

SEC Approves NASDAQ's Board Diversity Disclosure Requirements

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On August 6, the Securities and Exchange Commission (SEC) approved Nasdaq listing rules implementing new board diversity disclosure requirements that will apply to most Nasdaq-listed companies (Nasdaq Board Diversity Rules). The Nasdaq Board Diversity Rules will generally require Nasdaq-listed companies to:

- have, or publicly disclose why they do not have, at least two diverse directors (including at least one self-identified female director and at least one director who self-identifies as an "underrepresented minority" or LGBTQ+, each as defined below); and
- publicly disclose board diversity statistics using a standardized format on an annual basis.

As described in more detail below, the Nasdaq Board Diversity Rules have deferred compliance dates and transition periods. The Nasdaq Board Diversity Rules also provide flexibility and compliance alternatives for certain companies, including companies with five or fewer directors, foreign issuers and smaller reporting companies. While the Nasdaq Board Diversity Rules specifically carve out registered closed- end funds and special purpose acquisition companies (SPACs), the rules are applicable to business development companies (BDCs).

Background

The Nasdaq Board Diversity Rules follow various initiatives that aim to address corporate diversity. For example, California has adopted legislation that requires publicly traded companies headquartered in California to have board members from underrepresented communities, as well as to have a minimum number of female directors depending on board size. According to a *Los Angeles Times* article, as of September 29, women now hold more than 25 percent of board seats nationwide, which represents a 50 percent increase since the California legislation passed. See "State Law Board Diversity Rules" below for more detail.

Proxy advisory firms, institutional investors and investment banks also have developed policies that generally support increased board diversity. For example, Goldman Sachs has announced that it will only underwrite initial public offerings in the US and Europe if a company has multiple diverse candidates for board seats.

Nasdaq filed its original proposal with the SEC on December 1, 2020, and subsequently amended the proposal on February 26, 2021 to add compliance flexibility for smaller boards and allow for a lengthier compliance period for newly listed companies. The SEC approved the Nasdaq Board Diversity Rules as proposed.

Rule 5605(f): Diverse Board Representation

New Rule 5605(f) requires Nasdaq-listed companies to have, or publicly disclose why they do not have, at least two diverse directors, including:

- at least one self-identified female director; and
- at least one director who self-identifies as an underrepresented minority" or as LGBTQ+. For this purpose, the Nasdaq Board Diversity Rules include the following definitions:
- "Female" means an individual who self-identifies as a woman, without regard to the individual's designated sex at birth.
- "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.
- "Underrepresented Minority" means an individual who self-identifies as one or more of the following: Black or African American, His- panic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or "two or more races or ethnicities" (meaning a person who self-identifies with more than one of the following categories: White (not of Hispanic or Latinx origin), Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander).

Notably, Nasdaq provided some compliance flexibility for certain types of issuers:

- Companies with five or fewer directors will only be required to have one diverse director (or publicly disclose the absence of a diverse director), and are permitted to add a single diverse director to a five-person board without automatically becoming subject to the general requirement to have at least two diverse directors (so long as the company did not have any diverse directors before it expanded its board).

- Smaller reporting companies, as defined in SEC rules, can satisfy Rule 5605(f) with two female directors, or with one female director and one director who is an underrepresented minority or LGBTQ+.
- Foreign private issuers, as defined in SEC rules, can satisfy Rule 5605(f) with two female directors, or with one female director and one director who is 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 LGBTQ+.

Disclosure Requirements

A company that elects to meet the diverse board requirements outlined above is not required to disclose compliance. If a company elects not to meet the diverse board requirements outlined above, it can instead: (1) disclose the specific requirements of the Nasdaq Board Diversity Rules that are applicable; and (2) explain the reasons why it does not comply with those requirements. This disclosure must be provided in any proxy statement or information statement that the company files, or can alternatively be provided on the company's website so long as the company posts the disclosure concurrently with its annual proxy statement or information statement filing.

Compliance Period Phase-In

The compliance period for Rule 5605(f) is phased and varies depending upon which tier of Nasdaq a company is listed, as follows:

Untitled Document

Currently Listed Companies		
Nasdaq Tier	*Initial Compliance: One Diverse Director*	*Full Compliance: Two Diverse Directors*
Nasdaq Global/Global Select Market	Later of (i) August 7, 2023 or (ii) the filing date of the company's proxy statement	Later of (i) August 7, 2025 or (ii) the filing date of the company's proxy statement

	for its 2023 annual meeting	for its 2025 annual meeting
Nasdaq Capital Market	Later of (i) August 7, 2023 or (ii) the filing date of the company's proxy statement for its 2023 annual meeting	Later of (i) August 7, 2026 or (ii) the filing date of the company's proxy statement for its 2026 annual meeting
Newly Listed Companies		
Nasdaq Tier	*Initial Compliance: One Diverse Director*	*Full Compliance: Two Diverse Directors*
Nasdaq Global/Global Select Market	Later of (i) one year from listing or (ii) the filing date of the Company's proxy statement for its first annual meeting following listing	Later of (i) two years from listing or (ii) the filing date of the Company's proxy statement for its second annual meeting following listing
Nasdaq Capital Market	N/A	Later of (i) two years from listing or (ii) the filing date of the Company's proxy statement for its second annual meeting following listing

The transition period outlined above for newly listed companies applies to any company that lists on Nasdaq and that was not previously subject to a substantially similar requirement of another national

securities exchange, including through an initial public offering, direct listing, transfer from the over-the-counter market or another exchange, in connection with a spin-off or carve-out from a company listed on Nasdaq or another exchange, or through a merger with a SPAC.

Cure Period

A company that falls out of compliance with Rule 5605(f) will be required to achieve compliance by the later of (1) its next annual meeting; or (2) 180 days from the event causing the deficiency. However, if the compliance failure arises from a board vacancy, the company will be required to achieve compliance by the later of (1) one year from the date of vacancy; or (2) the filing date of its proxy statement for its annual meeting in the calendar year following the year of the vacancy.

Rule 5606: Board Diversity Disclosure

In addition to the disclosure requirements in Rule 5605(f) described above, new Rule 5606(a) requires Nasdaq-listed companies to publicly disclose board diversity statistics on an annual basis in a standardized format, as follows:

Board Diversity Matrix (As of [DATE])				
Total Number of Directors				
	Male	Female	Non-Binary	Gender Undisclosed
Part I: Gender Identity				
Directors				
Part II: Demographic Background				

African American or Black				
Alaskan Native or American Indian				
Asian				
Hispanic or Latinx				
Native Hawaiian or Pacific Islander				
White				
Two or More Races or Ethnicities				
LGBTQ+				
Did Not Disclose Demographic Background				

Foreign issuers will be permitted to provide a modified matrix that includes information about the issuer's home jurisdiction and is tailored to the applicable requirements of the Nasdaq Board Diversity Rules.

Board Diversity Matrix Compliance Date

A company is required to provide its initial board diversity matrix by the later of (1) August 8, 2022; or (2) the filing date of its proxy statement for its 2022 annual meeting. Following the first year of applicability, companies will be required to include in the matrix information for the current year and the immediately preceding year.

Exempt Entities

Entities exempt from compliance with the Nasdaq Board Diversity Rules include: SPACs (prior to a business combination); asset-backed issuers and other passive issuers; cooperatives; limited partnerships; management investment companies; and issuers whose only securities listed on Nasdaq are non-voting preferred securities, debt securities, derivative securities, and certain other securities listed under Nasdaq's Rule 5700 Series (which include, but are not limited to: non-convertible debt securities, exchange-traded fund (ETF) shares, equity and commodity index-linked securities, paired class shares and index warrants).

Nasdaq exempts “management investment companies” from certain of its corporate governance listing rules, including the Nasdaq Board Diversity Rules, based on the premise that funds “registered under the Investment Company Act of 1940 (Investment Company Act) are already subject to a pervasive system of federal regulation in certain areas of corporate governance.” The current Nasdaq definition of “management investment companies” excludes BDCs because BDCs are not registered under the Investment Company Act, even though BDCs are generally subject to all of the same corporate governance regulation under the Investment Company Act as registered investment companies. Due to this distinction, Nasdaq-listed BDCs will be required to comply with the Nasdaq Board Diversity Rules, unlike their registered open- and closed-end fund counterparts.

Board Recruiting Services

The SEC also approved the implementation of board recruiting services that will provide certain Nasdaq-listed companies with access to a network of board-ready diverse candidates for consideration and evaluation.

State Law Board Diversity Rules

The Nasdaq Board Diversity Rules follow several state law initiatives that aim to address board diversity, with most measures to date focusing on gender diversity and disclosure requirements.

California

California was the first state to legislate on the topic of board diversity. In September 2018, California passed SB 826, which requires each public company with corporate headquarters in California to

have at least one female director by the end of 2019. By the end of 2021, the minimum increases. Companies with six or more directors will be required to have three females and companies with five directors will be required to have two females. Companies with four or fewer directors are still required to have one female. The law also requires reports to be published on the website of the California Secretary of State reflecting the level of compliance with the new minimums, and imposes fines for companies that do not comply. We note that many California companies still have not achieved full compliance and will need to appoint additional female directors before the end of the year.

In September 2020, California enacted a second board diversity law, AB 979, which mandates board representation from underrepresented communities (including Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaska Native, or those who self-identify as gay, lesbian, bisexual or transgender). By the end of 2022, a company with more than four but fewer than nine directors will be required to have a minimum of two directors from underrepresented communities, and a company with nine or more directors will be required to have a minimum of three directors from underrepresented communities. This law includes similar reporting requirements and imposes fines for noncompliance. According to a *Los Angeles Times* article, despite this legislation and other similar state measures outlined below, people who self-identify as a member of an underrepresented community or as LGBTQ+ still hold only 18.4 percent of board seats in the top 1,000 companies nationwide.

Unlike the Nasdaq Board Diversity Rules, California's legislation scheme does not allow companies to choose whether to comply with the diversity requirements or disclose reasons for non-compliance. Instead, companies must comply. The California mandate has resulted in various legal challenges. Most have arisen under the Fourteenth Amendment's equal protection clause, alleging that the statutes require California companies to discriminate based on sex and race in selecting their board members. Some plaintiffs have alleged that by including required quotas, these diversity statutes seek to force shareholders to perpetuate discrimination. Some of the lawsuits have been dismissed and a few remain pending in California and federal courts.

Washington

In June 2020, Washington State passed a law similar in structure to the Nasdaq Board Diversity Rules. The law requires public companies incorporated in Washington to, by January 1, 2022, either (i) have a “gender-diverse board” or (ii) provide shareholders with a “board diversity discussion and analysis” as to why not. The law considers a board to be “gender-diverse” if, for at least 270 days of the fiscal year preceding the company's annual shareholder meeting, the board is composed of at least 25 percent of individuals who self-identify as female. If a public company's board is not

sufficiently diverse by January 1, 2022, it can alternatively disclose in its annual proxy statement to shareholders or post on its website a “board diversity discussion and analysis” that includes information regarding the company's approach to developing and maintaining board diversity. The law also contains exemptions for, among other entities, emerging growth companies and companies that are not required to have annual meetings.

New York

In June 2020, New York passed the “Women on Corporate Boards Study Law,” which calls for a study on the proportion of female directors on the boards of companies headquartered and authorized to do business in the state. To provide data for the study, each New York company is now required to include in its annual report filing with the state the number of directors on its board and how many of those directors are women. The New York Department of State will publish the findings of the study on its website on February 1, 2022 and follow up comparative reports will be filed every four years thereafter.

Maryland

In October 2019, Maryland passed HB 1116 requiring all business entities headquartered in Maryland to include in its annual report filing with the state the number of directors on its board and how many of those directors are women. Notably, the disclosure requirement specifically applies to all entities with revenues in excess of $5 million, whether or not they are publicly traded.

Illinois

Effective August 2019 pursuant to H.B. 3394, Illinois requires public companies headquartered in the state to provide certain diversity disclosures in their annual reports, including: the self-identified gender of each board member; whether or not board members self-identify as members of a minority group and if so, which group; a description of the company's process to identify and evaluate board and executive officer nominees that demonstrates how diversity is considered; and a description of the company's policies and practices for promoting diversity, equity and inclusion.

Colorado

In 2017, Colorado passed House Joint Resolution 17-1017 that urges, but does not mandate, “equitable and diverse gender representation on corporate boards.” The resolution encourages public companies in Colorado with nine or more directors to have at least three females; with five to eight directors to have at least two females; and with fewer than five directors to have at least one female representative on the board. There are no disclosure requirements associated with the Colorado resolution.

Pending Legislation

State legislatures in Hawaii, Massachusetts, Michigan and New Jersey are considering mandatory gender diversity legislation that largely mirrors California's approach. The proposed bills vary slightly by state with respect to the minimum number of female directors required and the timeline to achieve compliance.

State legislatures in Ohio and Pennsylvania are considering non-binding resolutions to encourage companies to improve gender diversity, and both resolutions leave the possibility for an annual reporting requirement open.

Conclusion

In preparation to comply with the Nasdaq Board Diversity Rules, Nasdaq-listed companies to which these rules apply should consider:

- identifying diverse candidates for vacant and/or additional board seats;
- developing disclosure controls and procedures and other compliance policies surrounding the collection and disclosure of board diversity information in advance of the 2022 proxy season (e.g. updating director and officer questionnaires to obtain the relevant information); and
- updating nominating and corporate governance committee charters and policies to specifically include diversity as defined under Nasdaq's Board Diversity Rules as a factor to consider in identifying and evaluating director candidates.

Additionally, all companies headquartered in any state that has adopted or is considering its own board diversity requirements will need to review the requirements of the applicable measure and ensure (or prepare for) compliance on the state law level.

The full text of the SEC approval order is available here, and the full text of the Nasdaq Board Diversity Rules is available here (see Sections 5605 and 5606).

Read *Capital Markets Compass* | Issue 1.

Editor's note: This client alert, initially published on August 16, 2021, has been updated to include additional developments in state law.

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