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## SEC Approves Nasdaq's Board Diversity Rules

On August 6, 2021, the Securities and Exchange Commission ("SEC") made history when it issued its order (the "Approval Order")<sup>1</sup> approving the Nasdaq Stock Market LLC's ("Nasdaq") board diversity rule request (the "Proposal")<sup>2</sup>, the first ever stock exchange board diversity requirement in the United States.

Beginning August 7, 2021, every company listed on or seeking to be listed on Nasdaq will be required, after a transition period, to disclose the composition of its board diversity and either meet specified diversity thresholds or explain why it does not. The Proposal was submitted in December 2020, and after garnering an overwhelming majority of supportive comments over the course of several months, it was revised in March 2021.<sup>3</sup> The revised rule request was approved by the SEC in its requested form. The Approval Order explained that by statute the SEC could either approve or deny the request but not modify it. After a lengthy analysis of the details of the request and its reasoning, the SEC approved the request, with three commissioners in support and two commissioners opposing.<sup>4</sup>

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### I. The Approval Order

The The Approval Order explains that Rules 5605(f) and 5606 (the "Rules") will establish a disclosure-based framework that will make consistent and comparable statistics widely available to investors and thereby enhance voting and investment decisions. The SEC observed that Board-level diversity statistics are currently not widely available on a consistent and comparable basis, even though Nasdaq and many commenters argue that this type of information is important to investors. The SEC concluded that the Proposal will augment existing SEC requirements that companies disclose whether, and how, their boards or board nominating committees consider diversity in nominating new directors and will mitigate concerns regarding unequal access to information that may currently exist between certain larger investors who can more easily obtain board diversity information and other smaller investors who may not be able to do so.

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<sup>1</sup> Securities and Exchange Commission, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Board Diversity and to Offer Certain Listed Companies Access to a Complimentary Board Recruiting Service, Exchange Act Release No. 34-92590, <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf>, 82 (Aug. 6, 2021).

<sup>2</sup> Nasdaq, NASDAQ'S PROPOSAL TO ADOPT LISTING REQUIREMENTS FOR BOARD DIVERSITY (Feb. 26, 2021) <https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf>.

<sup>3</sup> For a discussion of these revisions to the Proposal, see our firm memorandum dated March 12, 2021, which can be found [here](#).

<sup>4</sup> SEC Chair Gary Gensler and Commissioners Caroline A. Crenshaw and Allison Herren Lee supported the Proposal. Commissioners Hester M. Peirce and Elad L. Roisman opposed Rules 5605(f) and 5606 but Commissioner Roisman supported the proposal to offer listed companies recruiting services that may help them identify diverse members. Gary Gensler, Statement on the Commission's Approval of Nasdaq's Proposal for Disclosure about Board Diversity and Proposal for Board Recruiting Service, <https://www.sec.gov/news/public-statement/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621> (Aug. 6, 2021); Caroline A. Crenshaw and Allison Herren Lee, Statement on Nasdaq's Diversity Proposals – A Positive First Step for Investors, <https://www.sec.gov/news/public-statement/statement-nasdaq-diversity-080621> (Aug. 6, 2021), 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, <https://www.sec.gov/news/public-statement/peirce-nasdaq-diversity-statement-080621> (Aug. 6, 2021), Elad L. Roisman, Statement on the Commission's Order Approving Exchange Rules Relating to Board Diversity, <https://www.sec.gov/news/public-statement/roisman-board-diversity> (Aug. 6, 2021).

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The SEC found compelling the “comply or explain” structure of the Proposal and found that it was distinguishable from the board diversity mandates some commenters referred to in their opposition to the Proposal. In considering the potential cost to listed companies, the SEC noted that because the Proposal would not mandate any particular board composition, companies that choose to meet the diversity objectives (rather than explain why they do not) are likely to be the ones who stand to benefit the most, or incur the least cost. By focusing on transparency and not mandating any particular board composition, the Rule will provide information and explanations that will enhance investor decision making. In regard to Nasdaq’s definition of “diverse,”<sup>5</sup> the SEC believes it is not an unreasonable definition in that it uses categories already familiar to employers and that, by adopting a uniform definition and format for disclosure, it will make it less costly and more efficient for investors to compare information and make investment and voting decisions.

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## II. Nasdaq Board Diversity Rule

The new Rules have two parts: (1) Rule 5606 requires companies listed on Nasdaq to publicly disclose statistical information on their board diversity, and (2) Rule 5605(f) requires listed companies to have at least two diverse directors or explain why they do not.<sup>6</sup> In addition to the disclosure requirement and diversity objective, the SEC noted in the Approval Order that the Rules include a complimentary board recruiting service to help advance diversity on company boards. Nasdaq will host webinars to help companies access these recruiting services and inform them about its partnerships with Equilar, Athena Alliance, and the Boardlist.<sup>7</sup> This service is meant to help Nasdaq-listed companies in their search for highly-qualified, diverse, board-ready candidates.<sup>8</sup>

### Rule 5606: Disclosure Requirement

Compliance with Rule 5606 requires Nasdaq-listed companies to disclose demographic information about their board members in an annual board diversity matrix.<sup>9</sup> Importantly, the board diversity matrix anticipates that some demographic information will not be available as directors may decline to provide certain information.<sup>10</sup> See Exhibit A attached to this memorandum for the Board Diversity Matrix.

### Rule 5605(f): Board Diversity Objective

Compliance with Rule 5605(f) requires Nasdaq-listed companies to have at least two diverse directors, including one self-identified woman director and one director who self-identifies as an underrepresented minority or as LGBTQ+.<sup>11</sup> If a company does not meet this threshold, the company must explain which category of company it falls into, the requirements for companies in that category and an explanation as to why that requirement has not been met. Nasdaq will not evaluate whether the disclosure’s substance is satisfactory.<sup>12</sup> The objective of this

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<sup>5</sup> “Diverse” is defined as (i) female, (ii) Underrepresented Minority or (iii) LGBTQ+. The definition of “Underrepresented Minority” is consistent with the categories that companies are required to report to the Equal Employment Opportunity Commission and is defined 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.”

<sup>6</sup> The Nasdaq Stock Market LLC Rules, §§ 5605(f), 5606 (Aug. 6, 2021) <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>.

<sup>7</sup> Nasdaq, Nasdaq’s Board Diversity Rule: What Nasdaq-Listed Companies Should Know, 1, 3 (Aug. 6, 2021).

<sup>8</sup> *Id.*

<sup>9</sup> The Nasdaq Stock Market LLC Rules, § 5606(a).

<sup>10</sup> *Id.*

<sup>11</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(2)(A).

<sup>12</sup> See e.g. FAQ, Nasdaq’s Board Diversity Rule Proposal [https://listingcenter.nasdaq.com/Material\\_Search.aspx?mcd=LQ&cid=157&sub\\_cid=&years=2020&criteria=1&materials](https://listingcenter.nasdaq.com/Material_Search.aspx?mcd=LQ&cid=157&sub_cid=&years=2020&criteria=1&materials) (“FAQ”), Identification Number 1771. Nasdaq has noted that the following statements are examples of what would satisfy Rule 5605(f)’s explanation requirement: “A U.S. company may disclose that it chooses to define diversity more broadly than Nasdaq’s definition by considering national origin, veteran status or individuals with disabilities when identifying nominees for director because it believes such diversity brings a wide range of perspectives and experiences to the board. If under Israeli law regarding board diversity, an

disclosure is to provide transparency to shareholders. The requirement to explain will not be met by simply stating that the company does not comply with Nasdaq's diversity Rule.

The following exceptions to Rule 5605(f) apply: (1) companies with five or fewer board members will only need to have one diverse board member by the later of (a) two years from the date of listing or (b) the date of filing of its proxy or information statement for its second annual meeting following listing<sup>13</sup> and (2) foreign issuers (issuers organized outside of the U.S.) and smaller reporting companies (as defined in Rule 12b-2 under the Securities Exchange Act of 1934) are able to satisfy the board diversity objective by having two self-identified woman directors or one self-identified woman director and one director who self-identifies as an underrepresented minority or as LGBTQ+.<sup>14</sup>

Special purpose acquisition companies (SPACs), asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies and issuers of certain specified securities are exempt from both the board diversity objectives and the disclosure requirements of the new Rules.<sup>15</sup>

### **Effective Date**

Rule 5606 requires listed companies to begin reporting their board diversity matrix by the later of (i) one calendar year from the date of the Approval Order (August 8, 2022) or (ii) the date the company files its next proxy or information statement for its annual meeting of shareholders (or, if the company does not file these documents, the date that it files its Form 10-K or 20-F).<sup>16</sup> Newly-listed companies have a one year grace period after listing to comply with Rule 5606.<sup>17</sup> Listed companies must provide these disclosures in advance of the annual meeting of shareholders in its proxy or information statement (or in its Form 10-K or 20-F if it does not file a proxy or information statement) or on its website.<sup>18</sup> If the company chooses to disclose the information on its website, it must also provide such information in its proxy or information statement and submit the URL link to the Nasdaq Listing Center no later than one business day after publically releasing it.<sup>19</sup>

For the purposes of Rule 5605(f), listed companies fall into one of two tiers: (1) the Nasdaq Global Select Market or Nasdaq Global Market ("NGS/NGM") tier and (2) the Nasdaq Capital Market ("NCM") tier. The effective date varies based on the company's tier. Companies in the NGS/NGM tier have until August 7, 2023 (two years following the Approval Order) to have at least one diverse director on their board and until August 6, 2025 (four years following the Approval Order) to be in full compliance.<sup>20</sup> Companies in the NCM tier have until August 7, 2023 (two years following the Approval Order) to have at least one diverse director and until August 6, 2026 (five years following the Approval Order) to be in full compliance.<sup>21</sup> If a company files its proxy statement or its information statement (or, if the company does not file a proxy, in its Form 10-K or 20-F) for the company's annual shareholders

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Israeli company is required only to have a minimum of one woman on the board and such Israeli company chooses to comply with Israeli home country law in lieu of meeting the diversity objectives of Rule 5605(f)(2)(B), it may choose to disclose that "the Company is incorporated in Israel and required by Israeli law to have a minimum of one woman on the board, and satisfies home country requirements in lieu of Nasdaq Rule 5605(f)(2)(B), which requires each Foreign Issuer to have at least two diverse directors."

<sup>13</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(2)(D).

<sup>14</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(2)(B).

<sup>15</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(4).

<sup>16</sup> The Nasdaq Stock Market LLC Rules, § 5606(e).

<sup>17</sup> The Nasdaq Stock Market LLC Rules, § 5606(d).

<sup>18</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(3).

<sup>19</sup> *Id.*

<sup>20</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(7)(B).

<sup>21</sup> The Nasdaq Stock Market LLC Rules, § 5605(f)(7)(C).

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meeting after these dates in the calendar year for each respective year noted above, then the company will have until the date it makes such filing to meet, or explain why it does not meet, the applicable diversity objectives.

The compliance period for newly-listed companies follows a similar model. A newly-listed company in the NGS/NGM tier must have one diverse director by the later of (1) one year from the date of listing or (2) the date of filing its proxy or information statement for its first annual meeting following listing. A newly listed company in this tier must fully comply by the later of (1) two years from the date of listing or (2) the date of filing its proxy or information statement for its second annual meeting following listing. Companies in the NCM tier must have two diverse directors and be in full compliance by the later of (1) two years from the date of listing or (2) the date of filing its proxy or information statement for its second annual meeting following listing.<sup>22</sup>

If a company fails to comply or falls out of compliance with Rule 5605(f), it will have until the later of (i) its next annual meeting or (ii) 180 days from the event causing the deficiency to achieve compliance.<sup>23</sup> A company that relies on this grace period should disclose such reliance in advance of its next annual meeting of shareholders in its proxy or information statement or on its website. See Exhibit B attached to this memorandum for a summary of the timelines and requirements for compliance under the new Rules, as well as several useful definitions.

The Nasdaq Board diversity Rules are the first of their kind but may not be the last. In the Approval Order, the SEC suggests that for companies who do not want to “comply or explain” in accordance with the new Nasdaq Rules, they may decide to change their listing to another exchange that does not have such rules. For now, that remains a viable option. Only time will tell if other exchanges see the lack of a diversity rules as a competitive advantage or whether they will follow suit with similar rules of their own.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Helene R. Banks (partner) at 212.701.3439 or [hbanks@cahill.com](mailto:hbanks@cahill.com); or Elizabeth Sweeny (associate) at 212.701.3106 or [esweeny@cahill.com](mailto:esweeny@cahill.com); or email [publications@cahill.com](mailto:publications@cahill.com).

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<sup>22</sup> The Nasdaq Stock Market LLC Rules, § 5605(5)(A), (B).

<sup>23</sup> The Nasdaq Stock Market LLC Rules, § 5605(5)(6).

This memorandum is for general information purposes only and is not intended to advertise our services, solicit clients or represent our legal advice.

## Board Diversity Matrix

<b>Board Diversity Matrix (As of [Date])</b>				
<b>Total Number of Directors</b>		#		
<b>Part I: Gender Identity</b>	<b>Female</b>	<b>Male</b>	<b>Non-Binary<sup>24</sup></b>	<b>Did Not Disclose Gender</b>
<b>Directors</b>	#	#	#	#
<b>Part II: Demographic Background</b>	#	#	#	#
<b>African American or Black</b>	#	#	#	#
<b>Alaskan Native or Native American</b>	#	#	#	#
<b>Asian</b>	#	#	#	#
<b>Hispanic or Latinx</b>	#	#	#	#
<b>Native Hawaiian or Pacific Islander</b>	#	#	#	#
<b>White</b>	#	#	#	#
<b>Two or More Races or Ethnicities</b>	#	#	#	#
<b>LGBTQ+</b>	#	#	#	#
<b>Did Not Disclose Demographic Background</b>	#	#	#	#

<sup>24</sup> Non-Binary – Refers to genders that are not solely man or woman. Someone who is non-binary may have more than one gender, no gender, or their gender may not be in relation to the gender binary. Although non-binary is included as a category in the Board Diversity Matrix, a company would not satisfy the diversity objectives in proposed Rule 5605(f)(2) if a director self-identifies solely as non-binary. Order Approving Proposed Rule Changes, at 11. Nasdaq, Response to Comments and Notice of Filing of Amendment No.1 of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity (File No. SR-Nasdaq-2020-081), 66 (Feb. 26, 2021) <https://listingcenter.nasdaq.com/assets/Response%20to%20Comments%20Letter.pdf>.

## EXHIBIT B

## Rule 5605(f) and 5606 at a Glance

<b>Effective Dates</b>	<b>Listed Companies (NGS/NGM)</b>	<b>Listed Companies (NCM)</b>	<b>Newly Listed Companies (NGS/NGM)</b>	<b>Newly Listed Companies (NCM)</b>
<b>Initial Compliance</b>	Within two years following the Approval Order they must have at least one diverse director on their board (August 7, 2023)	Within two years following the Approval Order they must have at least one diverse director on their board (August 7, 2023)	The later of (i) one year from the date of listing or (ii) the date of filing its proxy or information statement for its first annual meeting following listing	
<b>Full Compliance</b>	Within four years following the Approval Order they must be in full compliance (August 6, 2025)	Within five years following the Approval Order they must be in full compliance (August 6, 2026)	The later of (i) two years from the date of listing or (ii) the date of filing its proxy or information statement for its second annual meeting following listing	The later of (i) two years from the date of listing or (ii) the date of filing its proxy or information statement for its second annual meeting following listing

## Rule 5605(f) and 5606 at a Glance

<b>Diversity Objective: Rule 5605(f)</b>	<b>Minimum Number of Diverse Directors</b>	<b>Minimum Requirement of One Woman Director</b>	<b>Minimum Requirement of at least One Underrepresented Minority or LGBTQ+ Director<sup>25</sup></b>
<b>General Diversity Objective</b>	2	Yes	Yes
<b>Foreign Issuers</b>	2	Yes	No
<b>Smaller Reporting Companies</b>	2	Yes	No
<b>Boards with 5 or Fewer Directors</b>	1	No	No

<sup>25</sup> For U.S. companies, the Rule defines an “underrepresented minority” as someone who self-identifies as African American or Black, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities. Foreign issuers may satisfy the diversity objective if their second director is an underrepresented individual in their home country jurisdiction. Rule 5605(f) also defines “LGBTQ+” as an individual who self-identifies as lesbian, gay, bisexual, transgender or as a member of the queer community. See the Annex below for these definitions. Order Approving Proposed Rule Changes, at 12, 36.

## Definitions

**Non-Binary** – Refers to genders that are not solely man or woman. Someone who is non-binary may have more than one gender, no gender, or their gender may not be in relation to the gender binary.

**African American or Black** (not of Hispanic or Latinx origin) – A person having origins in any of the Black racial groups of Africa.

**Alaskan Native or Native American** – A person having origins in any of the original peoples of North and South America (including Central America), and who maintain cultural identification through tribal affiliation or community recognition.

**Asian** – A person having origins in any of the original peoples of the Far East, Southeast Asia or the Indian subcontinent, including, for example, Cambodia, China, India, Japan, Korea, Malaysia, Pakistan, the Philippine Islands, Thailand and Vietnam.

**Hispanic or Latinx** – A person of Cuban, Mexican, Puerto Rican, South or Central American, or other Spanish culture or origin, regardless of race. The term Latinx applies broadly to all gendered and gender-neutral forms that may be used by individuals of Latin American heritage, including individuals who self-identify as Latino/a/e.

**Native Hawaiian or Pacific Islander** – A person having origins in any of the peoples of Hawaii, Guam, Samoa or other Pacific Islands.

**White** (not of Hispanic or Latinx origin) – A person having origins in any of the original peoples of Europe, the Middle East or North Africa.

**Two or More Races or Ethnicities** – A person who identifies with more than one of the above categories.

**Underrepresented Individual in Home Country Jurisdiction** – A person who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the country of the foreign issuer's principal executive offices (as reported on the foreign issuer's Forms F-1, 10-K, 20-F or 40-F).

**LGBTQ+** – A person who identifies as any of the following: lesbian, gay, bisexual, transgender or as a member of the queer community.