

Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090
20 October 2019

Submission on the Modernization of Regulation S-K Items 101, 103, and 105 (File Number S7-11-19)

Dear Ms. Countryman,

This comment letter addresses the discussion of human capital management disclosure contained in the Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105 (File Number S7-11-19). Specifically, they concern item 13 in the Request for Comment section: “Would the proposed principles-based requirements elicit information that is material to an investment decision? If not, how might Item 101(c) be further improved?” My answer to the first question is a resounding “no.” My answers to the second question can be discerned within the body of this comment letter.

Prior to my retirement, I spent 19 years investing professionally, first as a securities analyst, then a portfolio manager and leader of a fund group, then as Director of Research, Chief Investment Officer and member of the Executive Committee, all at AllianceBernstein, L.P. Since my retirement I have published academic research regarding sustainability disclosure, materiality and fiduciary duty.¹ During my time as an investor and fiduciary I evaluated and utilized “information that is material to an investment decision.” This information comprises disclosures that, as the Supreme Court has stated, “assum[e] actual significance in the deliberations of the reasonable shareholder,” in other words those that possess “a substantial likelihood that the disclosure...would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”²

In this regard, comparability between issuer disclosures is paramount. The Commission has long recognized that comparability is an essential aspect of materiality, as “...investment decisions essentially involve a choice between competing investment alternatives.”³ I am concerned that the proposed principles-based requirements will not provide adequate information that is material to an investment decision for two reasons: first, the way that the concept of materiality is used in the Proposed Rule seems to improperly place the determination of materiality in the

¹ Rissman, Paul and Kearney, Diana, Rise of the Shadow ESG Regulators: Investment Advisers, Sustainability Accounting, and Their Effects on Corporate Social Responsibility (February 1, 2019). 49 ELR 10155 (2019) . Available at SSRN: <https://ssrn.com/abstract=3332813>

² TSC Indus., Inc. v. Northway, Inc., 426 U.S. 449 (1976); see also Basic v. Levinson, 485 U.S. 224, 232 (1988) (“We now expressly adopt the TSC Industries standard of materiality for the §10(b) and Rule 10b-5 context.”); Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2413 (2014) (reaffirming this standard of materiality).

³ 40 Fed. Reg. 51,662 (Nov. 6, 1975)

hands of issuers rather than investors; second, even if this deficiency were corrected, in the absence of clear line-item guidance there is too much leeway for registrants to report in a way that vitiates the principle of comparability, one of the foundational concepts of materiality.

Materiality is an investor-focused concept

As cited above, it is the law of the land that materiality be focused on the needs of the “reasonable investor”. But the Proposed Rule appears to substitute the priorities of the reasonable investor with management judgment: “we propose replacing the current requirement to disclose the number of employees with a requirement to disclose a description of the registrant’s human capital resources, including in such description any human capital **measures or objectives that management focuses on** in managing the business, to the extent such disclosures would be material to an understanding of the registrant’s business....we believe that investors would be better served by understanding how each company looks at its human capital and, in particular, **where management focuses its attention in this space**. The intent of the proposed requirement is to elicit, to the extent material to an understanding of the registrant’s business, disclosures regarding human capital that allow investors to better understand and evaluate this company resource and **to see through the eyes of management how this resource is managed**. (File Number S7-11-19, at 48. Emphasis added).” The Commission should make the rule clear that the determination of materiality is not for the issuer, but is the responsibility of the investor. As Commissioner Robert Jackson has written, “Of course it’s true that materiality—the importance of a subject to a reasonable investor—is the touchstone of our securities laws. But too much of corporate America has forgotten *who* decides what is material....I want to remind everyone, and the corporate counsel with whom shareholder proponents engage with each year, that it is the *investor* who tells us what’s important.”⁴ The SEC Investor Advocate Rick Fleming has noted, “Granting issuers greater latitude to use discretion in evaluating the materiality of disclosures in the absence of a framework is fraught with the risk that disclosures that are unfavorable to the issuer are disproportionately viewed as immaterial and as a result excluded from the financial statements. Such a result is not in the best interest of investors, and is anathema to investor protection, capital formation, and the efficient functioning of the capital markets.”⁵ Rather than requiring investors to “see through the eyes of management,” the rule should, as the Supreme Court has implied, require management to see through the eyes of investors!⁶

⁴ Proxy Preview 2019, available at <https://www.proxypreview.org/>. At 6. (Original emphasis.)

⁵ Comment letter from Rick Fleming, Office of the Investor Advocate, RE: File Reference No. 2015-300, Proposed Amendments by the Financial Accounting Standards Board (“FASB”) to Concepts Statement No. 8, Conceptual Framework for Financial Reporting, July 11, 2017. <https://www.sec.gov/about/offices/investorad/letter-from-sec-investor-advocate-fasb-materiality.pdf>

⁶ “The determination [of materiality] requires delicate assessments of the inferences a ‘reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him . . .” (TSC Indus., Inc., 426 U.S. at 450).

Principles-Based Disclosure Will Not Promote Comparability

Two recent opinions by Commission Staff granting no-action relief illustrate how principles-based disclosure of human capital management, even when responsive to investor demands, does not serve well the goal of comparability. Shareholder resolutions filed with Advance Auto Parts⁷ and Autozone⁸ in 2019 referenced labor standards and diversity and inclusion standards promulgated for the specialty retail industry by the Sustainability Accounting Standards Board (SASB). In their no-action requests both companies claimed that their Sustainability Reports substantially implemented the resolutions, although their human capital management disclosures were largely aspirational boilerplate, and the few quantitative metrics that they provided, which could be the only possible bases for comparability, were idiosyncratic in nature and therefore non-comparable. Nevertheless, no-action relief on the basis of substantial implementation was granted to each company. These precedents indicate that a principles-based disclosure regime, unless it is grounded in standardized metrics, will be useless to the reasonable investor.

The Sustainability Accounting Standards Board Can Provide a Template for Human Capital Management Disclosures

I support the comment letter submitted by the SASB. The SASB standards were formulated using a rigorous approach to financial materiality⁹ that is supported by investors.¹⁰ The standards are industry-specific and therefore satisfy registrants' requirements that they not be subject to voluminous requests for immaterial information. In the case of industry standards that are simply not applicable to a given company, this circumstance can be resolved through a comply-or-explain mechanism.

The Proposed Rule regarding human capital management as currently written suffers from two shortfalls. The first is that the concept of materiality is insufficiently centered on the investor's perspective. The second is that a principles-based approach that is not grounded in

⁷ Response of the Office of Chief Counsel Division of Corporation Finance Re: Advance Auto Parts, Inc. Incoming letter dated February 4, 2019. Available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/asyousowdenhart040919-14a8.pdf>.

⁸ Response of the Office of Chief Counsel Division of Corporation Finance Re: AutoZone, Inc. Incoming letter dated August 8, 2019. Available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/asyousowautozone100919-14a8.pdf>.

⁹ Letter From SASB, to Brent J. Fields, Secretary, SEC 15 (July 1, 2016) (Re: Concept Release on Business and Financial Disclosure Required by Regulation S-K) (“[A]ny topics identified as likely being material have undergone a rigorous analysis of the likelihood and magnitude of its effect on the financial condition or operating performance of a company, or on the entire industry. Direct evidence was sought to establish a link between performance on the sustainability-related factor and financial performance. Actual or potential financial impacts were characterized by their impact on revenue and growth, operating expenses, the cost of capital, and/or the value of assets or liabilities. Where possible, SASB analysts modelled [sic] the range of impact using a typical discounted cash flow analysis to understand possible impacts within a five-year time horizon. If financial materiality and the link to financial impact could not be demonstrated for a particular topic, the topic was not included in the standards.”), <https://www.sec.gov/comments/s7-06-16/s70616-25.pdf>.

¹⁰ Support from Investors. Available at <https://www.sasb.org/investor-use/supporters/>.

standardized quantitative metrics cannot provide comparability, and therefore cannot be of use to investors.

Respectfully submitted,
Paul Rissman