Corporate Alert

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Nasdaq Proposes New Board Diversity Rules: What This Means for You

December 3, 2020

Key Points

- Nasdaq has proposed board diversity rules which would require companies to have, or explain why they do not have, at least two diverse directors on their boards and also provide statistical information on board diversity.
- When considering board diversity disclosure, companies should note the SEC guidance for disclosure of self-identified diversity characteristics in a company's proxy statement.

Nasdaq is encouraging an increase in boardroom diversity for the more than 3,000 companies listed on its United States stock exchange through new proposed rules on board diversity filed with the Securities and Exchange Commission (SEC) on December 1, 2020. The proposed rules were first discussed in our December 1 blog post, *What Is Old Is New Again: Nasdaq Asks the SEC to Tackle Boardroom Diversity*. This client alert provides a summary of the proposed rules as well as practical considerations for companies to consider with respect to board diversity disclosure.

1. What are the requirements of the proposed Nasdaq board diversity rules?

Diverse Board Representation

If approved, Rule 5605(f) would require each company to have, or publicly explain why it does not have, at least two diverse directors on its board. Each company must have at least one director who self-identifies as female and one director who self-identifies as an underrepresented minority (i.e., Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities) or LGBTQ+. Any company that does not have two diverse directors is required to explain why in either its proxy statement, information statement for its annual shareholder meeting or website. Any company that elects to disclose on its website must also submit such disclosure with a URL link to the information through the Nasdaq Listing Center within 15 days of the company's annual shareholder meeting.

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Board Diversity Disclosure

If approved, Rule 5606 would require each company to annually disclose information on each director's voluntary self-identified diversity characteristics. Such disclosure must be in a format substantially similar to the board diversity matrix Nasdaq proposed (see linked chart below). As with Rule 5605(f), this information must also be included in either the company's proxy statement, information statement for its annual shareholder meeting or website. Again, any company electing to disclose on its website must also submit such disclosure with a URL link to the information through the Nasdaq Listing Center within 15 days of the company's annual shareholder meeting. Following the first year of disclosure, all companies must disclose the current and immediately prior year diversity statistics using the board diversity matrix.

Chart here

Nasdaq will also introduce a partnership with Equilar, a provider of corporate leadership data, to aid companies with board composition planning challenges. The partnership will enable companies that have not yet met the proposed diversity objectives to access highly qualified, diverse, board-ready candidates to amplify director search efforts.

2. **When do companies need to comply with the proposed Nasdaq board diversity rules?**

Diverse Board Representation

If the SEC approves Rule 5605(f), each company will be required to have, or explain why it does not have, one diverse director no later than two years after the approval date. Each company will also be required to have, or explain why it does not have, two diverse directors no later than four years after the SEC approval date for companies listed on the Nasdaq Global Select or Global Market, or five years after the SEC approval date for companies listed on the Nasdaq Capital Market. A newly listed company must comply by the latter of such applicable periods or one year from the date of listing.

Board Diversity Disclosure

If the SEC approves Rule 5606, each company will be required to comply with the requirement to disclose statistical information regarding diversity within one year after the approval date. A newly listed company must comply within one year of listing.

3. **What are the consequences for failure to comply with the proposed Nasdaq board diversity rules?**

If a company fails to comply with the requirements of Rule 5605(f) and/or Rule 5606, it will have until the latter of its next annual shareholder meeting or 180 days from the event that caused the deficiency to cure the deficiency. Any company that does not regain compliance within the applicable cure period could be subject to delisting.

4. **Which companies are exempt from or subject to exceptions under the proposed Nasdaq board diversity rules?**

Rule 5605(f) and Rule 5606 exempt acquisition companies listed under IM-5101-2, asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies, issuers of non-voting preferred securities, debt securities and derivative securities and issuers of securities listed under the Rule 5700 Series. In addition, foreign issuers and smaller reporting companies are subject to exceptions and can meet the two diverse directors requirement by having two female directors. Foreign issuers also have a modified definition of diversity, which accounts for diverse characteristics in the company's home jurisdiction. Any company that ceases to be a foreign issuer, smaller reporting company or exempt company is permitted one year from the change of status to comply.

5. **What should companies be thinking about when considering board diversity disclosure?**

When considering board diversity disclosure, companies should note the SEC guidance for disclosure provided by the Compliance and Disclosure Interpretation (C&DI) Questions 116.11 and 133.13 released in 2019, which address the disclosure of self-identified diversity characteristics in a company's proxy statement under Items 401 and 407 of Regulation S-K.

Item 401(e) requires a company to describe the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director. If diversity is considered when nominating directors, Item 407(c)(2)(vi) requires a company to disclose whether its nominating committee or the board has a policy with regard to the consideration of diversity in identifying director nominees and describe how such a policy is implemented.

The C&DIs provide that, if a board or nominating committee considers self-identified diversity characteristics during the nomination process (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background), and the individual consents to disclose such characteristics, the SEC expects the company to disclose those characteristics and how they were considered. The SEC also expects the description of diversity policies to include a discussion of how such diversity characteristics are considered by the nominating committee during the nomination process. Companies should carefully consider how to document director consent in connection with any disclosure of self-identified diversity characteristics (i.e., Directors and Officers (D&O) Questionnaires, written consents, minutes, etc.).

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