

SEC Approves New Nasdaq Board Diversity Rules

Client Alert | August 12, 2021

On August 6, 2021, a divided Securities and Exchange Commission (the “SEC”) voted to approve [new listing rules](#) submitted by The Nasdaq Stock Market LLC (“Nasdaq”) to advance board diversity through a “comply or disclose” framework and enhance transparency of board diversity statistics (the “Final Rules”). The Final Rules continue the use of listing standards by Nasdaq and other securities exchanges to improve corporate governance at listed companies (e.g., requiring independent board committees) and reflect similar movement in the market (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).

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Overview

There are three key components of the Final Rules. Under the Final Rules, certain Nasdaq-listed companies are required to:

- annually disclose aggregated statistical information about the board’s voluntary self-identified gender and racial characteristics and LGBTQ+ status in substantially the format set forth in new Nasdaq Rule 5606 (the “Board Diversity Matrix”)[\[1\]](#) for the current year and (after the first year of disclosure) the prior year (the “Board Diversity Disclosure Rule”); and
- either include on their board of directors, or publicly disclose why their board does not include, a certain number (as discussed below) of “Diverse”[\[2\]](#) directors (the “Board Diversity Objective Rule”).

As discussed below, the compliance period for the Board Diversity Disclosure Rule begins in 2022, while the Final Rules take a tiered approach for the compliance period for the Board Diversity Objective Rule, which begins in 2023. These compliance periods are subject to certain phase-in-periods for companies newly listing on Nasdaq.

Third, the Final Rules provide for Nasdaq to offer certain listed companies access to a complimentary board recruiting service to help advance diversity on company boards (the “Board Recruiting Service Rule”). Companies that do not have a specified number of Diverse directors will have the opportunity to access “a network of board-ready diverse candidates” in order to help them meet the Board Diversity Objective Rule.[\[3\]](#)

Background and SEC Approval

Nasdaq first [proposed](#) these rules on December 1, 2020 (the “Proposed Rules”) as discussed in detail in our December [client alert](#). On February 26, 2021, following the receipt of over 200 comment letters from Nasdaq-listed issuers, institutional investors, state and federal legislators, advocacy organizations and other parties, Nasdaq filed an [amendment](#) to the Proposed Rules, as well as a [response letter](#) to the SEC addressing the comments it received. While Nasdaq indicated that almost 85% of substantive comment letters supported the Proposed Rules, Nasdaq responded to concerns raised by commenters by: amending the Proposed Rules to provide more flexibility for boards with

five or fewer directors; extending the compliance periods for newly listing Nasdaq companies; aligning the disclosure requirements with companies' annual shareholder meetings; and adding a grace period for covered companies that fall out of compliance with applicable board diversity objectives. In its response letter, Nasdaq emphasized that the rules are not intended to impose a quota or numeric mandate on listed companies, as companies will have the choice to either meet the board diversity objectives or explain both their different approach and why it is appropriate for the company. Nasdaq also responded to commenter concerns that the Board Recruiting Service Rule could create a conflict of interest by emphasizing that companies are not required to use the complimentary recruiting service and, accordingly, Nasdaq will not penalize companies that do not utilize the service.

The SEC approved the Board Diversity Disclosure Rule and Board Objective Rule by a 3-2 party-line vote and approved the Board Recruiting Service Rule by a 4-1 vote, with only Commissioner Peirce voting against its approval.^[4] The majority characterized the Final Rules as "improv[ing] the quality of information available to investors for making investment and voting decisions by providing consistent and comparable diversity metrics."^[5] As Chairman Gary Gensler explained, the Final Rules "reflect calls from investors for greater transparency about the people who lead public companies," and will "allow investors to gain a better understanding of Nasdaq-listed companies' approach to board diversity, while ensuring that those companies have the flexibility to make decisions that best serve their shareholders."^[6]

By contrast, Commissioners Peirce and Roisman expressed concern about the SEC's approval of the Board Diversity Disclosure Rule and Board Diversity Objective Rule. Commissioner Roisman expressed concern that the SEC failed to "meet[] the legal standards that [it is] required to apply in evaluating rules proposed by self-regulatory organizations" and that approval of the Final Rules could result in the SEC "tak[ing] future action in which the agency must consider disclosure of the racial, ethnic, gender, or LGBTQ+ status of individual directors."^[7] Commissioner Peirce separately criticized the empirical evidence cited by Nasdaq in support of the proposed rule changes. She also argued that the Final Rules are outside of the scope of the SEC's authority under the Securities Exchange Act of 1934, as amended, and "encourage discrimination and effectively compel speech by both individuals and issuers in a way that offends protected Constitutional interests."^[8]

Nasdaq's Board Diversity Disclosure Rule

Under the Board Diversity Disclosure Rule, Nasdaq-listed companies, other than "Exempt Entities,"^[9] are required to annually report aggregated statistical information about the Board's self-identified gender and racial characteristics and self-identification as LGBTQ+ using the Board Diversity Matrix or in a substantially similar format. For the first year companies are required to provide only current year data, and in subsequent years companies must disclose data on both the current and prior year.

This statistical information must be provided in a searchable format (1) in the company's proxy statement or information statement for its annual meeting of shareholders ("Proxy Materials"), (2) in an Annual Report on Form 10-K or Form 20-F ("Annual Report"), or (3) on the company's website. If provided on its website, the company must also submit the disclosure to the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholders meeting.

In addition to formatting and other non-substantive changes, the Final Rules reflect several changes to the matrix and related instructions initially included with the Proposed Rules.^[10] The amended instructions also clarify that companies may include supplemental data in addition to the statistical information required in the Board Diversity Matrix. However, companies may not substantially alter the matrix. Nasdaq provides on its [website](#) examples of the Board Diversity Matrix and the alternative disclosure matrix for Foreign Issuers as well as examples of acceptable and unacceptable matrices.

Nasdaq's Board Diversity Objective Rule

The Final Rules require most Nasdaq-listed companies, other than Exempt Entities and companies with boards consisting of five or fewer members ("Smaller Boards"), to:

- a. have at least two self-identified "Diverse"^[11] members of its board of directors; or
- b. explain why the company does not have the minimum number of directors on its board who self-identify as "Diverse."

Of the two self-identified Diverse directors, at least one director must self-identify as Female and at least one director must self-identify as an Underrepresented Minority and/or LGBTQ+.

In response to commenter concerns, the Board Diversity Objective Rule provides additional flexibility for listed companies with Smaller Boards. Specifically, Smaller Boards are required only to have at least one self-identified Diverse director. In addition, companies with Smaller Boards in place prior to becoming subject to the Board Diversity Objective Rule are permitted to add a sixth director who is Diverse in order to meet the one Diverse director requirement for Smaller Boards. However, if the company later increases its board to more than six members, it will become subject to the two Diverse director requirement.

Where a listed company determines instead to explain why it does not meet the applicable diversity objectives, Nasdaq emphasized that it will not evaluate the substance or merits of that explanation. However, companies must detail the reasons why they do not have the applicable number of Diverse directors instead of merely stating that they do not comply with the Board Diversity Objective Rule.

Compliance Periods

Under the Final Rules, the compliance periods for both the Board Diversity Disclosure Rule and the Board Diversity Objective Rule were extended.

- 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.

Phase-in Periods for Newly Listing Companies

Under the Final Rules, a company newly listing on Nasdaq will be subject to certain phase-in-periods for compliance with the Board Diversity Disclosure Rule and Board Diversity Objective Rule, as long as the company was not previously subject to a substantially similar requirement of another national securities exchange.

A company newly listing on Nasdaq must comply with the requirements of the Board Diversity Disclosure Rule within one year of its listing date.

For the Board Diversity Objective Rule, Nasdaq extended the phase-in period in response to comments. The Final Rules take a tiered approach based on the Nasdaq market on which the company is newly listing and the size of the company's board:

- A company newly listing on the Nasdaq Global Select Market or the Nasdaq Global Market must have or explain why it does not have:
 - at least one Diverse director by the later of (a) one year from the listing date, or (b) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, its Annual Report) for the company's first annual shareholders meeting after its listing; and
 - at least two Diverse directors by the later of (a) two years from the listing date, or (b) 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.
- A company newly listing on the Nasdaq Capital Market must have, or explain why it does not have, at least two Diverse directors 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.
- 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.

In addition, companies that cease to be a Foreign Issuer, a Smaller Reporting Company or an Exempt Entity will be permitted to satisfy the applicable requirements of the Board Diversity Objective Rule by the later of (1) one year from the date the company's status changes, or (2) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, its Annual Report) during the calendar year following the date the company's status changes.

Grace Period for Board Diversity Objective Rule

The Final Rules also provide a grace period for listed companies that fall out of compliance with the Board Diversity Objective Rule because of a board vacancy. In such a circumstance, a non-compliant company will have until the later of (1) one year from the date of the vacancy, or (2) the date the company files its Proxy Materials (or, if the company does not file Proxy Materials, its Annual Report) for its annual shareholder

meeting in the calendar year after the year in which the vacancy occurs, to comply with the Board Diversity Objective Rule. During this period, the company is not required to explain why it is not compliant with the Board Diversity Objective Rule, and it may publicly disclose that it is relying on the board vacancy grace period.

Cure Period

If a listed company fails to comply with the Board Diversity Objective Rule, Nasdaq's Listing Qualifications Department will notify the company that it has until the later of the company's next annual shareholders meeting, or 180 days from the event that caused the deficiency, to cure the deficiency.

If a listed company fails to comply with the Board Diversity Disclosure Rule, it will have 45 days after notification of non-compliance by Nasdaq's Listing Qualifications Department to submit a plan to regain compliance. Based on that plan, Nasdaq could provide the company with up to 180 days to regain compliance.

Practical Considerations

While Nasdaq-listed companies have some time to bring their boards into compliance with the Board Diversity Objective Rule, director recruitment is a time-consuming task that requires careful decision making. Accordingly, Nasdaq-listed companies and pre-IPO companies considering listing on Nasdaq should review the current composition of their boards in order to assess whether to make any changes in light of the Final Rules. Although both Nasdaq and the SEC have emphasized that the Final Rules do not impose a mandate on listed companies to have a certain number of Diverse directors, companies will need to carefully consider the disclosure requirements and potential investor reaction should they elect not to have the minimum number of Diverse directors required under the Board Diversity Objective Rule.

In addition, Nasdaq-listed companies should consider adding questions to their D&O questionnaires to elicit responses regarding the self-identified diversity characteristics required to be disclosed in the Board Diversity Matrix (as well as by other diversity requirements such as California's two board diversity laws, which impose diversity quotas for women and underrepresented minorities for publicly held companies with principal executive offices in California). As noted above, the Final Rules indicate that companies may also include supplemental data on their directors' diversity characteristics. Accordingly, companies should consider whether their D&O questionnaires should include questions about other diversity characteristics, such as a director's military service, disability status, language and/or culture.

We note that the Final Rules may face legal challenges from activists and other interest groups that have characterized the rules' requirements as inconsistent with the Constitution's equal protection principles and the Civil Rights Act of 1964. State laws that mandate board representation for women and other communities are already being challenged in court. For example, in June the U.S. Court of Appeals for the Ninth Circuit revived a legal challenge to California's board gender diversity law. In its reversal of the District Court's dismissal for lack of standing, the Ninth Circuit held that the plaintiff "plausibly alleged that [California's board diversity law] requires or encourages him to discriminate based on sex" and therefore has standing to challenge the law.^[12] And in July the Alliance for Fair Board Recruitment, a Texas-based nonprofit that submitted [comments](#) opposing approval of the Final Rules, filed suit against the state of California over both of its board diversity laws. The organization argues that the quotas require California corporations to impermissibly discriminate based on sex and race in selecting their board members.

It also remains to be seen whether the New York Stock Exchange will follow Nasdaq's lead and adopt its own board diversity rules. Nonetheless, the SEC's approval of Nasdaq's Final Rules is in keeping with increased market focus on board diversification.

And, in light of statements made by the majority in its approval of the Final Rules, the SEC appears poised to take future action to support board diversity initiatives.[\[13\]](#)

Exhibit A

Board Disclosure Format

Total Number of Directors	#			
	Female	Male	Non-Binary	Did Not Disclose Gender
Part I: Gender Identity				
Directors	#	#	#	#
Part II: Demographic Background				
African American or Black	#	#	#	#
Alaskan Native or Native American	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Did Not Disclose Demographic Background	#			

Country of Principal Executive Offices: [Insert Country Name]

Foreign Private Issuer: Yes/No

Disclosure Prohibited Under Home Country Law: Yes/No

Total Number of Directors: #

	Female	Male	Non-Binary	Did Not Disclose Gender
Part I: Gender Identity				
Directors	#	#	#	#
Part II: Demographic Background				
Underrepresented Individual in Home Country Jurisdiction	#			
LGBTQ+	#			
Did Not Disclose	#			

Demographic Background

[1] The Board Diversity Matrix included in the Final Rules is reproduced as [Exhibit A](#) below and is also available at the [Nasdaq Listing Center](#).

[2] Under the Final Rules, “Diverse” director means (1) a director who self-identifies her gender as female, without regard to the individual’s designated sex at birth (“Female”), (2) a director who self-identifies as one more or of: 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 (“Underrepresented Minority”), and (3) lesbian, gay, bisexual, transgender or a member of the queer community (“LGBTQ+”).

[3] Nasdaq has provided a [short primer](#) on the Final Rules, which includes additional compliance information and related resources for listed companies.

[4] Although she voted against it, Commissioner Peirce indicated she did not object to the approval of the Board Recruiting Service Rule. See Commissioner Hester M. Peirce, “Statement on the Commission’s Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Board Diversity submitted by the Nasdaq Stock Market LLC” (Aug. 6, 2021) at note 3, available [here](#).

[5] 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](#).

[6] Chairman Gary Gensler, “Statement on the Commission’s Approval of Nasdaq’s Proposal for Disclosure about Board Diversity and Proposal for Board Recruiting Service” (Aug. 6, 2021), available [here](#).

[7] Commissioner Elad L. Roisman, “Statement on the Commission’s Order Approving Exchange Rules Relating to Board Diversity” (Aug. 6, 2021), available [here](#).

[8] Commissioner Hester M. Peirce, “Statement on the Commission’s Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Board Diversity submitted by the Nasdaq Stock Market LLC” (Aug. 6, 2021), available [here](#).

[9] Under the Final Rules, “Exempt Entities” means: (1) acquisition companies; (2) asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); (3) cooperatives (as set forth in Rule 5615(a)(2)); (4) limited partnerships (as set forth in Rule 5615(a)(4)); (5) management investment companies (as set forth in Rule 5615(a)(5)); (6) issuers of non-voting preferred securities, debt securities, and derivative securities (as set forth in Rule 5615(a)(6)) that do not have equity securities listed on the Exchange; and (7) issuers of securities listed under the Rule 5700 series.

[10] The Board Diversity Matrix and related instructions were revised to refer to “Native American” instead of “American Indian” and include a definition of the term “Non-Binary.” For Foreign Issuers, the alternative disclosure matrix was amended to permit Foreign Issuers to note whether disclosure of the data required by the Board Diversity Disclosure Rule is prohibited under the company’s home country law.

[11] For Foreign Issuers the definition of “underrepresented individual” within the definition of “Diverse” was amended in the Final Rules to be based on identity in the country of the Foreign Issuer’s principal executive offices, as opposed to the Foreign Issuer’s home country jurisdiction.

[12] See *Meland v. Weber*, No. 20-15762 (9th Cir. 2021), available [here](#).

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[13] Notably, Commissioners Lee and Crenshaw emphasized their 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](#).

Gibson Dunn’s lawyers are available to assist with any questions you may have regarding these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work in the Securities Regulation and Corporate Governance or Capital Markets practice groups, or any of the following practice leaders and members:

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