

# SEC Approves Nasdaq Board Diversity Rules

August 10, 2021

On August 6, 2021, the United States Securities and Exchange Commission approved Nasdaq's Board Diversity Rule. The Board Diversity Rule requires all companies listed on Nasdaq's U.S. exchanges to publicly disclose board-level diversity statistics using a standardized disclosure matrix template. Additionally, the Board Diversity Rule requires most Nasdaq-listed companies to either (i) have at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an Underrepresented Minority or LGBTQ+ or (ii) explain why they do not have at least two diverse directors.

Foreign companies and smaller reporting companies have additional flexibility in satisfying the minimum diversity objective with two female directors, and companies with boards of five or fewer members can satisfy the requirement with one diverse director. Foreign issuers may also elect to satisfy the board composition disclosure requirement through an alternative disclosure matrix template, a form of which has been posted at the Nasdaq site.

Smaller reporting companies may satisfy the minimum diversity objective by including two female directors, or by including one female director and an individual who self-identifies as an Underrepresented Minority or LGBTQ+. Under 12b-2 of the Securities Exchange Act of 1934, a company generally may qualify as a smaller reporting company if it has: (i) public float of less than \$250 million; or (ii) annual revenues of less than \$100 million and either: (i) no public float; or (ii) public float of less than \$700 million.

## Next Steps

It is important for companies to carefully consider their approach to complying with the Nasdaq Board Diversity Rule, including formulating explanations in instances where companies will be unable to comply with this new rule. Companies will need to explore and determine appropriate methods with respect to both self-identification of racial/ethnic and LGBTQ+ for directors, including how such data can be collected as well as steps for identifying a pool of qualified candidates for meeting such new standards to satisfy the Nasdaq Board Diversity Rule. Consultation with your trusted attorneys and advisors is recommended in navigating these new standards.

In identifying and recruiting qualified Board candidates, members of your Nominating and Governance Committee will need to balance the best interests of the shareholders, state law requirements, guidelines established by proxy advisory firms such as ISS, the rules of the listing exchange and Board dynamics. Be ready, Board members, for a very busy year.

## Timing for Compliance with the Board Diversity Rule

All Nasdaq-listed companies are required to publicly disclose director self-identified board-level diversity statistics using a standardized disclosure matrix template by the later of one calendar year from August 6, 2021 (the “Effective Date”) or the date the company files its proxy statement or its information statement (or, if the company does not file a proxy statement, in its Form 10-K or 20-F) for its annual meeting of shareholders during the calendar year of the Effective Date.

Companies have a transition period to meet the diversity objectives or explain their reasons for not doing so. 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 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 within four years (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 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 within five years (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 within two years of the Effective Date (or at that time, explain why the company does not have one diverse director).

If a company files its proxy statement or its information statement (or, if the company does not file a proxy statement, in its Form 10-K or 20-F) for the company’s annual shareholders meeting after the anniversary of the Effective Date in the calendar year for each respective year noted above, then the company will have until the date it makes such filing to meet, or explain why it does not meet, the applicable diversity objectives. In lieu of providing such disclosure in a proxy statement, Form 10-K or Form 20-F, a company may provide such required disclosure on its company’s website. If a company elects to provide such disclosure on its website, then the company must publish this disclosure concurrently with its proxy statement or its information statement (or if the company does not file a proxy statement, its Form 10-K or 20-F). It must also submit a URL link to the disclosure through the Nasdaq Listing Center within one business day after such posting.

Companies that are not in a position to meet the minimum diversity objectives within the required timeframes will not be subject to delisting if they provide an alternative public disclosure explaining why they did not meet the applicable minimum diversity objectives.

## Phase-In Period for Newly Listed Companies

After the initial four or five year period set forth in Nasdaq Rule 5606(f)(7) expires, newly listed companies on Nasdaq, including those who list following an IPO, direct listing, or in connection with a business combination with a SPAC (a “de-SPAC” transaction), must meet, or explain why they do not meet, the applicable diversity objectives by the later of two years from the date of listing or the date the company files its proxy statement or its information statement (or, if the company does not file a proxy statement, in its Form 10-K or 20-F) for the company’s second annual meeting of shareholders subsequent to the company’s listing, with differing milestones depending on the company’s market tier. Companies listing before the expiration of the initial four or five year period set forth in Nasdaq Rule 5605(f)(7) have the remainder of the applicable initial four or five year period or two years from the date of listing, whichever is longer, to satisfy the requirement.

# Implications of Non-Compliance with Nasdaq Board Diversity Rule

If a company (i) does not meet the applicable diversity objectives set forth under Nasdaq Rule 5605(f)(2) and also fails to provide the alternative public disclosure set forth in Nasdaq Rule 5605(f)(3) (and is not otherwise subject to a grace period), or (ii) fails to hold an annual meeting of shareholders during the applicable periods in Nasdaq Rule 5605(f)(5) or (7) and therefore fails to meet, or explain why it does not meet, the diversity objectives of Nasdaq Rule 5605(f)(2), then Nasdaq's Listing Qualifications Department would promptly notify the company that it has until the later of its next annual shareholders meeting or 180 days from the event that caused the deficiency to cure the deficiency. The company can cure the deficiency either by meeting the applicable minimum diversity objectives of Nasdaq Rule 5605(f)(2) or by providing the alternative public disclosure set forth in Nasdaq Rule 5605(f)(3). If a company does not regain compliance within the applicable cure period, the Listings Qualifications Department would issue a Staff Delisting Determination Letter. A company that receives a Staff Delisting Determination can appeal the determination to the Hearings Panel through the process set forth in Rule 5815.

If a company fails to disclose board diversity metrics as required by Nasdaq Rule 5606, Nasdaq will notify the company that it is not in compliance with a listing requirement, and the company will be allowed 45 calendar days to submit a plan sufficient to satisfy Nasdaq staff that the company has adopted processes and procedures designed to identify and disclose the information required under Nasdaq Rule 5606 in the future. If the company does not do so, it would be issued a Staff Delisting Determination, which the company could appeal to a Hearings Panel pursuant to Nasdaq Rule 5815.

## Exemptions from the Board Diversity Rule

The Board Diversity Rule exempts non-operating companies. Consistent with Nasdaq's corporate governance rules the following types of companies are exempt:

- acquisition companies listed under Nasdaq IM-5101-2;
- asset-backed issuers and other passive issuers (as set forth in Nasdaq Rule 5615(a)(1));
- cooperatives (as set forth in Nasdaq Rule 5615(a)(2));
- limited partnerships (as set forth in Nasdaq Rule 5615(a)(4));
- management investment companies (as set forth in Nasdaq Rule 5615(a)(5));
- issuers of only non-voting preferred securities, debt securities and Derivative Securities (as set forth in Nasdaq Rule 5615(a)(6)); and
- issuers of securities listed under the Nasdaq Rule 5700 Series.

In addition, SPACs listed under Nasdaq IM-5101-2 are exempt from the Board Diversity Rule until they de-SPAC. Following the business combination, such companies must meet, or explain why they do not meet, the applicable diversity objectives by the later of two years from the date of listing or the date the company files its proxy statement or its information statement (or, if the company does not file a proxy statement, in its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing, with differing milestones depending on the company's market tier.

# Nasdaq Assistance in Complying with the Board Diversity Rule

Nasdaq has developed a board diversity tool kit and created a dedicated mailbox ([drivingdiversity@nasdaq.com](mailto:drivingdiversity@nasdaq.com)) to respond to questions related to the Rule. Nasdaq has established partnerships with Equilar, Athena Alliance, and the Boardlist to aid Nasdaq-listed companies in their search for highly-qualified, diverse, board-ready candidates.

## Trends in Board Diversity

While the Nasdaq Board Diversity Rule is the most recent, it is not the only action with respect to board diversity. In September 2020, California Governor Newsom signed into law a bill that required publicly held companies headquartered in the state to include board members from underrepresented communities by the end of 2021. This action follows a similar law in 2018 mandating that public companies headquartered in the state have at least one woman on their board of directors by the end of 2019.

While the NYSE agrees with encouraging board diversity, they have not taken steps to change their exchange listing rules. However, in 2019 the NYSE established a Board Advisory Council to help identify and connect diverse candidate with NYSE-listed companies seeking new board members.

Furthermore, ISS has also made changes to its voting policies related to diversity that will reach companies in the S&P 1500 and Russel 3000. Starting with meetings on or after February 1, 2022, ISS recommends withholding a vote, or voting against, the reelection of any chair of a nominating committee, or other directors on a case-by-case basis, where the company's board has no apparent racial or ethnic diversity. ISS has stated this policy is designed to help investors identify companies with which they may wish to engage and to help foster a dialogue on this topic between companies and investors. ISS' new policy on racial and ethnic diversity augments ISS' current policy on gender diversity, pursuant to which ISS will recommend withholding a vote, or voting against, the reelection of any chair of a nominating committee, or other directors on a case-by-case basis, where there are no women on a company's board.

## Definitions:

Underrepresented individual (foreign issuers) is defined as a person who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the country where the Foreign Issuer's principal executive offices are located.

Underrepresented Minority – refers to 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.

**Note** that there are subtleties to each category that should be thought of when final decisions are being made.

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