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SEC approves Nasdaq board diversity rule

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The SEC has approved a Nasdaq rule requiring listed companies to: (i) have at least two diverse board members — or explain why they don't, and (ii) disclose a board diversity matrix. The rule will give investors, proxy advisers and other stakeholders more detailed and consistent data about Nasdaq-listed companies' board diversity, and a greater understanding of why some boards are not diverse. It will also pressure the New York Stock Exchange and other exchanges to adopt a similar rule. To help companies comply, Nasdaq will provide free access to a board recruiting service. The diversity requirement will be phased in over several years, and companies have until the later of Aug. 8, 2022, or the date they file their 2022 proxy or information statement, to disclose their matrix.

At least two diverse members

Nasdaq-listed companies must have (or explain why they don't have) at least two diverse board members, including one director who self-identifies as female and one who self-identifies as an underrepresented minority or LGBTQ+, with limited exceptions for smaller reporting companies, companies with small boards and foreign issuers, as described below.

An underrepresented minority is someone who self-identifies as 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+ includes someone who self-identifies as lesbian, gay, bisexual, transgender, or as a member of the queer community.

Companies have until Aug. 7, 2023 to have their first diverse director, and until 2025 or 2026 (depending on the company's listing tier) to have their second. Companies that don't meet the diversity objective (or fail to explain why) have 45 calendar days to submit a compliance plan and up to 180 days to regain compliance or face delisting.

Nasdaq is careful to say the rule isn't a mandate and if a company chooses to explain rather than comply, Nasdaq won't assess the merits of the explanation. But the rule is likely to pressure companies to recruit more diverse directors to avoid having to explain their lack of diversity.

Diversity matrix disclosure

Companies must annually disclose board-level diversity data in a "Board Diversity Matrix" that includes the total number of directors and number of directors who self-identify as:

- Female, male, or non-binary
- 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
- LGBTQ+

Companies must include the diversity matrix on their website or in their proxy or information statement by the later of Aug. 8, 2022, or the date the company files its proxy or information statement for its annual shareholder meeting

during 2022. Presenting this information in a consistent format should make it easier for investors and proxy advisers to assess diversity.

Smaller reporting companies, companies with five or fewer directors and foreign issuers

Smaller reporting companies and foreign issuers can choose to meet the diversity objective with two female directors (vs. one female director and one director who is an underrepresented minority or LGBTQ+). Companies with five or fewer directors can meet the diversity objective by having one diverse director. For foreign issuers, identification of underrepresented minorities will be based on standards in the country of their principal executive offices.

Nasdaq resources

A Nasdaq summary — What Nasdaq-listed companies should know — includes key takeaways and links to a recommended matrix format, as well as examples of acceptable and unacceptable alternatives. Nasdaq will host live webinars beginning Aug. 17 and offer a year of access to a board recruiting service to companies that don't have: (i) at least one director who self-identifies as female and (ii) at least one director who self-identifies as an underrepresented minority or LGBTQ+ or both. Nasdaq has also posted a set of FAQs.

Related developments

Proxy advisers, investors and state legislatures have also weighed in on board diversity:

- Proxy advisers Institutional Shareholder Services and Glass Lewis currently recommend voting against nominating committee chairs if boards don't have a minimum number of women, and beginning in 2022, if they don't have a minimum number of racially or ethnically diverse members.
- States including California, Colorado, Illinois, Massachusetts, New York, Pennsylvania and Washington have finalized board diversity requirements.
- Shareholder proposals seeking reports or a policy on board diversity passed at three companies this proxy season.
- BlackRock will vote against directors who fail to act to improve board diversity.
- State Street Global Advisors will vote against the nominating and governance committee chairs at S&P 500 companies that don't disclose the racial and ethnic composition of their board.
- Investors have sought the adoption of the "Rooney rule" for director and CEO searches, which requires at least one woman and one underrepresented minority be considered in the slate of candidates for every open position.
- Shareholders have sued for failure to diversify the board and for misleading proxy disclosures on board diversity.

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