Skadden

SEC Reporting & Compliance Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

One Manhattan West
New York, NY 10001
212.735.3000

1440 New York Avenue, N.W.
Washington, D.C. 20005
202.371.7000

SEC Approves Nasdaq Board Diversity Listing Standards

This alert reflects updates from Nasdaq guidance issued August 13, 2021.

On August 6, 2021, the Securities and Exchange Commission (SEC) approved[1] the Nasdaq Stock Market's (Nasdaq) proposal to amend its listing standards to encourage greater board diversity and to require board diversity disclosures for Nasdaq-listed companies. Subject to transition periods and limited exceptions, Nasdaq-listed companies will be required to (i) publicly disclose board-level diversity statistics on an annual basis using a standardized matrix template under Nasdaq Rule 5606 and (ii) have, or disclose why they do not have, a minimum of two diverse board members under Nasdaq Rule 5605(f).[2] The mandatory "board diversity matrix" disclosure and the "comply or explain" board diversity framework are described in greater detail below.

Background

Original Proposal. On December 1, 2020, Nasdaq filed its original proposal with the SEC to amend its listing standards related to board diversity and enhanced diversity disclosures. The original proposal set forth board diversity matrix disclosure and board member diversity objectives. In response, the SEC received over 200 comment letters, of which the overwhelming majority supported the goals of the proposed rule. Some commenters, however, requested revision or clarification of the proposed rule to account for factors such as board size, burdens on newly listed companies, feasibility of near-term compliance and alignment of additional disclosures with existing disclosure timelines.

Amended Proposal. On February 26, 2021, Nasdaq amended the original proposal to address commenters' concerns. In particular, the amended proposal (i) allows companies with five or fewer board members to meet the board diversity objective by having only one instead of two diverse directors, (ii) grants newly listed companies additional time to comply with the diversity objective and (iii) provides a grace period for regaining compliance with the rule in the event that a director's departure and subsequent board vacancy results in a company falling out of compliance.

[1] *See* Securities and Exchange Commission, "Order Approving Proposed Rule Changes," (August 6, 2021).

[2] The text of the amended Nasdaq Rule 5605 and new Nasdaq Rule 5606 begins on page 401 of 412 of Nasdaq's "Response to Comments and Notice of Filing of Amendment No. 1 of Proposed Rule Change To Adopt Listing Rules Related to Board Diversity" (February 26, 2021) (Nasdaq's Amended Proposal). Exhibit 4 provides a blackline reflecting changes to the original proposed rule beginning on page 388 of 412 of the document.

SEC Approval. In a 3-2 vote, the SEC approved the amended proposal in its entirety. SEC Chair Gary Gensler noted that "[t]hese rules 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."[3]

New Nasdaq Rules

Board Diversity Matrix

Format and Categories. Nasdaq Rule 5606 will require companies to disclose, in a standardized matrix set forth in the rule or in a substantially similar format, (i) the total number of company board members and (ii) how those board members self-identify regarding gender, predefined race and ethnicity categories[4] and LGBTQ+ status. Nasdaq published sample matrix disclosures (updated February 23, 2022) to demonstrate how companies can comply with the rule. Foreign issuers with principal executive officers outside the U.S., including foreign private issuers (Foreign Issuers), must disclose a similar matrix, but they can apply a broader definition of diversity and report the number of individuals who self-identify as underrepresented in their home country jurisdiction based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity. Matrices require aggregated disclosures instead of identifying individual directors by name, and directors will not be compelled to identify as a member of any group, in which case the matrix will reflect a response of "undisclosed." This disclosure requirement would not preclude companies from providing more detailed diversity disclosures — such as on an individual basis — in addition to the matrix required by Nasdaq Rule 5606.

Publication. Companies will be required to publish the board diversity matrix in their annual meeting proxy statement, or alternatively, on the company's website, provided that the company submits 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.

Compliance Date. All Nasdaq-listed companies must comply with the board diversity matrix disclosure rule by the later of (i) August 8, 2022, or (ii) the date the company files its proxy statement for its 2022 annual meeting of shareholders (or, if the company does not file a proxy statement, in its annual report on Form 10-K or 20-F).[5] If a company files its 2022 proxy statement (or its annual report on Form 10-K or 20-F) before August 8, 2022, and does not include the matrix, the company will have until August 8, 2022, to disclose its matrix either (i) on the company's website or (ii) in an amended annual report (such as on Form 10-K or 20-F).

Appointment of Diverse Directors

Comply or Explain. Nasdaq Rule 5605(f) requires companies to have at least two diverse board members or to explain the company's reasons for not meeting this diversity objective. For U.S. issuers, one diverse director must self-identify as female, and the other director must self-identify as either a racial or ethnic minority or a member of the LGBTQ+ community. Companies may comply with the rule by having two directors who self-identify in racial or ethnic categories beyond those described in the Nasdaq rule, and explaining that the company considers diversity more broadly than the categories defined in the rule.[6] Smaller reporting companies and Foreign Issuers also will be required to have two diverse directors, at least one of whom identifies as female, but companies may satisfy the diversity requirement for the second director by appointing a second director who identifies as female. Unlike U.S. issuers, Foreign Issuers may satisfy the board diversity requirement under the broader definition of diversity applicable to the matrix disclosures by appointing a director who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. Companies with five or fewer board members can meet the board diversity objective by having only one instead of two diverse directors.

Transition Period. The phase-in period depends on a company's listing tier, as Nasdaq recognizes that smaller companies may face greater director recruitment challenges. While all companies are expected to have at least one diverse director within two years (by August 7, 2023), larger companies listed on the Nasdaq

[3] *See* Securities and Exchange Commission, "Statement on the Commission's Approval of Nasdaq's Proposal for Disclosure About Board Diversity and Proposal for Board Recruiting Service" (August 6, 2021).

[4] *See* Rule 5605 in Nasdaq's Amended Proposal. The definition of "Diverse" includes those who self-identify as female, an Underrepresented Minority or LGBTQ+. "Underrepresented Minority" is defined as someone 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, which is defined as a person who identifies with more than one of the following categories: White (not of Hispanic or Latinx origin), Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander.

[5] Nasdaq clarified deadlines for initial compliance in its FAQ 1796 (August 13, 2021).

[6] *See* Nasdaq's Amended Proposal. Although Nasdaq Rule 5605(f) defines "Underrepresented Minority" to reflect the EEO-1 report categories, companies may meet the rule's objectives by having two directors who self-identify in racial or ethnic categories beyond those defined in the EEO-1 report categories, such as Middle Eastern, North African or Central Asian. In other words, a director of Middle Eastern descent would be classified as "White" in the diversity matrix, but may be considered diverse for purposes of "comply or explain."

Global Select Market or Nasdaq Global Market tiers have four years from August 6, 2021 (so by August 6, 2025) to have two diverse directors, while smaller companies listed on the Nasdaq Capital Market tier have five years (until August 6, 2026) to appoint a second diverse director.

Companies that do not meet the applicable board diversity objective by the end of the phase-in period will not be subject to delisting, provided that they publicly disclose the reasons they did not satisfy the objective. Similar to the disclosure requirements for the board diversity matrix, a company needs to publish such explanation in its annual meeting proxy statement or on the company's website (provided that the company furnishes Nasdaq with timely notice of website location). Nasdaq will verify that companies have provided an explanation in the event of noncompliance, but will not evaluate the disclosure from a substantive perspective. Companies that have not appointed a sufficient number of diverse directors also will be eligible to access, through Nasdaq, free services to help identify suitable, diverse board candidates.[7]

[7] For additional information on these services, see question 7 on page 3 of "Nasdaq's Board Diversity Rule — What Nasdaq-Listed Companies Should Know."

Compliance Considerations

Limited Exemptions. Both rules are broadly applicable, exempting only a limited number of investment and other companies that do not have boards, are not operating companies or do not list equity securities. Special purpose acquisition companies (SPACs) are exempt from the rules until the completion of their initial business combination. Companies may reference Nasdaq's related FAQs to understand and assess compliance with the new rules.

Next Steps. Nasdaq-listed companies should assess their board composition and director succession planning in light of the amended listing standards and consider any necessary changes to the information they request from directors in order to comply with the new director diversity matrix requirements in 2022. In addition, companies should consider the voting policies and guidelines of their significant shareholders, which may reflect board diversity expectations that differ in scope or timing from the Nasdaq rules.

Contacts

Brian V. Breheny
Partner / Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Raquel Fox
Partner / Washington, D.C.
202.371.7050
raquel.fox@skadden.com

Marc S. Gerber
Partner / Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Andrew J. Brady
Of Counsel / Washington, D.C.
202.371.7513
andrew.brady@skadden.com

Caroline S. Kim
Counsel / Washington, D.C.
202.371.7555
caroline.kim@skadden.com

Ryan J. Adams
Associate / Washington, D.C.
202.371.7526
ryan.adams@skadden.com

Andrew T. Bond
Associate / Washington, D.C.
202.371.7244
andrew.bond@skadden.com

Jeongu Gim
Associate / Washington, D.C.
202.371.7223
jeongu.gim@skadden.com

Blake M. Grady
Associate / Washington, D.C.
202.371.7591
blake.grady@skadden.com

Khadija Lalani
Associate / Chicago
312.407.0116
khadija.lalani@skadden.com

Leo W. Chomiak
Law Clerk / Washington, D.C.
202.371.7511
leon.chomiak@skadden.com