

INSIGHTS

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INSIDE THE SEC

SEC Approves Nasdaq Diversity Proposal

By Teresa L. Johnson and Sara Adler

On February 26, 2021, Nasdaq filed Amendment No. 1 to its initial proposed rule change regarding board diversity disclosures, in response to more than 200 comment letters received from Nasdaq-listed issuers, institutional investors, asset managers, legislators, advocacy organizations, law firms, individual board members and other citizens.¹ On August 6, 2021, the Securities and Exchange Commission (SEC) issued an order approving Amendment No. 1.² The order also approves Nasdaq's proposal to provide one-year of complimentary access for eligible Nasdaq-listed companies to a board recruiting service to help advance diversity on company boards.

A substantial majority of substantive comment letters received were in favor of the Amendment. However, a number of supporters of the Amendment, including several advocacy organizations, including the National LGBT Chamber of Commerce (NGLCC), US Black Chambers, Inc. (USBC), US Hispanic Chamber of Commerce (USHCC), and US Pan Asian American Chamber of Commerce Education Foundation (USPAACC), suggested that the definition of "Diverse" be expanded to include people with disabilities, consistent with the view that such inclusion would lead to better business performance and shareholder returns, in addition to supporting such underserved communities.

Those that opposed the Amendment, including Republican members of the Senate Banking

Committee, as well as Competitive Enterprise Institute and Heritage Foundation (each think tanks), expressed concerns about government interference with the "free and open market," increased regulatory costs associated with meeting the proposed requirements, potential deterrence to IPOs, and harm to overall economic growth. Due to the volume of the comments received, the SEC extended the comment period twice before making a final decision on approval of the Amendment.

New Rule 5605(f)—Diverse Board Representation

General Requirement

Nasdaq-listed companies, other than Foreign Issuers, Smaller Reporting Companies, companies with five or fewer directors (a Smaller Board), or specified exempted companies, will be required to have, or explain why they do not have, at least two board members who are Diverse, including at least one Diverse director who self-identifies as Female and at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+.

Foreign Issuers

Each Foreign Issuer (other than a company with a Smaller Board) is required to have, or explain why it does not have, at least two members of its board of directors who are Diverse, including at least one Diverse director who self-identifies as Female. The second Diverse director may include an individual who self-identifies as one or more of the following: Female, LGBTQ+, or an Underrepresented Individual.

Smaller Reporting Companies

Each Smaller Reporting Company (other than a company with a Smaller Board) must have, or explain

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why it does not have, at least two members of its board of directors who are Diverse, including at least one Diverse director who self-identifies as Female. The second Diverse director may include an individual who self-identifies as one or more of the following: Female, LGBTQ+, or an Underrepresented Minority.

Companies with Smaller Boards

Companies with Smaller Boards must have, or explain why they do not have, at least one Diverse director. In addition, if a company has five directors before becoming subject to the rule and adds one director to satisfy the diversity objective, its diversity objective would remain at one Diverse director (even though it would have a six member board). However, if the company subsequently expands its board, it would be required to have at least two Diverse directors (or disclose why it does not).

Exempt Companies

The following types of companies are exempt from the new rule: (1) acquisition companies; (2) asset-backed issuers and other passive issuers; (3) cooperatives; (4) limited partnerships; (5) management investment companies; (6) issuers of non-voting preferred securities, debt securities, and derivative securities that do not have equity securities listed on Nasdaq; and (7) issuers of securities listed under the Rule 5700 series.

Operative Dates

The Approval Date is August 6, 2021 (the date that the SEC approved Rule 5605(f)).

- Each listed company on the Nasdaq Global Select Market (NGS), the Nasdaq Global Market (NGM), and Nasdaq Capital Market (NCM), including a company with a Smaller Board, must have, or explain why it does not have, one Diverse director by the later of: (i) August 7, 2023 (First Effective Date); or (ii)

the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's annual shareholders meeting during the calendar year of the First Effective Date.

- Each company listed on the NGS or the NGM with a board of more than five members must have, or explain why it does not have, at least two Diverse directors by the later of: (i) August 6, 2025 (Second NGS/NGM Effective Date); or (ii) the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's annual shareholders meeting during the calendar year of the Second NGS/NGM Effective Date.
- Each company listed on the NCM with a board of more than five members must have, or explain why it does not have, at least two Diverse directors by the later of: (i) August 6, 2026 (Second NCM Effective Date); or (ii) the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's annual shareholders meeting during the calendar year of the Second NCM Effective Date.
- Notwithstanding the foregoing, a newly listed company or a company that ceases to be a Foreign Issuer, Smaller Reporting Company or an exempt company will not be required to comply with the requirements of Rule 5605(f) prior to the end of the applicable phase-in periods described below, and a company listing after the Approval Date, but prior to the end of the periods set forth in this "Operative Dates" section, must fully satisfy the requirements of 5605(f) by the later of the periods set forth in this section or the two-year phase-in periods described below.

Grace Period for Vacancies

Listed companies that no longer meet the diversity objectives as a result of a board vacancy will have until the later of: (i) one year from the date of vacancy, or (ii) the date the company files its proxy statement or information statement, or, if it does not file a proxy, in its Form 10-K or 20-F in the calendar year following the date of vacancy, to meet, or explain why it does not meet, the applicable diversity objectives. In lieu of otherwise required disclosure, a company may publicly disclose that it is relying on this grace period.

Disclosure Alignment with Annual Meetings

For companies required to explain why they do not meet applicable Board diversity objectives, such disclosure must: (1) specify the applicable subparagraph and diversity objectives; and (2) explain the reasons why it does not have two Diverse directors (or one Diverse director for a company with a Smaller Board).

Such disclosure must be provided in advance of the company's next annual meeting of shareholders: (1) in any proxy statement or any information statement (or, if it does not file a proxy, in its Form 10-K or 20-F); or (2) on the company's website. If the company provides such disclosure on its website, then it must add the disclosure to the website concurrently with the filing made pursuant to (1) and submit a URL link to the disclosure through the Nasdaq Listing Center within one business day after such posting.

Phase-in Periods for Newly-Listed Companies

- Any company newly listing on the NGS or NGM that was not previously subject to a substantially similar requirement of another national securities exchange will be permitted to satisfy the requirement to have, or explain why it does not have:

- (1) at least one Diverse director by the later of:
 - (a) one year from the date of listing; or
 - (b) the date the company files its proxy statement or its information statement (or, if the company does not file a proxy, in its Form 10-K or 20-F) for the company's first annual meeting of shareholders subsequent to the company's listing; and
- (2) at least two Diverse directors by the later of:
 - (a) two years from the date of listing; or
 - (b) the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing.

- Any company newly listing on the NCM that was not previously subject to a substantially similar requirement of another national securities exchange will be permitted to satisfy the requirement to have, or explain why it does not have at least two Diverse directors by the later of: (a) two years from the date of listing; or (b) the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing.
- Notwithstanding the foregoing, any company newly listing on the NGS, NGM or NCM that has a Smaller Board and was not previously subject to a substantially similar requirement of another national securities exchange will be permitted to satisfy the requirement to have, or explain why it does not have at least one Diverse director by the later of: (a) two years from the date of listing; or (b) the date the company files its proxy statement or its information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing.

Phase-in Periods for Companies Ceasing to be a Foreign Issuer, Smaller Reporting Company or Exempt Company

Any such company will be permitted to satisfy the requirements of Rule 5605(f) by the later of: (i) one year from the date that the company no longer qualifies as a Foreign Issuer, Smaller Reporting Company or Exempt Company, or (ii) the date the company files its proxy statement or information statement (or, if it does not file a proxy, in its Form 10-K or 20-F) for the company's first annual meeting of shareholders subsequent to such event.

New Rule 5606—Board Diversity Disclosure

Board Diversity Matrix

Each Nasdaq-listed company (other than exempt companies as described above) will be required to annually disclose (to the extent permitted by applicable law) board-level diversity data based on each director's voluntary self-identified characteristics in a substantially similar format to the "Board Diversity Matrix" set forth below. Supplemental data may be included, and the information must be disclosed in a searchable format.

The required disclosure must be provided in the same manner as, and concurrently with, the disclosure required by Rule 5605(f). A company that qualifies as a Foreign Issuer may elect to use the alternative Board Diversity Matrix format set forth below. Following the first year of disclosure,

companies must disclose the current year and immediately prior year diversity statistics using the Board Diversity Matrix.

Board Diversity Matrix (As of [DATE])

Total Number of Directors				
	Female	Male	Non-Binary	Did Not Disclose Gender
Part 1: Gender Identity				
Directors	#	#	#	#
Part II: Demographic Background				
African American or Black	#	#	#	#
Alaskan Native or Native American	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+			#	
Did Not Disclose Demographic Background			#	

Board Diversity Matrix (As of [DATE])

To be completed by Foreign Issuers (with principal executive offices outside of the US) and Foreign Private Issuers

Country of Principal Executive Offices	[Insert Country Name]			
Foreign Private Issuer	Yes/No			
Disclosure Prohibited Under Home Country Law	Yes/No			
Total Number of Directors	#			
	Female	Male	Non-Binary	Did Not Disclose Gender
Part I: Gender Identity				
Directors	#	#	#	#
Part II: Demographic Background				
Underrepresented Individual in Home Country Jurisdiction			#	
LGBTQ+			#	
Did Not Disclose Demographic Background			#	

Operative Dates

Companies will be required to provide statistical information regarding their board's diversity by the later of: (1) August 8, 2022 (Matrix Effective Date); or (2) the date the company files its proxy statement or its information statement for its annual meeting of shareholders (or, if it does not file a proxy or information statement, the date it files its Form 10-K or 20-F) during the calendar year of the Matrix Effective Date. A company newly listing on Nasdaq

that was not previously subject to a substantially similar requirement of another national securities exchange may satisfy this requirement within one year of listing.

Notes

1. https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081_Amendment_1.pdf.
2. <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf>.