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Nasdaq Proposes Board Diversity Mandate For Listed Companies

On December 1, 2020, Nasdaq submitted to the Securities and Exchange Commission (SEC) proposed listing rules that would mandate a Nasdaq-listed company disclose whether it meets certain Board diversity requirements. The proposed rules are subject to the review and approval of the SEC.

On December 1, 2020, Nasdaq became the first U.S. national securities exchange to submit a proposal to the SEC seeking approval of new listing rules focused on board diversity. Nasdaq's principal rationale for the proposed listing requirement is twofold: (i) the belief that "diversity at the top sets the expectation for inclusion throughout" an organization; and (ii) the positive association between diverse boards and improved financial performance and corporate governance, as demonstrated by numerous studies.

Nasdaq's proposed rules would require a public company to have two diverse directors within a specified timeframe (as described below), or publicly disclose and explain the noncompliance with the board diversity requirement. Such a "comply-or-explain" regulatory regime is unusual for U.S. companies, but is commonplace in other markets.

Key Elements of the Board Diversity Listing Rules

Under Nasdaq's proposed board diversity listing rules, each company listed on Nasdaq's U.S. exchange would be required to:

- Publicly disclose diversity statistics in a prescribed uniform format regarding their boards of directors.
- Include at least two diverse directors by a specified date based on their listing tier (applicable to most but not all listed companies). A listed company would meet the diversity requirement if its board includes **both** (i) a director who self-identifies as female and (ii) a director who self-identifies as either an underrepresented minority or LGBTQ+.
- Publicly disclose any noncompliance with the board diversity requirement and an explanation for such noncompliance in the annual proxy statement or on the company's website.

The proposed listing rules would allow smaller reporting companies and foreign companies to meet somewhat less rigorous board diversity requirements.

- Smaller reporting companies could satisfy the board diversity requirement by having two female board members.
- Foreign companies could satisfy the board diversity requirement by having at least two female directors, or one female director and a director who is an underrepresented individual in the company's home

country jurisdiction. Foreign companies include (i) Foreign Private Issuers and (ii) other foreign issuers incorporated and headquartered outside the U.S.

For purposes of the proposed listing requirement, an "underrepresented minority" is an individual who self-identifies in one or more of the following groups: Black or African American, Hispanic or Latin, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities. For purposes of the proposed listing requirement, an "LGBTQ+" person means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or as a member of the queer community.

Timeframe for Compliance

The proposed listing rules set forth the following timeframe for compliance:

- Listed companies would be required to disclose board-level diversity statistics through Nasdaq's proposed disclosure framework within one year of the SEC's approval of the listing rule.
- Listed companies would be required to meet the minimum board diversity requirements within a specified timeframe based on their listing tier, as set forth in the following chart:

	# of Years Following SEC Approval of Listing Rules to Achieve Specified Minimum Number of Diverse Directors	
Nasdaq Listing Tier	**At Least 1 Diverse Director**	**At Least 2 Diverse Directors**
Nasdaq Global Select Market	2 years	4 years
Nasdaq Global Market	2 years	4 years
Nasdaq Capital Market	2 years	5 years

- Companies that are not in a position to meet the board diversity objectives within the required timeframes would not be subject to delisting if they provide a public explanation of their reasons for not meeting the objectives.

Comment Period and SEC Review Period

The public (including investors, companies and their representatives) may provide comments on the proposed listing rules to the SEC during a 21-day period from the date in which the proposed rules are published in the Federal Register (*note:* the SEC may provide for a longer comment period).

After publication in the Federal Register, the SEC has 30 to 240 calendar days to review and approve Nasdaq's proposed listing rules. If the SEC approved the Nasdaq proposed rule within 60 calendar days of such publication, then Nasdaq-listed companies would likely have to disclose board-level diversity statistics in their annual proxy statement filed during the 2022 proxy season and have one diverse director by 2023.

Meridian Comment. Nasdaq's proposed diversity mandate reflects the increasing focus on public companies to address representation of women and minorities on their boards of directors. Nasdaq is not alone in seeking to regulate or prescribe standards regarding board composition. Recently, California enacted legislation that requires public companies headquartered in California to meet board diversity mandates over a multi-year period (see Meridian Client Update dated October 22, 2020). In addition, the two major proxy advisors have recently implemented policies on board diversity.

- Beginning with the 2021 proxy season, (i) ISS and Glass Lewis will generally recommend AGAINST the nominating committee chair if a company's board does not include any female directors and (ii) Glass Lewis will raise as a concern any board that does not have at least two female directors.
- During the 2022 proxy season, (i) ISS will generally recommend AGAINST the nominating committee chair if a board does not have any apparent racial or ethnical minorities members, absent exceptional circumstances and (ii) Glass Lewis will generally recommend AGAINST the nominating committee chair if a board with at least seven directors does not include two female directors (Glass Lewis's current policy requiring a minimum of one female director will remain in place for boards composed of six or fewer directors).

The proposed listing rules, if approved by the SEC, will almost certainly draw litigation on the grounds that the rules violate federal anti-discrimination laws and/or are unconstitutional.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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