

August 2021

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## *SEC Approves Nasdaq's New Board Diversity Disclosure Listing Rule*

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On August 6, 2021, the U.S. Securities and Exchange Commission ("SEC") issued an order approving Nasdaq's proposed Board Diversity Rule requiring Nasdaq-listed companies to disclose the diversity metrics of their boards.<sup>1</sup> Nasdaq's new Board Diversity Rule<sup>2</sup> will require most companies listed on the Nasdaq exchange, after a transition period, to have at least two diverse directors, or alternatively, publically disclose why not.<sup>3</sup>

In approving the Nasdaq Rule, the SEC stated that it believes the new rules will "provide widely available, consistent, and comparable information that would contribute to investors' investment and voting decisions" as well as "make it more efficient and less costly for investors to collect, use, and compare information on board diversity."<sup>4</sup> The SEC acknowledged the arguments in favor of, and opposed to, the Nasdaq Rule, including the myriad of studies finding—or disputing—a correlation between board diversity and corporate performance, as well as citations to experiences in countries which have mandated board diversity. The SEC concluded that, "[s]tudies of board diversity mandates . . . do not provide a reliable basis for evaluating the likely overall effects of the Board Diversity Proposal, which does not mandate any particular board composition. Unlike companies in those studies, Nasdaq-listed companies would have the option of providing an explanation for their board composition under the new listing standard."<sup>5</sup>

The SEC viewed the Nasdaq Rule as facilitating access to information "that may currently exist between certain (likely larger and more resourceful) investors who could obtain board diversity information and other (likely smaller) investors who may not be able to do the same." Further, the SEC considered that companies have several options under the Nasdaq Rule. As the Rule is aspirational and not mandatory, companies can either choose to meet the diversity objectives, choose to explain why they are not meeting the objectives, or list on a different exchange. "For these reasons, the costs of the Board Diversity Proposal are likely to be relatively limited as compared to those regulatory regimes that have mandated board diversity and provided neither the option to explain or to opt-out of the regimes by listing elsewhere."<sup>6</sup>

The SEC concluded that, in light of these disclosure-related benefits, "and given that the studies of the effects of board diversity are generally inconclusive and the costs of the proposal are likely to be comparatively limited, the Commission finds that the Board Diversity Proposal is consistent with the requirements of the Act."<sup>7</sup>

## Defining Diversity

The definition of diversity adopted by Nasdaq was one of the areas of focus for a number of commenters who argued for a broader definition of "Diversity". Under Nasdaq's Rule, diversity is defined as one self-identified female director and one self-identified Underrepresented Minority or LGBTQ+ director. The definition of Underrepresented Minority is consistent with the definitions provided by the Equal Employment Opportunity Commission ("EEOC") which include individuals self-identifying as one or more of the following: 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. The new Diversity Rule defines female as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth."<sup>8</sup>

Noting that the current reporting of board-level diversity statistics is "unreliable and unusable" to investors with inconsistent definitions across companies, Nasdaq argued that "a transparent, consistent definition of Diverse would provide stakeholders with a better understanding of a company's current board composition and philosophy regarding diversity if the company does not meet the proposed diversity objectives...[and] a broader definition of 'Diverse' would permit inconsistent, non-comparable disclosures, whereas a narrower definition of 'Diverse' focused on race, ethnicity, sexual orientation, and gender identity will promote the public interest by improving transparency and comparability."<sup>9</sup>

In approving Nasdaq's definition of Diversity, the SEC found that "[i]t is not unreasonable for the Exchange to propose a definition of 'Underrepresented Minority' that is consistent with the EEO-1 categories" which is familiar to companies, thereby "promot[ing] efficiency for companies in complying with the proposed rules. It is also not unreasonable for the Exchange to include LGBTQ+ in its proposed definition of 'Diverse.'"<sup>10</sup> Importantly, the SEC noted that "companies are not precluded from considering director characteristics that do not fall within the proposed definition of 'Diverse' and providing the disclosures under proposed Rule 5605(f)(3) if the company does not satisfy the proposed board diversity objectives."<sup>11</sup>

## Flexibility

Recognizing that "operations, size, and current board composition of each Nasdaq-listed company are unique," the SEC noted that the Nasdaq Rule provides "a disclosure-based, business-driven framework to enhance board diversity that balances the need for flexibility with each company's particular circumstances."<sup>12</sup> Smaller Reporting Companies<sup>13</sup> are provided greater flexibility and can satisfy the new Diversity Objectives by having two female directors, or one female director and one director who self identifies as LGBTQ+. <sup>14</sup> For Foreign Issuers specifically, the Nasdaq Rule recognized that "EEOC categories of race and ethnicity may not extend to all countries globally since each country has its own unique demographic composition, and because on average women tend to be underrepresented in boardrooms across the globe."<sup>15</sup> Therefore, for Foreign Issuers, the diversity objectives can be met by having one Female director and one Underrepresented Individual or LGBTQ+ director, or two Female directors. Further, an underrepresented director can be based on "national, racial, ethnic, indigenous, cultural, religious, or linguistic identity in the country where the Foreign Issuer's principal offices are located."<sup>16</sup>

## Board Diversity Matrix

Under Rule 5606(a), a Nasdaq-listed company will need to disclose annually its board diversity data in a format substantially similar to the Board Diversity Matrix that lists the total number of Directors, and includes columns for gender as well as minority or LGBTQ+ status.<sup>17</sup> Directors can also choose not to

disclose their demographic backgrounds and thereby be included in the “Did not Disclose Demographic Background” category.<sup>18</sup> If a company fails to adhere to this requirement, Nasdaq would notify the company and allow 45 days to submit a plan to bring it into compliance, and Nasdaq may allow up to a further 180 days to come into compliance. “If the company does not submit a plan or regain compliance..., it would be issued a Staff Delisting Determination, which the company could appeal to a Hearings Panel.”<sup>19</sup>

### **Opportunity not Mandate**

The rules take a market led approach and respond to calls from investors for increased diversity on public company boards. This disclosure-based framework is not a mandate or quota according to Nasdaq, but it does set forth “aspirational diversity objectives and aims to provide investors with consistent and comparable diversity metrics to evaluate board diversity.”<sup>20</sup> Companies that do not meet the objectives are simply required to explain publically why they do not.<sup>21</sup> The lack of uniformity and transparency “creates barriers to investment analysis, due diligence, and academic study, and affects investors who are increasingly basing public advocacy, proxy voting, and direct shareholder-company engagement decisions on board diversity considerations.”<sup>22</sup>

Nasdaq provided examples of explanations for not meeting these objectives which include describing a different approach to diversity, indicating that they do not believe the rule is appropriate, or explaining that the objectives are not feasible.<sup>23</sup> Nasdaq rejected comments challenging the Diversity Objectives on Constitutional grounds. Nasdaq argued that the rule will not violate the Fifth Amendment since a Self-Regulatory Organization (“SRO”), such as Nasdaq, is not a state actor and the SEC’s approval of a private entity’s action does not convert their action into a state action.<sup>24</sup> Additionally, as the rule does not mandate a number of diverse directors, rather establishes aspirational objectives and requires disclosure, it would survive scrutiny.<sup>25</sup>

### **Exemptions**

Special Purpose Acquisition Companies (“SPACs”) listed under IM-5101-2 are exempt from the Board Diversity rule until they de-SPAC. In addition, asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies, and issuers of only non-voting preferred securities, debt securities and derivatives securities are exempt from the diversity disclosure requirements.<sup>26</sup>

### **Compliance Dates**

Companies will have a gradual compliance transition period to phase in disclosure and diversity requirements. Nasdaq-listed companies will be required to disclose board diversity metrics using the Board Diversity Matrix template by the later of one calendar year from the Effective Date (which is the date of the SEC’s Order, August 6, 2021), or the date the company files its proxy statement, information statement, or Form 10K or 20-F.

The timeline for meeting diversity objectives or explaining their reasons for not doing so provides companies a transition or phase-in period. The timeframe to meet the minimum diversity objectives is based on a company’s listing tier:

- Companies listed on Nasdaq Global Select Market or Nasdaq Global Market are required to have one diverse director by 2023 (e.g., within two years of the Effective Date) or at that time explain why the company does not have one diverse director, and two diverse directors by

2025 (e.g., within four years of the Effective Date), or at that time explain why the company does not have two diverse directors.

- Companies listed on the Nasdaq Capital Market are required to have one diverse director by 2023 (e.g., within two years of the Effective Date), or at that time explain why the company does not have one diverse director, and two diverse directors by 2026 (e.g., within five years of the Effective Date), or at that time explain why the company does not have two diverse directors.
- Companies with boards that have five or fewer directors, regardless of listing tier, are required to have one diverse director by 2023 (e.g., within two years of the Effective Date), or at that time explain why the company does not have one diverse director.<sup>27</sup>

### Board Recruiting Service

In order to assist companies in achieving board diversity, Nasdaq will provide some listed companies with one year of access to complimentary board recruiting services to assist in increasing board diversity by identifying qualified candidates of diverse backgrounds.<sup>28</sup> Nasdaq is providing this service, valued at approximately \$10,000 per year, to eligible companies that request access through the Nasdaq Listing Center.<sup>29</sup> “Nasdaq believes that offering a board recruiting solution will assist and encourage listed companies to increase diverse representation on their boards, which can result in improved corporate governance, thus strengthening the integrity of the market and building investor confidence.”<sup>30</sup>

### Looking Ahead

SEC approval of the Nasdaq Rule reflects the priority long given—and accelerating today—by institutional investors, activist investors, and more recently by proxy advisory firms in the generally acknowledged correlation between board diversity and effective corporate governance and risk management. While the implementation date gives companies that are currently in non-compliance a period of time to comply—and only applies to Nasdaq listed companies—all companies are well-advised to take steps to address their board composition from a skills and diversity perspective. We recommend that companies conduct a skills assessment according to a skills matrix responsive to the anticipated challenges and opportunities facing the business in coming years, define the qualities, characteristics and demographics needed in board members to best address those challenges and opportunities, and assess current directors against those metrics. After conducting that assessment, companies should develop a plan for board evolution, including with regard to diversity. Fundamentally, companies should define what diversity means for them, both on their boards and management teams, and develop and implement a plan to achieve diversity in their boardrooms.

### Additional Resources

- [NASDAQ’S BOARD DIVERSITY RULE WHAT NASDAQ-LISTED COMPANIES SHOULD KNOW](#)
- [NASDAQ LISTING CENTER BOARD DIVERSITY RULE FAQ](#)
- [DISCLOSURE MATRIX TEMPLATE](#)
- [BOARD DIVERSITY MATRIX EXAMPLES](#)

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- <sup>1</sup> Chair Gary Gensler, Statement on the Commission's Approval of Nasdaq's Proposal for Disclosure about Board Diversity and Proposal for Board Recruiting Service, (Aug. 6, 2021) [https://www.sec.gov/news/public-statement/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/public-statement/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621?utm_medium=email&utm_source=govdelivery).
  - <sup>2</sup> Adopting Rule 5606 (Board Diversity Disclosure), Listing Rule IM-5900-9 (Board Diversity Services), and Rule 5605(f) (Diverse Board Representation); revising Rule 5615, IM-5615-3 (Foreign Private Issuers) and Rule 5810(c) (Types of Deficiencies and Notifications).
  - <sup>3</sup> See Securities Exchange Act Release No. 34-92590 (August 6, 2021) (order approving SR-NASDAQ-2020-081 and SR-NASDAQ-2020-082) <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf>.
  - <sup>4</sup> SEC Order at 25.
  - <sup>5</sup> SEC Order at 34.
  - <sup>6</sup> SEC Order at 35.
  - <sup>7</sup> Id.
  - <sup>8</sup> Id.
  - <sup>9</sup> SEC Order at 36.
  - <sup>10</sup> SEC Order at 38.
  - <sup>11</sup> SEC Order at 38–39.
  - <sup>12</sup> SEC Order at 39.
  - <sup>13</sup> Defined under Rule 12b-2 as "an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than \$250 million; or (2) Had annual revenues of less than \$100 million and either: (i) No public float; or (ii) A public float of less than \$700 million."
  - <sup>14</sup> SR-NASDAQ-2020-081 Amendment 1, p. 9–10, [https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081\\_Amendment\\_1.pdf](https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081_Amendment_1.pdf).
  - <sup>15</sup> SEC Order at 41.
  - <sup>16</sup> FAQs provided by Nasdaq on Rule 5605(f) specifically exclude consideration of emeritus directors, retired directors, and members of advisory boards from fulfilling the diversity requirements. Qualifying directors must actually be on the board of directors.
  - <sup>17</sup> Board Diversity Matrix examples are provided here: [https://listingcenter.nasdaq.com/assets/Board%20Matrix%20Examples\\_Website.pdf](https://listingcenter.nasdaq.com/assets/Board%20Matrix%20Examples_Website.pdf)
  - <sup>18</sup> See *id.*
  - <sup>19</sup> SEC Order at 12.
  - <sup>20</sup> SECURITIES AND EXCHANGE COMMISSION, Release No. 34-92590; File Nos. SR-NASDAQ-2020-081; SR-NASDAQ-2020-082, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Board Diversity and to Offer Certain Listed Companies Access to

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a Complimentary Board Recruiting Service (August 6, 2021) p. 13, 15 <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf>. (SEC Order Approving Proposed Rule Changes).

- <sup>21</sup> See Nasdaq Response Letter, Re: Response to Comments and Notice of Filing of Amendment No. 1 of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity (Feb. 26, 2021) p. 7 <https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8425992-229601.pdf>. (“A company that chooses to not meet the diversity objectives will not face consequences or be delisted. Rather, they can describe their reasons for following a different path. Nasdaq will not adjudicate the merits of a company’s reasons for not achieving the diversity objectives, and will not assess the substance of a company’s explanation. It will simply verify that the company has specified the requirements of Rule 5605(f)(2) that are applicable to the company (for example, describing the objectives applicable to a Smaller Reporting Company, Foreign Issuer, a smaller board, or the general objective) and has provided an explanation of its reasons for not meeting the objectives of the applicable rule, which could include describing a different approach.”).
- <sup>22</sup> SEC Order at 19.
- <sup>23</sup> *Id.* at p. 8.
- <sup>24</sup> SEC Order at p. 59.
- <sup>25</sup> *Id.*
- <sup>26</sup> IM-5101-2; Rule 5615(a)(1); Rule 5615(a)(2); Rule 5615(a)(4); Rule 5615(a)(6); Rule 7500 Series.
- <sup>27</sup> Nasdaq Listing Center, Nasdaq Board Diversity Rule Information, [https://listingcenter.nasdaq.com/ViewPDF.aspx?Material\\_Search.aspx?mcd=LO&cid=157&years=2020&sub\\_cid=&searchkeywords=&exactsearchddvalue=1&Print=N&materials=0&popularfl=](https://listingcenter.nasdaq.com/ViewPDF.aspx?Material_Search.aspx?mcd=LO&cid=157&years=2020&sub_cid=&searchkeywords=&exactsearchddvalue=1&Print=N&materials=0&popularfl=)
- <sup>28</sup> IM-5900-9 (Board Diversity Services) (Offering eligible companies complimentary access to two seats of a board recruiting solution to evaluate diverse board candidates).
- <sup>29</sup> *Id.*
- <sup>30</sup> Amendment No. 1 (SR-NASDAQ-2020-082) (Feb. 26, 2021) p. 11, <https://www.sec.gov/comments/sr-nasdaq-2020-082/srnasdaq2020082-8425987-229599.pdf>.