
Hughes Hubbard & Reed

SEC Approves New Nasdaq Rules Promoting Board Diversity

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Executive Summary

On August 6, 2021, the Securities and Exchange Commission (the "Commission") issued an order (the "Approval Order")¹ approving rules proposed by The Nasdaq Stock Market LLC ("Nasdaq"). New Rules 5605(f) and 5606 require a listed company to have at least two diverse board members or explain why it does not and to disclose board-level diversity data annually (the "Board Diversity Rule"). New Rule 5900-9 offers listed companies access to a complimentary board recruiting service (the "Board Recruiting Service Rule"). The new rules respond to investors' increasing demand for diverse boards and diversity-related information about public companies.

The Board Diversity Rule

Rule 5605(f) requires each Nasdaq-listed company to have, or explain why it does not have, at least two members of its board of directors who are "Diverse", i.e., at least one director who self-identifies as Female² and at least one director who self-identifies as an "Underrepresented Minority"³ or "LGBTQ+"⁴. Companies may not count directors emeritus, retired directors, or advisory board members as directors for this purpose. These standards apply with modifications to certain foreign companies, smaller listed companies and companies with smaller boards. They do not apply to Special Purpose Acquisition Companies (SPACs) prior to their business combination transaction and certain other types of issuers.

Nasdaq explains that while it will verify whether a company has provided an explanation if it does not have two Diverse directors, it will not assess the merits of the explanation and that there is no right or wrong reason that a company may give for not having at least two Diverse directors.⁵

Rule 5606 requires each Nasdaq-listed company to disclose annually its board-level diversity data in a "Board Diversity Matrix" which includes (i) the total number of directors on its board, (ii) the number of directors based on gender identity (female, male, or non-binary) and the number of directors who did not disclose gender; (iii) the number of directors based on race and ethnicity disaggregated by gender identity (or that did not disclose

gender); (iv) the number of directors who self-identify as LGBTQ+; and (v) the number of directors who did not disclose a demographic background. A company must provide this disclosure in its proxy statement or its information statement (or if the company does not file a proxy, its Form 10-K or 20-F), or on its website.

Timing and Transition Periods for the Board Diversity Rule

Companies generally have until the later of August 8, 2022, or the date the company files its proxy or information statement for its annual shareholder meeting during 2022 to publish the Board Diversity Matrix and comply with Rule 5606.

Companies have a transition period to implement the diversity requirements of Rule 5605(f), with time frames depending on a company's listing tier and ranging from August 7, 2023 through August 6, 2026 (or the company's filing of its annual proxy statement or other applicable annual disclosure for such calendar year, if later).

The Board Recruiting Service Rule

Under Rule 5900-9, Nasdaq furnishes to companies that do not have a specified number of Diverse directors ("Eligible Companies") a one year complimentary access for two users to a board recruiting service providing access to a network of board-ready diverse candidates to identify and evaluate.

The service will be a one-year complimentary subscription to the Equilar diverse director candidate database. Use of the service is optional and Nasdaq stated that whether a listed company takes advantage of the service would have no relationship to how, or whether, Nasdaq will enforce the Board Diversity Rule, and that there would be no circumstances under which it would penalize a company solely for its decision to not use the service.

Background

In its rulemaking proposal Nasdaq pointed to an extensive body of empirical research demonstrating a positive association between diverse boards and improved corporate governance and company performance.⁶ It intended for the disclosures in the Board Diversity Matrix to provide consistent information to the public and to enable investors to continually review board composition as an indicator of corporate governance or to track trends, as well as to simplify or eliminate the need for a company to respond to multiple investor requests for board diversity information.⁷

In the Approval Order the Commission agreed with Nasdaq and welcomed that the Board Diversity Matrix would make consistent and comparable statistics widely available to investors regarding the number of Diverse directors serving on a Nasdaq-listed company's board.⁸ It criticized that board-level diversity statistics were currently not widely available on a consistent and comparable basis, even though Nasdaq and many commenters asserted that this type of information was important to investors. The Commission found that by providing investors with information to facilitate evaluation of companies in which they might invest, the Board Diversity Rule would contribute to the maintenance of fair and orderly markets, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.⁹

The Commission found that the Board Recruiting Service Rule would enable Eligible Companies to identify and evaluate Diverse candidates in order to increase diverse representation on their boards at levels that meet or exceed the standard in the Board Diversity Rule.¹⁰ The Commission further stated that the Board Recruiting Service Rule would potentially help Nasdaq compete to attract and retain listings, was not designed to permit

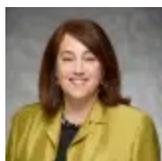
unfair discrimination between issuers, and reflected the current competitive environment for listings among national securities exchanges.¹¹

References

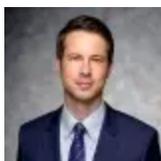
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- 1 Securities Exchange Act Release No. 34-92590 (August 6, 2021) (order approving SR-NASDAQ-2020-081 and SR-NASDAQ-2020-082). ^
- 2 The Board Diversity Rule defines "Female" as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth." ^
- 3 The Board Diversity Rule defines "Underrepresented Minority" as "an individual who self-identifies 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. ^
- 4 The Board Diversity Rule defines "LGBTQ+" as "an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community." ^
- 5 <https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf> ^
- 6 SEA Rel. No. 90574 (Dec. 4, 2020), as amended February 26, 2021, <https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8425992-229601.pdf>, p. 290. ^
- 7 Id., p.112. ^
- 8 Approval Order, p. 5. ^
- 9 Id., p. 7. ^
- 10 Id., p. 8. ^
- 11 Id., p. 8. ^

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