

SEC Approves Nasdaq Board Diversity Listing Rules

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On August 6, 2021, the Securities Exchange Commission (the “SEC”) approved Nasdaq [Rules 5605\(f\) and 5606](#) on board diversity, which are the first of their kind to be implemented on a national scale in the United States. They are controversial, opposed by SEC Commissioners Hester Peirce and Elad Roisman, and may face legal challenges. While there has been no indication that the NYSE will follow, the SEC’s rulemaking agenda indicates that the Commission may propose new rules regarding board and director nominee diversity disclosures as soon as October 2021.

Board Diversity Matrix

Rule 5606 will require each Nasdaq-listed company subject to certain exceptions, to publicly disclose in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender, racial characteristics, and LGBTQ+ status of the company’s board of directors. The requirements are intended to make consistent and comparable statistics widely available to investors regarding the number of diverse directors serving on a Nasdaq-listed company’s board.

Companies must present this information in Nasdaq’s [board diversity matrix](#) or a substantially similar searchable format by the later of: (i) August 8, 2022 or (ii) the date the company files its proxy statement or its information statement for its annual meeting of shareholders (or, if the company does not file a proxy or information statement, the date it files its Form 10-K or 20-F) during 2022.

The matrix must indicate the total number of directors and (1) the number of directors based on gender identity (female, male, or non-binary) and the number of directors who did not disclose gender; (2) the number of directors based on race and ethnicity (African American or Black, Alaskan Native or Native American, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, White, or Two or More Races or Ethnicities), disaggregated by gender identity (or did not disclose gender); (3) the number of directors who self-identify as LGBTQ+; and (4) the number of directors who did not disclose a demographic

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background under item (2) or (3) above. After the first year of disclosure, companies must disclose the matrix for the current year and immediately prior year.

The required disclosure can be presented on a company's website or in its proxy statement, information statement, Form 10-K, or 20-F. If a company decides to include the disclosure on its website, it must publish it concurrently with the applicable SEC filing. It must also submit a URL link to the disclosure through the Nasdaq Listing Center within one business day after posting.

A company that does not comply with proposed Rule 5606 would have 45 calendar days to submit a plan of compliance to Nasdaq and upon review of such plan, Nasdaq staff may provide the company with up to 180 days to regain compliance or face a delisting determination, which may be appealed to a hearings panel.

"Comply or Explain" Approach to Board Diversity

In addition to the board diversity matrix, pursuant to Rule 5605(f), Nasdaq adopted a "comply or explain" approach to board composition that requires each Nasdaq-listed company, subject to certain exceptions, to have at least two "diverse" board members, including:

- (i) at least one director who self-identifies as female; and
- (ii) at least one director who self-identifies as an "underrepresented minority" or part of the LGBTQ+ community.

If a company does not have such diverse directors by the deadlines described under "Transition Periods" below, it must: (i) specify the applicable requirements of Rule 5605(f) (2); and (ii) explain the reasons why it does not have them, which could include a description of a different approach to diversity. For example, in the commentary, Nasdaq explains that companies do not need to agree with the definition of "underrepresented minority," and they may consider diversity more broadly, for example, to include persons of Middle Eastern, Central Asian or North African descent. Veterans are another example of a category not currently covered under Nasdaq's definition of "diversity." The company's explanation for not reaching the diversity requirement must be disclosed at the same time and in the same location as its board diversity matrix. While Nasdaq will verify that the company has provided an explanation, it will not assess the explanation on its merits.

For purposes of this Rule, "underrepresented minority" is defined to mean an individual 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, which are categories consistent with categories reported to the Equal Employment Opportunity Commission through the Employer Information Report EEO-1 Form. If a director self-identifies in the "Two or More Races or Ethnicities" category, the director must also self-identify in each individual category, as appropriate. "LGBTQ+" is defined to mean an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.

Modified Requirements and Exemptions for Certain Companies

There are modified requirements for companies with smaller boards, smaller reporting companies, foreign issuers and newly listed companies.

Companies with smaller boards of five or fewer directors can meet the requirements by having at least one diverse director, who can be either a female, an underrepresented minority or a member of the LGBTQ+ community. The diverse director can also be appointed as the sixth director on the board without triggering additional diversity requirements.

Smaller reporting companies (as defined in Rule 12b-2) can meet the requirements by having at least two female directors, or one female director and a second director who is an underrepresented minority or a member of the LGBTQ+ community.

Foreign issuers can meet the requirements by having at least two female directors, or one female director and one director who is either (i) an underrepresented individual (based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the country of the company's principal executive offices), or (ii) a member of the LGBTQ+ community. Foreign issuers include a "foreign private issuer" or a "foreign issuer" (Rule 3b-4(b)) that has its principal executive offices located outside of the United States.

There are various phase-in periods for newly listed companies under Rule 5605(f), depending on the Nasdaq market. For example, special purpose acquisition companies ("SPACs") listed under IM-5101-2 of the Nasdaq Regulatory Authority are not required to provide disclosure information or to have the minimum number of diverse directors until their business combination. However, following the business combination, such companies must meet, or explain why they do not meet, the applicable diversity requirements by the later of (i) two years from the date of listing or (ii) the date the company files its proxy statement or its information statement (or 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing.

Certain types of companies are exempt under Rule 5605(f)(4), because they do not have boards, do not list equity securities, list only securities with no voting rights towards the election of directors, or are not operating companies, and holders of the securities they issue do not expect to have a say in the composition of their boards.

Transition Periods

Nasdaq-listed companies will have a transition period to comply with these rules, based on their listing tier:

- *All Nasdaq-listed companies, including companies with smaller boards, should have at least one diverse director by the later of August 7, 2023 or the date the company files its proxy or information statement (or Form 10-K or 20-F) for the company's annual shareholder meeting in 2023.*
- *Nasdaq Global Select Market and Nasdaq Global Market companies should have at least two diverse directors by the later of August 6, 2025 or the date the company*

files its proxy or information statement (or Form 10-K or 20-F) for the company's annual shareholder meeting in 2025.

- *Nasdaq Capital Market companies* should have at least two diverse directors by the later of *August 6, 2026* or the date the company files its proxy or information statement (or Form 10-K or 20-F) for the company's annual shareholder meeting in 2026.

If a company fails to comply with Rule 5605(f), Nasdaq will notify the company of a deadline to cure the deficiency and regain its compliance, which if not met, will result in a delisting determination subject to appeal before a hearings panel. Nasdaq has established that the deadline to cure is the later of (i) the company's next annual meeting or (ii) 180 days from the event that caused the deficiency. Listed companies that no longer meet diversity requirements due to a board vacancy will have a one-year grace period to resume compliance, but they must disclose this reliance on the grace period in their proxy statement or on their website.

Board Recruiting Service

The SEC also approved a proposal to offer eligible listed companies access to a one-year complimentary board recruiting service, which would provide access to a network of diverse candidates.

In order to be eligible, a listed company must represent to Nasdaq that it does not have (i) at least one director who self-identifies as female; and it does not have (ii) at least one director who self-identifies as an underrepresented minority or LGBTQ+. Foreign issuers and smaller reporting companies have separate eligibility criteria consistent with their diversity requirements. A company that is not eligible may still receive complimentary 90-day access.

What To Do Now

Nasdaq will host several live webinars to help companies understand key elements of these listing rules and how to gain access to a variety of free board recruiting services. Webinars will also be available for replay. The first webinar is scheduled for August 17, 2021 at noon eastern.

In preparation for the 2022 proxy season, companies are encouraged to provide their directors with an opportunity to self-identify diversity characteristics for the matrix, either as part of a D&O questionnaire or a separate survey. To the extent that the board does not currently meet Nasdaq's diversity criteria, they may decide to review director succession plans, or otherwise be prepared to explain the decision not to undertake such a review. Where the board uses a definition of "diversity" that is different from the Nasdaq definition, it should be prepared to explain why the definition is appropriate for the company and how board composition measures up to that definition. While the Nasdaq rules do not mandate board diversity, and Nasdaq will not assess the validity of any explanations provided, companies should be sensitive to how their investors will interpret the disclosure. It is also important to monitor existing or developing legislation on board diversity, as states including California, Colorado, Illinois, Maryland, New York,

Pennsylvania, and Washington have enacted such legislation.