Cheetah®

Securities Regulation Daily Wrap Up, TOP STORY—Nasdaq amends diversity disclosure proposal to give more flexibility for smaller boards, (Mar. 12, 2021)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By John M. Jascob, J.D., LL.M.

Other material changes would allow additional compliance time for newly listing companies while providing a grace period for firms that no longer meet the diversity objectives due to board vacancies.

The Nasdaq Stock Market LLC has filed amendments to the exchange's proposed rules requiring Nasdaq-listed companies to either have a specified number of diverse directors or explain why they do not. In response to comments from issuers and stakeholders, Nasdaq has revised the proposal to provide listed companies with boards of five or fewer directors the ability to achieve the diversity objective by having just one diverse director, rather than at least two as in the initial proposal. Other material amendments would provide a one-year grace period for a company that no longer meets the diversity objectives due to a vacancy on the board, such as from illness, while providing all new companies listing after the phase-in period with two years to fully meet the diverse director objective (Release No. 34-91286, March 10, 2021).

Stakeholder comments. In its response to the SEC concerning the comments submitted on its initial rule filing, Nasdaq noted that nearly 85 percent of the over 200 substantive letters supported the proposal, including commenters representing every constituency of corporate stakeholder. After reviewing the comment letters, Nasdaq reiterated its belief that the proposal's diversity objectives for Nasdaq-listed companies will promote board diversity and, thus, enhance corporate governance and strengthen the market integrity by building investor confidence and enhancing capital formation, efficiency, and competition. In Nasdaq's view, the proposal ameliorates concerns regarding the consistency and comparability of current board disclosure data by enhancing transparency related to board diversity.

Nasdaq's letter also sought to address what it described as common misperceptions expressed by commenters. For example, Nasdaq's proposal is a disclosure framework, not a quota or numeric mandate. Companies can elect to meet the diverse director objective or disclose why they do not, and the explanation can include a description of a different approach. Moreover, Nasdaq companies will not be subject to delisting solely for choosing not to meet the minimum diverse director objective since companies have the option to provide an explanation instead. The proposal will not force companies to appoint unqualified directors because the proposal does not discourage board candidate recruitment on the basis of merit, and there is a sufficient community of available and qualified diverse candidates, Nasdaq wrote.

Companies with smaller boards. Among the material changes in the amendments, Nasdaq has amended proposed Rule 5605(f)(2)(D) to require a company with a board of directors of five or fewer members to have, or explain why it does not have, at least one member of its board of directors who is diverse, rather than two. Nasdaq made the changes in response to requests to allow greater flexibility for companies with relatively small boards. Nasdaq observed that not all companies with small boards are Smaller Reporting Companies who may avail themselves of the rule's alternative diversity objective. In addition, companies with smaller boards may have been disproportionately impacted if they plan to satisfy the rule by adding additional directors due to additional costs such as director compensation and D&O insurance.

"Cure" period for unanticipated departures. In response to comments, Nasdaq recognized that a company that satisfies Rule 5605(f)(2) with two diverse directors may no longer satisfy the requirement due to a vacancy on the board, for example if a diverse director resigns or falls ill. Given the personal circumstances that may accompany a vacancy on the board, Nasdaq amended its proposal to provide each company that previously satisfied Rule 5605(f)(2)'s diversity objectives with a grace period of the later of: (1) one year from the date of vacancy; or (2) the date the company files its proxy statement or information statement (or, if the company does not file a proxy, in its Form 10-K or 20-F) in the calendar year following the date of vacancy, to meet, or explain why it does not meet, the applicable diversity objectives.

Grace period for compliance. Nasdaq has also amended the proposal to provide newly listed companies with 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, its Form 10-K or Form 20-F, for the company's second annual meeting of shareholders subsequent to the company's listing, whichever is longer) to satisfy the requirements of Rule 5605(f). The purpose of the amendment, which provides an additional year for compliance from that of the initial proposal, is to prevent the proposal from being a barrier to private companies accessing capital through the public markets. Nasdaq noted that newly public companies may have unique governance structures, such as staggered boards or director seats held by venture capital firms, that require careful timing when adjusting the composition of the board of directors.

Other substantive changes. Among the other substantive changes, Nasdaq amended the proposal to add a defined term for "Two or More Races or Ethnicities" to proposed Rule 5605(f)(1). The amendments also modify the application of proposed Rule 5605(f) to foreign issuers and while clarifying the scope of exempt companies.

Request for comments. Comments on the revised proposal must be submitted within 21 days from the date of publication in the *Federal Register*.

The release is No. 34-91286.

MainStory: TopStory CorporateGovernance DirectorsOfficers ExchangesMarketRegulation GCNNews PublicCompanyReportingDisclosure