

December 14, 2020

Nasdaq Proposes Board Diversity Requirements

Proposed Rule Would Require Companies to Maintain at Least Two Diverse Directors or Explain Why They Do Not Meet That Standard

SUMMARY

On December 1, Nasdaq submitted new proposed listing rules to the Securities and Exchange Commission (the “SEC”) regarding board diversity. The first proposed rule would require listed companies to (i) have at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority (based on EEO-1 reporting categories, including 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) or as LGBTQ+¹ or (ii) explain why the company does not satisfy that requirement. The second proposed rule would require public disclosure of the number of directors who voluntarily self-identify as male, female or non-binary and who voluntarily self-identify as an underrepresented minority or LGBTQ+.

If approved by the SEC, Nasdaq-listed companies would have (i) two years to have (or explain why they do not have) at least one diverse director, (ii) four or five years (depending on their Nasdaq listing tier) to have (or explain why they do not have) at least two diverse directors and (iii) one year to meet the public disclosure requirement, in each case, from the date of SEC approval. The full text of the proposed listing rules is available [here](#).

CURRENT FOCUS ON BOARD DIVERSITY

Nasdaq’s proposed rules continue a trend of focus on board diversity. Board diversity at public companies has increasingly attracted the attention of a number of key constituencies, including proxy advisors, investors, legislators, and shareholder proponents. Recent developments include:

New York Washington, D.C. Los Angeles Palo Alto London Paris Frankfurt Brussels
Tokyo Hong Kong Beijing Melbourne Sydney

SULLIVAN & CROMWELL LLP

- **ISS Policy Updates:** Beginning in February 2021, ISS will generally recommend voting against or withholding votes from the chair of the nominating committee (and other directors on a case-by-case basis) at Russell 3000 and S&P 1500 companies where there are no women on the board. Beginning in February 2022, ISS's policy on racial/ethnic diversity will mirror its board gender diversity policy.²
- **Glass Lewis Policy Updates:** Beginning in 2021, Glass Lewis will note boards with fewer than two female directors as a concern and, for shareholder meetings held after January 1, 2022, will generally recommend voting against the chair of the nominating committee of boards with fewer than two female directors (Glass Lewis already recommends against the nominating committee chair if the board has no female directors). Additionally, for S&P 500 companies, Glass Lewis's 2021 reports will reflect how companies' proxy statements present the current percentage of racially/ethnically diverse directors, whether the board's definition of "diverse" includes gender, race and/or ethnicity and whether the board has adopted a "Rooney Rule" policy requiring that women and minorities be included in the initial pool of candidates when selecting new director nominees.³
- **BlackRock, Vanguard and State Street:** BlackRock reported voting against directors in the Americas region 1,367 times in 2020 for insufficient progress on board diversity. BlackRock's stewardship report also notes BlackRock is increasingly looking for companies to consider the ethnic diversity of their boards, and to meet its expectations that boards have, in addition to other aspects of diversity, at least two women directors.⁴ In a December 2020 update, BlackRock reiterated both its intention to continue these voting practices in 2021 and its request that companies disclose data on the race and ethnicity of their board members to enable investors to make informed diversity assessments.⁵ In its annual stewardship report, Vanguard requests that companies: (i) publish their policies on board diversity; (ii) disclose, at least on an aggregate basis, the diversity of their boards, including gender, age, race, ethnicity, and national origin; (iii) purposely consider diverse director candidates; and (iv) make progress by adding diverse directors to their boards in the coming years.⁶ Similarly, in an August update, State Street asked companies to disclose the diversity characteristics of their boards, including racial and ethnic makeup, and to describe how the board reflects the diversity of the company's workforce, community, customers, and other key stakeholders.⁷
- **ISS Letter and Benchmark Policy Survey:** In July, ISS wrote to U.S. companies requesting disclosure of the self-identified race/ethnicity of directors and named officers and noting they intended to engage with stakeholders on whether to expand the use of race and ethnicity director data in their ESG ratings methodologies, voting research and policies, and other offerings.⁸ Months later, ISS reported that 73% of investor respondents to ISS's annual policy survey indicated issuers should disclose the demographics of their board members, including directors' self-identified race and/or ethnicity, to the fullest extent permitted by law. A majority of investor respondents indicated they would consider (i) support for shareholder proposals that urge the board to adopt a "Rooney Rule" for every open senior position and (ii) a vote against members of the nominating committee (or other directors) where board racial and ethnic diversity is lacking.⁹
- **SEC C&DIs:** In February 2019, the SEC released Compliance and Disclosure Interpretations clarifying that U.S. public companies, in preparing Item 401, should disclose how director candidates' race, gender, and other self-identified characteristics are considered by a company's nominating committee (to the extent they were considered).¹⁰ Similarly, the SEC would expect any description of diversity policies followed by the company under Item 407 "to include a discussion of how the company considers the self-identified diversity attributes of nominees" as well as any other qualifications taken into account by its diversity policy.
- **Recent Proposed Federal Legislation:** The "Improving Corporate Governance Through Diversity Act," introduced by Representative Gregory Meeks (D-N.Y.) and other co-sponsors, would require that U.S. public companies disclose information regarding their boards', director nominees', and executive officers' gender, racial, and ethnic makeup based on self-identification, as well as policies or procedures to promote the gender, racial, and ethnic diversity of the board and executive team. The House passed the bill in November 2019, and it was referred to the Committee on Banking,

SULLIVAN & CROMWELL LLP

Housing, and Urban Affairs in the U.S. Senate, but no further action has been taken on the bill in the Senate.

- **Recent State Legislation:** In the past two years, California, Washington, Illinois, and Maryland have each adopted legislation variously requiring minimum levels of board diversity or disclosure of director diversity and/or the processes companies use to identify diverse candidates for board roles.
- **New York City Comptroller:** In October 2019, the Comptroller launched his “Boardroom Accountability Project 3.0” initiative by sending letters to 56 companies requesting that they adopt “Rooney Rule” policies for open board and CEO positions. The Comptroller subsequently submitted shareholder proposals to 17 of those 56 companies for shareholder meetings in 2020, and reached negotiated settlements with 14 companies that agreed to adopt and disclose a compliant search policy.¹¹

Nasdaq’s proposed rule application noted that the U.S. is a relative global laggard in achieving higher levels of both gender and racial/ethnic board diversity. It also noted that reporting of board diversity data was inconsistent and not sufficiently widespread. Smaller companies often have relatively low levels of board diversity compared to larger companies. According to a Nasdaq review, over 75% of listed companies would not currently meet the proposed minimum diversity standards and, in particular, the proposed standard of having at least one underrepresented minority director.

COMPLY OR EXPLAIN REQUIREMENT

The comply or explain requirement of the proposed rule would require companies to have at least two diverse board members, including one self-identifying female and one self-identifying underrepresented minority or LGBTQ+ director. The proposed rule contains a phase-in period, with all companies required to have at least one diverse director (or explain why they do not have such a director) within two years of approval of the rule, and Nasdaq Global Select or Global Market listed companies required to have the two diverse directors specified above (or explain why they do not have such directors) within four years. Companies listed on the Nasdaq Capital Market would have five years to meet the requirement of two diverse directors. Newly listed companies on any of Nasdaq’s markets that were not previously subject to a similar requirement of a national securities exchange would have one year from the date of initial listing to comply with the proposed requirement.

Any required disclosure or explanations would need to be included in the annual meeting proxy statement or on a company’s website; companies that fail to comply or explain will be notified and provided an opportunity to regain compliance by the later of 180 days from the time of notice and their next annual meeting. Companies failing to meet the requirements after that time would be subject to delisting.

PUBLIC DISCLOSURE REQUIREMENT

The proposed rule would also require companies to disclose, in matrix format, the number of directors who self-identify as male, female or non-binary, underrepresented minorities (and, if so, in which category), and LGBTQ+. To the extent directors choose not to self-identify, companies would be required to include those

SULLIVAN & CROMWELL LLP

directors in an “undisclosed” category. The proposed rule contains forms of disclosure matrices, which are attached as Annex A to this memorandum.

Companies would be required to provide this disclosure either in their annual meeting proxy statements or on their website. Companies who fail to comply would be notified and provided 180 days to regain compliance before being subject to delisting.

EXCEPTIONS TO THE REQUIREMENTS

*Foreign Issuers*¹²

Certain foreign issuers may not be permitted to request or report self-identification of their directors by law, particularly as it relates to racial, ethnic, or LGBTQ+ identification. Additionally, certain of the underrepresented minority groups that the proposed rule targets may be inapplicable to companies in certain foreign jurisdictions. Recognizing these limitations, the proposed rule permits compliance by foreign issuers by either (i) having at least two female directors or (ii) having one female director and one director who either self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious, or linguistic identity in a foreign issuer’s home country jurisdiction, or as LGBTQ+.

Smaller Reporting Companies

Smaller reporting companies (as defined under Rule 12b-2 under the Exchange Act) would be able to satisfy the diversity requirement by having at least two female directors, instead of at least one underrepresented minority or LGBTQ+ director.

Companies will have one year from the time they cease to be a smaller reporting company to meet the general requirement of having one female and either one underrepresented minority or LGBTQ+ director.

Exempt Companies

Certain companies, notably special purpose acquisition companies (known as SPACs), would be exempt from the proposed rule until one year after completing their initial business combination. Asset-backed issuers and other passive issuers, issuers of non-voting preferred securities, debt securities and derivative securities, and issuers of securities listed under the Rule 5700 Series also would be exempt. Nasdaq reasons that these companies are either (i) not operating companies or companies in which shareholders have an expectation of having a say on board composition or (ii) are companies that have no board at all or only list securities without shareholders having the right to elect directors and so are appropriately exempted from the proposed rules.

* * *

Copyright © Sullivan & Cromwell LLP 2020

ENDNOTES

- 1 For purposes of the disclosure, LGBTQ+ refers to an individual who identifies as lesbian, gay, bisexual, transgender or a member of the queer community.
- 2 Specifically, beginning in February 2022, ISS will generally recommend against or withhold votes for the chair of the nominating committee (and other directors on a case-by-case basis) at companies where there are no racially/ethnically diverse individuals on the board unless (i) there was such an individual on the board at a company's last annual meeting and (ii) the board has made a firm commitment to return to a racially/ethnically diverse status within a year. See ISS, ISS BENCHMARK POLICY UPDATES, Executive Summary (Nov. 12, 2020), available at <https://www.issgovernance.com/file/policy/latest/updates/Executive-Summary-of-ISS-Policy-Updates-and-Process.pdf>.
- 3 GLASS LEWIS, 2021 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE UNITED STATES (2020), available at <https://www.glasslewis.com/wp-content/uploads/2020/11/US-Voting-Guidelines-GL.pdf>.
- 4 BlackRock's full report is available [here](#) and executive summary [here](#).
- 5 See BLACKROCK, OUR 2021 STEWARDSHIP EXPECTATIONS (2020), available at: <https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf>.
- 6 See VANGUARD, INVESTMENT STEWARDSHIP 2020 ANNUAL REPORT (2020), available at: <https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2020-investment-stewardship-annual-report.pdf>.
- 7 See Richard F. Lacaille, "Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies," STATE STREET GLOBAL ADVISORS (Aug. 27, 2020), available at <https://www.ssga.com/us/en/intermediary/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies>.
- 8 The form letter is available on ISS's website at https://www.issgovernance.com/file/duediligence/July_2020_Letter_US_Corporations_Board_NE_O_Race-Ethnicity.pdf.
- 9 ISS, 2020 GLOBAL BENCHMARK POLICY SURVEY SUMMARY OF RESULTS (Sept. 25, 2020), available at <https://www.issgovernance.com/file/publications/2020-global-policy-survey-summary-of-results.pdf>.
- 10 For a more complete review of these CD&Is, see our memorandum of February 11, 2019, entitled [SEC Provides Guidance on Director Diversity Disclosure](#).
- 11 See NYC Comptroller's Boardroom Accountability 3.0 Results (June 24, 2020), available at <https://corpgov.law.harvard.edu/2020/06/24/nyc-comptrollers-boardroom-accountability-3-0-results>.
- 12 The proposed rules define a foreign issuer as either (a) a foreign private issuer (as defined in Rule 3b-4 under the Securities Exchange Act of 1934 ("Exchange Act") or (b) a company that (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Exchange Act and (ii) has its principal executive offices located outside of the United States.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

ANNEX A

Board Diversity Matrixes

Domestic Issuer

Board Diversity Matrix (As of [DATE])				
Board Size:				
Total Number of Directors	#			
Gender:	Male	Female	Non-Binary	Gender Undisclosed
Number of directors based on Gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
African American or Black	#	#	#	#
Alaskan Native or American Indian	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Undisclosed	#			

SULLIVAN & CROMWELL LLP

Foreign Issuer

Board Diversity Matrix (As of [DATE])				
Foreign Issuer under Rule 5605(f)(1)				
Country of Incorporation:	[Insert Country Name]			
Board Size:				
Total Number of Directors	#			
Gender:	Male	Female	Non-Binary	Gender Undisclosed
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
LGBTQ+	#			
Underrepresented Individual in Home Country Jurisdiction	#			
Undisclosed	#			