

Testimony of

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Before the

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Committee on Financial Services

Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Hearing on

**“Promoting Economic Recovery: Examining Capital Markets and the Real Economy and
Strengthening Worker Protections in the COVID-19 Era”**

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

Thank you for the opportunity to testify at today's hearing. My name is Anne Simpson. I am the Interim Managing Investment Director for Board Governance & Sustainability at the California Public Employees' Retirement System ("CalPERS"). I am pleased to appear before you today on behalf of CalPERS. We applaud and support the Subcommittee's focus on building a sustainable and competitive economy and repairing the damage done by the COVID crisis.

In this testimony, I will provide an overview of CalPERS' investment principles, highlight our approach to human capital management, and offer some suggestions on how to move forward.

CalPERS

As the largest public defined benefit pension fund in the United States, we are fiduciaries managing nearly \$400 billion in global assets on behalf of more than 1.9 million public employees, retirees, and beneficiaries to support their retirement and health needs. Our responsibility to pay benefits decades into the future requires that we take a long-term, multi-generational view when assessing performance. We are not only long-term investors. CalPERS pays \$25 billion in retirement benefits each year to our retired members. Nearly 60 cents of every dollar paid in those benefits comes from investment returns. This means that our members depend upon safety and soundness in the capital markets for their retirement security.

As a pension fund, CalPERS' fiduciary duty is to its members: "we serve those who serve California." Our members include janitors, police, firefighters, school employees and health care workers who contribute to the fund during their working career. To meet our investment goals, CalPERS needs to earn 7 percent risk-adjusted returns across the portfolio over the long term. CalPERS is just 70 percent funded which means that meeting our return target is our highest priority.

To achieve those long-term returns, CalPERS is guided by its fiduciary duties of prudence, care and loyalty whilst minimizing costs to the employers. We ensure full compliance with all laws and regulations provided by government and regulators. Our Board has also adopted [Investment Beliefs](#), which recognize the importance of today's hearings for long-term fiduciaries.

Investment Belief number four states, “Long-term value creation requires effective management of three forms of capital: financial, physical and human.” Therefore, CalPERS engages companies and managers on their human capital practices, including fair labor practices, health and safety, responsible contracting and diversity.

Our Investment Beliefs are grounded in an extensive review of evidence during CalPERS’ Sustainable Investment Research Initiative. This evidence has since been strengthened by the work of Dr. Anthony Hesketh who presented to the CalPERS board yesterday in order to highlight the growing case for human capital disclosure by firms.¹

We have been engaged in a multi-year pursuit of human capital disclosures to improve transparency, consistency, assurance and timeliness in reporting. We have worked with the Human Capital Management Coalition (HCMC)² since its inception and also hosted the HCMC Co-Chair, Cambria Allen-Ratzlaff, during our Board’s July offsite meeting. CalPERS highlights enhancing human capital disclosures in its Total Fund Governance and Sustainability Strategic Plan.

I commend this Subcommittee for focusing on these critical matters during this COVID crisis, but we must acknowledge that there was much work to be done prior to the crisis. Current regulations require very little human capital reporting. The reports investors receive from public companies are largely voluntary and often do not cover issues of relevance to capital allocators.

Disclosure for Strengthening Capital Markets

Disclosure is an essential precondition for sound investment, effective and consistent corporate accountability, and sustainable economic growth. As the Securities and Exchange Commission (“SEC”) says on its website:

Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.

The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation so important to our nation's economy.

We agree.

¹ Dr. Anthony Hesketh, [Intangible or Invisible? The growing case for human capital disclosure by firms](#) (July 13, 2020)

² Human Capital Management Coalition’s [Petition for Rulemaking](#) to the SEC (July 6, 2017)

The SEC Investor Advisory Committee (IAC) made recommendations on Human Capital Management Disclosure on March 28, 2019. I am a member of this body. The IAC's recommendations include expanding the current disclosure of the number of employees to break down such requirement into full-time, part-time, and contingent workers. In addition, the IAC recommends adding the following:

- the stability of the workforce, including voluntary and involuntary **turnover** and **internal hire** and **promotion** rates;
- the **safety** of the workforce, including frequency, severity and lost-time due to injuries, illnesses and fatalities, and percent of first-tier suppliers that were audited for safety and health compliance;
- average hours of **training** per employee per year,
- race/ethnicity and gender **diversity data**, and
- standardized survey measures of employee **satisfaction**.

Finally, the background section (of corporate reports) could also be augmented with a summary of material elements of material **company policies** and goals regarding career development, safety and health compliance, subcontracting and outsourcing.

In a joint public statement SEC Chair Clayton and Director, Division of Corporation Finance Hinman highlighted “The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19.” The two leaders stressed the following:

Company disclosures should ... respond to investor interest in: (1) where the company stands today, operationally and financially, (2) how the company's COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress. Historical information may be relatively less significant.

The leaders also add:

[W]e have also discussed the stark reality that virtually all participants in our highly integrated economy—including our workers, our retail investors and our small businesses—are facing profound economic challenges and personal uncertainties that are not of their own making and over which they have little control. Discussions of the scope and size of these millions of individual challenges inevitably lead to near unanimous agreement that the current strategy—combining dramatic health-focused mitigation efforts with massive monetary and fiscal intervention—must evolve over the longer-term.

However, the current corporate disclosure regime in the United States does not provide investors with the information they need to assess drivers of value and sources of risk. In part, this is because reporting has not kept pace with changes in the economy. In the SEC’s Investor Advisory Committee recommendations data is cited to show that 85% of S&P 500 company balance sheets consist of intangible assets. However, much of this is a “black box” without sufficient disclosure.

We believe the current reporting regime requires improvement in terms of the scope of regulatory disclosures and should apply to all listed companies so that investors can assess risk and return across their portfolio. In the public markets, investors rely on standardized reporting, provided within a framework of board governance with internal controls, in the context of audited financial statements, and investor rights, such as the ability to exercise proxy votes, file proposals for shareholder votes and bring derivative lawsuits for fraud. CalPERS and other investors have asked Congress and the SEC to expand disclosures for investors in a number of issues relevant to risk and return, including human capital. Last year, CalPERS testified before this Subcommittee on the need for enhanced disclosure. We encourage you and the SEC to consider proposals to expand and improve information whilst protecting investor rights.

Investments During the COVID Crisis

CalPERS recognizes that more than 70 percent of capital is raised in the private markets. Accordingly, corporate growth is increasingly concentrated among private companies. As fiduciaries focused on maximizing investment returns for our beneficiaries, we are expanding our investments in private market opportunities as part of our plan to bring “more and better assets” into the portfolio, as set out by our Chief Investment Officer in his presentation to our Board’s June meeting.

We appreciate the language included in the Financial Services and General Government Appropriations legislation that would stop the SEC from moving to finalize proposals that would impair the ability of investors like CalPERS to fulfill our fiduciary responsibilities. Absent meaningful vehicles for shareholder engagement, the alternative can be a call for divestment, which is not aligned with our fiduciary responsibilities highlighted above.

CalPERS supports efforts to expand disclosures to cover issues that we, as long-term investors, need to consider, including human capital management.

These are vitally important issues especially in light of the current pandemic. We appreciate being included in this discussion and stand ready to work with you to modernize corporate reporting in the United States so that it better serves the needs of investors and contributes to the strengthening of the capital markets on which so many rely.

Thank you, Chairman Sherman and Ranking Member Huizenga, for inviting me to participate in this hearing, and I look forward to your questions.

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