TESTIMONY ON WORKFORCE MANAGEMENT DISCLOSURES AND OTHER SEC ISSUES

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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.

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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. Bemstein 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.

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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.