December 17, 2020

Nasdaq Proposes New Listing Rules Regarding Board Diversity

On December 1, 2020, The Nasdaq Stock Market LLC ("Nasdaq") submitted a proposal to the SEC to adopt listing rules related to board diversity. There appears to be some confusion in the news media about the concept. The proposed rule does not impose a hard mandate or quota system, as some of its critics have suggested. Instead, the Nasdaq proposal is a disclosure-based rule that offers companies flexibility to maintain their decision-making authority over the board's composition.

The Proposed Rule. If the proposal is approved, each Nasdaq-listed company would be required to, subject to certain exceptions:

- annually publish in a uniform format (available here), either in the company's annual proxy statement or on the company's website, statistical information regarding its directors' self-identified gender, race, and self-identification as LGBTQ+; and

- either (1) have at least two "Diverse" directors, including at least one director who self-identifies as female and 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 LGBTQ+ or (2) explain why its board does not have at least two directors on its board who self-identify in the categories listed above.

A company would not be delisted for not having two Diverse directors, but would be required to provide an explanation if it does not. Nasdaq would not assess the substance of a company's explanation, but instead only verify that one was provided.

Timeline for Compliance. All Nasdaq-listed companies would be required to comply with the statistical information requirement within one year of SEC approval of the proposed rule. Companies listed on the Nasdaq Global Select tier or Global Market tier would have to have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within four years of SEC approval. Companies listed on the Nasdaq Capital Market tier would have to have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within five years of SEC approval. To support companies in their search for directors, Nasdaq also announced its partnership with Equilar to assist companies with finding diverse candidates who are ready for board service.

Foreign Issuers, Smaller Reporting Companies and Exempt Entities. The proposed rule provides greater flexibility for smaller reporting companies, allowing them to satisfy the rule's requirements with two female directors. This flexibility applies to foreign private issuers and foreign issuers headquartered outside of the United States. The rule would permit them to define unrepresented minorities with respect to underrepresented individuals based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the home country and have the option of using a different uniform disclosure format for foreign issuers. The proposed rule exempts certain categories of listed entities, such as acquisition companies, asset-backed issuers, limited partnerships and management investment companies.

Rationale for the Proposed Rule. Nasdaq's rule proposal notes the difficulty that investors have had accurately measuring diversity due to the lack of reliable, uniform metrics for reporting board-level data. The proposed rule intends to provide stakeholders with a better understanding of a company's current board composition and that listed companies are considering diversity in the context of selecting directors, either by including at least two diverse directors on their boards or by explaining their rationale for not meeting that standard.

In these respects, the proposal is consistent with the positions advocated by the major proxy advisory firms and many of the nation's largest institutional investors and the growing wave of support for robust environmental, social, and governance (ESG) disclosure. As we discussed, Glass Lewis' recently released 2021 U.S. Voting Policies demonstrate its commitment to diverse gender representation and expanded disclosure regarding diversity matters, including racial and ethnic diversity. The U.S. Voting Policies published by Institutional Shareholder Services similarly reveal a focus on board diversity disclosure and composition. BlackRock's recently released 2021 Stewardship Expectations prominently list board and workforce diversity as a key priority, as do the policies and expectations of other investors. The Nasdaq listing rule is intended to provide investors with consistent disclosure on board diversity matters. However, in contrast to a hard mandate or quota system, such as California's newly passed board diversity law, the rule would permit companies to explain their rationale for not meeting a particular diversity standard and, therefore, allow them to maintain their decision-making authority over board composition.

The SEC is accepting comments from the public on Nasdaq's proposal until January 4, 2021.

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