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SEC Reporting & Compliance Alert

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Nasdaq Proposes New Board Diversity Requirements

On December 1, 2020, the Nasdaq Stock Market filed a proposal with the Securities and Exchange Commission (SEC) to amend its listing standards to encourage greater board diversity and enhanced diversity disclosures for Nasdaq-listed companies. If approved, Nasdaq-listed companies will be required to (1) disclose certain board diversity statistics on an annual basis and (2) have, or disclose why they do not have, a minimum of two diverse board members. These requirements would be phased in over a four- or five-year period, subject to listing tier.

Proposed Rules

Citing more than two dozen studies documenting the positive impact of board diversity on company performance and corporate governance metrics, along with considerable investor, industry and regulatory support for enhancing board diversity requirements, the proposed rules would impose a mandatory "board diversity matrix" disclosure framework and implement a "comply or explain" framework, whereby Nasdaq-listed companies would have to meet board composition requirements or publicly explain why they do not. Both rules are described in more detail below.

Board Diversity Matrix

Within one year of SEC approval of the proposed rules — or, for newly listed companies, within one year of listing — domestic companies would be required to disclose, in a standard form board diversity matrix provided by Nasdaq or in a substantially similar format, the total number of board members and how those board members self-identify when it comes to gender, predefined race and ethnicity categories, and LGBTQ+ status.[1] Foreign private issuers would complete a similar matrix, but instead of using the racial and ethnic categories that apply to U.S. issuers, they would be able to apply a broader definition of diversity and disclose the number of individuals who self-identify as underrepresented in their home country jurisdiction based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity. Matrices would not identify individual directors by name, and directors would not be compelled to identify as a member of any group, in which case the company would record a response of "undisclosed."

[1] The predefined racial and ethnic categories that will apply to domestic issuers include 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, each of which must be disclosed).

Companies would be required to publish the board diversity matrix in their annual meeting proxy statement, or alternatively, on the company website provided the company submits a link to the information through the Nasdaq Listing Center no later than 15 calendar days following the annual meeting. After the first year, companies would disclose the board diversity matrix for both the current and immediately preceding year on an annual basis.

Appointment of Diverse Directors

The proposed rules also would require companies to appoint at least two diverse board members or explain their reasons for not meeting the standard. For domestic companies, one diverse board member must self-identify as female and the other as either a racial or ethnic minority, or a member of the LGBTQ+ community. Smaller reporting companies and foreign private issuers also would be required to have two diverse board members, at least one of whom identifies as female, but would be permitted to satisfy the diversity requirement for the second board member by appointing a second who identifies as female. Due to the broader definition of diversity applicable, foreign private issuers could also satisfy the diversity requirement by appointing a board member who self-identifies as having a minority nationality, language, religion or indigenous identity.

The phase-in period would be dependent on listing tier, with Nasdaq recognizing that smaller companies will typically face greater compliance challenges. While all companies would be expected to have at least one diverse director within two years, larger companies listed on the Nasdaq Global Select or Nasdaq Global markets would have four years after the SEC's approval of the rule to have two diverse directors, while smaller companies listed on the Nasdaq Capital Market would have five years to appoint a second diverse director.

Companies that do not meet the applicable board diversity standards by the end of the phase-in period would not be subject to delisting, provided they publicly disclose the reasons the requirement was not satisfied. Similar to the board diversity matrix requirements, such explanation would need to be published in the annual meeting proxy statement or company website (provided Nasdaq is provided timely notice of website location). Nasdaq will verify that companies have provided an explanation but will not evaluate it from a substantive perspective. Companies that have not appointed a sufficient number of diverse directors also will be eligible to access, through Nasdaq, a free service to help identify suitable, diverse board candidates.

Both proposed rules would be broadly applicable, exempting only a limited number of investment and other companies that do not have boards, are not operating companies or do not list equity securities.

Next Steps

After publication in the *Federal Register*, the proposed rules will be subject to a public comment period of at least 21 days before the SEC determines whether to approve them.

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