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NEW NASDAQ LISTING PROPOSAL: ADD DIVERSE DIRECTORS OR EXPLAIN WHY NOT

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Nasdaq yesterday announced a proposed new listing rule that would require all Nasdaq-listed companies to publicly disclose consistent, transparent board diversity statistics in a specified form of matrix. In addition, the proposed rule would require Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors: one woman and one person who self-identifies as either an underrepresented minority or LGBTQ.

Nasdaq believes its proposal would benefit investors and the public interest, citing in its SEC filing numerous empirical studies as support for its finding that diverse boards "are positively associated with improved corporate governance and financial performance." It also noted calls for diversity from institutional investors, corporate stakeholders and legislators.

If the rule is approved by the SEC, companies would be required to disclose board-level diversity statistics within one year of the SEC's approval of the listing rule. In addition:

- All operating companies will be expected to have one diverse director within two years of the SEC's approval of the listing rule (non-operating companies, such as asset-backed issuers, cooperatives, limited partnerships and investment management companies, as well as certain specified issuers of non-equity securities, would be exempt from the proposed rule).
- Companies listed on the Nasdaq Global Select Market and Nasdaq Global Market will be expected to have a second diverse director within four years of the SEC's approval.
- Companies listed on the Nasdaq Capital Market will be expected to have a second diverse director within five years of the SEC's approval.

Smaller reporting companies can also satisfy the new diversity requirements by having two women directors. Foreign companies can satisfy the requirement by having two women directors, or one woman and one underrepresented person in the company's home country jurisdiction.

The proposed rule defines an "underrepresented minority" as a person who self-identifies in one or more of the following groups: 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. Nasdaq stated that it determined the definition after considering diversity laws, as well as input from social justice and governance organizations.

Nasdaq stated that companies who are unable to meet the board diversity requirements in the specified time frames will not be subject to delisting if they provide a public explanation of their reasons for not meeting the objectives. Nasdaq FAQs state that Nasdaq will not assess the substance of a company's explanation, but will verify the company has provided one. Nasdaq said it believes the disclosures will provide stakeholders with a better understanding of a company's current board composition and philosophy regarding diversity. Nasdaq FAQs, however, also state that if a company fails to add the minimum number of diverse directors by the applicable deadline and fails to explain why by making the required disclosure or refuses to disclose board diversity metrics as required by the proposed rules, it could be subject to de-listing if the company fails to cure the deficiency within specified time frames following notice from Nasdaq.

According to the Wall Street Journal, a Nasdaq study showed that more than 75% of Nasdaq-listed companies would have failed the proposed requirements, with 80-90% having at least one female director but only about 25% having a second. However, it notes that a lack of reliable and consistent data make precise tracking difficult – a deficiency that Nasdaq believes its proposal would address.

"Our proposed listing rule is, at a minimum, a catalyst for debate as part of a broader journey to achieve inclusive representation in business," stated Nelson Griggs, President of the Nasdaq Stock Exchange.

Nasdaq's proposed rule adds to the growing pressure for diversity disclosures from investors, proxy advisors, activists and others, as noted in our September 10 and August 10 posts. As in the case of previous calls for voluntary diversity disclosure, boards must grapple with how to accurately collect diversity data for potentially-mandatory disclosure. Nasdaq FAQs note that directors may choose to opt out rather than reveal their diversity characteristics to the company. The Nasdaq disclosure matrix template includes an "undisclosed" category for such cases.

Companies can choose whether to annually disclose the board diversity information in the proxy or information statement for annual meetings, or provide the information on the company's website. If a company elects to disclose the information only on its website, the company must also submit such disclosure and a URL link through the Nasdaq Listing Center within 15 days of the annual meeting. Nasdaq also introduced a partnership with Equilar to help Nasdaq-listed companies with board diversity objectives and provide access to "highly-qualified, diverse, board-ready candidates."

The SEC will provide a minimum of 21 days from the time the proposed rule change is published in the Federal Register for public comment. After publication in the Federal Register, the SEC has 30 to 240 calendar days to approve the proposal. Under current SEC Chairman Jay Clayton, who retires at the end of 2020, the SEC has maintained its disclosure framework rooted in materiality and not heeded calls for SEC-mandated ESG (Environmental, Social or Governance) matters. That could change in 2021 when a new SEC Chairman takes the helm.

Nasdaq also provided a summary of five things companies should know about the proposed new board diversity rule, which includes the availability of resources such as a December 9 webinar to be hosted by Nasdaq to explain the proposed rule and answer questions.

The Nasdaq FAQs also compare the proposed rule to California's currently effective diversity mandate for public companies having executive offices in California. Under the California rules, each such board must have one female director and one director from an underrepresented community by the end of 2019 and 2022, respectively. For larger boards, the California rules also require additional female directors by the end of 2021 and additional directors from underrepresented communities by the end of 2022.

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