

Legal Update

SEC Approves Nasdaq Board Diversity Rule

On August 6, 2021, the US Securities and Exchange Commission (SEC) approved Nasdaq's board diversity rule.¹ Nasdaq originally proposed its rule in December 2020 and subsequently amended the proposal to reflect feedback submitted by commenters.

Nasdaq Board Diversity Standards. The new rules require Nasdaq-listed companies to have, or to explain why they do not have, at least two diverse directors, including (1) at least one director who self-identifies as female (regardless of gender designation at birth) and (2) at least one director who self-identifies as either an "Underrepresented Minority," as defined in the Nasdaq rule, or as LGBTQ+. Foreign issuers (including foreign private issuers) and smaller reporting companies may satisfy the board-composition requirement by having two directors who self-identify as female. Companies with five or fewer directors may satisfy the diversity objective by having one diverse director. Nasdaq's board diversity representation provisions are set forth in new clause (f) of Rule 5605 of Nasdaq's corporate governance requirements.

Nasdaq Board Diversity Disclosure Requirements. The new rules also require Nasdaq-listed companies to annually disclose directors' self-identified gender, race and ethnicity (i.e., African American or Black, Alaskan Native or Native American, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, White, or Two or More Races or Ethnicities) and LGBTQ+ status in a standardized board diversity matrix.² A foreign issuer may elect to use an alternative board diversity matrix format, which, among other things, requires disclosing the number of directors who self-identify as underrepresented individuals in the foreign issuer's home country jurisdiction, as well as indicating whether diversity disclosure is prohibited under its home country law. Nasdaq's board diversity disclosure provisions are set forth in new Rule 5606 of Nasdaq's corporate governance requirements.

Nasdaq Board Recruiting Services. As part of its order, the SEC also approved the provision by Nasdaq of a board diversity recruiting service through Nasdaq's partnership with Equilar. The service will be available to certain Nasdaq-listed companies, with one year of complimentary access for two users per company. This service is intended to provide access to a network of board-ready diverse candidates for companies to identify and evaluate.

Transition and Phase-In Periods. The timeframe for compliance with Nasdaq's board diversity rule depends on the company's listing tier and board size:

- Nasdaq Global Select Market and Nasdaq Global Market companies must have, or explain why they do not have, one diverse director by August 7, 2023, and two diverse directors by August 6, 2025.

- Nasdaq Capital Market companies must have, or explain why they do not have, one diverse director by August 7, 2023, and two diverse directors by August 6, 2026.
- Companies with boards of five or less directors, regardless of listing tier, must have, or explain why they do not have, one diverse director by August 7, 2023.

In each of these cases, the deadline would be extended to the date, if later, that the company files its proxy or information statement (or, if the company does not file a proxy, its Form 10-K or 20-F) for the company's annual shareholder meeting in the applicable year.

The Nasdaq rule provides a one-year grace period for a listed company that no longer meets the diversity objectives as a result of a vacancy on the board of directors and provides companies that list on Nasdaq after the phase-in period additional time to add diverse directors.

Cure Period. If a Nasdaq-listed company does not comply with the rule's diversity objectives and does not provide the explanatory disclosure, 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. If a company fails to disclose the required board diversity metrics, Nasdaq would notify the company that it is not in compliance with a listing requirement and that the company has 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 such information in the future. If the company does not comply within the applicable cure period, the Listing Qualifications Department would issue a staff delisting determination letter, and the company could appeal the determination to the hearings panel through the process set forth in Nasdaq rules.

Exemptions. Listed SPACs are not required to have, or disclose that they do not have, any minimum number of diverse directors until their business combination, after which they 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, its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing. There are also exemptions applicable to certain types of issuers, as further specified in Nasdaq's rules, including asset-backed issuers, cooperatives, limited partnerships, management investment companies and issuers of non-voting preferred securities, debt securities and derivative securities that do not have equity securities listed on Nasdaq.

SEC Approval. The SEC's approval of Nasdaq's board diversity proposal was not unanimous. While Chair Gensler and Commissioners Lee and Crenshaw approved the proposal in its entirety, Commissioner Peirce voted against it. Commissioner Peirce released a statement explaining that while she supports the goal of board diversity, she believes the Nasdaq proposal was inconsistent with and outside the scope of the Securities Exchange Act of 1934 as well as contrary to fundamental constitutional principles. Commissioner Roisman supported only the portion of Nasdaq's proposal offering listed companies recruiting services to potentially identify new candidates outside these companies' go-to networks. However, he did not support the portion of the SEC's order that approved Nasdaq's proposed disclosure requirements for listed companies. Commissioner Roisman stated that he does not believe the SEC fulfilled its obligation to find that the proposal, which has delisting implications for companies, meets the legal standards that the SEC is required to apply while evaluating rules proposed by self-regulatory organizations.

Practical Considerations

Disclosures under the Nasdaq board diversity rule are based on voluntary self-identification of characteristics. Therefore, Nasdaq companies should consider adding diversity questions based on the Nasdaq diversity categories to their annual director and officer questionnaires or otherwise developing a mechanism for gathering that information, which should include the director's or nominee's consent to disclosure.

Even companies that are not listed on Nasdaq should pay attention to Nasdaq's new board diversity policy because additional board diversity initiatives may be forthcoming. While the Nasdaq rule is the most recent board diversity development, there are already other drivers of board diversity, such as California's statutory mandates for companies with principal executive offices in the state, voting policies established by proxy advisory firms, voting policies and engagement priorities of large institutional investors and public perception. At least one major underwriter has established minimum board diversity requirements for the clients it assists with initial public offerings. The SEC's spring 2021 regulatory agenda targets the fall of 2021 for proposed rule amendments to enhance company disclosures about the diversity of board members and nominees. And a number of states are considering board diversity legislation. Taken together, all of these actions may prompt additional board diversity requirements for a growing number of companies, with the Nasdaq rule being the latest catalyst.

Although Nasdaq has not styled its rule as a mandate requiring a specified number of diverse directors as a listing condition, allowing companies instead to explain why they do not have the targeted level of board diversity, it is likely that many Nasdaq-listed companies would find such explanatory disclosures unpalatable in the current environment.

The new rule will likely prompt Nasdaq-listed companies to strengthen their recruitment of diverse board candidates. Companies have the flexibility to meet the Nasdaq diversity objectives in the manner they feel is appropriate, which might include increasing board size or encouraging shorter tenure to create more board vacancies. Nasdaq companies that do not yet meet the diversity standards specified by the new rule should consider availing themselves of the free board recruiting services offered by Nasdaq.

Companies subject to the Nasdaq board diversity rule, including foreign issuers, should also consider whether there are any privacy considerations that need to be addressed.

A reporting requirement pursuant to Item 3.01 of Form 8-K is triggered if a company receives a notice from the securities exchange that maintains the principal listing for any class of its common equity that the company does not satisfy a rule or standard for continued listing on the exchange. Accordingly, failure to comply with the Nasdaq diversity rule could give rise to an SEC filing obligation.

The Nasdaq rule allows a company to make the required disclosures either (1) 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 (2) on the company's website. If the company chooses website disclosure, it must publish this disclosure concurrently with such SEC filing and submit the URL link through the Nasdaq Listing Center within one business day after such posting.

In addition to Nasdaq board diversity disclosure requirements, companies should remember that changes to their nominating committee's process for identifying and evaluating nominees for director may require revised disclosure in a Form 10-K or proxy statement in response to Item 407(c)(vi) of Regulation S-K. Additionally, according to SEC staff compliance and disclosure interpretations 116.11 and 133.13, if a board or nominating committee has considered self-identified diversity characteristics such as the race, gender,

ethnicity, religion, nationality, disability, sexual orientation or cultural background of an individual in determining whether to recommend a person for board membership, and the individual has consented to the company's disclosure of those characteristics, the SEC staff expects the company's proxy statement will include, but not necessarily be limited to, identification of those characteristics and how they were considered. Similarly, in such a circumstance, the staff expects the proxy statement's description of company diversity policies to discuss how the company considers the self-identified diversity attributes of nominees, as well as any other qualifications its diversity policy takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics. For more information, see our Legal Update "Disclosure of Board Self-Identified Diversity Characteristics," dated February 11, 2019.³

In working through the details of Nasdaq's board diversity rule, companies may find it useful to consult the series of frequently asked questions that Nasdaq has made available on its Listing Center.⁴

For more information about the topics raised in this Legal Update, please contact the author of this Legal Update, Laura D. Richman, at +1 312 701 7304, any of the following lawyers, or any other member of our Corporate & Securities practice.

Laura D. Richman

+1 312 701 7304

lrichman@mayerbrown.com

Jennifer J. Carlson

+1 650 331 2065

jennifer.carlson@mayerbrown.com

Robert F. Gray, Jr.

+1 713 238 2600

rgray@mayerbrown.com

Phyllis G. Korff

+1 212 506 2777

pkorff@mayerbrown.com

Christina M. Thomas

+1 202 263 3344

cmthomas@mayerbrown.com

Endnotes

¹ See <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf>

² Companies are required to use the matrix format available at <https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Matrix.pdf> or a substantially similar format. Nasdaq provides examples of formats that it accepts as substantially similar as well as examples that it finds unacceptable as substantially different at https://listingcenter.nasdaq.com/assets/Board%20Matrix%20Examples_Website.pdf

³ Available at <https://www.mayerbrown.com/en/perspectives-events/publications/2019/02/disclosure-of-board-selfidentified-diversity-chara>

⁴ https://listingcenter.nasdaq.com/Material_Search.aspx?mcd=LQ&cid=157&sub_cid=&years=2020&criteria=1&materials

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Any tax advice expressed above by Mayer Brown LLP was not intended or written to be used, and cannot be used, by any taxpayer to avoid U.S. federal tax penalties. If such advice was written or used to support the promotion or marketing of the matter addressed above, then each offeree should seek advice from an independent tax advisor.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.

"Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2021 Mayer Brown. All rights reserved.