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DEI Alert

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DEI and corporate governance: increasing board diversity

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How are legislative requirements impacting board diversity?



What's the Impact

- / Calls for greater diversity in organizations have put a spotlight on board composition and board oversight of DEI programs
- / State and federal legislatures and agencies have added to the calls for boards to increase board diversity through various legislative and compliance requirements
- / As boards work to answer the calls for greater diversity in the boardroom, it is important that directors are well-informed, advised, and prepared on the various aspects of director selection

Overview

For the roughly 1.8 million nonprofit organizations and 5,000 public companies in the United States, boards generally oversee the activities of their organization, and are responsible for the direction and operations of the company under state corporate laws.

For those organizations, studies have long confirmed the clear business case for board diversity—heterogeneity allows boards to better identify and manage risks due to the range of experiences and skill sets that diversity brings to boardroom discussions. CEOs also recognize that a diverse

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board leads to a better understanding of customers and the ability to build better products and services for those customers.¹

In addition to the business case for diversity and the reputational benefits that accompany having a diverse board (or negative impacts for a board lacking diversity), efforts to identify and attract diverse directors are quickly becoming a legal and compliance issue as well. While shareholders have led efforts over the last decade to increase board diversity through various corporate governance levers, legislative changes introduced new pressures on organizations.

All of these efforts to increase board diversity have led to some progress in diverse representation in the boardroom. Over the last decade, racial diversity on boards has increased from 13.3% in 2012 to 21.5% in 2022, with gender diversity increasing from 16.6% to 31% over the same period.²

In this series, we are going to take you on a three-part journey exploring how the business case for board diversity and corporate DEI strategies more broadly intersect with the legal obligations, corporate governance, and other key areas that impact your business.

How are legislative requirements impacting board diversity?

Beginning in 2018, laws passed in California mandating gender, racial, and ethnic diversity on the boards of public companies headquartered in the state garnered a lot of attention. The U.S. was not the first country to consider legislative action in pursuit of greater board diversity from its companies, however. Since 1999, nearly 20 governments around the world have instituted diversity efforts in boards, namely gender quotas. Quotas and related target-based provisions for publicly traded firms are currently at different stages of consideration in Canada, the EU, Germany, Scotland, South Africa, and the United Arab Emirates. Quotas in these countries range anywhere from requiring one female director (Israel, India, Pakistan) to 40% female representation (Norway, Spain, Iceland).

In addition to California, U.S. states like Illinois, Maryland, New York, and Washington have introduced laws designed to increase board diversity, ranging from reporting requirements to representation mandates.³ And at least seven other states are considering or encouraging diversity legislation.⁴

¹ [Esther Shein, "CEOs say diverse corporate boards are a necessity: Here's how to build one," TechRepublic \(Aug. 9, 2021, 11:32 AM\).](#)

² ["Missing Pieces: Women and Minorities on Fortune 500 Boards," Alliance for Board Diversity, 15 \(Aug. 15, 2013\).](#)

³ [Maeve Allsup, "Diversity Disclosure Rules Thrive as Mandates Die in Court \(1\)," Bloomberg Law \(Jun. 14, 2022, 4:45 AM\).](#)

⁴ *Id.*

Illinois has legislation aimed at promoting gender, racial, and ethnic diversity on boards through reporting requirements.⁵

Both Maryland and New York have laws requiring certain businesses to disclose the number of women on their boards.⁶

Washington state requires certain boards to be made up of at least 25% women. If the requirement is not met, those companies must explain why and disclose methods taken to address their lack of gender diversity.⁷

On the federal level, the Security and Exchange Commission (SEC) approved a proposal from Nasdaq to require all listed companies to disclose board-level diversity using a standard template and have at least two directors from underrepresented groups, "including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+," or explain why they do not.⁸ The SEC Regulatory Agenda currently targets April 2023 for proposed rule amendments to enhance disclosures about the diversity of board members and nominees.

While efforts to encourage and require board diversity continue to grow across the country, there has also been pushback. Following the passage of California's two laws requiring minimum levels of diverse representation on public company boards, two recent rulings have held that the legislation violated the Equal Protection Clause of California's constitution.⁹ California's secretary of state has announced an intention to appeal both rulings. The Fifth Circuit also recently heard arguments in litigation challenging the SEC's approval of Nasdaq's board diversity disclosure rules.¹⁰

So what does this mean for you and your organization?

As stewards for their organizations, it is important that boards are well-informed, advised, and prepared on the various aspects of director selection, from the strategic benefits to the enterprise and reputational risks. Boards must understand applicable laws and their reporting requirements. And they must also be prepared for the possibility of director candidates who are not selected challenging those decisions as discriminatory.

⁵ Richard A. Benton & Eunmi Mun, [Illinois Corporate Board Diversity, Inclusion, and Representation Report – 2021](#), 1 (last visited Sept. 9, 2022).

⁶ [Executive Alliance](#) (last visited Sept. 9, 2022).

⁷ Natalie Guevara, "[What to know about Washington's new rules for boardroom diversity.](#)" *Puget Sound Business Journal* (Feb. 28, 2021).

⁸ Nasdaq, [Nasdaq's Board Diversity Rule, what Nasdaq-listed companies should know](#) (2022).

⁹ Alisha Haridasani Gupta, "[Another California board diversity law was struck down](#), but it already had a big impact," *N.Y. Times: Daily Business Briefing* (May 19, 2022).

¹⁰ Alexander Osipovich, "[Nasdaq Board-Diversity Rule Takes Center Stage in Court Battle](#)," *Wall St. J.* (Aug. 29, 2022).

We recommend that boards regularly review all aspects of their board refreshment processes, from the skills matrix and nomination process to the laws that apply to governance and disclosure requirements. We also recommend that as part of their regular governance review, boards ensure that they are prepared for shareholder and stakeholder inquiries that may arise.

Up next:

The next piece in this series will focus on recent shareholder litigation and its impact on board diversity.

Nixon Peabody's DEI Strategic Services works with clients to develop inclusive cultures, drive business success, and elevate their brands. Learn more about our [three-phased approach to help clients](#): (1) assess current efforts, (2) address challenges, and (3) guide long-term success.

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