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AUGUST 17, 2021

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SEC approves Nasdaq's proposed board diversity rules

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On August 6, 2021, the Securities and Exchange Commission ("SEC") approved an amended rule proposal filed by the Nasdaq Stock Market LLC ("Nasdaq"), which intends to advance greater board diversity and enhance transparency and comparability regarding board diversity among Nasdaq-listed companies (the "Board Diversity Rule"). The SEC's approval of the Board Diversity Rule comes amidst increasing pressure for greater diversity on public company boards—as well as expanded diversity-related disclosures—from institutional investors, proxy advisers, advocacy groups, and lawmakers. The SEC also approved a related proposed Nasdaq rule change to offer eligible Nasdaq-listed companies complimentary access to certain board recruitment services for a limited period (the "Board Recruiting Service Rule").

As originally proposed in December 2020, Nasdaq's initial proposed board diversity listing rule would have required all Nasdaq-listed companies to: (1) have, or explain why they do not have, at least two "Diverse" members of their boards of directors, generally including at least one director who self-identifies as "Female" and at least one director who self-identifies as an "Underrepresented Minority" or as "LGBTQ+"; and (2) publicly disclose specified diversity statistics regarding their boards of directors in their proxy statement or information statement filings, or alternatively on their websites, subject to certain exceptions.

Over 200 comment letters were submitted in response to the initial Nasdaq "comply or explain" board diversity rule proposal. In response to certain concerns expressed in these letters, as well as opposition from Republican members of the Senate Banking Committee, Nasdaq filed in February 2021 an amended proposal, which retained the initial proposal's disclosure-based approach but provided greater flexibility in meeting the proposed rule's requirements. With this amended proposal, Nasdaq also addressed several "common misperceptions expressed by commenters," emphasizing that the proposed Board Diversity Rule establishes a disclosure framework and minimum diversity objectives rather than a quota or numeric mandate for board composition, and that companies will not be forced to appoint unqualified directors to meet the specified objectives and will not be delisted solely for choosing not to meet those objectives.

The approved Nasdaq Board Diversity Rule "will allow investors to gain a better understanding of Nasdaq-listed companies' approach to board diversity, while ensuring that those companies have the flexibility to make decisions that best serve their shareholders," SEC Chairman Gary Gensler said in a brief statement on August 6, 2021. The proposed changes to Nasdaq's listing rules were approved by a 3–2 vote along party lines. Commissioner Hester Peirce voted against the proposals, arguing in a lengthy statement in opposition that Nasdaq had not sufficiently demonstrated that the proposed rules were consistent with applicable requirements of the Securities Exchange Act of 1934 ("Exchange Act"), that the rules were outside the scope of the Exchange Act, and that the rules are contrary to fundamental Constitutional principles. Commissioner Elad Roisman offered a partial dissent, opposing the proposed board diversity rule's disclosure requirements on grounds similar to those expressed by Commissioner Pierce, but approving of the proposed rule change to offer free access to board recruitment services.

The Board Diversity Rule

As set forth in new Nasdaq Rules 5605(f) and 5606, the Board Diversity Rule will require Nasdaq-listed companies (other than certain exempted entities) to:

- have, or explain why they do not have, at least two "Diverse" members of their boards of directors, including at least one director who self-identifies as "Female" and at least one director who self-identifies as an "Underrepresented Minority" or as "LGBTQ+"[1]; and
- publicly disclose on an annual basis specified diversity statistics regarding their boards of directors.

For purposes of the Board Diversity Rule, "***Diverse***" means a director who self-identifies as: (i) Female, (ii) an Underrepresented Minority, or (iii) LGBTQ+. "***Female***" means a person who self-identifies as a woman, regardless of that person's sex at birth. "***Underrepresented Minority***" means a person who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities. "***LGBTQ+***" means a person who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.

What disclosures will be required under the Board Diversity Rule?

Aggregated board-level statistical information

Nasdaq-listed companies will need to disclose, on an annual basis, certain Board-level diversity characteristics by gender, race/ethnicity, and sexual orientation using a Board Diversity Matrix template provided by Nasdaq or a substantially similar format. The presentation must identify the total number of directors and the number of directors who self-identify in each of the various Diverse categories defined under the Board Diversity Rule. To assist companies in the preparation of this disclosure, Nasdaq's FAQs offer illustrative examples of acceptable and unacceptable disclosures.

Satisfaction of diversity objectives

Once the objective for a certain number of Diverse directors becomes applicable to a company, if that company does not meet this diversity objective as specified under the Board Diversity Rule, it will be required to:

[1] Foreign private issuers and smaller reporting companies may satisfy the diversity objective with two Female directors. A listed company with a board of five or fewer directors will be permitted to meet the diversity objective by having, or explaining why it does not have, at least one Diverse director.

- specify the relevant diversity objective of the Board Diversity Rule; and
- explain why it has not met such objective.

Companies will be required to provide the specified disclosures, at the company's option, either:

- in the company's proxy statement or information statement for its annual meeting;
- if the company does not file a proxy statement, in its Form 10-K or Form 20-F; or
- on the company's website (subject to Nasdaq notification requirements).

When will the Board Diversity Rule's disclosure requirements become effective?

Aggregated board-level statistical information

Each Nasdaq-listed company must provide the required board-level disclosure regarding diversity by gender, race/ethnicity, and sexual orientation, as self-identified by directors, by the later of: (a) August 6, 2022; and (b) the date a company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for its annual shareholder meeting during 2022.

Satisfaction of diversity objectives for Nasdaq-listed companies

Nasdaq provides a phased approach to disclosure requirements regarding satisfaction of the Board Diversity Rule's diversity objectives based in part on the company's Nasdaq market tier. Compliance dates are as follows:

- Each Nasdaq-listed company will be required to have, or explain why it does not have, at least ***one*** Diverse director by the later of: (a) August 6, 2023 and (b) the date a company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for its annual shareholder meeting during 2023.
- Each company listed on the Nasdaq Global Select Market or Global Market tiers will be required to have, or explain why it does not have, at least ***two*** Diverse directors by the later of: (a) August 6, 2025 and (b) the date a company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for its annual shareholder meeting during 2025.
- Each company listed on the Nasdaq Capital Market tier will be required to have, or explain why it does not have, at least two Diverse directors by the later of (a) August 6, 2026 and (b) the date a company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for its annual shareholder meeting during 2026.

A company may also follow a timeframe applicable to a different market tier so long as it publicly discloses the reasoning behind its decision.

Are there any accommodations for companies that have a small board?

A company with a board of directors consisting of five or fewer members (a "Small Board Company") will only be required to have, or explain why it does not have, at least one Diverse director. Moreover, before August 6, 2025 or August 6, 2026, depending on its market tier, a Small Board Company may add a sixth director who is Diverse in order to meet this reduced board diversity objective without becoming subject to the requirement to have, or explain why it does not have, at least two Diverse directors. However, a Small Board Company will be required to have at least two Diverse directors if it subsequently expands its board.

What are the compliance dates for companies newly listing on Nasdaq?

A newly listed company (including a company listed through a traditional initial public offering, direct listing, transfer from over-the-counter market or another exchange, in connection with a spin-off or carve-out or through a merger with a special purpose acquisition company (SPAC) will be required to annually disclose board-level diversity statistics beginning one year from listing. However, the Board Diversity Rule provides an extended phase-in period for a newly listed company to meet the applicable diversity objective based in part on the company's specific Nasdaq market tier, as follows:

- A company listing on the Nasdaq Global Select or Nasdaq Global Market will be required to have, or explain why it does not have:
  - at least one Diverse director by the later of: (a) one year from the date of listing and (b) the date the company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for the company's first annual shareholder meeting subsequent to listing; and
  - at least two Diverse directors by the later of: (a) two years from the date of listing and (b) the date the company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for the company's second annual shareholder meeting subsequent to listing.
- A company listing on the Nasdaq Capital Market will be required to have, or explain why it does not have, at least two Diverse directors by the later of: (a) two years from the date of listing and (b) the date the company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for the company's second annual shareholder meeting subsequent to listing.
- A Small Board Company listing on any Nasdaq market tier will be required to have, or explain why it does not have, at least one Diverse director by the later of: (a) two years from the date of listing and (b) the date the company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) for the company's second annual shareholder meeting subsequent to listing.

The phase-in periods for newly listed companies will apply after the end of the transition periods described above.

Is there a cure or grace period for failure to meet applicable board diversity objectives?

A Nasdaq-listed company that fails to meet applicable diversity objectives or provide the required explanation of why it does not meet the objectives will have until the latter of it next annual shareholder meeting or 180 days from the event that caused the deficiency to effect a cure.

A Nasdaq-listed company that satisfied applicable diversity objectives but no longer meets an applicable objective due to an unexpected vacancy on its board of directors, such as from a Diverse director's death or resignation, will have a grace period to return to compliance until the later of (i) one year from the date of vacancy and (ii) the date the company files its proxy statement or information statement (or, if the company does not file a proxy statement, its Form 10-K or Form 20-F) in the calendar year following the date of vacancy.

Does the Board Diversity Rule apply to all Nasdaq-listed companies?

The Board Diversity Rule applies to all Nasdaq-listed companies except pre-business combination special purpose acquisition companies, asset-backed issuers and other passive issuers, limited partnerships, management investment companies, issuers of non-voting preferred securities, debt securities and certain derivative securities that do not have equity securities listed on Nasdaq, and issuers of certain securities other than common or preferred stock and warrants.

Nasdaq Board Recruiting Service Rule

In connection with the approval of the Board Diversity Rule, the SEC also approved Nasdaq's proposed Board Recruiting Service Rule, which will provide to certain eligible Nasdaq-listed companies access to a network of Diverse director candidates for a one-year period.

What should Nasdaq-listed companies do now to prepare?

For most calendar year-end Nasdaq-listed companies, the earliest mandatory compliance date for disclosure regarding aggregated board-level statistical information will be the date of the company's filing of the proxy statement for its 2022 annual shareholder meeting and for disclosure regarding satisfaction of diversity objectives will be the date of the company's filing of the proxy statement for its 2023 annual shareholder meeting. To the extent they have not already done so, Nasdaq-listed companies should begin considering how to gather and present the information required by the Board Diversity Rule, along with any necessary disclosure controls. Additionally, we expect that most Nasdaq-listed companies will endeavor to meet applicable diversity objectives under the Board Diversity Rule, rather than provide an explanation of why they do not. Boards of companies which do not currently satisfy the Board Diversity Rule's diversity objectives may want to begin to consider timelines and plans to identify and select Diverse board candidates well in advance of the disclosure deadline, in order to afford sufficient time to recruit suitably qualified Diverse director candidates.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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