest in their workforce.

I share the view of our Working Group that investors need additional information to examine whether and how public companies invest in their workforce. As Senator Mark Warner wrote in 2018:

> Unlike significant physical investments, which are often capitalized, investments in human capital (and R&D investments) are expensed, as if increased worker capability were less useful to a company in successive quarters than a new building. At least R&D is disclosed on its own expenditure line—investors can assess company expenditures on R&D separately from other firm costs. Because human capital is included in administrative expenses, not as a stand-alone item, it is plausible that capital markets punish companies that invest in their workers as if those companies had excessive energy bills.[1]

I agree. Despite the value generated by employees, U.S. accounting principles provide virtually no information on the knowledge, skills, competencies, and attributes of firms' workforces. Investors

[1] Letter from Sen. Mark Warner to Hon. Jay Clayton, Chairman, Sec. & Exch. Comm'n 3 (July 19, 2018); *see also id.* (calling for "quantitative and qualitative" disclosure requirements in this area).

typically cannot even determine total workforce costs—much less identify how much a firm invests in its employees.[2] I believe that increased transparency around intangible assets such as human capital will better allow shareholders to assess public companies' investments in their people—just as our transparency around investment in tangible assets has long facilitated analysis of public companies' investments in their physical operations.

In today's testimony, I explain that prompt action on labor cost disclosures is necessary due to two market trends: the growth of human capital firms and the increasing prominence of net loss firms. The lack of human capital disclosure, I will show, limits investors' ability to accurately value these firms. Finally, drawing on core accounting principles, I conclude my testimony by proposing three reforms that would allow investors to better analyze public companies' investments in their workforce. ***First,*** managers should be required to disclose what portion of workforce costs should be considered an investment in the firm's future growth. ***Second,*** workforce costs should be expensed for accounting purposes but disclosed, allowing investors to capitalize workforce costs in their own valuation models as appropriate. ***Third,*** the income statement should be disaggregated to give investors more insight into operational costs.

I. MARKET TRENDS REQUIRE PROMPT ACTION ON HUMAN-CAPITAL ACCOUNTING

Two key market trends demand prompt regulatory attention in this area. First, an increasing proportion of public companies derive much of their value from intangible assets, including human capital—yet only about 15% of those firms even disclose their labor costs.[3] Second, an increasing number of public companies report a loss for accounting purposes, making analysis of firms' operational costs—the most significant of which is likely to be labor—more important than ever to

[2] See Honigsberg and Rajgopal, *Wage Wars: The Battle over Human Capital Accounting*, 12 HARV. BUS. L. REV. ____ (2022).

[3] Shivaram Rajgopal, *Labor Costs Are the Most Pressing Human Capital Disclosure the SEC Should Consider Mandating*, FORBES (May 17, 2021).

understanding firm value. As explained below, disclosure rules have not kept pace with either of these two trends, leaving investors in the dark with respect to key measures of firm value.

First, accounting rules have not kept pace with the emergence of the so-called human-capital firm in the 21st century, leaving investors without information necessary to accurately value the firms that they own. When the first accounting standard-setter came into existence in the 1930s,[4] the bulk of industries were made up of firms that built, moved, and sold tangible products using tangible assets.[5] Accordingly, America's accounting standard-setters designed rules that made sense for those firms at that time.

We see the legacy of these rules in accounting today, as different forms of investment are treated differently. Compare the different accounting treatment for a firm's spending on capital expenditures (i.e., physical property), research and development ("R&D"), or its people. When a firm invests in capital expenditures, that property's value is included as an asset on the firm's balance sheet and depreciated over time. By contrast, spending on R&D and labor are typically treated as expenses: they reduce net income in the current period, and they do not appear as assets on the balance sheet.[6]

These legacy rules do not reflect the current reality that the largest firms add value through internally developed intangible assets such as human capital. And while accounting rules have been sporadically updated over time, they have not been sufficiently reimagined to address the changes in the characteristics of today's public companies. As evidence of the increased importance of intangible assets to the value of U.S. public companies, consider that, in 1975, intangibles represented 17% of the value of the S&P 500.[7] By 2020, intangibles represented 90% of the S&P 500 market value.[8] The

[4] Stephen Zeff, EVOLUTION OF U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) 3.

[5] In 1925, the largest industries in the S&P 500 were transportation (28.75%), energy (19.48%), consumer discretionary (17.08%), and industrials (10.53%). *GFD Indices - Market Capitalization*, GLOB. FIN. DATA. Honigsberg & Rajgopal, *supra* note 2.

[6] PETER D. EASTON ET AL., FINANCIAL ACCOUNTING FOR MBAS (8th ed. 2021).

[7] Intangible Asset Market Value Study, Ocean Tomo.

[8] *Id.* This study suggests that intangibles are especially important for U.S. firms; among the other indices examined by Ocean Tomo, the S&P Europe 350 had the highest share of intangible market value at 75%.

growth of human capital firms is also apparent if we look at industry composition. Two of today's largest industries, healthcare and information technology (industries which rely heavily on human capital), jointly account for more than 33% of the market capitalization of the S&P 500, despite the fact that they are relatively new industries.

Second, accounting rules have not been updated to reflect the fact that in 2020, for the first time, more than half of U.S. listed companies reported negative earnings.[9] As shown in Figure 1, there has been a steady increase in the percentage of net loss firms over the past several decades. A leading explanation for the growing number of net loss companies is that many of these companies are relatively young, technology-heavy firms, and investors are betting on their future profitability.[10]

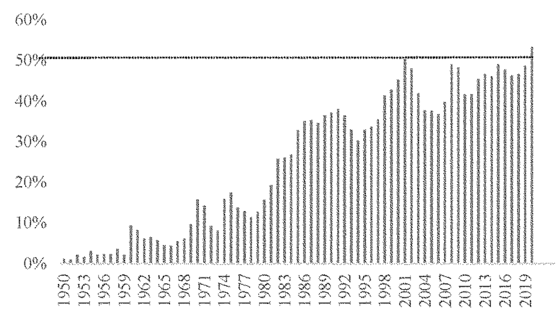

FIGURE 1. THE INCREASING PROPORTION OF LOSS-MAKING FIRMS AMONG PUBLIC COMPANIES.[11]

Commonly used valuation techniques, such as price-to-earnings ratios, cannot be used to value these firms. Instead, investors must project future earnings—an analysis that requires reliable information about costs, margins, and scalability. Unfortunately, this information is commonly

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[9] Honigsberg & Rajgopal, *supra* note 2.

[10] As noted in CEO Today Magazine, "[b]ack in the day, investing in a firm that is not making profits would be considered insane, but the status quo is changing." Richard Rossington, *5 of the World's Biggest Companies That Are Making Zero Profit*, CEO TODAY.

[11] Figure 1 includes firms traded on the New York Stock Exchange, American Stock Exchange, OTC Bulletin Board, NASDAQ-NMS Stock Market, NASDAQ OMX Boston, Midwest Exchange (Chicago), NYSE Arca, Philadelphia Exchange, and Other-OTC.

obfuscated under current accounting principles, as investors typically do not receive a sufficiently detailed breakdown of the firm's cost structure to identify contribution margins. And, of course, given the different accounting treatment for different types of investment, it is possible that these firms would be profitable if they were investing in physical equipment rather than R&D or people.

In sum, accounting rules have not kept up with two defining trends of 21st-century capital markets: the rise of the human-capital firm and the growth of lossmaking public companies. For the reasons explained below, the outdated accounting framework creates difficulties for investors.

II. VALUATION CHALLENGES UNDER TODAY'S OUTDATED DISCLOSURE RULES

The prominence of human capital firms and lossmaking firms poses challenges to valuation. To accurately value a firm, investors must distinguish whether cash outflows should be considered investments or maintenance expenses.[12] For example, the purchase of new equipment that improves the firm's operational efficiency and contributes to revenue growth is often considered an investment, as that equipment will be used going forward and will create future value. By contrast, the replacement of existing equipment to maintain current levels of revenue is often considered a maintenance expense, as that expenditure allows the firm to maintain its current productivity, but does not increase its productivity.

It is clear that sophisticated investors consider the distinction between investment and maintenance expenditures to be important. For example, skilled investors such as Warren Buffet have long incorporated this information in valuation of physical assets.[13] Mr. Buffet and other investors can perform this analysis for physical assets because existing accounting rules require disclosures that allow

[12] The absence of disclosure breaking down costs into fixed, variable, and semivariable is a concern with accounting principles more broadly. Because labor costs are likely to be firms' largest operating cost, it is intuitive to first address the lack of disclosure in this area, but it would be beneficial to consider the opacity of cost disclosures more generally.

[13] Letter from Warren E. Buffett, Chairman of Berkshire Hathaway Inc., to Shareholders of Berkshire Hathaway Inc. (1987). *But see* Venkat Peddireddy *Estimating Maintenance CapEx* (Sept. 2021) (distinguishing maintenance and investment capital expenditures, but describing the limitations of the current approach).

investors to estimate, albeit imperfectly, the portion of capital expenditures that can be considered investment and the portion that can be considered maintenance expense.

By contrast, current disclosures do not even allow investors to determine total workforce costs, much less to identify a firm's investment in its workforce. As the SEC recently recognized, information of this kind is "an important driver of long-term value."[14] That's why our Working Group reached broad agreement that, to improve pricing accuracy, investors need the information that will allow them to distinguish the portion of labor costs that should be considered an investment and the portion should be considered a maintenance expense.

III. Proposed Reforms

Our Working Group has proposed three straightforward disclosure rules in this area that would allow investors to draw that distinction. ***First***, managers should be required to disclose, in the Management's Discussion & Analysis ("MD&A") section of the annual report, what portion of workforce costs should be considered an investment in the firm's future growth. ***Second***, workforce costs should be treated *pari passu* with research and development costs, meaning that workforce costs should be expensed for accounting purposes but disclosed, allowing investors to capitalize workforce costs in their own valuation models as appropriate. ***Finally***, the income statement should be disaggregated to give investors more insight into workforce costs.

As a first step, managers should be required to disclose in the MD&A what portion of labor costs they view as an investment and why. This would allow investors better insight into what portion of labor costs should be capitalized in their own models—and may incentivize management to consider employees as a source of value creation.

Second, managers should also be required to give investors quantitative, tabular disclosure containing information on the number of employees, their total compensation (broken down by type of

[14] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rule Amendments to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K (Aug. 26, 2020).

compensation), and turnover rates. Although management's perspective is always helpful, the limits of quantitative disclosures are well-documented.[15] Detailed, quantitative disclosure is especially necessary in this area because some labor-related expenditures are more likely to reflect investments than others. For example, employee training costs seem likely to be considered an investment. Equity compensation, too, seems more likely to be classified as an investment, given the evidence that providing employees with equity compensation significantly improves retention.[16]

The Working Group's proposed "disclosure-only" approach is consistent with the treatment of R&D under current U.S. accounting rules. Although R&D is expensed, it is disclosed, allowing investors to make their own decisions regarding how R&D investments should be assessed. The result is that investors frequently, though not always, capitalize R&D.

I also note that, to be most helpful to investors, the tabular disclosure should include employee turnover rates. This information would permit investors, as appropriate, to amortize a firm's investments in labor. For example, if a firm has investments in labor of $100,000 and employees typically remain at the firm for five years, investors might capitalize that $100,000 and amortize it at $20,000 per year for five years. This is akin to how physical property is capitalized and depreciated under current accounting rules. Of course, whether to capitalize and amortize labor costs is a decision that investors can and should make—but they are only able to do so if the law gives them the pertinent information.

Finally, the income statement should be disaggregated so that investors have detailed information about specific operating costs—including labor. As noted above, investors in lossmaking firms need information on costs, margins, and scalability to estimate future profitability. Unfortunately,

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[15] *See, e.g.*, Andrew A. Acito, Jeffrey J. Burks & W. Bruce Johnson, *The Materiality of Accounting Errors: Evidence from SEC Comment Letters*, 36 CONTEMP. ACCT. RES. 839, 862 (2019) (documenting differing managerial approaches to SEC inquiries about the need for disclosure of particular items). *See also* Shivaram Rajgopal, *Amazon Spends $42 Billion on R&D but the 10K Discusses R&D in 300 Words*, FORBES (Mar. 8, 2021).

[16] *See, e.g.*, Bo Cowgill & Eric Zitzewitz, *Incentive Effects of Equity Compensation: Employee-Level Evidence from Google* (working paper 2015) (documenting retention effects of equity-based incentives).

this information is obfuscated under current accounting principles. Scores of costs are aggregated together under generalized headers such as "Cost of Goods Sold" or "Selling, General, & Administrative Expenses." Rather than purely generalized categories, investors need detailed information on specific operating costs, the most important of which is labor, to predict future margins, and to determine what portion of cash outflows reflect investment that will improve firm productivity and what portion reflect maintenance expenses that merely maintain the firm's current productivity. Without more detailed cost-level information, it is difficult, if not impossible, to reliably value these firms, or to stress-test the market's valuations of a firm using fundamental analysis. Further, disaggregating labor costs in this manner would allow investors to better understand the job function of employees, their expected value creation, and the firm's reliance on those employees.[17]

* * *

Given the importance of workers in today's economy, it is long past time for modernization of these rules. Specifically, public companies should be required to discuss what portion of their labor costs should be considered an investment in future firm profitability, disclose tabular information that would allow investors to assess that question for themselves, and disaggregate the income statement to show what portion of major expenses are attributable to labor costs.

Thank you again for the opportunity to testify before you today. I would be delighted to answer any questions you might have.

[17] Consider Microsoft's reporting from the early 2000s. In the Employee Stock and Savings Plan footnote, Microsoft presented pro forma disclosures showing the effect of expensing stock options on different operating expenses. The 2003 Annual Report showed that, if it were to expense stock options, operating expenses would have been nineteen percent higher in total. The allocation was not spread evenly across different expenses. Cost of revenue would have increased by only seven percent, but research and development would have increased by forty-two percent! Microsoft Corp., Annual Report (Form 10-K), Note 16 to Financial Statements.

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Columbia University
Graduate School of Business
Kravis 1111, 665 W 130th St, New York, NY
10027
sr3269@gsb.columbia.edu

Shivaram Rajgopal
Roy Bernard Kester and T.W. Byrnes
Professor of Accounting and Auditing

December 3, 2022

House Financial Services Committee

Re: Testimony before the House Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets related to "E, S, G and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data"

Thank you, Chairwoman Waters, ranking member McHenry and the esteemed members of the subcommittee for inviting me to speak today. It is an honor to be here. My name is Shiva Rajgopal and I am the Kester and Byrnes Professor of Accounting and Auditing at Columbia Business School.

My testimony touches on the "E" and "W" part of our hearing today. I express support for the SEC's proposed rules with mixed feelings about scope 3 emissions disclosures. I also highlight the need for mandatory disclosure related to compensation, workforce tenure and turnover for publicly listed U.S. companies.

Proposed SEC climate rules and scope 3 emissions

Let us start with the SEC's proposed climate rules related to E. The SEC has asked public listed firms to disclose the impact of climate-related risks on the firm's business model, its financial statements and governance process to manage such risk. Turning to quantitative disclosures, the SEC has asked firms to disclose scope 1 and 2 greenhouse gas (GHG) emissions and scope 3 emissions, if material, or if the firm has set a GHG emissions reduction target that includes Scope 3 emissions. Scope 1 covers direct emissions from owned or controlled sources. Scope 2 refers to indirect emissions from the generation of purchased electricity consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in a company's value chain especially from consumption of the product by customers.

I support the SEC's attempt to mandate rigorous, comparable, consistent data on GHG emissions across companies. My perspective is informed by a research project where my colleagues and I tried to assess whether the net-zero pledges of 57 odd oil and gas firms are credible. It took us close to six months to code what these companies were doing. The underlying data is scattered across press releases, websites, 10-Ks and sustainability reports. There is tremendous variation in the path followed to a net zero promise, the GHG scope category the promise covered, the reporting framework followed and the verifiability, if any, of the promised path to net zero. Companies routinely follow multiple NGO (non-governmental organization) sponsored frameworks such as those proposed by the TCFD (The Task Force on Climate related Financial Disclosures), GRI (Global Reporting Initiative), CDP (Carbon Disclosure Project) and the SASB's (Sustainability Accounting Standards Board). On top of that, the four ESG rating agencies, ISS (Institutional Shareholder Services), Sustainalytics, Bloomberg and MSCI provide environmental ratings that do not converge and are all over the map. Without rigor, consistency, comparability, and verifiability of climate risk disclosures, these companies cannot be held accountable for the promises they make in terms of carbon reduction. This concern is even more pressing for investors of ESG funds that claim to hold stocks that are climate friendly.

It is useful to point out that the disclosure framework suggested by the SEC is agnostic with respect to investor preferences about GHG emissions. Comparable and consistent GHG disclosures can also inform an investor who wants to bet on high GHG emitters. If an investor wants to buy stocks with higher GHG emissions, so be it.

However, I have mixed feelings about the SEC's requirement to disclose scope 3 disclosures. Although the SEC only asks for scope 3 emissions if material to a firm, I can think of cases where the costs of gathering material scope 3 data can be quite high. Consider the scope 3 emissions related to say a public listed pizza company that sells prepared pizzas to a retail distributor. The retail distributor uses delivery services to get the pizza to the customers' homes. Asking the publicly listed pizza company to calculate scope 3 emissions related to those deliveries can be potentially burdensome.

Another issue is the significant double counting of emissions if one adds up all the emissions across companies. If Chevron sells jet fuel to Delta Airlines for use in a plane made by Boeing, these emissions are scope 3 for Chevron and Boeing, and scope 1 for Delta. These emissions are effectively counted three times, which is problematic for any decent accounting system. Every scope 2 or scope 3 emission is someone else's scope-1 emission.[1] Having said that, if a firm has promised a scope 3 reduction to investors, we need disclosures to check whether that promise is being met.

The need for mandatory disclosure on labor costs and turnover

Let me devote my remaining time to the W aspect of the hearing today. In a typical high school economics class, we teach students that a typical company creates shareholder value by combining materials, labor, capacity using physical or intangible investments and managerial talent. However, an investor struggles to place even a range of values to the components of such a model for an American public company. This is because the standard income statement of a U.S. company lists expenses that a company incurs by function such as cost of goods sold, research and development, selling, general and administrative expenses (SG&A) but not by the value drivers of a business such as materials, labor and capacity costs needed to produce this year's product or services.[2]

Having laid out the limitations of the reporting model in general, let us concentrate on the topic at hand: labor, which I define broadly to include all compensation costs paid by firms. Labor costs are tangled up in every functional line item on the income statement where labor is employed, leaving pieces to a puzzle scattered throughout the income statement without thorough disclosure. For instance, compensation paid to scientists and engineers is tallied in the research and development number, or R&D. A significant portion of selling, general and administrative (SG&A) expenses is tied to compensation paid to hourly workers in stores and distribution centers, compensation for salespeople and to administrative labor such as accountants, lawyers and support staff. Very few U.S.

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[1] https://www.project-syndicate.org/commentary/carbon-offsets-types-of-corporate-emissions-by-geoffrey-heal-2021-11

[2] https://www.forbes.com/sites/shivaramrajgopal/2020/01/24/why-the-public-reporting-model-is-broken-and-how-to-fix-it/?sh=33f6b97f5b09

firms gather the puzzle pieces together for the investor to provide a cohesive, total picture of labor costs, stripped away from function.[3]

To be sure, the SEC has made some progress on this issue by mandating qualitative disclosures of human capital. However, a review of current voluntary disclosures of human capital metrics spans a wide array of non-comparable, often qualitative, information: For example, Tyson Foods has a new goal on employee retention, Visa has announced a target of increasing number of employees from underrepresented minorities at the vice president level and higher, Wells Fargo has disclosed adjusted pay gaps between women and men and between people of color and their white peers, Broadcom and Qualcomm talk about employee retention relative to their industry benchmarks, and Jacobs Engineering and Tyson Foods want to bring down reportable incidents to the OSHA. A glaring omission from this conversation is the most basic human capital metric: "compensation costs." As of now, approximately 15% of U.S. public firms disclose their compensation costs in their financial statements.[4]

How can an investor use information about labor costs to ascertain the financial sustainability of a business? Physical and tangible assets are now less important compared to human capital, especially in a rapidly digitizing corporate America. As an example, consider the business models of so-called network businesses such as Facebook or Uber.[5] The basic idea of such models is to keep building platforms, mostly in the form of labor costs embedded in software or brand building costs, till the business hits the so-called tipping point where the network is seen as large enough to become a dominant platform. Once that tipping point is hit, incremental revenue, net of variable costs, is supposed to contribute to the bottom line in an exponential manner. How is an investor supposed to track a company's progress towards the tipping point if the investor does not know the investment portion of labor employed to build the platform relative to the variable cost of labor associated with selling the product?

Another immediately useful application of reliable labor data would be to compute whether the gains made by shareholders reflect the gains made by employees. That is, if labor and shareholders truly operate as a partnership, we would expect percentage increases in shareholder value to mirror percentage increases in the value the company adds to its labor. My co-author and I have tried to test whether American companies reflect such a partnership using very coarse compensation data.[6] Precise self-reported compensation cost data by companies would greatly improve our ability to identify which companies follow such a partnership model and hence contribute meaningfully to the measurement of stakeholder value added, which is an important aspect of our hearing today.

This discussion is also related to the larger anxieties about the future of labor in our economy. There are legitimate concerns that automation and AI (artificial intelligence) will systematically replace

[3] https://www.forbes.com/sites/shivaramrajgopal/2021/05/17/labor-costs-are-the-most-pressing-human-capital-disclosure-the-sec-should-consider-mandating/?sh=4e165d615192

[4] https://www.forbes.com/sites/shivaramrajgopal/2021/05/17/labor-costs-are-the-most-pressing-human-capital-disclosure-the-sec-should-consider-mandating/?sh=4e165d615192

[5] https://www.forbes.com/sites/shivaramrajgopal/2021/04/12/what-would-a-new-financial-reporting-model-for-network-businesses-look-like/?sh=2227a6862af3

[6] O'Byrne S and S. Rajgopal. 2022. Employee value added: A new measure of gain-sharing between labor and capital. Journal of Applied Corporate Finance 34(2): 30-44. Available at https://onlinelibrary.wiley.com/doi/abs/10.1111/jacf.12503

labor as manufacturing has been outsourced from the U.S. to overseas destinations and our service companies become increasingly dependent on "gig" workers or contractors. Indeed, branded hotels appear to carry a large portion of the workforce who work their hotel ecosystem in off-balance sheet entities.[7] How does an investor assess the impact of these forces on the company's financial sustainability unless that investor can observe the firm's labor costs, including that related to compensation paid to contractors and its employees on its payroll?

The pressing concern on many investors' minds these days is to assess and understand how the company attracts and retains human capital which I define as the knowledge, skills, competencies, and attributes of the workforce, that enable the firm to earn higher operating returns and stock-based returns. Essential information that an investor needs to assess the quality of a company's human capital is the average number of years a worker spends with the firm and the level of employee turnover. My research suggests that employee turnover is robustly associated with the effectiveness of corporate culture in a firm.[8]

Guided by such research and observations, my co-author, Colleen Honigsberg of Stanford Law School, and I have filed a petition with the SEC detailing a suggested grid on what such mandatory labor disclosures might look like.[9] In particular, we ask for quantitative data related to salary, bonus, pension, stock awards, option awards, non-equity incentive compensation, pension and deferred compensation, health care, training and other costs. We suggest that these expenses be disclosed separately for full time employees, part time employees and contingent workers. We also ask for quantitative data related to mean tenure, employee turnover and number of workers for these three categories of labor.

We believe that such disclosure will enable investors assess the financial sustainability of companies better and hence improve the efficiency of stock prices and allocation of capital to public enterprises. We also believe that the cost of compiling such data is unlikely to be significant given that such data is already likely prepared by firms to send tax statements to their workforce.

Thanks again for listening to my testimony. I look forward to answering your questions.

Yours sincerely

Shiva Rajgopal

[7] https://www.forbes.com/sites/shivaramrajgopal/2022/03/20/asset-lite-companies-rely-on-labor-based-arbitrage-heres-the-investor-and-esg-case-for-disclosing-their-labor-practices/?sh=34693fdf5f09

[8] Graham, J., J. Grennan, C. Harvey and S. Rajgopal. Corporate culture: Evidence from the field, Journal of Financial Economics 146(2): 552-593. Available at https://www.sciencedirect.com/science/article/pii/S0304405X22001684

[9] https://www.sec.gov/rules/petitions/2022/petn4-787.pdf

THE U.S. IMPACT INVESTING ALLIANCE

December 6, 2022

Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Hearing entitled, "E, S, G and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data"

Written Testimony before the U.S. House of Representatives Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets Hearing

Fran Seegull
President
U.S. Impact Investing Alliance

Thank you to the Subcommittee for convening today's hearing on a topic as important as private sector disclosures on workforce management, investment and diversity data. Thank you to Subcommittee Chair Sherman and Subcommittee Ranking Member Huizenga for your leadership.

Markets can only exist and operate efficiently when there is a free flow of information, and this is particularly true for our capital markets. Investors depend on clear, comparable and reliable data on material factors to make prudent decisions in the near- and long-term. It is core to the mission of the Securities and Exchange Commission ("SEC") to empower investors by ensuring they are equipped with this kind of decision-useful information. As the head of an organization representing a wide range of investor perspectives, I join you today to share my support for SEC action to promulgate standardized corporate disclosures on material human capital management factors.

I serve as President of the U.S. Impact Investing Alliance ("the Alliance"), a non-partisan organization committed to catalyzing the growth of impact investing in the United States. The Alliance defines impact investing as those that create financial returns alongside measurable and positive social, economic or environmental impacts across asset classes. Members of our boards and councils include institutional investors and high-net-worth individuals collectively owning hundreds of billions of dollars of invested assets, in addition to asset and fund managers collectively managing over one trillion dollars in assets.

At the Alliance, we do not seek to advance any particular set of impact objectives. We have members who are motivated by a range of missions and values. Some impact investors seek to create economic opportunity in historically underinvested communities. Others look to foster the technology and industry that will drive a sustainable 21st century economy. Others are driven by personal religious or moral convictions.

What unites these different motivations and animates the work of the Alliance is the need to develop more effective capital markets, undergirded by enabling public policy, which allow investors to express their individual or institutional priorities and to invest their assets accordingly. Every investor has a unique set of risk and return preferences and time horizons that can only be expressed effectively when they have access to essential, material information about their investment options. So, while I represent an alliance of impact investors, I speak with you today about the broader needs of the capital markets.

The Alliance strongly urges the SEC to pursue a rulemaking on human capital management disclosures for corporations as soon as possible. We echo many investors in supporting the commonsense framework championed by the Human Capital Management Coalition, including disclosures on the total number of employees (including full-time, part-time and contingent labor), the total cost of a company's workforce, workforce turnover and employee diversity demographics by seniority level.[1] In addition to these quantitative measures, the agency should carefully consider what qualitative disclosures would be valuable to investors around other material workforce factors, such as worker health and safety and worker training policies.

Transparency and accountability are the hallmarks of efficient markets. Conversely, the lack of information creates market inefficiencies, which most often accrue first to the detriment of investors who have been kept in the dark. But these inefficiencies also compound over time and weaken the entire market system. In the capital markets, issuers rely on price signals from investors to improve their operational performance over time. It is therefore in the long-term interest of both individual companies and the wider economy to be responsive to emerging disclosure requirements.

Today, investors are increasingly calling for clear and comparable data on material environmental, social and governance ("ESG") factors. There are a variety of reasons that investors seek this information. Some in our network seek to promote specific impact goals, such as improving company workforce practices to create career opportunities for every employee. But in the capital markets, particularly in the public markets most closely regulated

[1] Human Capital Management Coalition, Foundational Human Capital Reporting: Taking a Balanced Approach.

by the SEC, the conversation about ESG factors between investors and company managers is first and foremost motivated by the desires to mitigate risk and pursue opportunities for growth.

On this topic, the Alliance is supportive of the SEC's proposed corporate climate disclosure requirements, which many investors and businesses also expressed support for during the public comment period earlier this year.[2] Most relevant to our conversation today, the Alliance has urged the agency to build upon its progress to-date by also prioritizing human capital management - or workforce - disclosures, inclusive of information on workforce diversity.

It is clearly within the mandate of the SEC to require standardized corporate disclosures on human capital management factors, and indeed, such action is necessary. A company's workforce is in many ways its greatest asset, and investors are eager to understand how a company attracts, manages and retains its talent - factors that relate directly to business performance.[3] The COVID-19 pandemic and its impacts on the economy and the workforce, in particular, helped to further demonstrate the importance of a company's recruitment, treatment and retention of its workers in terms of its short-term success and long-term viability.

As former SEC Chair Jay Clayton wisely stated while pursuing a rulemaking on principles-based human capital management disclosures, we need more information "from public companies on how they think about human capital."[4] The SEC should build upon the progress made during former Chair Clayton's term to better equip investors with high-quality data and in turn, promote transparency, accountability and fairness across the capital markets.

Unfortunately, investors must currently contend with incomplete and sometimes inaccurate information about workforce practices that is not comparable across companies, thus imposing inefficiencies and costs on investors.[5] Further, when companies report this information inconsistently, it can impede investment decision making. The lack of clarity also imposes costs

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[2] Cynthia A. Williams (Indiana University) and Robert G. Eccles (Oxford University), Review of Comments on SEC Climate Rulemaking, Harvard Law School Forum on Corporate Governance, November 2022.
[3] Investor Responsibility Research Center Institute (IIRCi), "The Materiality of Human Capital to Corporate Financial Performance," April 2015; Shivaram Rajgopal, Labor Costs Are The Most Pressing Human Capital Disclosure The SEC Should Consider Mandating, Forbes, May 2021.
[4] FY 2019 Budget-U.S. Securities and Exchange Commission, Hearing Before the H. Comm on Appropriations, 115th Cong. (2018) (statement of Jay Clayton, Chairman, Securities and Exchange Commission).
[5] JUST Capital, The Current State of Human Capital Disclosure in Corporate America: Assessing What Data Large U.S. Employers Share.

on companies who may face competing and duplicative requests for information on workforce practices from investors, regulators and other stakeholders. It is for these reasons that the Alliance supports a standardized approach to human capital management disclosures.

Investors in the Alliance's network tell us that information on diversity demographics, the total cost of a company's workforce, and turnover and retention statistics are material factors in their investment decision-making. In June of this year, nearly 50 investor and business organizations joined us in writing to SEC Chair Gensler encouraging the agency to prioritize standardized disclosures on human capital management factors specifically.[6] I am confident that public comments around a future rulemaking on human capital management disclosures would be strongly in favor and point to clear areas of consensus for disclosures.

Disclosures related to workforce diversity data are particularly important to investors. This is because there is a growing body of evidence to suggest that diversity across corporate boards, senior management and overall workforce corresponds with better financial performance and resiliency, as well as a company's ability to attract and retain talent.[7] The Alliance has not supported blanket quotas on matters such as board representation, but the investors we work with do seek to understand how issues of diversity are broadly addressed by companies in which they invest. Specifically, investors in our network have emphasized the importance of workforce diversity disclosures by race, gender, LGBTQ+ and disability status. The Alliance has advocated for the inclusion of disability status when considering diversity factors, given the compelling evidence base that good corporate disability inclusion practices are linked to improved business performance.[8]

Human capital management disclosure would not create significant burdens on issuers. We are mindful that policymakers may be wary of regulatory changes that could burden U.S. companies. Careful consideration of impacts on issuers is critical, though we strongly believe that human capital management disclosure requirements would not be overly burdensome to companies and would instead result in overall benefits to investors, companies and the broader markets.

[6] U.S. Impact Investing Alliance, Letter to SEC Chair Gensler on Investor and Business Group Support for Mandated Human Capital Management Disclosures for Corporations, June 2022.
[7] McKinsey & Company, Diversity Still Matters, May 2020; Morgan Stanley, Why it Pays to Invest in Gender Diversity, May 2016; Glass Door, What Job Seekers Really Think About Your Diversity and Inclusion Stats, July 2021.
[8] Accenture, Getting to Equal: The Disability Inclusion Advantage, 2018.

The SEC's cost-benefit analysis of its proposed corporate climate disclosure rulemaking revealed that the costs to implement would be limited. This finding was also validated by an independent study finding the agency's estimates in line with corporate issuers' current average spend on climate-related disclosure activities.[9] It stands to reason that the costs of a human capital management disclosure rule would also be minimal.

Broadly speaking, publicly listed companies will already have access to extensive information on their workforce. Collection of diversity data in particular is already required through the U.S. Equal Employment Opportunity Commission in the form of EEO-1 data, covering data by race/ethnicity, sex and job categories.[10] Therefore, a requirement to publicly disclose data that is already collected would not impose significant incremental burdens on companies.

Further, absent a federal standard, corporate leaders are currently having to navigate a complex web of overlapping and duplicative private disclosure standards to meet investor demands. The SEC has the opportunity to standardize these disclosures and create clarity for both issuers and investors alike.

How the SEC proceeds on standardized corporate workforce disclosures is also a matter of American economic competitiveness. The United States is a global economic leader because investors have ample confidence in the transparency and accountability of our public capital markets. However, global regulators are moving forward with their own disclosure regimes, placing those seeking to invest in U.S. corporations at an information disadvantage if we do not pave our own path forward. American businesses would, in turn, face barriers to raising capital without a streamlined process for disclosing information investors increasingly expect and demand. Conversely, mandated, clear and consistent disclosure of human capital management factors will make existing issuers stronger, and it will attract more capital into industries that will, in turn, create pathways to economic opportunity for American workers.

The SEC has made significant strides in promoting regulations that would instill more transparency in the capital markets on material sustainability issues like climate change, but we risk losing momentum without a complementary rulemaking on human capital management disclosures. Across the federal government, we encourage policymakers to consider their collective role in cementing American leadership and U.S. economic competitiveness on these issues.

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[9] The Sustainability Institute by ERM, Costs and Benefits of Climate-Related Disclosure Activities by Corporate Issuers and Institutional Investors, May 2022.
[10] U.S. Equal Employment Opportunity Commission, EEO-1 Data Collection.

Conclusion: Changes to the rules underpinning our capital markets deserve careful consideration. The Alliance and the investors in our network are encouraged by the thoughtful consideration of human capital management disclosures demonstrated by the SEC over the past several years, guided by the expertise of those such as the experts sitting on the Investor Advisory Committee.[11]

The Alliance and the investors in our network strongly support SEC action to require standardized corporate disclosures on workforce management, investment and diversity data. Empowering investors with clear, comparable and decision-useful data on material ESG and specifically human capital management factors is squarely in line with the SEC's critical mission to protect investors; ensure fair, orderly and efficient markets; and facilitate capital formation.

A streamlined and standardized disclosure framework from the SEC will cement the transparency, accountability and efficiency of our capital markets and enhance American economic competitiveness for many years to come. Thank you to the Subcommittee for this opportunity to speak on such an important topic for U.S. investors.

[11] Recommendation of the Investor Advisory Committee Human Capital Management Disclosure, March 2019.

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TESTIMONY

TESTIMONY ON WORKFORCE MANAGEMENT DISCLOSURES AND OTHER SEC ISSUES

ANDREW N. VOLLMER
Senior Affiliated Scholar, Mercatus Center at George Mason University

Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets of the Committee on Financial Services, US House of Representatives
E, S, G and W: Examining Private Sector Disclosure of Workforce Management, Investment, and Diversity Data

December 6, 2022

Chair Sherman, Ranking Member Huizenga, and members of the subcommittee:

I am pleased to have an opportunity to comment on several timely and important issues related to the federal securities laws. I have extensive experience with those laws. I was deputy general counsel of the Securities and Exchange Commission (SEC) from mid-2006 to March 2009 and was on the faculty and taught courses on securities regulation at the University of Virginia School of Law from 2014 to 2019. For many years, I was a partner in the securities enforcement practice of Wilmer Cutler Pickering Hale and Dorr LLP and am currently a senior affiliated scholar with the Mercatus Center at George Mason University.

My testimony will address the following:

- The proposals for further disclosures on workforce management and diversity. I will outline some basic principles that should guide Congress or the SEC when they contemplate the possibility of requiring new areas of disclosure from reporting companies.
- The need for Congress to improve the rules for raising capital.
- Issues with the SEC's internal operations and management, such as the harmful effects on the rulemaking process and staff morale from the number and pace of rulemakings and unduly short public comment periods.

The views I express in this written statement and in my oral testimony are solely my own and are not on behalf of and do not necessarily reflect the views of any other person.

DISCLOSURE OF WORKFORCE MANAGEMENT

Calls for additional disclosure obligations on specialized topics regularly occur. Today's hearing is about the need for further disclosures on workforce management and diversity. Another example is the SEC's proposal for new, detailed, and extensive obligations for companies to make public disclosures of information related to climate change. Congress in the past ordered public disclosures on conflict minerals and payments to governments for the development of oil, natural gas, or minerals.

When Congress or the SEC considers adding a new category of disclosure, it should take into account a series of basic principles. Congress and the SEC should not impose new disclosure regulations lightly.

- A new disclosure obligation should be based on data and evidence demonstrating a serious unmet need or the existence of a continuing, severe harm to investors. A preference of some investors for the information usually should not be sufficient.
- Congress or the SEC should reach a conclusion that the private markets are not able to correct the problem and that a new law would address or correct the problem.
- Congress should consider whether a new disclosure obligation would comply with the Constitution, and the SEC should consider whether a new disclosure obligation would comply with the Constitution and the SEC's statutory authority to adopt the new regulation.
- A new disclosure should further the core purposes of the federal securities laws. Congress originally wanted disclosures under those laws to cover "items indispensable to any accurate judgment upon the value of the security" and important to the proper direction of capital resources.[1] With few exceptions, Congress consistently limited disclosure topics to financial statements and financial performance of the disclosing company, the business, management, and a description of securities. Often, a proposed new disclosure area is outside of these purposes and is aimed at a different social policy objective. Congress should be circumspect about imposing new disclosure obligations in the federal securities laws that are designed to advance an unrelated policy goal.
- If regulation is justified, it should be narrow and go no further than necessary to correct the harm. Each new disclosure obligation should be carefully weighed. Disclosure documents have grown increasingly prolix, complicated, and difficult to comprehend. New disclosure areas make understanding corporate disclosures harder. As a result, in the past 10 years, Congress has demanded fewer and simpler disclosure obligations, not more and more complicated ones. Congress used two enactments to express disapproval of the length and complexity of the disclosure rules and to instruct the SEC to modernize and simplify them.[2]
- A new disclosure obligation should be reasonably likely to produce quantifiable benefits that exceed the quantifiable costs when the new regulation is compared with existing law.

1. H.R. Rep. No. 73-85, at 3 (1933).
2. Section 108 of the JOBS Act, Pub. L. No. 112-106, 126 Stat. 306 (2012), requires the SEC to review Regulation S-K to determine how it could be modernized and simplified and to reduce the costs and burdens of compliance for emerging growth companies. At the end of 2015, Congress ordered the SEC to revise Regulation S-K to reduce the disclosure burden on emerging growth companies and small issuers. Fixing America's Surface Transportation Act, Pub. L. No. 114-94, § 72002, 129 Stat. 1784, 1784 (2015). Congress also ordered the SEC to conduct a study to determine "how best to modernize and simplify" the requirements in Regulation S-K "in a manner that reduces the costs and burdens on issuers while still providing all material information." § 72003, 129 Stat. 1784, 1785.

- An important cost consideration should be that government obligations restrict personal freedom. A founding principle and continuing aspiration of the country has been to preserve personal freedom, extend it when it has been denied, and use government regulation only when a serious and widespread harm is recurring.

The bills this subcommittee is considering and proposals in the human capital or workforce management area should be closely examined under these criteria. For example, the extent of the need for additional human capital disclosure, especially the need for detailed numerical or statistical data, is open to question.

In 2020, the SEC expanded the required disclosures on human capital.[3] The new requirement states a company must provide a "description of the registrant's human capital resources, including the number of persons employed by the registrant, and any human capital measures or objectives that the registrant 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 development, attraction and retention of personnel)."[4]

The commission had given the matter careful thought, agreed that "human capital is a material resource for many companies and often is a focus of management, in varying ways, and an important driver of performance,"[5] and explained that it decided not to adopt prescriptive metrics:

> The final amendments identify various human capital measures and objectives that address the attraction, development, and retention of personnel as non-exclusive examples of subjects that may be material, depending on the nature of the registrant's business and workforce. We emphasize that these are examples of potentially relevant subjects, not mandates. Each registrant's disclosure must be tailored to its unique business, workforce, and facts and circumstances. Consistent with the views expressed by some commenters, we did not include more prescriptive requirements because we recognize that the exact measures and objectives included in human capital management disclosure may evolve over time and may depend, and vary significantly, based on factors such as the industry, the various regions or jurisdictions in which the registrant operates, the general strategic posture of the registrant, including whether and the extent to which the registrant is vertically integrated, as well as the then-current macro-economic and other conditions that affect human capital resources, such as national or global health matters.[6]

The SEC did not require more specifics because its approach afforded flexibility for companies to tailor their disclosure to their own circumstances.[7]

3. Sec. & Exch. Comm'n, Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63726 (Oct. 8, 2020).
4. 17 C.F.R. § 229.101(c)(2)(ii).
5. 85 Fed. Reg. at 63739.
6. *Id.*
7. *Id.*

Companies responded to the new human capital disclosure rule with a wide range of quantitative and qualitative information.[8] The rule therefore raises a doubt about the present need for and the amount of benefit from further required disclosures.

Some proposals, such as H.R. 3471, would add extensive additional qualitative and quantitative workforce management disclosures, and another proposal would also add detailed new accounting rules.[9] The potential costs and benefits of such proposals need careful study and need to be compared to the disclosures already being made under current SEC rules.

Quantitative prescriptions and new accounting rules would apply to all reporting companies, reduce the flexibility of the current rule, and increase costs. A company would need to comply even if human capital management information did not bear significantly on its business. Accounting rules are costly and time-consuming to comply with and costly and time-consuming to develop. In addition, many proposed disclosures in the human capital area are broad and general, such as the proposal in H.R. 3471 to require disclosure of policies and procedures on workforce engagement, productivity, and mental well-being of employees, which makes them more difficult to implement and increases costs. Benefits from many types of proposed disclosures would be speculative and might not be greater than under the current disclosure obligation.

To a large extent, many of the bills under consideration would make securities activities in the United States more costly and would burden the capital formation process without sufficient offsetting benefits. Adding costs to required public disclosures is one of the reasons successful private companies do not become public companies.

Areas other than human capital and workplace disclosures could use this subcommittee's attention. I will mention two: improvement of the rules for raising capital and issues with the SEC's internal operations and management.

CAPITAL FORMATION

The securities statutes and regulations governing the capital formation process continue to impose regulatory and compliance costs and disincentives that discourage the formation and growth of new products, services, and jobs. Reform of the public offering process and the exemptions from that process would reduce the cost of raising capital, feed economic growth and enable job creation, and preserve investor protections.

The subcommittee has many proposals it could consider. Ranking Member McHenry and representatives Budd and Steil, among others, have submitted bills to increase the access of small businesses to capital. Outside commentators also have offered ideas.[10]

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8. *See* GIBSON DUNN, DISCUSSING HUMAN CAPITAL (2021) (reviewing human capital management disclosures from S&P 500 companies that filed an annual report between the time the new rule went into effect and the middle of 2021), https://www.gibsondunn.com/wp-content/uploads/2021/11/discussing-human-capital-survey-of-sp-500-compliance-with-new-sec-disclosure-requirement-one-year-after-adoption.pdf.

9. WORKING GROUP ON HUMAN CAPITAL ACCOUNTING DISCLOSURE, PETITION FOR RULEMAKING (2022), https://www.sec.gov/rules/petitions/2022/petn4-787.pdf.

10. *See, e.g.*, *Keeping Markets Fair: Considering Insider Trading Legislation: Hearing before the S. Comm. on Banking, Hous., and Urban Aff.*, 117th Cong. (Aug. 11, 2022) (statement of David R. Burton, Senior Fellow in Econ. Pol'y, Heritage Foundation), https://

SEC INTERNAL PROCEDURES AND MANAGEMENT

Congress should consider improvements to the internal procedures and management of the SEC. The chair and majority of the current commission have taken several actions demonstrating the need for management systems that create incentives for more collegial and accountable decision-making.

Rule proposals from the current commission are extreme and partisan. The majority disregards the minority commissioners and has a winner-take-all mentality. That is not consistent with the reason for creating commissions with several members and requiring commissioners to come from more than one political party. Such agencies were to benefit from different points of view and foster discussion, negotiation, and compromise.[11]

Congress could consider requiring internal procedural changes at the SEC. It could allow two commissioners, one from the majority and one from the minority, to act together to put an item on the agenda for a commission vote. At the moment, the chair controls the agenda. Another idea is to require supermajority voting—that is, one more than a bare majority—on major SEC matters such as new or amended rules or the initiation of enforcement cases. A supermajority voting requirement would create a formal incentive for consultation and cooperation among the commissioners.[12]

Another problem is that the majority of the current commission is in a rush to regulate. They have proposed a long list of major rules in quick succession and in ways that have disserved the rulemaking process and the public. Commissioner Hester Peirce summarized the problem this way: The "rush of radical rulemakings remains relentless, despite pleas from almost every type of market participant and other interested party that the Commission slow down so that the public can catch up and provide meaningful input on our outstanding proposals."[13]

The accelerated schedule has prevented the SEC staff from adequately developing and preparing draft rules and has denied reasonable amounts of time for the public to comment. That has diminished the quality of the rules and has led to lower staff morale and staff departures.

Managers from major parts of the SEC have expressed a variety of concerns with the increase in the SEC's rulemaking activities, according to a recent review of the management at the SEC by the SEC Office of Inspector General (IG):

> For example, some reported an overall increase in attrition . . . and difficulties hiring individuals with rulemaking experience. In the interim, managers reported relying on detailees, in some cases with little or no experience in rulemaking. Others told us that they may have not received as much feedback during the rulemaking process, either as a result of shortened timelines

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www.heritage.org/testimony/entrepreneurial-capital-formation; Andrew N. Vollmer, *Abandon the Concept of Accredited Investors in Private Securities Offerings*, 49 SEC. REG. L.J. 5 (2021); Andrew N. Vollmer, *Investor-Friendly Securities Reform to Increase Economic Growth*, 49 SEC. REG. & L. REP. (Bloomberg BNA) 904 (June 2, 2017).

11. *See* Andrew N. Vollmer, *How to Dilute Political Polarization at the SEC*, THE HILL (Sept. 7, 2022), https://thehill.com/opinion/finance/3632542-how-to-dilute-political-polarization-at-the-sec/.

12. *See id.*

13. Hester M. Peirce, Comm'r, Sec. & Exch. Comm'n, Rip Current Rulemakings: Statement on the Regulatory Flexibility Agenda (Jun. 22, 2022), https://www.sec.gov/news/statement/peirce-statement-regulatory-flexibility-agenda-062222.

> during the drafting process or because of shortened public comment periods. Although no one we met with identified errors that had been made, some believed that the more aggressive agenda—particularly as it relates to high-profile rules that significantly impact external stakeholders—potentially (1) limits the time available for staff research and analysis, and (2) increases litigation risk. Finally, some managers noted that fewer resources have been available to complete other mission-related work, as rulemaking teams have borrowed staff from other organizational areas to assist with rulemaking activities.[14]

The IG report notes that, at the same time, staff was leaving the SEC at an unusually high rate: The "SEC has seen a significant increase in attrition over the last few years, from 3.8 percent in FY 2020 to an estimated 6.4 percent in FY 2022 (as of September 20, 2022) – the highest attrition rate in 10 years. Most concerning is the increased attrition in Senior Officer and attorney positions, expected to be about 20.8 percent and about 8.4 percent for FY 2022, respectively."[15] Senior officers are some of the most knowledgeable and experienced officials at the SEC. A 20 percent loss is a genuine and substantial human capital management problem.

The picture that emerged from the IG report is troubling. The SEC is trying to adopt too many rules, too quickly, and without sufficient research, analysis, and public comment. Inexperienced staff are being used on rulemakings, and the rate of staff departure is high.

A third concern is that the current commission has given members of the public insufficient time to comment on many of its recent proposals. Commissioners, both past and present, have criticized short comment periods,[16] as have many commenters on proposed rules.[17] Members of Congress have also objected to these short comment periods.[18] The SEC was finally compelled to extend the time for public

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14. SEC Office of Inspector General, The Inspector General's Statement on the SEC's Management and Performance Challenges 3 (2022), https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf. On one rulemaking, Commissioner Mark Uyeda observed that he had not received the usual detailed comment summary from the staff. Mark T. Uyeda, Comm'r, Sec. & Exch. Comm'n, Statement on the Final Rule for Enhanced Reporting of Proxy Votes by Registered Management Investment Companies (Nov. 2, 2022), https://www.sec.gov/news/statement/uyeda-statement-amendments-form-npx-110222.
15. *Id.* at 21.
16. Hester M. Peirce, Comm'r, Sec. & Exch. Comm'n, Rat Farms and Rule Comments – Statement on Comment Period Lengths (Dec. 10, 2021), https://www.sec.gov/news/statement/peirce-rat-farms-and-rule-comments-121021; Hester M. Peirce, Comm'r, Sec. & Exch. Comm'n, Dissenting Statement on the Proposal to Amend Regulation ATS (Jan. 26, 2022), https://www.sec.gov/news/statement/peirce-ats-20220126; Elad L. Roisman, Comm'r, Sec. & Exch. Comm'n, Statement on the Proposed Rules Regarding 10b5-1 Plans (Dec. 15, 2021), https://www.sec.gov/news/statement/roisman-10b5-1-20211215; Mark T. Uyeda, Comm'r, Sec. & Exch. Comm'n, Remarks at the APABA-DC Awards and Installation Reception (Oct. 19, 2022), https://www.sec.gov/news/speech/uyeda-apaba-dc-20221019.
17. *See, e.g.*, Letter from Tom Quaadman, Exec. Vice President, U.S. Chamber of Com., to Vanessa A. Countryman, Sec'y, Sec. & Exch. Comm'n (Apr. 19, 2022) (on the "Proposed Rule Regarding "The Enhancement and Standardization of Climate-Related Disclosures for Investors"), https://www.centerforcapitalmarkets.com/letter/ccmc-urges-the-sec-to-extend-comment-period-on-proposed-rule-regarding-the-enhancement-and-standardization-of-climate-related-disclosures-for-investors/; Letter from Alternative Credit Council et al. to Gary Gensler, Chair, Sec. & Exch. Comm'n (Apr. 5, 2022) (on "Importance of Appropriate Length of Comment Periods"), https://www.ici.org/system/files/2022-04/22-ici-letter-to-sec-chair-gensler.pdf; Letter from Gail C. Bernstein et al., to Vanessa A. Countryman, Sec'y, Sec. & Exch. Comm'n (n.d.), https://investmentadviser.org/wp-content/uploads/2022/03/Extension-Request-File-Nos.-S7-03-22-S7-01-22.pdf.
18. *See* Letter from Patrick McHenry, Ranking Member, House Comm. on Fin. Serv., & Pat Toomey, Ranking Member, S. Comm. on Banking, to Gary Gensler, Chair, Sec. & Exch. Comm'n (Jan. 10, 2022), https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

comment on some rulemakings, but that of course did not assist those who had already compressed their efforts and submitted their comments.[19]

Unduly short public comment periods have negative consequences. According to Commissioner Mark Uyeda, the "shortened comment periods significantly weaken a cornerstone of effective rulemaking."[20] A reasonable amount of time is necessary to allow the public to provide substantive analysis, warn of unintended negative consequences, and suggest alternative approaches. Comments help refine and improve adopted rulemakings.

Finally, the current commission has not tended to the basic machinery of the agency. In violation of the Administrative Procedure Act and internal rules, personnel in the Division of Enforcement gained access to memoranda written by a different part of the agency to assist the full commission in its adjudication function.[21] The commission has not provided the public with the promised full explanation and details of this disturbing incident. Then, in October 2022, the SEC discovered a technological error that affected at least 10 commission requests for comment and prevented the SEC from receiving public comments submitted through the commission's internet comment form. The SEC reopened the affected comment periods.[22]

Thank you for the opportunity to comment on these matters. I would be pleased to answer questions.

19. Press Release, Sec. & Exch. Comm'n, SEC Extends Comment Period for Proposed Rules on Climate-Related Disclosures, Reopens Comment Periods for Proposed Rules Regarding Private Fund Advisers and Regulation ATS (May 9, 2022), https://www.sec.gov/news/press-release/2022-82.
20. Mark T. Uyeda, Comm'r, Sec. & Exch. Comm'n, Statement on the Final Rule Related to Listing Standards for Recovery of Erroneously Awarded Compensation (Oct. 26, 2022), https://www.sec.gov/news/statement/uyeda-statement-clawbacks-102622#_ftn9.
21. SEC. & EXCH. COMM'N, COMMISSION STATEMENT RELATING TO CERTAIN ADMINISTRATIVE ADJUDICATIONS (2022), https://www.sec.gov/news/statement/commission-statement-relating-certain-administrative-adjudications#_ftn4.
22. Press Release, Sec. & Exch. Comm'n, SEC Reopens Comment Periods for Several Rulemaking Releases Due to Technological Error in Receiving Certain Comments (Oct. 7, 2022), https://www.sec.gov/news/press-release/2022-186.

AON

Key Themes Emerge in the Second Year of Human Capital Management Disclosure for U.S. Companies

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Industries

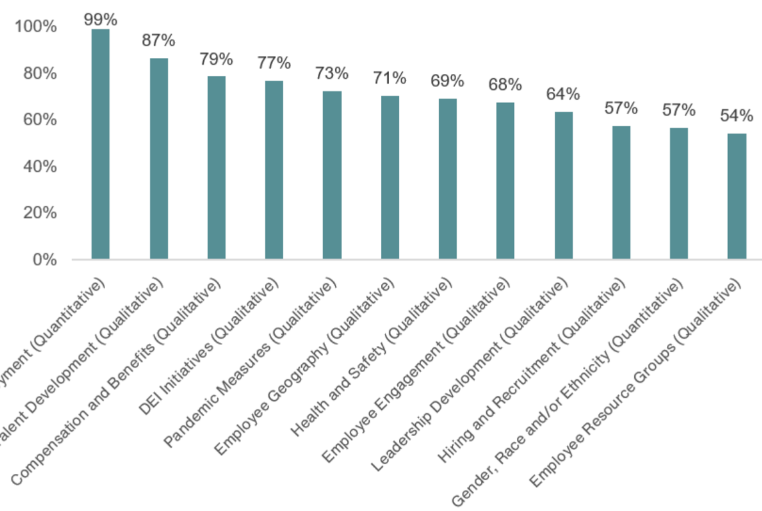
Our research into the second year of required human capital management disclosure in companies' Form 10-Ks finds a continued general lack of quantitative information. However, within the most prevalent topics for disclosure, we are observing more data being included, particularly when it comes to diversity, equity and inclusion.

Public companies in the United States (U.S.) have completed the second year of required disclosure regarding human capital management (HCM), allowing stakeholders to compare year-over-year changes in how companies are disclosing HCM and different topics of interest.

To see how this disclosure is evolving, we analyzed 496 filings from S&P 500 companies for the 2021 fiscal year and compared to the prior year. The most common topics covered by companies are largely the same as the first year of the disclosure rule (see our analysis of year one disclosures here). However, individual companies are disclosing more details on these topics, leading to more robust disclosures.

In this article, we explore year-over-year changes in disclosure, hot topics being addressed, and how companies can prepare to meet stakeholder expectations for HCM disclosures in the future. The chart below illustrates the most common categories in year two of the required disclosure.

Figure 1: Most Prevalent Categories for HCM Disclosure in 2021 Fiscal Year



Source: Aon research of 496 10-K filings from S&P 500 companies from fiscal years 2020 and 2021

How Year Two Disclosure Compares to Year One

While the categories of these disclosures have not changed meaningfully in this second year, S&P 500 companies are including a broader set of topics and more in-depth information. We looked at a subset of 374 companies in the S&P 500 to analyze how their year-over-year disclosures have evolved. The results in Figure 2 show the nine categories where we saw a greater than 10 percent increase or decrease in disclosure across the same sample of companies.

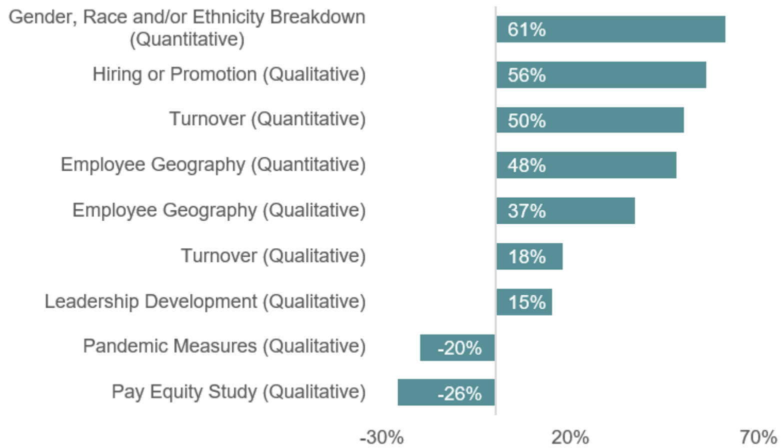
The category with the most additional information added is gender or race/ethnicity breakdown. Companies disclosing this quantitative data increased by 61 percent in year two compared to year one. We also saw an increase in disclosure related to talent attraction and retention — a hot topic many companies are currently challenged with. Consider the following year-over-year changes:

- 56 percent increase in hiring or promotion disclosures
- 50 percent increase in data on employee turnover
- 48 percent increase in quantitative data on employee geography, such as the number of employees by country or region
- 15 percent increase in leadership development disclosures

However, quantitative turnover was still reported by less than 20 percent of the subset of the 374 companies.

In some cases, companies reduced the amount of disclosure. There was a 26 percent drop in pay equity study disclosures and a 20 percent decline in discussions on pandemic measures. The drop in pay equity study disclosures may indicate that companies are acting on the results that came out of the flood of pay equity audits conducted in 2020, rather than focusing discussion on the audits themselves. Going forward, we may see a cyclical pattern with a surge in pay equity discussions tied to headline pressures and companies' periodic pay gap analyses.

Figure 2: Top Changes in HCM Disclosure by Topics: Year One vs. Year Two



Source: Aon research of 374 10-K filings from S&P 500 companies from fiscal years 2020 and 2021

The increase in topics covered by individual companies may be a move to get in front of additional human capital disclosure requirements in anticipation of potential forthcoming rules that may be issued by the SEC. Chairman Gary Gensler stated in August 2021 that he asked the SEC staff to propose recommendations for enhanced HCM metric disclosures beyond the number of employees, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.

“As the SEC rule is principles-based disclosure, we expect the types of information provided by companies to continue to be refined over the coming years,” says Pamela Greene, Aon’s head of North America Corporate Governance and ESG Advisory group. “Just as we have seen an evolution within Compensation Discussion & Analysis disclosures over the last 15 years, we expect human capital disclosures to similarly progress in their structure, issue-coverage and depth over time, reflecting dynamic investor expectations,” she says.

Key Themes From Year Two Disclosures

The increase in topics and quantitative metrics covered by individual companies may also help convince the SEC it's not necessary to revise the rule to make it more formulaic and require specific human capital metrics to be disclosed. SEC Chairman Gary Gensler stated in August 2021 that he asked the SEC staff to propose recommendations for enhanced HCM metric disclosures beyond the number of employees, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.

"As the SEC rule is principles-based disclosure, we expect the types of information provided by companies to continue to be refined over the coming years," says Pamela Greene, head of Aon's North America Corporate Governance and ESG Advisory group. "Just as we have seen an evolution within Compensation Discussion & Analysis disclosures over the last 15 years, we expect human capital disclosures to similarly progress in their structure, coverage of issues and depth over time. This all reflects dynamic investor expectations," she says.

Key Themes From Year Two Disclosures

Most of the S&P 500 companies begin their year two disclosures with a workforce overview, with 99 percent including data on the size of their workforce and 71 percent providing details on their geographic footprint. Following this information, nearly half of companies provide a statement on the existence of collective bargaining agreements (CBAs). Of the companies subject to CBAs, 58 percent provide quantitative data such as number of CBAs or number of employees covered by them.

Topics of disclosure can be largely grouped into four categories. These include hiring and retaining talent; diversity, equity and inclusion; employee engagement; and COVID-19, health and safety.

We explore each of these sections in more detail below to provide trends on HCM actions and disclosures to help organizations consider for next year the level of disclosure around their HCM strategy.

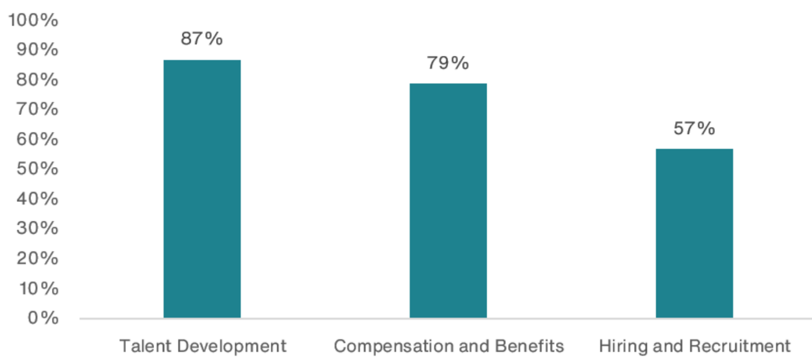
Hiring and Retaining Talent

The majority of companies address the current competitive job market by highlighting their hiring and talent development strategies: Fifty-seven percent of companies discussed recruitment and hiring, with 21 percent of those companies including quantitative data predominantly around new-hire statistics.

Similar to the first year of disclosure, talent and leadership development was an area of focus, with 87 percent of companies covering this topic. Companies discussed training and mentorship programs, including data on participation rates.

In addition to employee development, 79 percent of companies discussed the competitiveness of their compensation and benefits as part of their hiring and retention strategy. Some companies discussed the shift in their benefit programs to address the effects of the pandemic on their workforce, such as the expansion of mental health and wellness benefits.

Figure 3: Common Topics Under the Hiring and Retaining Talent Category of Disclosure



Source: Aon research of 496 10-K filings from S&P 500 companies, April 2021 through April 2022

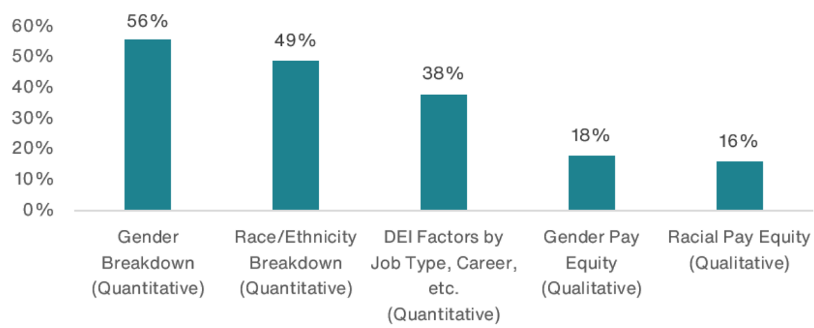
Diversity, Equity and Inclusion (DEI)

Most companies discussed DEI in their human capital management disclosure. Seventy-seven percent discussed specific DEI initiatives, such as unconscious bias training, diverse candidate recruitment and employee resource groups.

We also saw an increase in quantitative DEI disclosures compared to the prior year, with 56 percent disclosing the gender breakdown and 49 percent disclosing the race/ethnicity composition of their workforce. In addition, 38 percent of companies overlay these quantitative diversity metrics with job type, career levels and other categories, which presents a more in-depth look at their workforce diversity.

As mentioned, we did see a decline in disclosure of pay equity studies from the prior year. Only 18 percent of companies mentioned conducting gender or race/ethnicity pay equity studies, and 31 percent of those include quantitative data. Examples of this include the percentage of pay disparity and cents on the dollar earned by women or people of color compared to men or non-minority employees.

Figure 4: Common Topics Under the DEI Category of Disclosure

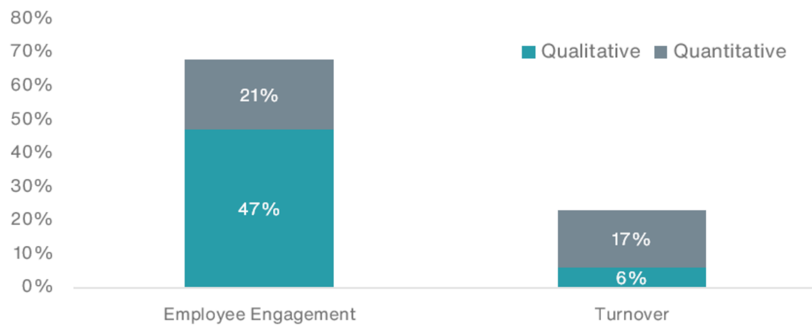


Source: Aon research of 496 10-K filings from S&P 500 companies, April 2021 through April 2022

Employee Engagement

Employee engagement was a popular topic in this second year of disclosure, with 68 percent discussing it. Of that group, 31 percent included quantitative metrics, such as participation rates in pulse surveys or the results of those surveys. Employee resource groups were discussed in 54 percent of disclosures, which often intersected with DEI initiatives. Employee turnover — an important indicator of employee engagement — was mentioned by nearly a quarter of companies.

Figure 5: Qualitative and Quantitative Disclosure of Topics in the Employee Engagement Category

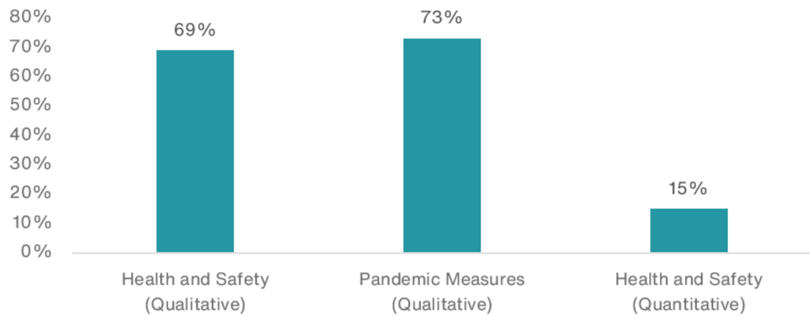


Source: Aon research of 496 10-K filings from S&P 500 companies, April 2021 through April 2022

COVID-19, Health and Safety

Although there was a year-over-year decline in COVID-19 coverage, pandemic measures continued to be a prevalent topic, with nearly three-quarters of our sample companies providing disclosure. The pandemic was often mentioned as part of location strategies and protocols. Sixty-nine percent of companies discussed the health and safety of their workforces, including mental health and wellbeing. Of those that covered health and safety, 22 percent included quantitative data such as injury rates in their disclosure.

Figure 6: Prevalent Topics in the COVID-19, Health and Safety Category



Source: Aon research of 496 10-K filings from S&P 500 companies, April 2021 through April 2022

Staying Current on Hot Topics in Disclosure

The four key themes discussed above represent topics that most organizations believe to be material. If your human capital management disclosure does not include these topics, consider adding this information in next year's Form 10-K to align with general market practice.

It is also important to monitor topics that have begun to gain significant traction, such as disclosing quantitative DEI factors by job type or career, discussing pay equity studies and addressing turnover. This information may become more commonplace next year. Companies can prepare now by gathering this information and presenting it to the full board or a board committee so they can be apprised of these metrics and understand the year-over-year changes and reasons for it.

In addition to these key themes, there are other sector or company-specific issues that may be relevant to include as well. Looking to industry peer practices can help ensure company disclosures are aligned with the market on issues and metrics.

Next Steps

Put simply, investors, proxy advisors and employees want to see more detailed and quantitative human capital management disclosures. When addressing these topics, companies should consider the following:

1. Provide detail that demonstrates the depth of your HCM strategy to best meet stakeholder expectations.
2. Include information on leadership responsibility, relevant programs, established publicly disclosed goals and targets (including employee engagement scores, pay equity and diversity), as well as recognitions and metrics.
3. For calendar year-end companies, begin thinking about revisions to your 2023 HCM disclosure now rather than waiting until the end of 2022 or the start of 2023.
4. Consider peer benchmarking to identify any gaps in your disclosure and needed policy updates in light of changes in the business environment over the past year. For example, determine whether COVID-19 safety measures and pandemic-era employee benefits should be omitted from the 2023 disclosure. Likewise, consider whether the adoption of a hybrid or virtual work model or benefits to stave off the high employee turnover should be added to the disclosure.
5. Keep in mind that the company will need to review the proposed disclosures with the board committee responsible for human capital oversight. Build in time for this review so the company can consider and incorporate feedback well in advance of next year's 10-K filing deadline.

If you have questions about your human capital disclosure and strategy or how your disclosure compares to your peers, please contact one of the authors or write to humancapital@aon.com.

Authors
Pam Greene, Partner
David Kritz, Associate Partner
Anna Barrera, ESG Director
Grant Hinrichsen, Intern

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Congress of the United States
Washington, DC 20515

December 7, 2022

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Dear Chair Gensler,

We are writing to request additional information about your plan to propose significant changes to the way retail investors interact with United States financial markets. In comments you delivered earlier this year, you indicated that "retail investors have greater access to markets than any time in the past."[1] You also described your intention to modify rules governing key aspects of our national market system. Given these comments, we would like to better understand the direction the Securities and Exchange Commission (Commission) will pursue through a potential rulemaking process, including the concerns it is meant to address. We believe that any proposed changes should be supported by a fact-based and data driven demonstration of how investors will be better served than under the existing equity market structure.

Retail participation in U.S. markets has grown across every demographic, and today, self-directed retail investors make up a significant portion of daily activity in our markets. The current state of equity markets is the product of years of private-sector innovation and prudent, fact-based and data driven public-sector rulemaking. The result is a market where retail investors enjoy better prices, increased liquidity and, in many cases, no transaction fees. These conditions have been fostered by current SEC regulations that promote robust private sector competition among market centers and retail brokers alike.

We welcome further innovations that can be shown to add meaningful competition to the marketplace and further improve the experience for retail investors. We are concerned, however, that certain changes being considered at the Commission, in particular one that would require order-by-order auctions, are not supported by robust empirical evidence that demonstrates the potential benefit these changes provide to American investors. We believe a thorough analysis of the current functioning of the market is necessary to eliminate the risk of unintended consequences.

Given the importance of the market for publicly traded companies, both for investors and for the broader U.S. economy, we believe it is prudent that the SEC conduct a thorough analysis of how equity markets function today. This analysis should document the ways in which the market performs well for retail investors, identify any perceived shortcomings, and gather data for how any proposed changes to market structure would or would not benefit retail investors.

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[1] https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822.

We note that previous wholesale market structure reforms were conducted with extensive outreach prior to formal rulemaking. Regulation NMS, for instance, which shapes much of our modern market structure, was formally proposed after months of public engagement, public/private dialogue, and stakeholder feedback.

Further analysis by the SEC should include a cost-benefit evaluation in the following areas:

- Clear identification and quantification of problems identified by the SEC in current market functioning, and where retail investors are not getting a fair result.
- Evidence supporting the notion that any proposed changes will produce a better result for retail investors, including by lowering the cost for retail investors to trade.
- An analysis of the anticipated effect of these changes on the broader market, institutional investors, and publicly traded companies.
- Specific, quantifiable, and data-driven analysis of the economic impact of contemplated changes including:
    - equity auctions,
    - quoting increment changes,
    - changes to exchange access fees, rebates, and payment for order flow, and
    - any other significant changes to market structure.
- The projected cost of implementing these sweeping changes, and analysis of the potential alternatives.

Lastly, a recent report by the SEC's Office of the Inspector General (IG) raises concerns about the level of expertise and infrastructure needed to complete a potential rule of this size and scope.[2] We support the IG's recommendation for the Commission to take action that will reduce missteps that could significantly impact external stakeholders.

One of the SEC's chief mission objectives is to maintain fair, orderly, and efficient markets, which is something we wholeheartedly support. However, market reforms should be developed transparently with input from affected stakeholders, and with evidence that the proposed changes will achieve the intended goal. We look forward to receiving your response.

Thank you for your consideration.

Bill Huizenga
Member of Congress

Josh Gottheimer
Member of Congress

[2] https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf

ANN WAGNER
2nd District, Missouri

2350 Rayburn House Office Building
Washington, DC 20515
(202) 225–1621

301 Sovereign Court
Suite 201
Ballwin, MO 63011
(636) 779–5449

wagner.house.gov

Congress of the United States
House of Representatives
Washington, DC 20515–2502

Vice Ranking Member
COMMITTEE ON
FINANCIAL SERVICES

Ranking Member
Subcommittee on Diversity and Inclusion

Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets

Vice Ranking Member
COMMITTEE ON
FOREIGN AFFAIRS

Subcommittee on Europe, Eurasia, Energy, and the Environment

Subcommittee on Asia, the Pacific, and Nonproliferation

November 28, 2022

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Dear Chair Gensler:

I write to express my concerns about potential rule proposals related to the U.S. equity market structure that I understand the Commission will consider in the coming months. Your June 8, 2022 remarks entitled, "Market Structure and the Retail Investor," described six areas of anticipated reforms, including improving order-by-order competition by requiring retail investors' stock trades to be executed in auctions, implementing an SEC best execution rule, and addressing alleged conflicts of interest regarding payment for order flow, exchange rebates, and related access fees.[1] Since those remarks, the discussions I have had with market participants, regulated entities, and main street investors, lead me to believe these proposals are not based upon a clearly identified problem, will not achieve their purported objectives, and instead will harm millions of Americans who, for the first time in their lives, are investing in the stock market to build a more secure financial future for themselves and their families.

Stated simply, the SEC has yet to produce empirical evidence demonstrating that there is a problem with the current quality of U.S. equity markets for retail investors that would justify increased government intervention. Furthermore, the SEC has not demonstrated there is a problem severe enough to justify an onslaught of highly prescriptive, complex and untested "solutions," such as forcing retail orders to be executed in intraday auctions.

The concept of intraday auctions for retail stock trades appears to have been hastily developed over the last year without any basis in decades of market structure debate among market participants, Congress, and the SEC.[2]

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1 "Market Structure and the Retail Investor:" Remarks Before the Piper Sandler Global Exchange Conference: https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822. In your remarks, you outlined the following areas of anticipated reforms: 1) harmonizing the tick size regime across different market centers; 2) accelerating the implementation of new round lots and accelerating the enhanced transparency for quotation information with the remaining odd lots from the Market Data Infrastructure Rule, along with potentially creating a odd-lot best bid and offer; 3) requiring all Rule 605 reporters to provide summary statistics of execution quality; 4) implementing an SEC best execution rule; 5) enhancing order-by-order competition through auctions; and 6) mitigating conflicts with respect to payment for order flow and exchange rebates.

2 Unlike Regulation NMS and other prior SEC market structure reforms, the idea for intraday retail auctions has been subject to little, if any, real public debate or review by the Commission over decades of market structure discussions and rulemaking efforts. For example, auctions do not appear to have ever been suggested by or to the SEC's Equity Market Structure Advisory Committee, which was established in 2015, and held meetings through April 2017.

This suggested reform generally lacks economic justification when order competition exists in today's equities markets and investors already receive low-cost, high quality trade executions. It is untested, overly complex and likely to cause poor outcomes for a substantial number of issuers and investors compared to the current market structure. Other concepts like an SEC best execution rule are likely to be duplicative and unnecessary.[3]

The reality is our equity markets remain the deepest, most liquid in the world, and provide retail investors with historically high access to low-cost investment opportunities.[4] You claim that your agenda will make markets more fair for retail investors, but I believe that your rush to regulate and fundamentally alter the way our equity markets function through multiple expansive, burdensome reforms will do the opposite.

Equity markets reforms should be data-driven, deliberate, and without political influence. They should be inclusive of industry and investor feedback and ensure that the benefits outweigh the costs for our capital markets, our economy, and tens of millions of retail investors.

I am also troubled by the number and scope of interrelated and, in some cases, overlapping proposals you have directed SEC staff to develop. In particular, I question the SEC's ability to conduct an adequate and methodological economic analysis of your sizeable and complex rulemaking package. Any one of the six areas of potential changes alone could significantly impact market function, market quality and costs for retail investors. The problem is only compounded when the full set of anticipated proposals are considered together, which they must be in any serious economic analysis.

With actions on each of the six components, the number of variables will only multiply, and it is unlikely that the Commission will be able to reasonably predict and evaluate the consequences that so many complicated and interconnected rule proposals will have on market quality and the costs to retail investors. The result will be a flawed and incomplete economic analysis and, in turn, a new set of government rules will fail to meet the basic standards of the Administrative Procedure Act and may significantly disrupt market liquidity and harm millions of retail investors.

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3 As you know, pursuant to SEC authorization under Section 19 of the Securities Exchange Act of 1934, FINRA has enforced a best execution rule (Rule 5310) for decades. *See* https://www.govinfo.gov/content/pkg/FR-2011-12-09/pdf/2011-31606.pdf. There has been no evidence presented to date that FINRA's best execution rule is outdated or otherwise incapable of ensuring that retail broker-dealers achieve best execution for their customers' stock trades. Indeed, FINRA's best execution rule has been enforced by both FINRA *and* the SEC for decades.

4 *See* "The 'Actual Retail Price' of Equity Trades," Sept. 2022, by Christopher Schwarz, Brad M. Barber, Xing Huang, Philippe Jorion, and Terrance Odean available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4189239; "Commission Savings and Execution Quality for Retail Trades" (Dec. 2, 2021), by S.P. Kothari, S.P., Travis L. Johnson, and Eric C. So available at: https://ssrn.com/abstract=3976300; "The Impact of Zero Commissions on Retail Trading and Execution," by Shane Swanson available at: https://www.greenwich.com/equities/impact-zero-commissions-retail-trading-and-execution; "Payment for order flow provides a better cost of execution, says former SEC Chair Jay Clayton" (CNBC) available at: https://www.cnbc.com/video/2022/08/03/payment-for-order-flow-provides-a-better-cost-of-execution-says-former-sec-chair-jay-clayton.html. Although the Commission has discussed some of these suggested reforms in the context of the Gamestop events of early 2021, the market structure concerns that contributed to that event relate primarily to the outdated T+2 settlement cycle, as well as short-term, pandemic-driven trading activities among some retail investors, not competition among trading centers or payment for order flow. *See* "Republicans Correct the Record Regarding the Meme Stock Event of January 2021" available at: https://republicans-financialservices.house.gov/news/documentsingle.aspx?DocumentID=408380. Moreover, rushing to implement fundamental changes to our equity market structure based on a very brief, unprecedented period of market volatility and trading activity would be inappropriate and inconsistent with the Commission's historic rulemaking practices.

Given these very serious investor protection concerns, I would request that you respond to the following questions no later than December 13th, 2022:

1. Over the last several years, millions of new retail investors have begun participating in our equities markets, and many of these investors are younger and more diverse than ever. Will your suggested market structure proposals raise costs, including potential brokerage fees, for many of these retail investors?

2. I am concerned that intraday auctions may harm liquidity for many small and mid-cap issuers – and retail investors in these issuers – to the extent that liquidity providers in auctions are no longer willing to take the other side of these trades or less willing to provide a price that meets or beats the National Best Bid and Offer. Is it the SEC's belief that an auction system will result in reduced liquidity for less actively traded stocks and lead to higher costs for many retail investors? If not, why?

3. To date, how many SEC employees have been involved with developing the market structure proposals you described in your June 8, 2022, remarks?

4. A recent report from the SEC's Acting Inspector General states that the SEC has had "difficulties hiring individuals with rulemaking experience," has resorted to "relying on detailees, in some cases with little or no experience in rulemaking," and has "borrowed staff from other organizational areas to assist with rulemaking activities."[5] Of the employees listed in response to question #3, how many 1) do not work in either TM or the Division of Economic and Risk Analysis; or 2) have little or no experience on matters related to equity market structure; or 3) are detailees?

Sincerely,

Ann Wagner
Member of Congress

5 https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.