

# SEC Approves Nasdaq's Diversity Proposal: What It Means for Boards

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Despite the growing business case for diversity and pressure from institutional investors and others, companies are still [struggling to make meaningful advancements](#) on diversity. On August 6, 2021, the [SEC approved a Nasdaq proposal](#) that would establish a disclosure-based framework to advance board diversity and enhance transparency of board diversity statistics.

In what Nasdaq Chief Executive Adena Friedman called “a comply-or-explain rule,” the SEC’s New Rule 5605(f) sets out a recommended objective that companies listed on Nasdaq’s U.S. exchange have at least two diverse directors, including:

- One self-identified woman director
- One director who self-identifies as an underrepresented minority (defined below) or as LGBTQ+
- If a company does not satisfy both of these criteria, the company must:
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  - Specify the particular aspect(s) of board diversity it fails to satisfy
  - Provide the reasons why it does not have two diverse directors

The approval notes that according to the Nasdaq proposal, a company that does not want to meet diversity objectives nor explain why “may transfer its listing to a competing listing exchange.”

Separately, the SEC also approved the implementation of a board recruiting service portal that will allow certain Nasdaq-listed companies free access a network of diverse candidates.

***This client advisory will outline the components of the Nasdaq Proposal and provide a Checklist of Board Requirements.***

## Board Representation: The 2021 State of Diversity

Women and minorities have been underrepresented in the top ranks of companies, leading to the recent reckoning on racial and gender diversity in Corporate America.

While some companies have adopted specific diversity requirements (e.g., [Goldman Sachs’s requirement](#) to have at least two diverse directors, including one woman, on boards of companies it helps take public after July 1, 2021), according to [data from Equilar](#), only 18.4% of Russell 1000

board members have a background from an under-represented minority group. (*See, Equilar, BoardEdge, Gender Diversity Index, as of 2Q 2021.*)

Source: *Equilar, BoardEdge, Gender Diversity Index, as of 2Q 2021.*

Investor efforts to scrutinize diversity on boards have also been stymied by a lack of disclosure, with many companies not detailing the gender and race or ethnicity of directors.

## Components of the Nasdaq Board Diversity Proposal

A Nasdaq-listed issuer, subject to some exceptions discussed below, will now be required to include two "Diverse" members on its board or explain why it does not meet this standard.

Diversity is defined as an individual who self-identifies in one or more of the following categories: 1) Female, 2) Underrepresented Minority or 3) LGBTQ+.

- Rule 5605(f)(1) defines "Female" as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth."
- Rule 5605(f)(1) defines "Underrepresented Minority" 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."
- Rule 5605(f)(1) defines "LGBTQ+" as "an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or as a member of the queer community."

## Disclosure Requirements

The phase-in period for public disclosure of board-level diversity statistics will begin within one year of the SEC's approval of the Rule. The SEC will require all companies to have one diverse director, or explain why not, within two years of the SEC's approval of the Rule.

By requiring expanded disclosures regarding board composition, the hope is that the new Rule change should lead to comparable diversity metrics across issuers.

Pursuant to proposed Rule 5606(a), each Nasdaq-listed company will be required to disclose board-level diversity data annually using a format referred to as the "Board Diversity Matrix." The matrix must include the total number of directors, the breakdown of gender identity and LGBTQ+ status of the board, and the race and ethnicity of the board, as well as information on any directors who did not disclose demographic information. A company that qualifies as a foreign issuer can elect to provide information in an alternative Board Diversity Matrix format.

## Compliance Periods

Listed companies (other than newly listing companies) now must comply with the Board Diversity Disclosure Rule by the later of:

- (1) August 6, 2022, or
- (2) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, the date it files its Annual Report) for the company's annual shareholders meeting held

during the 2022 calendar year.

Listed companies (other than newly listing companies) now must comply with the Board Diversity Objective Rule as follows:

- At Least One Diverse Director by 2023: A company listed on the Nasdaq Global Select Market, Nasdaq Global Market or Nasdaq Capital Market must have, or explain why it does not have, one Diverse director by the later of (1) August 6, 2023, or (2) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, the date it files its Annual Report) for the company's annual shareholders meeting held during the 2023 calendar year.

## At Least Two Diverse Directors

- A company listed on the Nasdaq Global Select Market or Nasdaq Global Market with more than five directors must have, or explain why it does not have, at least two Diverse directors by the later of:

(1) August 6, 2025, or

(2) the date the Company files its Proxy Materials (or, if the company does not file Proxy Materials, the date it files its Annual Report) for the company's annual shareholders meeting held during the 2025 calendar year.

- A company listed on the Nasdaq Capital Market with more than five directors must have, or explain why it does not have, at least two Diverse directors by the later of:

(1) August 6, 2026, or

(2) the date the Company files its Proxy Materials (or, if the company does not file Proxy Materials, the date it files its Annual Report) for the company's annual shareholders meeting held during the 2026 calendar year.

- A company newly listing on the Nasdaq Global Select Market, Nasdaq Global Market or Nasdaq Capital Market **with a Smaller Board** must have, or explain why it does not have, at least one Diverse director by the later of:

(1) two years from the listing date, or

(2) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, its Annual Report) for the company's second annual shareholders meeting after its listing. Importantly, foreign issuers and smaller reporting companies would be able to satisfy the board diversity objective by having two women directors.

## Checklist of Board Requirements under Rule 5605(f)

- **Total Number of Diverse Directors: Two**
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  - Must Have At Least One Women and
  - One Member of an Under-Represented Community

- **Foreign Issuers Minimum Number of Diverse Directors: Two**

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- Must Have At Least One Women Director
- Not required to Have One Member of an Under-Represented Community

- **Smaller Reporting Companies Minimum Number of Diverse Directors: Two**

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- Must Have At Least One Women Director
- Not required to Have One Member of an Under-Represented Community

- **Boards with Five or Fewer Directors Minimum Number of Diverse Directors: One**

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- Must Have At Least One Diverse Director
- Companies with boards of five or fewer members are only required to have one diverse director by the later of (i) two years from the date of listing or (ii) the date of filing its proxy or information statement for its second annual meeting following listing, to fully comply with Rule 5605(f).

- **SPACs:** SPACs are not required to have any minimum number of diverse directors until their business combination.

**Importantly, we provide the [Matrix form](#) for disclosure of board-level diversity data.**

If a company elects the disclosure option over satisfying the Diversity Proposal's requirements, then such disclosure must be provided in advance of the company's next annual meeting of shareholders and should be included in a proxy or informational statement (or in its Form 10-K or Form 20-F, if it does not file a proxy statement) or on its website. The company must submit a link to the information through the Nasdaq Listing Center no later than 15 calendar days following the annual meeting. After the first year of publishing the statistics, companies would disclose the board diversity matrix for both the current and the immediately preceding year on an annual basis.

## Board Recruiting Service Proposal

In a separate proposal, Nasdaq would offer "eligible companies" free access for one year to a board recruiting services to facilitate and expand access to a network of diverse candidates. While the service is optional, it could assist companies in achieving compliance with the Diversity Proposal.

An “eligible company” is a Nasdaq listed company that represents to Nasdaq that it does not have at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority or LGBTQ+ individual, though different requirements apply to foreign issuers and smaller reporting companies. A company that is not an “eligible company” may still receive complementary access to the network for 90 days.

## Conclusion

We anticipate that approval by the SEC of Nasdaq’s Diversity Proposal will likely lead to greater pressure, consistent with existing market dynamics, on public companies to increase board diversity.

The SEC appears poised to take future action to support board diversity initiatives. (See, Commissioners Lee and Crenshaw support for additional action to enhance both diversity and transparency and expressed the hope that the Final Rules are “a starting point for initiatives related to diversity, not the finish line.” Commissioner Allison Herren Lee and Commissioner Caroline A. Crenshaw, “Statement on Nasdaq’s Diversity Proposal – A Positive First Step for Investors” (Aug. 6, 2021), available [here](#).)

Kelley Drye lawyers would be pleased to answer questions regarding the new SEC rules 5605 and 5606 as well as help you evaluate any effects that the SEC's approval of Nasdaq's rules may have on an ongoing basis for your company.