September 1, 2023 Via email: commentletters@ifrs.org

International Sustainability Standards Board
The IFRS Foundation
Columbus Building
7 Westferry Road
Canary Wharf
London, E14 4HD

Re: Request for Information: *Consultation on Agenda Priorities*

Dear Members of the International Sustainability Standards Board:

We are writing on behalf of the Human Capital Management Coalition[1] ("HCMC" or "Coalition") to offer our feedback on the Request for Information *Consultation on Agenda Priorities* ("Consultation"), regarding the International Sustainability Standards Board's ("ISSB") two-year work plan. We commend the ISSB for soliciting feedback from users of financial and sustainability information to help guide its standard-setting priorities, and we are pleased to offer our written perspectives on the Consultation.

Established in 2013, the HCMC is a cooperative effort among a global group of 36 large institutional asset owners and asset managers representing over $9 trillion in assets. As investors and stewards of capital on behalf of our beneficiaries and clients, we focus on generating returns over the long term. Asset owner members have large, complex global portfolios across multiple asset classes with a combination of active and passive mandates executed internally and through external managers that are carefully selected and monitored by internal investment teams. Asset manager participants typically provide investment management, research and trading, and financial data analytical services for institutional clients, including governmental bodies, public and corporate retirement and welfare benefits plans, health plans, mutual funds, foundations, and endowments. Individuals participating in the Coalition on behalf of member organizations also represent a breadth of skills and perspectives, including portfolio managers, buy-side equity analysts, fixed income analysts, stewardship and engagement professionals, and securities lawyers; many possess various professional designations such as Chartered Financial Analyst and Certified Public Accountant.

[1] Established in 2013, the HCMC is a cooperative effort among 36 large asset owners and asset managers representing over $9 trillion in assets to engage the investment community, companies, and other market participants to understand and improve how human capital management contributes to the creation and protection of long-term shareholder value. More information about the Coalition, including a current list of members, is available at https://www.hcmcoalition.org.

Below we share perspectives on select questions posed in the Consultation.

Question 3–New research and standard-setting projects that could be added to the ISSB's work plan

(a) Taking into account the ISSB's limited capacity for new projects in its new two-year work plan, should the ISSB prioritise a single project in a concentrated effort to make significant progress on that, or should the ISSB work on more than one project and make more incremental progress on each of them?
   (i) If a single project, which one should be prioritised? You may select from the four proposed projects in Appendix A or suggest another project.
   (ii) If more than one project, which projects should be prioritised and what is the relative level of priority from highest to lowest priority? You may select from the four proposed projects in Appendix A or suggest another project (or projects).

We strongly believe that ISSB should prioritize human capital first, with a focus on decision-useful human capital disclosures that are universally-applicable across all markets, industries, sectors, and issuers. The Coalition views the following four disclosures as absolutely critical in providing investors the high-quality information we need to understand how well a company manages its workforce:

(1) **the number of full time and part-time employees** directly involved in firm operations, as well as the **number of contingent or contracted persons** who produce products or services;
(2) **turnover**, or comparable workforce stability metric;
(3) **workforce diversity data** sufficient to understand the company's efforts to access and develop new sources of talent, as well as how effective these efforts are; and
(4) **total cost of the issuer's workforce**, including wages, benefits and other transfer payments, and other employee expenses.

All four foundational disclosures also have received broad support.[2]

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[2] *See, e.g., Letter from John Streur*, President and CEO of Calvert Research and Management, to Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission regarding Human Capital Disclosure ("Calvert Letter") (Aug. 30, 2021) https://www.sec.gov/comments/climate-disclosure/cll12-9190246-249462.pdf. ("Calvert agrees that disclosure of the [Human Capital Management Coalition's] four metrics would provide the type of specific and reliable date that is needed to evaluate and compare company performance"); *Letter from Jonathan Grabel*, Chief Investment Officer, LACERA, to Vanessa A. Countryman, Secretary, U.S. SEC re: Proposed Rule: Modernization of Regulation S-K Items 101, 103 and 105 (Nov. 27, 2019), https://www.sec.gov/comments/4-711/4711-6403561-198430.pdf ("To complement a principles-based approach (and address its shortcomings), we suggest that the Commission incorporate rules-based disclosures for a select number of consistent, universally applicable human capital metrics, to facilitate a base level of disclosures and broad comparability. In this regard, the Commission should consider core metrics related to workforce composition and structure (such as the number of full-time, part-time, and contingent workers, as well as diversity data consistent with Equal Employment Opportunity EEO-1 reporting, where permissible), indicators of workforce stability (such as turnover), and data points enabling investors to assess a registrant's return on human capital investments."); *Letter from Sandra J. Peters*, Senior Head, Global Financial Reporting Policy, CFA Institute, to Vanessa A. Countryman, Secretary, U.S. SEC re: Proposed Rule: Modernization of Regulation S-K Items 101, 103 and 105 (Nov. 27, 2019),

We note that *IFRS International Accounting Standard (IAS) 19: Employee Benefits* already requires companies to report the total value of salaries, bonuses, and pension benefits. We still reference workforce cost disclosure here as we believe that the four disclosures above, *taken together*, would give investors a needed baseline to understand and evaluate a company's labor management skill. Should the aforementioned disclosures be accessible in a clear, consistent, comparable, and reliable way, investors would have a solid, workable foundation to begin to understand a company's overall business, risks and prospects – and to appropriately price these risks and prospects – for investment purposes.

The Modernization of the Global Economy Underscores the Urgent Need for Clear, Consistent, Comparable, and Reliable Human Capital Information from Firms.

The importance of human capital – the collective knowledge, skills, and experiences of the workforce – to corporate value creation has grown considerably over the past fifty years. Fundamental structural shifts toward a knowledge-based economy worldwide have resulted in a growing reliance on the talents of the workforce as the driver of innovation and engine of economic growth, allowing companies to compete in an environment where ingenuity and the ability to quickly adapt to novel technologies are the keys to lasting success. The Coalition considers effective human capital management material and fundamental to navigating these shifts and to ensure the ongoing creation and preservation of long-term shareholder value.

Consider this trend in the United States, where the entire U.S. equity markets account for over 40 percent of the total global equity market capitalization, eclipsing the EU – the next largest equity market – by close to a factor of four.[3] In 1975, companies in the S&P 500 – accounting for roughly 80 percent of the entire U.S. market capitalization – derived approximately 83 percent of their value from property, plan, equipment, and other tangible assets.[4] This share has fallen to 10 percent of the S&P 500 market capitalization, while intangible assets – represented largely by human capital – now capture the remaining 90 percent. Intangible assets also represent a significant share of the total market capitalization of large equities indices in Europe and Asia.[5]

Despite Compelling Evidence of a Clear Relationship Between Human Capital Management Skill and Performance, Investors Generally Cannot Access Reliable, Decision-Useful Information to Assess Human Capital Management Performance

The rise of human capital has had significant implications for financing and capital structure, valuation, and corporate governance. Human capital is now a central component of

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https://www.sec.gov/comments/s7-11-19/s71119-6490515-199568.pdf ("We are supportive of universal disclosures proposed by the Human Capital Management Coalition.").

[3] *See, e.g.,* SIFMA, Research Quarterly: Equities (26 July 2023), https://www.sifma.org/resources/research/research-quarterly-equities/.

[4] Ocean Tomo, Intangible Asset Market Value Study (28 Dec 2022), https://oceantomo.com/intangible-asset-market-value-study/.

[5] For example, 75% of the market capitalization of the S&P Europe 350 and 57% of Korea's KOSDAQ Index is intangible. *See Ibid.,* at 2-3

company value, and it is critical that accounting standards allow investors to adequately price human capital management into the market. A growing body of research supports the conclusion that companies with effective human capital management perform better than those that manage their human capital poorly,[6] while incorporating fundamental human capital management data into investment strategies may yield superior performance for investors.[7]

Further, high-quality accounting can improve investment efficiency and affect nearly every aspect of the financing decision-making process by reducing information asymmetry and improving the overall efficacy of monitoring.[8] Additionally, high-quality human capital disclosures that are reliable, clear, consistent, and comparable would lower the cost of capital for

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[6] *See, e.g.,* Aaron Bernstein and Larry Beeferman, *The Materiality of Human Capital to Corporate Financial Performance*, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School (Apr. 2015), https://lwp.law.harvard.edu/files/lwp/files/final_human_capital_materiality_april_23_2015.pdf (Review of 92 studies assessing traditional financial performance indicators widely used by institutional investors finds positive correlations between human capital management and total shareholder return, return on assets, return on earnings, return on investment, return on capital employed, profitability and Tobin's Q); Mark Huselid, *The Impact of Human Resource Management Practices on Turnover, Productivity, and Corporate Financial Performance*, Academy of Management Journal (1995): 635-672, http://www.markhuselid.com/pdfs/articles/1995_AMJ_HPWS_Paper.pdf (finding that certain combinations of high-performance workplace practices were associated with statistically significant increases in productivity, Tobin's Q and gross rate of return on capital); Mark Huselid and Brian Becker, *The Strategic Impact of High Performance Work Systems*, at 2 (Aug. 25, 1995), http://www.bhbassociates.com/docs/articles/1995_Strategic_Impact_of_HR.pdf (high performance workplace practices have a statistically significant positive effect on firm performance); Brian Becker and Barry Gerhart, *The Impact of Human Resource Management on Organizational Performance: Progress and Prospects*, Academy of Management Journal Vol. 39, No. 4, at 797 (1996), https://doi.org/10.5465/256712 ("In sum, at multiple levels of analysis there is consistent empirical support for the hypothesis that HR can make a meaningful difference to a firm's bottom line.").

[7] *See, e.g.,* Mattias Regier and Ethan Rouen, *The Stock Market Valuation of Human Capital Creation*, Harvard Business School Accounting & Management Unit Working Paper No. 21-047 (Oct. 2, 2020), https://www.hbs.edu/ris/Publication%20Files/21-047_0369ca63-540e-4f5c-bd38-87ac8953ea24.pdf (hereinafter "Regier and Rouen") (Long-short portfolios based on human capital creation efficacy produced annualized abnormal returns of 4.0-5.4%. Portfolios formed on the combination of efficacy and opportunities produce the strongest annualized abnormal returns of 6.3-9.3%.); Morgan Stanley Investment Management Counterpoint Global Insights, *Culture Quant Framework* (Jan. 2021), https://mgstn.ly/2XgLsn6, hereafter "MSIM Counterpoint Global Insights" (Examination of employee retention at 2,000 publicly-traded companies over a 10-year period found companies with better employee retention saw cumulative stock returns that were 25 percent higher, or 2.8 percent annualized, than those with the lowest retention. Research also showed predictive association between a YoY increase (decrease) in employee retention and positive (negative) alpha generation in the subsequent year.); Laurie Bassi and Dan McMurrer, *Human Capital Management Predicts Stock Prices*, at 1 (Jun. 2010), https://mcbassi.com/wp/wp-content/uploads/2018/07//HCMPredictsStockPrices.pdf (Two portfolios of large capitalization companies launched in 2001 and 2003 using criteria related to training and employee development outperformed the S&P 500 on an annualized basis by 3.1% and 4.4%, respectively, through May 25, 2010. Four other portfolios launched in 2008, selected using a wider variety of HCM factors including commitment to talent management, also outperformed the S&P 500 through May 25, 2010, on an annualized basis to varying degrees, from 0.1% to 11.9%.).

[8] *See, e.g.,* Catherine Shakespeare, *Reporting matters, the real effects of financial reporting on investing and financing decisions*, Accounting and Business Research 50:5 (Jun. 26, 2020) at 425-441, https://www.tandfonline.com/doi/full/10.1080/00014788.2020.1770928 (presenting an overview of research on impact of financial reporting on investing and financing decision made by firms, showing that "[a]ccounting can improve investment efficiency and affect nearly every aspect of the financing decision by reducing information asymmetry and improving monitoring.").

well-managed companies while allowing investors to more efficiently direct capital to its highest value use. An analysis of U.K. firms shows that companies with higher human capital reporting scores, defined as reporting that is more quant-focused with fewer words, enjoy higher operating margins, carry less debt, and generate nearly three times the economic return on human capital,[9] as compared to firms with lower-quality disclosures.[10]

It is therefore no surprise that human capital-driven investment products and strategies are a fast-emerging growth area. Asset managers have launched at least 20 funds featuring a human capital-driven investment strategy, while another 34 funds meaningfully incorporate workforce data in decision-making.[11] The California State Public Employees Retirement System ("CalPERS") joined Schroders and the Saïd Business School at the University of Oxford to publish a framework to support the valuation of human capital in financial analysis, demonstrating that strong human capital management skill can create higher returns for investors.[12]

We believe it is appropriate for ISSB to act in the near term to improve the utility of financial reporting to investors by incorporating human capital information that is both foundational and decision-useful.

Researchers from Harvard Business School's Accounting and Management Unit examined various dimensions of intangible human capital investment embedded in a firm's personnel expense.[13] They found that (1) personnel expense is positively associated with characteristics of human-capital intensive firms and employee productivity growth; and (2) personnel expense has a positive pricing coefficient, implying that the market recognizes some of its variation. The authors also found that long-short portfolios constructed based on both the quantity and quality of human capital investments (based on total personnel expense) produced statistically significant annualized abnormal returns, providing important evidence of *accurate* human capital measurement to valuation. Based on these findings, the authors observe, "The

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[9] *See, Letter from Anthony Hesketh*, Lancaster University Management School, to Anne Sheehan, Chairman, Investor Advisory Committee, U.S. Securities and Exchange Commission, regarding Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management Disclosure Presented at the March 28, 2019, IAC Meeting (Mar. 21, 2019), at 2-4 and Appendix, https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf. ("Hesketh IAC Letter") (Presenting empirical research generated for the Embankment Project for Inclusive Capitalism analyzing over 2,000 public reporting documents from 700 firms from 2012-2017, including financial statements and other SEC disclosures, quantifying the value of human capital management disclosure.).
[10] Hesketh also found that S&P 500 firms disclosing material human capital information (such as workforce cost) outperformed non-disclosing firms from 2012-2017, as measured by mean excess return and the Sharpe Ratio. *See Ibid.*, Appendix at 12.
[11] Figures as of the end of Q3 2022. Data collected and presented by Schroders to the HCMC in December 2022 and remains on file with the HCMC.
[12] Schroders, CalPERS, and the Saïd Business School, University of Oxford, *Human Capital Management research summary: people are our greatest asset* (July 2023), https://mybrand.schroders.com/m/63d2ad02332cbde8/original/SC_IDD_Human-Capital-Research_US.pdf.
[13] *See* FN2, *Regier and Rouen,* at 1 ("As defined in IAS 19, ["personnel expense" or "personnel expenditure"] includes, among others, the costs for hiring, wages, salaries and bonuses, social security and insurance costs, costs for employee training and development, perquisites like catering and work wear, and post-termination benefits.").

evidence supports the notion that markets fail to fully account for the intangible asset value generated by personnel expenses."[14]

Investors and Other Users of Financial Statements Already are Using the Human Capital Information Available for Investment Analysis and Decision-Making. Higher-Quality Information is Needed to Improve Financial Analysis, Including Price Discovery.

Numerous financial analysts and academics have acknowledged that the lack of a comparable source for standardized human capital information forces key actors in the investment process to rely on limited approximations of critical data that are often costly, inefficient, and unreliable.[15] Professor Shiva Rajgopal, the Roy Bernard Kester and T.W. Byrnes Professor of Accounting and Auditing at Columbia Business School, commented that analysts and researchers are forced to rely on crude workarounds to fill the human capital reporting gap, such as using Glassdoor, Indeed, and LinkedIn to create proxies for needed human capital disclosures to "guestimate" human capital data that should otherwise be accurate and verifiable.[16]

In a letter to the U.S. Securities and Exchange Commission ("SEC") urging the SEC to focus on human capital data availability,[17] asset manager and HCMC member Calvert Research and Management ("Calvert") similarly reported that since retention and turnover data is typically unavailable but is financially material, Calvert's analysts have developed various proxies for turnover that are narrowly scoped to a particular industry or type of employee, and therefore limited in application.[18]

These roundabout attempts by investors to obtain actionable human capital information from public companies domiciled in jurisdictions where it is largely absent underscore the value

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[14] *Ibid.* at 22-23.

[15] *See, e.g.*, Jack Ciesielski, *In Search of Practical Information*, Barron's (Oct. 12, 2013) ("Managers like to say that 'our greatest assets are our people,' yet they tell their shareholders nothing about the total cost of those greatest assets – until they are eliminated in restructuring actions."); Shivaram Rajgopal, *Why the Public Reporting Model is Broken and How to Fix it*, Fortune (Jan. 24, 2020) ("[L]abor costs . . . are tangled up in every functional line item on the income statement where labor is employed, leaving pieces to a puzzle scattered throughout a disclosure. . . .Very few U.S. firms gather the puzzle pieces together for the investigating investor or analyst to provide a cohesive, total picture of labor costs, stripped away from function.").

[16] *Stakeholder Capitalism and ESG with Professor Shiva Rajgopal*, Voice of Corporate Governance (Nov. 19, 2020), available through https://www.cii.org/podcasts/ (subscription required) ("One of the distressing things to me as a fundamental analyst is that only 15 percent of American companies actually tell us what their labor costs are, which to me is astonishing.").

[17] *Letter from John Streur*, President and CEO of Calvert Research and Management, to Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission regarding Human Capital Disclosure ("Calvert Letter") (Aug. 30, 2021), 5, https://www.sec.gov/comments/climate-disclosure/cll12-9190246-249462.pdf.

[18] *Calvert Letter* at 5 ("Since retention and turnover data is not widely available but has been determined to be financially material, Calvert analysts have developed proxies for turnover to support our analysis of companies and their ESG performance. One example of such a proxy is an in-house proprietary indicator that was developed for the real estate sector to measure and track the forfeiture of stock option grants in order to glean the level of professional turnover at companies that offer stock options as a component of compensation. There are obvious limitations to this approach, as it would not apply to sectors and companies where stock options are not a component of compensation. Having a standardized, publicly reported metric for turnover would enhance our ability to more directly measure performance of this important human capital management factor across all sectors.").

of this information to the broader capital markets. It would be far more efficient for companies to provide human capital information directly and for investors to have access to reliable information that has undergone rigorous assurance consistent with other fundamental financial data.

When the SEC's Investor Advisory Committee ("IAC") recommended in March 2019 that the SEC pursue rulemaking to substantially improve human capital disclosures from U.S. publicly-listed firms to investors, it observed that "[v]aluation of firms with few hard assets based on public SEC-mandated disclosure alone is increasingly difficult. Currently available information is not consistent, verified, or comparable across companies."[19] The IAC also observed that despite the use of HCM metrics as "as routine part of financial due diligence, such as in M&A transitions, including for basic valuation models," the lack of consistency and reliability around existing disclosures made the information "difficult for investors to interpret or use."

The IAC also cautioned the financial markets regulator against treating human capital as only a cost, noting that this posture runs counter "to the financial markets' view of human capital as a source of value:"[20]

> [C]urrent accounting standards on their own may obscure workforce investment by reflecting it only as an expense not distinguished from other inputs. Investing in research and development, by contrast, is often identified by its separate line item in the income statement, and acquired in-process R&D can be reflected on the balance sheet. While these distinctions may be grounded in rational if competing goals of the financial accounting system, qualitative disclosures about HCM do not currently reflect these distinctions in accounting treatment in a clear way, potentially skewing investor understanding of sources of value. Some but not all companies use disparate ad hoc supplemental disclosures that vary in substance and form within industries, and even for the same firm over time, which can add further misunderstandings to how HCM and value are related.[21]

While *IAS 19* already captures certain personnel expenses, information about cost alone likely would not provide sufficient context for an investor to understand the full breadth of labor resources, and how labor resources create value for investors. By prioritizing the development of critical baseline and decision-useful human capital reporting standards that go beyond personnel

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[19] *See* recommendation of the investor Advisory Committee, Human Capital Management Disclosure (March 28, 2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf, at 2. Also note that current SEC rulemaking on human capital disclosures remains limited. U.S. public issuers are required to disclose human capital risks and resources. This is in addition to the requirement that firms report the number of persons they employ, adopted in 1973. The current rules, which were updated in 2020, offer no guidance or prescription about what information should be disclosed, and explicitly does not define "human capital." As of this writing, it is widely expected that the SEC will revisit the current human capital disclosure rules in the near future. *See, e.g.,* Spring 2023 Agency Rule List, U.S. Securities and Exchange Commission, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202304&RIN=3235-AM88.

[20] *Ibid.*

[21] *Ibid.*, 2-3.

expense, such as the four metrics we suggest above, the ISSB is in a strong position to help investors understand human capital as a source of both cost *and* value across global capital markets.

Question 8–Other comments

Do you have any other comments on the ISSB's activities and work plan?

Yes. We respectfully request that our past submissions to FASB and the SEC on the topic of human capital management disclosure are incorporated herein by reference.[22]

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The HCMC appreciates the opportunity to provide the ISSB with our response to the Consultation. If you have any questions, or need anything further, please do not hesitate to contact us at info@hcmcoalition.org.

Respectfully submitted,

The Human Capital Management Coalition

On behalf of the Human Capital Management Coalition:

Sincerely,

Cambria Allen-Ratzlaff
Co-Chair, Human Capital Management Coalition

Tamara Sells
Co-Chair, Human Capital Management Coalition

[22] *See, e.g.*, https://www.hcmcoalition.org/_files/ugd/ee804c_53b7be8712c14111b976951d3e38689f.pdf, https://www.sec.gov/comments/s7-11-19/s71119-6322887-194462.pdf, and https://www.sec.gov/comments/265-28/26528-5180975-183539.pdf. Additional statements and correspondence are available on the HCMC's website at https://www.hcmcoalition.org/letters-and-statements.