Investment Office

Memorandum

June 24, 2022

To: CalPERS Board of Administration

From: Board Governance & Sustainability

Subject: Background material for July 2022 offsite presentation on Human Capital Management titled "Shaping Our Strategy on Human Capital Management."

Investment Belief #4

Long-term value creation requires effective management of three forms of capital: financial, physical and human[1]

What is Human Capital Management?

Human Capital encompasses the knowledge, motivation, skills and experience of a company's entire labor force and the population from which it might draw its labor force.

Human Capital Management includes a broad range of corporate practices related to the management of employees and interactions with the communities that the company impacts, including (but not limited to):

- Hiring and retention
- Employee engagement
- Training
- Compensation
- Fair labor practices
- Health and safety
- Responsible contracting
- Ethics
- Company culture
- Diversity, Equity, and Inclusion

In CalPERS' view[2], companies should adopt progressive human capital management practices in all countries or environments in which the company operates accompanied by fair, accurate, timely, and integrated reporting on how they mitigate human capital risks and generate sustainable returns. Boards should be accountable for companies to develop and implement

[1] See CalPERS' Investment Beliefs, page # 6
https://www.calpers.ca.gov/docs/board-agendas/201702/pension/item7-01.pdf

[2] See CalPERS' Governance & Sustainability Principles, page # 22
https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf

company policies, procedures, integrated financial reporting, training and internal reporting structures.

Why are investors focused on Human Capital Management?

The convergence of the current economic, climate, and public health crises, as well as the mounting call to advance racial equity have heightened investors' focus on the effective management of human capital. Businesses depend on the workforce as a source of value creation which, if mismanaged, could harm long-term performance. Workforce insights from the pandemic have simply highlighted how critical, and material human capital risks are to the size, scale, and viability of a company's operations.

Investor's desire human capital data that is decision-useful, consistent, clear, and comparable, and that can be benchmarked over time. Despite the value of human capital management and the importance to investors of understanding related risks, the current regulatory disclosure regime for corporate reporting is inadequate as it requires companies to disclose very little information about how human capital is measured or managed.

What is CalPERS' strategy around Human Capital Management?

Guided by deep research, we **advocate** with regulators and standard setters for universal reporting of sustainability disclosures in a consistent, comparable, and reliable way. We **engage** companies, managers, and other investors to further the development and adoption of standards for reporting with a particular focus on human capital policies, practices, and performance. We seek to **integrate** these human capital disclosures across the portfolio in order to better measure long-term risk and opportunities. These efforts are supported by the following strategic partnerships:

- Human Capital Management Coalition
- SEC Investor Advisory Committee
- ILPA Diversity and Inclusion Advisory Council
- Equilar
- Council of Institutional Investors
- International Corporate Governance Network

What are some of the Challenges in Human Capital Management Disclosures?

- Current regulatory regime follows a principles-based approach that yields very little information on how companies are managing their human capital.
- Disclosures that are provided are not consistent and therefore not comparable.
- Total labor costs are not currently required in the financial statements.
- As little as 15% of U.S. firms disclose basic compensation or labor costs.

- Qualitative disclosures are little more than marketing pieces with statements that state the value of employees and little evidence to back-up those statements in terms of pay and benefits
- Recent SEC enhancements have resulted in little reporting beyond the traditional number of employees