How to Respond to SEC's Focus on Human Capital Disclosures

The Securities and Exchange Commission may now be shifting focus from the "E" to the "S" in environmental, social, and governance matters. This was conveyed in the March 2022 climate-related disclosure rulemaking currently in proposed form.

And SEC Chair Gary Gensler at conference in September referenced 2020 rule revisions to require human-capital disclosure in public company filings and indicated that he found certain details lacking.

Gensler also has instructed SEC staff to focus on enhancing such disclosure, echoing a prior statement that he made in August 2021.

Disclosure of human capital was also included on the SEC's short-term rulemaking agenda that was published over the summer and highlighted in the agency's accompanying press release, along with workforce diversity and corporate board diversity.

All of this means the SEC will most likely begin to scrutinize human-capital resources disclosure more vigorously with possible additional rulemaking on the horizon. As such, public companies need to be proactive and take action now in order to meet their disclosure requirements.

SEC's Modernization Efforts

In 2020, as part of the SEC's ongoing efforts to modernize the disclosure requirements for public companies, it amended Item 101 of Regulation S-K to require that companies describe their human-capital resources. This includes any human-capital measures or objectives that management focuses on in conducting business, to the extent such disclosure would be material.

The adopting release stressed the SEC's belief that human capital is a material resource for companies and an important disclosure for investors, and it emphasized a principles-based approach to the disclosure. Although the rule identifies examples of human-capital measures, such as development, attraction, and retention of personnel, the SEC declined to adopt a formal definition of "human capital," noting the possible evolution of the term over time.

For public companies, disclosures about human capital can run the gamut from Covid-19 protocols, hiring practices, workplace culture and employee well-being efforts, overall policy and strategy toward maintaining its workforce, and diversity, equity, and inclusion policies and procedures.

As the 2020 rules reflected the agency's traditional, principles-based approach to disclosure—rather than the prescriptive approach reflected in the SEC's recently proposed climate-related disclosure rulemaking—what companies choose to disclose in public filings can vary significantly.

For some this variance is an example of the type of tailored disclosure expected in public company disclosure, but the SEC has recently emphasized the importance of consistent and comparable disclosure across all public companies, and Gensler has identified human-capital disclosure as lacking in that respect.

Accounting Disclosure

Another possible disclosure option is human-capital accounting disclosure, which was presented by a group of academics, including former SEC officials, in a rulemaking petition filed in June 2022. The petition requested that the SEC "develop rules to require public companies to disclose sufficient information to allow investors to assess the extent to which firms invest in their workforce," and recommended enhanced accounting-related disclosure to depict what aspects of human capital are considered expenses rather than investments.

This concept echoes what former SEC Chair Jay Clayton stated in August 2020 when the human-capital disclosure rules were finalized. He said that he expected "to see meaningful qualitative and quantitative disclosure," yet some companies do not provide any quantitative information other than the number of people employed.

Since the rule's adoption, investors and other stakeholders also have placed pressure on companies to publicly disclose EEO-1 data that describes the gender, race, and ethnicity of their employees across job categories, including through direct requests to the SEC that it mandate this disclosure. It is unclear whether these petitions will have any impact on the SEC's eventual approach to possible revisions to human-capital resources disclosure requirements, but Gensler has stressed the importance of specific metrics, both qualitative and quantitative, in such disclosure.

Although the SEC's climate-related disclosure initiative remains pending—and Gensler recently indicated a willingness to revise certain aspects of the proposal—we expect that the SEC will scrutinize human-capital resources disclosure more vigorously in the near term with possible additional rulemaking on the horizon.

Take Action Now

Public companies should proactively consider which aspects of their current human-capital resources disclosure could be improved or revised, and the following steps should be taken.

Conduct a peer review to assess whether other companies' disclosures stand out as something to emulate or avoid, especially if the disclosures introduce any risk of litigation. In particular, avoid being an outlier among peer companies.

Consider what aspects of human-capital management resources are material to your business and investors against the backdrop of any concerns raised by stockholders or other stakeholders, including your own employee population.

Also, examine your workplace policies and procedures to ensure that they align with company values.

Finally, evaluate workplace safety measures that may have changed due to Covid-19, including those that have been retained or eliminated.

As always, a holistic approach to public company disclosure will result in meaningful disclosure responsive to potential regulatory scrutiny and investor demands.

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