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ALERT

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SEC Approves NASDAQ Board Diversity Rules

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On August 6, 2021, the U.S. Securities and Exchange Commission approved Nasdaq's proposed Board Diversity Rules (the Diversity Rules), which establish a framework designed to encourage a minimum board diversity objective for companies, and provide stakeholders with consistent disclosures concerning a company's current board composition.

What You Need to Know:

The Diversity Rules include:

- A recommendation for companies with more than five directors to set a minimum board diversity objective;
- A requirement for Nasdaq-listed companies to provide on an annual basis statistical information about certain characteristics of their board of directors, using a standardized board diversity matrix;
- A gradual compliance framework, whereby the currently-listed companies must have at least one diverse director by an earlier date and full compliance at a later date.

More specifically, Nasdaq's Diversity Rules recommend companies with more than five directors set an objective to include at least one woman on their board of directors, along with one person who is an underrepresented minority or self-identifies as LGBTQ+[1], or explain in writing why they do not. The Diversity Rules provide for a transition period for companies to comply with the new rules.

Further, the Diversity Rules require Nasdaq-listed companies to provide on an annual basis statistical information about self-identified gender, race and LGBTQ+ affiliation characteristics of their board of directors, using a standardized board diversity matrix (the Board Diversity Matrix). Nasdaq also provides a transition period for the Board Diversity Matrix requirement.

Additionally, Nasdaq has announced that it will introduce a partnership with Equilar[2] to help Nasdaq-listed companies with board composition planning, including access to a larger community of highly qualified, diverse, and board-ready candidates through Equilar's Board Edge platform.

Practical Takeaways

Companies should consider the following key Diversity Rules takeaways:

- Ultimately, these rules only serve to establish a floor, and investors and other stakeholders may still require additional standards for board diversity.
- Companies that are not currently soliciting self-identification of diversity status from directors and director nominees, which is typically accomplished through D&O questionnaires, will want to consider how they want to solicit this information.
- Private sector organizations have already expressed their intent to challenge the Diversity Rules through litigation, and such lawsuits may result in years of delay and ultimately may significantly alter

the disclosure requirements originally adopted by the SEC.

- Notwithstanding any anticipated litigation, companies should realize that board diversity is clearly a serious consideration for public company boards.

Board Diversity Rules

The Diversity Rules require companies listed on Nasdaq to (i) publicly disclose board-level diversity statistics using a standardized template, and (ii) have or explain why they do not have at least two diverse directors. If a company chooses to explain why they do not have at least two diverse directors, Nasdaq will verify that the company has provided an explanation, but will not assess the merits of the explanation. For most U.S. companies, the target would be to have at least one woman director, as well as a director who self-identifies as a racial minority or as LGBTQ+. The Diversity Rules also provide additional flexibility for Smaller Reporting Companies and Foreign Private Issuers, which can meet the diversity objective by including two female directors. In addition, all companies with five or fewer directors can meet the diversity objective by including one diverse director. According to a Nasdaq study last year, more than 75 percent of its listed companies would not have met these targets.[3]

The Diversity Rules provide for gradual compliance for currently-listed companies, whereby they must have at least one diverse director by an earlier date and full compliance at a later date. The period for achieving compliance with the number of diverse directors depends on the company's tier:

- Nasdaq Global Select Market or Nasdaq Global Market companies are required to 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 are required to 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 that have five or fewer directors, regardless of listing tier, are required to have, or explain why they do not have, one diverse director by August 7, 2023.

Board Diversity Matrix

The disclosures required by the Diversity Rules must be made on an annual basis, using the Board Diversity Matrix, or a format substantially similar. Covered companies will first need to provide their Board Diversity Matrices by the later of:

- August 8, 2022; or
- the date the company files its proxy statement or information statement for its annual meeting (or, if the company does not file a proxy or information statement, in its Form 10-K or 20-F) in calendar year 2022.

Companies that do not wish to include the Board Diversity Matrix in their proxy or information statement (or if the company does not file a proxy, its Form 10-K or 20-F), may provide it on the company's website instead. If the 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, 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.

After the first year of applicability, the Diversity Rules require the inclusion of the company's Board Diversity Matrix disclosure for the current year and the immediately preceding year. Newly-listed companies must comply with the Diversity Rules within one year of listing.

Special Case - SPACs

SPACs listed under IM-5101-2 are not subject to the Diversity Rules before their business combination. However, 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, in its Form 10-K or 20-F) for the company's second annual meeting of shareholders subsequent to the company's listing.

Conclusion

The Diversity Rules establish a framework designed to encourage a minimum board diversity objective for companies. The rules set up a comply or explain regime that requires disclosures but does not mandate actual hiring of diverse directors. Most companies will need to (i) have two diverse board members, or explain why not, beginning in 2025 and (ii) disclose the self-identified gender, race and LGBTQ+ affiliation characteristics of their board of directors, using a standardized board diversity matrix. This will need to be done on an annual basis thereafter. In light of the Diversity Rules, a Nasdaq-listed company should evaluate the composition of its board and its director succession planning, and consider any necessary changes to the information they request from directors in order to comply with the new director diversity matrix requirements in 2022.

1. An "underrepresented minority" is defined as "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." "LGBTQ+" is defined as "an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community."
2. Equilar, Inc. is the leading provider of corporate leadership data solutions.
3. https://www.bbc.com/news/business-58123730

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