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Nasdaq Introduces Board Diversity Requirements

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On August 6, 2021, the U.S. Securities and Exchange Commission approved Nasdaq's proposed rule regarding diversity of boards of directors.[1] The approved rule requires that most companies listed on Nasdaq (i) "[p]ublicly disclose board-level diversity statistics using a standardized template," and (ii) "[h]ave or explain why they do not have at least two diverse directors."[2]

The Rule

Nasdaq's new rule requirements will typically require disclosure of the board's diversity using a standard matrix. This disclosure can either be made in the company's proxy or information statement or, alternatively, through the company's website. If the company choose to disclose via its website, it "must submit such disclosure concurrently with the filing [of its proxy or information statement] and submit a URL link to the disclosure through the Nasdaq Listing Center, within one business day after such posting."[3]

In addition, the rule requires that boards, with limited exceptions, maintain two diverse directors, including at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority or LGBTQ+.[4] If a company has not met the diversity requirements, it must then provide an explanation why it has not met the requirements. A company is not subject to delisting or other penalties for failure to meet the requirements, so long as it has provided an explanation. Nasdaq has stated that it will not assess the merits of the explanation. Nasdaq has defined an underrepresented minority as "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" and LGBTQ+ as "lesbian, gay, bisexual, transgender, or as a member of the queer community."[5]

There is a transition period for companies to comply with the new diversity requirements.[6] For listings on the Nasdaq Global Select Market and the Nasdaq Global Market, companies will need to have one diverse director by August 7, 2023 and two diverse directors by August 6, 2025, or if later, the date the company files its proxy or information statement for the annual shareholder meeting during the 2023 and 2025 calendar years, respectively. For companies listed on the Nasdaq Capital Market, such requirements will apply August 7, 2023 (or during the calendar year 2023) and August 6, 2026 (or the calendar year 2026), respectively. Notwithstanding the transition period for compliance with the new diversity requirements, companies will be required to begin using and disclosing the diversity matrix by the later of August 6, 2022 or the date the company files its proxy statement or its information statement for its annual meeting during the 2022 calendar year.[7]

While many companies will of course need to comply with the requirements of the rule, there are also several exceptions. Notably, as a response to public comments, companies with five or fewer directors may satisfy the diversity requirements with one diverse director, and would not need to otherwise explain a lack of diversity.[8] There are also modifications and exceptions for foreign issuers, smaller reporting companies, and SPACs.[9]

Effect of the Rule

The Nasdaq rule and its approval by the SEC should promote diversity in the make-up of corporate boards. Although, as Nasdaq has made clear, the rule is not a mandate for diversity, the requirement for disclosure if the targeted diversity is not achieved will encourage companies to meet the diversity target rather than to have to explain to shareholders and the marketplace why they have not done so. The rule also fosters transparency regarding the status of board diversity. As SEC Chair Gensler has stated, the rule reflects calls from investors for greater transparency and "will allow investors to gain a better understanding of the Nasdaq-listed companies' approach to board diversity, while ensuring that those companies have the flexibility to make decision that best serve their shareholders."[10]

To assist companies achieve diversity, Nasdaq is offering a board diversity referral service that will allow companies to access "a network of board-ready diverse candidates."[11]

With the SEC's recent approval of the Nasdaq rule, it remains to be seen what action the New York Stock Exchange will take regarding board diversity.

Practical Considerations

Companies listed on Nasdaq should begin to assess their own situation under the new rule and determine what actions they might need to take to comply. If diverse directors will need to be added, board recruitment steps should begin sooner rather than later because board recruitment can be a lengthy and intensive process. Alternatively, if the explanatory disclosure route will be followed, a company should begin to consider how it will explain its failure to comply and what shareholder relations actions might be necessary.

Companies also should consider how they will obtain the required disclosure information for the diversity matrix if they are not already receiving that information in their D&O questionnaires or otherwise. This should begin by reviewing the company's form of D&O questionnaire to see what additional information will be needed to meet the detailed information called for in the diversity matrix.

If you have any questions about these or related topics, your regular Locke Lord contact or any of the authors can discuss these matters with you.

[1] NASDAQ's Board Diversity Rule: What NASDAQ-Listed Companies Should Know, NASDAQ (updated Aug. 16, 2021) (available here).

[2] *Id.*; Nasdaq Rule 5605(f), 5606.

[3] Nasdaq Rule 5605(f)(6).

[4] Nasdaq Rule 5605(f)(2)(A).

[5] Nasdaq Rule 5605(f)(1).

[6] Nasdaq Rule 5605(f)(7).

[7] Nasdaq Rule 5606(e).

[8] Nasdaq Rule 5605(f)(2)(D).

[9] Nasdaq Rule 5605(f)(2).

[10] Statement on the Commission's Approval of Nasdaq's Proposal for Disclosure about Board Diversity and Proposal for Board Recruiting Service (Aug. 6, 2021) (available here).

[11] Securities Exchange Act Release No. 34-92590 (Aug. 6, 2021) (available here).

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