Articles + Publications | August 9, 2021

SEC Approves Nasdaq's Proposed Listing Standards for Board Diversity

WRITTEN BY

David I. Meyers | Steven Khadavi | Betty Linkenauger Segaar | Wallace Bao | Dylan Denslow

On August 6, the Securities and Exchange Commission (SEC) approved Nasdaq's proposed "Board Diversity Rule," noting that this new listing standard "represents a step forward for investors on board diversity." As discussed in our prior client alert on Nasdaq's proposed rule changes, the new Board Diversity Rule requires all Nasdaq-listed companies (subject to certain exceptions described below), including smaller reporting companies, to have at least two diverse directors (or explain the reasons why they do not), including one self-identified female and one who self-identifies as an underrepresented minority or LGBTQ+, and to disclose board diversity statistics. The new Board Diversity Rule becomes effective based on a two-stage deferred basis, with transition periods for newly Nasdaq-listed companies and listing transfers and exceptions for certain companies.

Disclosure Requirement. Each Nasdaq-listed company must annually disclose board diversity data on its website or in its proxy or information statement for its annual meeting of shareholders. Initial disclosures of this data must occur by the later of August 8, 2022, or the date on which a company files its proxy or information statement for its annual shareholder meeting during 2022. Each company must disclose the number of directors based on the directors' self-identified gender, race, and LGBTQ+ status, respectively, using a Nasdaq-standardized diversity matrix. Any director who chooses not to self-identify will be counted in an "Undisclosed" category. After the first year of applicability, the Board Diversity Rule requires disclosure for the current year and the immediately preceding year. Companies that fail to comply with the disclosure requirement could be delisted if they fail to regain compliance within a cure period of up to 180 days.

Diversity Objective. In addition, Nasdaq-listed companies must meet minimum board diversity requirements within specified transition periods based on the company's listing tier. All Nasdaq-listed companies must have, or explain why they do not have, at least one diverse director within two years of the proposal's approval. For most calendar year-end Nasdaq-listed companies, this will be not later than the date on which such company files its proxy statement for its 2023 annual meeting. Companies listed on the Nasdaq Global Select Market or the Nasdaq Global Market must have, or explain why they do not have, at least two diverse directors (including one self-identified as female and one self-identified as an underrepresented minority or LGBTQ+) within four years of the proposal's approval (the date on which a calendar year-end company files its proxy statement for its 2025 annual meeting), while companies listed on the Nasdaq Capital Market will have five years to meet this requirement (the date on which a calendar year-end company files its proxy statement for its 2026 annual meeting). A Nasdaq-listed company with a board of five or fewer directors can meet the diversity objective by having one diverse director, instead of two, within one year of the proposal's approval. Foreign issuers and smaller reporting companies can satisfy this requirement with two female directors. The rules provide a one-year grace period for a listed company that no longer meets the diversity objective due to a vacancy on its board of directors, such as when a diverse director falls ill or resigns. However, a company that cannot meet the diversity requirement will not be subject to delisting if it explains the reasons for not doing so on its website or in its proxy or information statement for its annual meeting of shareholders. If a company fails to provide an explanation, it will have until the later of its next annual shareholder meeting or 180 days from the event that caused the deficiency to cure the deficiency, either by nominating additional diverse directors or by providing the required disclosures.

This disclosure-based framework addresses the current absence of board-level diversity statistics and aims to provide investors with more reliable and comparable information — information investors have been increasingly demanding. Such information should enhance current SEC rules, requiring that companies disclose whether, or how, they consider diversity when nominating new directors. By providing for more standardized diversity data, the SEC seeks to aid investors' investment and voting decisions.

Approval of the announcement did not come without opposition, as one SEC commissioner voted against the Board Diversity Rule, and another only gave partial support. In its order approving the Board Diversity Rule, the SEC expressly acknowledged that investors and companies differ in their beliefs as to the impact of board diversity on company performance and governance. Nonetheless, the SEC makes clear that the availability of diversity-related data is intended to benefit the investing public.

RELATED INDUSTRIES + PRACTICES

- Corporate
- Corporate Governance
- Financial Services