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Nasdaq's "New Diversity Rule"

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Update January 7, 2025: On December 11, 2024, the Fifth Circuit vacated the SEC's order approving Nasdaq's board diversity rules, holding that the rules did not relate to the purpose of the Exchange Act of nor did the SEC have the authority to approve the rules.

On August 6, 2021 the U.S. Securities and Exchange Commission approved Nasdaq's new Board Diversity Rule that is designed to increase diversity on the boards of companies listed on its exchange. According to Nasdaq, the proposal will "encourage a minimum board diversity objective" for companies and provide stakeholders with "consistent, comparable disclosures concerning a company's current board composition."

Rule Requirements

Nasdaq's Board Diversity Rule requires companies listed on Nasdaq to publicly disclose board-level diversity statistics using a standardized template. Companies must also either have or explain why they do not have at least two diverse directors on their Board of Directors.

Timeline for Disclosure

Nasdaq-listed companies have until the later of August 8, 2022, or the date the company files its proxy or information statement for the company's annual shareholder meeting during 2022. The required disclosure must be provided in the company's proxy statement or its information statement (or if the company does not file a proxy, in its Form 10-K or Form 20-F), or on the company's website.

Companies will need to disclose board-level diversity data annually.

Smaller Reporting Companies and Foreign Issuers

The rule provides flexibility for smaller reporting companies and foreign issuers. These companies can meet the diversity objective by including two female directors, and for all companies with five or fewer directors, the objective may be met by including one diverse director.

Foreign Issuers can meet the diversity objective with two female directors, or with one female director and one director who is an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the country of the company's principal executive offices.

As with other Nasdaq-listed companies, if a company chooses to explain why it does not meet the diversity objectives, it should provide its explanation in its proxy statement, information statement for its annual shareholder meeting, or on the company's website.

Timeline for Diversity Compliance / Explanation of Non-Compliance

There is a transition period for Nasdaq-listed companies to meet the diversity objectives, or explain why they do not. The transition period is based on a company's listing tier:

- Nasdaq Global Select Market or Nasdaq Global Market companies are required to have, or explain why they do not have, one diverse director by August 7, 2023, and two diverse directors by August 6, 2025.
- Nasdaq Capital Market companies are required to have, or explain why they do not have, one diverse director by August 7, 2023 and two diverse directors by August 6, 2026.
- Companies with boards that have five or fewer directors, regardless of listing tier, are required to have, or explain why they do not have, one diverse director by August 7, 2023.

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 meeting after the anniversary of the Effective Date 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.

Nasdaq's Review

Nasdaq says it will verify that a listed company has provided an explanation if it does not meet the diversity standard, but will not assess the merits of the explanation. There is no right or wrong reason that a company may give for not having at least two diverse directors.

Nasdaq gives the following examples of explanations:

1. If a company is listed on Nasdaq Global Select or Global Market but believes that it is similarly situated to companies listed on Nasdaq Capital Market in terms of its annual revenues and public float, it may explain that for these reasons it therefore has chosen to meet the objectives applicable to companies listed on the Nasdaq Capital Market instead.

2. 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' disabilities when identifying nominees for director because it believes such diversity brings a wide range of perspectives and experiences to the board.

3. If under Israeli law regarding board diversity, an 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 instead of meeting the diversity objectives of the new rule, 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 instead of the new Nasdaq rule, which requires each Foreign Issuer to have at least two diverse directors.

SPAC Exemption

SPACs listed under IM-5101-2 are not required to provide disclosure information or to have, or disclose that they do not have, any minimum number of diverse directors until their business combination. Following the business combination, former SPACs must meet, or explain why they do not meet, the applicable diversity objectives by the later of two years from the date of listing or the date the 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 second annual meeting of shareholders subsequent to the company's listing.

Legal Challenges

The new rule was narrowly approved along political lines and it is very possible that the argument that the rule falls "outside the scope" of the securities laws and "contrary to fundamental constitutional principles" may be ultimately decided by the courts.

D&O Questionnaires

Companies will need to think about how to gather diversity information. While a possible way to gather such information is to include additional questions in its annual Director & Officer Questionnaire, companies may seek a more discreet self-identification process with proper documentation.

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