Board Diversity Considerations In Light Of New Nasdaq Rules

By **David Huntington, Valerie Radwaner and Laura Turano** (September 14, 2021)

David Huntington

Valerie Radwaner

Laura Turano

On Aug. 6, the U.S. Securities and Exchange Commission approved Nasdaq's board diversity requirements.[1] Starting with required disclosure of board diversity characteristics in 2022, the new rules will require Nasdaq-listed companies to have at least one diverse[2] director in 2023 or to publicly explain why not, and culminate with Nasdaq-listed companies having two diverse directors by 2025 or publicly explaining why not (2026 for Nasdaq capital markets companies).

Implementation Timeline

Applicable Nasdaq Tier	Deadline	Requirement
Nasdaq Global Select Nasdaq Global Market Nasdaq Capital Market	By Aug. 8, 2022, or the date of the company's proxy/information statement for its 2022 annual meeting, if later.	Required to provide statistical disclosures regarding the self-identified diversity characteristics of board members in the prescribed board diversity matrix format.
Nasdaq Global Select Nasdaq Global Market Nasdaq Capital Market	By Aug. 7, 2023, or the date of the company's proxy/information statement for its 2023 annual meeting, if later.	Required to have at least one director who self-identifies as diverse or to alternatively explain why the company does not meet this board diversity objective.
Nasdaq Global Select Nasdaq Global Market Nasdaq Capital Market	By Aug. 6, 2025, or the date of the company's proxy/information statement for its 2025 annual meeting, if later.	Required to have at least two directors who self-identify as diverse, including at least one who self-identifies as female and one who self-identifies as an underrepresented minority, or to alternatively explain why the company does not meet this board diversity objective.
Nasdaq Capital Market	By Aug. 6, 2026, or the date of the company's proxy/information statement for its 2026 annual meeting, if later.	Required to have at least two directors who self-identify as diverse, including at least one who self-identifies as female and one who self-identifies as an underrepresented minority, or to alternatively explain why the company does not meet this board diversity objective.

Note: These listing requirements also apply to non-U.S. issuers (including foreign private issuers) and smaller-reporting companies, though they will be permitted to satisfy the board diversity objectives with two directors who self-identify as female, and, in the case of non-U.S. issuers, will have more flexibility to identify appropriate and applicable diversity categories reflective of the demography of their principal jurisdictions. Companies with small boards (five or fewer directors) will only need one director who self-identifies as diverse to meet the board diversity objectives.

This is a significant step by a U.S. securities regulator, and is likely just the first of more rules related to environmental, social and governance issues to come. The SEC has indicated that it too is considering rulemaking in this space; it included board diversity rulemaking in the 2021-2022 regulatory agenda published in June.

Up until now, the SEC's rulemaking on governance topics has been principles based, but it is possible that they could replicate Nasdaq's new requirements in substance to provide uniformity across the market.

And, while the New York Stock Exchange has so far declined to act and has left it to investors to require diversity — and they have, as we note below — it may find itself under pressure to do so itself in coming months, now that Nasdaq's rules have taken effect and other regulatory organizations around the world consider similar requirements, though SEC action may preempt that.

In July, the U.K. Financial Conduct Authority proposed similar "comply or explain" board diversity requirements for U.K.-listed companies; the Hong Kong and Tokyo exchanges are also taking steps to increase the representation of women.

And, finally, the states of California and Washington already require the boards of public companies to meet diversity requirements, and a number of other states have similar proposals before their legislatures.

Beyond regulators, private ordering has accomplished much to advance board diversity and related disclosure, particularly among larger public companies. Institutional investors and proxy advisory firms have been pushing for diversity on boards and related disclosure for several years, and boards have been responsive, adding both female and other underrepresented populations to their membership.

The adoption of voting policies by proxy advisory firms Institutional Shareholder Services Inc. and Glass Lewis & Co. LLC, as well as similar policies by institutional investors including Blackrock Inc., State Street Global Advisors Inc. and Fidelity Investments Inc., among others, will further push larger public companies to have at least one racially or ethnically diverse director, and at least one female director on their boards by the 2022 proxy season. Glass Lewis will require two, though many institutional investors only currently require one.

Private ordering is extending beyond shareholders: The Goldman Sachs Group Inc. announced in 2020 that it would not underwrite an IPO where the company board did not satisfy board diversity goals of at least one diverse board member in 2020, increasing to two diverse board members in 2021.

As a result, many larger Nasdaq companies will find that while they may need to revise the format of their diversity disclosure, they have already done significant work to meet these board diversity objectives or have met them. Smaller companies that have not yet faced shareholder calls to meet these diversity objectives, and may not yet have any diverse directors on their board, may find recruiting diverse board talent more challenging given the competitive market.

All companies should be mindful that the market for diverse board candidates is tight as thousands of companies are seeking to further diversify their boards within the next few years. As noted above, increasing board diversity is not uniquely a Nasdaq concern, and an increasing number of companies are aligning with these requirements — and touting them publicly — regardless of whether they are required to do so or not.

The competition to attract diverse directors is exacerbated by the frequent requirement that public board candidates have previous public company board experience. Historically, women and underrepresented minorities have not had the same opportunities to sit on public company boards.

These existing criteria will have to change in order to accommodate the demand for talent noted above, and recruitment firms and companies will need to work to train candidates to be public company board ready without the prior experience.

In addition to leveraging their own networks, Nasdaq companies that do not yet meet the full board diversity objectives, required by 2025, are eligible for free board recruiting services for one year being offered by Nasdaq to help them meet these objectives.

Successful board planning takes time and consideration, and companies' efforts at board diversification will not end with identifying the right candidates. Companies will need to consider their existing board composition in light of new potential members, and determine whether to increase their board size to include new diverse directors, or to replace existing board members.

Both of these alternatives will take time to consider and to effect. Companies planning an IPO should bear these diversity objectives in mind as they assemble their public company boards.

As a result, companies need to plan ahead to be able to meet the new Nasdaq requirements. All companies, including those that already meet the Nasdaq board objectives, should start now by reviewing and updating their directors and officers questionnaires, to the extent they have not already done so, to ensure they are capturing the information they need to make the required Nasdaq disclosures in 2022.

Companies that do not yet meet the Nasdaq board diversity objectives will need to start planning to meet the Nasdaq board diversity objectives in 2023 and beyond.

On a practical note, while companies will have until Aug. 8, 2022, to publish their diversity disclosures, we expect that many will include this information in their proxy statements for their 2022 annual meetings — overwhelmingly many of which are filed in spring — and similarly, that they will demonstrate that they meet the 2023 and 2025 diversity objectives, or will explain why not, in their annual meeting proxy statement filings.

David Huntington is a partner, Valerie Radwaner is deputy chair and Laura Turano is a partner at Paul Weiss Rifkind Wharton & Garrison LLP.

Paul Weiss practice management consultant Jane Danek contributed to this article.

[1] The Nasdaq proposal adopted by the SEC is available NASDAQ-2020-081_Amendment_1.pdf" target="_blank">here. Nasdaq's guidance on the implementation of these rules is available here.

[2] "Diverse" for the purposes of the Nasdaq rules means a director self-identifies as female or as an underrepresented minority which is defined as African American or Black, Alaskan Native or Native American, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or LGBTQ+.