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Nasdaq Proposed Rules Promote Board Diversity: What Businesses Need to Know

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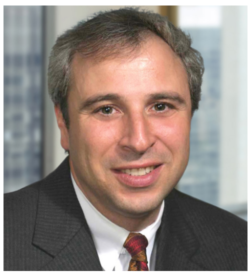
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Nasdaq proposed new rules that would require listed companies to have minimum diverse representation on their boards of directors—or explain why they do not—and provide public disclosures about this to investors and others. The rules are subject to review by the SEC and will undergo a public comment process prior to approval. Attorneys from Willkie Farr & Gallagher explain what companies need to know.

In light of the accelerating societal, institutional, and governmental recognition in recent years of the critical importance of diversity, Nasdaq recently proposed new rules that would require listed companies to have certain minimum diverse representation on their boards of directors—or explain why they do not—and provide disclosure regarding their diverse board representation.

According to Nasdaq, the proposal is designed both to provide investors with greater transparency regarding the composition of boards of directors and to substantively promote greater diverse board representation, which, according to cited studies, is associated with better financial performance and corporate governance. More broadly, Nasdaq's effort to promote diversity is emblematic of the private sector's increasing focus on environmental, social and governance (ESG) factors.

If adopted as proposed, the changes would have a significant impact, given that most Nasdaq-listed companies now fall short of these goals. The proposed rules are subject to review by the Securities and Exchange Commission and will undergo a public comment process prior to approval.

Details of the Proposal

Under the proposed rules, subject to certain exceptions, a Nasdaq-listed company must:

- have (i) at least one director who self-identifies as a female, and (ii) at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native

Hawaiian or Pacific Islander; two or more races or ethnicities or as LGBTQ+, or explain why the company does not have at least two directors on its board who self-identify in the categories listed above; and

- provide statistical information in a uniform matrix format regarding its directors' self-identified gender, race and self-identification as LGBTQ+.

A company may provide the board diversity information (both the above statistical information and the explanation for the lack of diverse directors, if applicable) either in the proxy statement for its annual meeting of shareholders, or on its website, provided it also provides Nasdaq with a link to such information within 15 days of the annual meeting.

Individual directors would have the right to opt out of disclosing their gender, race or LGBTQ+ status. In such event, the company would be required to report such directors as "Gender Undisclosed" or "Undisclosed" depending on the category.

If a company fails to make the required disclosure explaining why it does not meet the diversity requirement, Nasdaq's Listing Qualification department would notify the company of the deadline to cure the deficiency by the later of its next annual meeting or 180 days from the event that caused the deficiency.

Accommodations and Exemptions

The proposed rules make accommodations for both foreign private issuers and smaller reporting companies by allowing them to satisfy the requirement by having two female directors instead of one female director and another in one of the other diverse categories.

Consistent with the approach taken by Nasdaq with respect to other board corporate governance requirements, the rules would not apply to companies with only non-voting preferred securities, debt securities or derivative securities listed, or to acquisition companies, asset-backed issuers, limited partnerships or management investment companies.

Effective Date and Transition Periods

Under proposed Rule 5605(f), no later than two calendar years after the approval date, each listed company must have, or explain why it does not have, one diverse director.

For companies listed on the Nasdaq Global Select or Global Market tiers, each company must have, or explain why it does not have, two diverse directors no later than four calendar years after the approval date. For companies listed on the Nasdaq Capital market tier, each company must have or explain why it does not have two diverse directors no later than five calendars years after the approval date.

In addition, a newly listed company that was not subject previously to a substantially similar requirement of another national securities exchange would be allowed one year from the date of listing to satisfy the diversity requirements.

Impact of the Proposed Rules

The rules, if adopted as proposed, would likely have a significant impact. More than three-quarters of Nasdaq-listed companies would have fallen short of the proposed requirements, according to a recent study conducted by Nasdaq. Although 80% to 90% of companies had at least one female director, only a quarter had a second female director who would satisfy the diversity requirements.

If the rules are adopted, most listed companies that are not currently in compliance with the proposed requirements would likely add diverse directors to bring themselves into compliance, rather than have to explain why they do not meet these minimal diversity requirements.

Nasdaq's effort to promote diversity is part of the private sector's increasing focus on ESG factors. For example, BlackRock, State Street Global, and other influential investors have encouraged their portfolio companies to have more female directors, and Goldman Sachs Group stated last year it would no longer underwrite initial public offerings of companies that did not have at least one diverse board member.

So far, only states—for example, California and Washington—have adopted board diversity requirements; however, the SEC under the new Biden administration is expected to move away from its current trend of "principles-based" disclosure, instead adopting specific disclosure mandates, particularly relating to diversity, climate change, and other ESG-related areas.

Following Nasdaq's proposal, the SEC is likely to adopt additional measures regarding board diversity and other ESG issues.

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