Public Statement

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

Commissioner Hester M. Peirce

Aug. 6, 2021

I write in opposition to the approval of the Board Diversity Proposal ("Board Diversity Proposal" or "Proposal") submitted for approval by the Nasdaq Stock Market LLC ("the Exchange").[1] The Proposal attempts to expand opportunity, a goal I share,[2] but it does so in a way that improperly leverages authority that Congress has entrusted to it under the Exchange Act. Because the Exchange cannot show that its Proposal is consistent with the Exchange Act, and because the Proposal is in fact outside the scope of the Act and contrary to fundamental Constitutional principles, I cannot support its approval.[3]

I. The Board Diversity Proposal is not designed to achieve the purposes of the Exchange Act.

The Exchange submitted its Board Diversity Proposal with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").[4] Under Section 19(b)(2)(C)(i), the Commission "shall approve" a proposal "if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations issued under this chapter that are applicable to such organization."[5] To determine whether an exchange rule filing is consistent with the Act, the Commission looks primarily to Section 6(b)(5), which requires an exchange's rules to be:

> designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade,. . . to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and [] not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.[6]

a. The Exchange has failed to meet its burden of showing that the Board Diversity Proposal is consistent with the Exchange Act.

The Exchange dutifully recites the statutory standard but never actually provides evidence sufficient to establish that the Board Diversity Proposal is reasonably designed to satisfy any of the affirmative criteria enumerated in Section 6(b)(5). The Exchange's argument essentially distills to this: A number of studies—most examining only the effects of gender diversity, and a few addressing racial diversity—appear to show (or suggest, or perhaps to hint at) a correlation between (primarily) gender diversity and (to a lesser extent) racial diversity on the one hand and, on the other, certain desirable effects on corporate performance, such as greater transparency, fewer financial restatements, higher quality audits, reduced information asymmetry, and lower stock price volatility.[7] Accordingly, the Exchange asserts, investors and the market would benefit if Exchange-listed issuers were required to report specified demographic characteristics of board members and to either meet a "diversity objective" or explain why they do not. Further, the Exchange contends, having a certain number of directors who are diverse according to the demographic characteristics it has chosen would benefit issuers by reducing "groupthink."[8]

The Exchange makes no effort to examine the underlying quality of the studies to which it points, nor does it attempt to establish that any of them demonstrates a causal relationship between diversity, however defined, and any of the purported positive effects.[9] Moreover, several commenters identified serious weaknesses with this empirical research,[10] and one commenter submitted two separate studies that closely examined the studies supporting the Exchange's Proposal.[11] These commenters and studies persuasively demonstrate that the studies used by the Exchange are generally of low quality; that several do not make public the underlying data and the others that make the underlying data available show, at best, correlation; and that the Exchange has disregarded several high-quality studies that contradict the studies upon which the Exchange relies. Finally, the Exchange makes no effort to explain why studies examining the effects of gender and, to a lesser extent, racial diversity support its decision to include in its rule other types of diversity for which there is no evidence linking board membership to corporate performance.

These deficiencies should have doomed the Board Diversity Proposal, as they leave the Exchange without a persuasive basis for concluding that the Proposal is reasonably designed to advance the objectives set forth in Section 6(b)(5) of the Exchange Act. The Exchange insists that, even if the empirical evidence is equivocal, its conversations with various stakeholders and statements by current and former SEC Commissioners demonstrate that investors desire consistent and comparable information relating to diversity in making their investment decisions, but this type of anecdotal support for the rule is insufficient to meet the Exchange's burden to show that its Proposal is consistent with the Act. That investors or the significantly more nebulous "stakeholder" community wants certain information does not itself determine whether an exchange rule mandating or incentivizing the disclosure of that information is consistent with the Exchange Act. The Act nowhere delegates authority to exchanges to impose on issuers disclosure mandates or "objectives"[12] related to internal corporate affairs, much less those related to important societal problems, simply because current investor or "stakeholder" sentiment is said to favor such requirements.

If the Exchange were able to show compelling evidence that the obligations imposed by the Proposal satisfy one or more of the affirmative criteria enacted in Section 6(b)(5), this anecdotal evidence might be relevant in weighing whether the Proposal is a prudent exercise of the Exchange's authority under the Exchange Act. The Exchange, however, has presented no compelling evidence that the Proposal satisfies any of these criteria; and assertions that some investors and some "stakeholders" would really like to have it cannot bootstrap the Proposal into consistency with the Act.

The Commission's Order, in turn, politely declines to wade into the messy job of assessing the Exchange's empirical claims on their merits and instead finds that investors would be served by this diversity information because "commenters representing a broad array of investors" so clearly want it.[13] The Order attempts to establish a link between the Proposal and the Section 6(b)(5) criteria by asserting that it "would provide investors with information to facilitate their evaluation of companies in which they might invest."[14] By providing this information, the Order concludes, the Proposal would "contribute to the maintenance of fair and orderly markets," which in turn demonstrates that "the Board Diversity Proposal is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest."[15]

But this reasoning either begs the very question that needs to be asked—whether the information is relevant to investors in a way that matters under the Exchange Act—or suggests that an exchange may impose any

obligation on issuers for which "commenters representing a broad array of investors" are clamoring. To the extent that it is begging the question, it fails under the D.C. Circuit's decision in *Susquehanna International Group LLC v. SEC*, in which the Court held that the Commission's "unquestioning reliance" on a self-regulatory organization's analysis in approving a rule filing violated both the Exchange Act and the Administrative Procedure Act.[16] The Commission is obliged to critically assess the "self-serving views of the regulated entit[y],"[17] and it cannot evade this obligation by assuming that the Proposal imposes disclosures and other obligations that are meaningful to investors (and "commenters representing" them) in a way that is relevant under the Exchange Act.

To the extent that the Commission's Order is approving the Proposal because it finds the Exchange Act permits exchanges to impose any disclosure requirement that some investors (or their purported representatives) demand, it is adopting a standard that is both contrary to the Exchange Act and ultimately unworkable. Section 6(b)(5) of the Act prohibits exchanges from adopting rules that "regulate by virtue of any authority conferred by [the Exchange Act] matters not related to the purposes of [the Act] or the administration of the exchange." One can easily imagine investors—and more importantly, as their views seem to have been given particular weight in this Proposal, "stakeholders" and other non-investor groups—asking for disclosure on any number of issues of public or social concern. Most of these issues, however, fall outside the purposes of the Act, which Congress made quite narrow in scope.[18]

b. The Board Diversity Proposal does not protect investors.

As noted above, the Exchange contends that the Board Diversity Proposal responds to investor demand for consistent, comparable information about directors. Even setting aside the deficiencies in the empirical evidence relied upon by the Exchange and in the Commission's analysis, it is worth taking a closer look at how the Exchange's diversity disclosures create the impression of clarity for investors while actually serving to mislead them.

The Exchange's designation of relevant demographic categories is arbitrary, as it has not shown that they are tailored to provide the "consistent" and "comparable" diversity-related information the Exchange believes investors are demanding. First, the Proposal relies on self-identification, which is unlikely to be comparable within any one board, let alone across all boards.[19] Second, because the rule applies different categories to foreign listed companies, even assuming that all board members self-identify in a consistent manner and that they all self-identify in accordance with some generally accepted norm, the rule will not facilitate comparisons across all firms. Third, because the Board Diversity Proposal elicits aggregate information about a company's board broken down by race and ethnicity, gender, and LGBTQ+ status presumably to protect director privacy, cross-company comparisons of the number of directors who have some Diversity characteristic will be difficult.

The information required under the Proposal obscures by eliding the type of detail that may be important to an investor trying to assess a board's effectiveness. For one thing, the mandated diversity matrix will encourage investors to overlook important differences in director perspectives by shifting their focus to demographic characteristics of the board as a whole rather than to the individual experiences and skill sets that each director brings to the board room. Is a Black director who grew up in the Cleveland suburbs and studied accounting at Ohio State before embarking on a long career at a large American public company really likely to represent the same perspective as a Rwandan director who has an engineering degree and runs a large manufacturing plant in Rwanda? Unlikely, but both show up in the same boxes in an American company's matrix if they self-identify as Black cis-gendered heterosexual males. For that matter, two Black men who grew up in Cleveland and attended Ohio State before embarking on impressive careers in different fields are unlikely to represent the same perspective on a board, but the Exchange's rule may encourage the belief that, because one of the two is sitting on the board and thus the "diversity objective" is satisfied, the company should be less concerned about trying to recruit the other. Comparability has its merits, but reducing a person to a few checkmarks on a chart presents the person in a manner that strips away his or her unique, hard-won expertise and knowledge and thus is not meaningfully illuminating for investors or salutary for issuers.

c. The Board Diversity Proposal harms market integrity.

Although the Exchange argues that the Proposal will "remove impediments to and perfect[] a free and open market and a national market system," the Proposal will actually harm the market in several ways. First, the

Exchange seeks to micromanage the delicate process of composing a board, a process that does not lend itself well to standardization. If, for example, a company with an all-male board seeks to fill a director opening, and the candidate with the qualifications the board most needs—industry-specific cybersecurity expertise—is a Native American man, the company may pass him over in favor of a non-minority woman without that experience, particularly if the cybersecurity expert opts not to self-identify as belonging to any demographic category (other than cybersecurity expert). The company would want to be able to report that it complies with the Exchange's diversity targets (and to avoid the likely reputational and market consequences if it does not), so it may choose the woman who is less likely to round out the expertise of the board of that particular company.[20] The company is at reputational, legal, and financial risk regardless of which path it takes: If it does not hire the woman in this scenario, it has to explain why it does not meet the mandate, which may lead to outcry, a drop in its stock price, and a shareholder suit. If it does hire the woman, it avoids those particular consequences in exchange for possible longer-term reputational, legal, and financial consequences, as it finds itself without necessary expertise. The Exchange's rule may contribute inadvertently to short-term decision-making in board selection.

Second, the Commission's approval of the Board Diversity Proposal will have consequences on matters beyond board composition. By approving the Proposal on the strained rationale cobbled together from a less than compelling set of empirical studies and closed door conversations with select issuers, investor "representatives," and stakeholders, the Commission can expect to receive poorly reasoned and poorly substantiated rationales for future rule filings. Moreover, approval of Nasdaq's filing on the basis given by the Exchange may send the message that "the SEC could or should approve nearly any [SRO proposal]—hardly the result the Exchange Act envisions."[21]

Third, notwithstanding its argument that the Board Diversity Proposal is designed to prevent fraudulent and manipulative acts and practices, the Exchange's Proposal will incentivize misleading disclosure. By setting "diversity objectives," requiring companies that fail to reach those targets to explain publicly why they have failed to do so, and relying on director self-identification, the Proposal invites disclosure that pushes the envelope of plausibility. To avoid having to admit noncompliance with the Exchange's "diversity objectives," a confession that likely will draw negative attention, including perhaps shareholder litigation,[22] customer boycotts, and higher capital costs, companies will be under tremendous pressure to fit their directors into one of the favored categories.

While most companies will proceed honestly, experience in other areas of corporate disclosure suggests that some companies will not. Some issuers that do not satisfy the Exchange's "diversity objectives" might falsify the prescribed diversity matrix to make it appear that they do. These companies may be willing to gamble that nobody will second-guess their matrices because doing so would require deconstructing the aggregated presentation to second-guess very personal information about individual directors. Self-identification, while certainly preferable to an alternative that would require proof of membership in a particular group, makes deception by a company intent on doing so easier.[23]

Fourth, the Exchange's Proposal may lead to less effective oversight of boards of directors by investors and asset managers. Even assuming that the Exchange's proposed Board Diversity Matrix actually facilitates consistent reporting and comparable disclosure across issuers (which it, of course, does not, for the reasons explained above and below), it could overshadow the obligation of asset managers to assess the qualifications, skills, experience, and background of each nominee to each issuer's board. If a company reports compliance with the Exchange's "diversity objectives," will investors and asset managers continue to push companies to conduct wide-ranging director searches to ensure that female or minority candidates with needed expertise are not overlooked?

Finally, the Board Diversity Proposal will create an unfair advantage for certain issuers. Specifically, the Board Diversity Proposal favors foreign issuers by giving them a more flexible set of "diversity objectives" and an option to choose among disclosure matrices. Further, practically speaking, it will be more difficult for the Exchange to monitor and enforce compliance by foreign issuers since it is unlikely that Exchange personnel will understand foreign issuers' home country diversity dynamics sufficiently to assess those issuers' compliance.

d. The Board Diversity Proposal is contrary to the public interest.

The Exchange contends that the public interest will be served by a disclosure-based framework that encourages meaningful board diversity.[24] However, Commission approval of the Exchange's Proposal lends a government imprimatur to the race- and sex-based board-selection objectives that are contrary to the public interest. The disclosure categories and the Exchange's numerical "diversity objectives" rely on inappropriate stereotyping, are poorly tailored to the Exchange's justifications for selecting them, and—intending to remedy societal discrimination—actually place a disproportionate burden on women, underrepresented minorities, and LBGTQ+ individuals.

First, a key rationale underlying the Board Diversity Proposal assumes that people within a particular diversity category necessarily provide a different perspective from those within a different diversity category. The Proposal thus treats women as interchangeable with one another because it assumes that, if nothing else, any given woman necessarily will bring a consistently different, *womanly* perspective to the board than would a male director. Because the Proposal allows a company to choose its second "diverse" director from among enumerated minorities or the LGBTQ+ community, the Proposal seems to assume that directors within and between these two groups are interchangeable, again because any given member of either of these groups necessarily will bring a uniformly different perspective on matters related to the board from a non-minority cis-gendered heterosexual man or woman.

As noted above, the Exchange relies on generally poor-quality or irrelevant empirical evidence to support this view, which should perhaps not surprise us, as it echoes essentialist conceptions of race and sex that are now broadly considered offensive and reminiscent of historical racist and sexist thinking. It should be obvious to anyone with a diverse group of friends or colleagues that two people who look different may share very similar backgrounds and attitudes toward a range of issues, including corporate governance, whereas two people who look similar may bring very different qualities to a board's decision-making.[25]

Moreover, the Exchange looks to the Board Diversity Proposal to combat "groupthink," but the Proposal may in fact encourage groupthink. The Proposal singles out companies that choose not to select directors based on candidates' race, ethnicity, gender, and LGBTQ+ status as qualifying characteristics when choosing their boards. Although the Exchange emphasizes the option the Proposal gives to issuers to explain why they do not satisfy the disclosure requirements, it disregards the current social and political context that is likely to make this alternative extremely undesirable to most issuers.[26] In addition, given these high stakes, it is possible that companies may reject underrepresented minorities or women who choose not to self-identify, which could transform the proposed framework into an ideological screen that selects for people who are willing to subject themselves to the prescribed categorization. To the extent that the Proposal selects for a director's willingness to overcome personal discomfort with such classifications in response to pressure from future board or management colleagues to self-identify, it may filter out people who would be willing to push back against management: Their unwillingness to pay the self-identification entry price will bar them from the boardroom. The Exchange's hopes of combatting groupthink might not materialize.

Second, none of the Exchange's justifications provide a non-arbitrary basis for its decision to include the three categories it has chosen to include. For example:

- *The Exchange's selected Diversity characteristics are not tailored to the evidence provided by the Exchange.* The evidence cited by Nasdaq relates primarily to female participation on boards[27] and, to a lesser extent, racially diverse boards, but Nasdaq has cited no empirical evidence regarding the effect of LGBTQ+ diversity on boards. Notwithstanding this lack of evidence, the Exchange includes LGBTQ+ diversity in its Diversity Matrix and "diversity objectives," explaining that including this category may facilitate the analysis of potential links between LGBTQ+ diversity and board performance.[28] At the same time, it dismisses suggestions that it include categories such as veteran status, disability status, and national origin, in part because there is inadequate information about the effects these types of diversity on board performance. Nasdaq offers no explanation for its arbitrary imposition of asymmetrical evidentiary requirements among different categories within its own definition of Diverse director.
- *The Exchange's selected Diversity characteristics are not tailored to facilitate disclosure of consistent and comparable information.* The Exchange repeatedly emphasizes that it is important that investors receive consistent, comparable data regarding diversity. It explains that this objective influenced its decision to use the characteristics required on the U.S. Equal Employment Opportunity Commission's

EEO-1 report, which many issuers already are required to submit. The Exchange further states that it considered other characteristics, "including LGBTQ+, nationality, veteran status, and individuals with disabilities,"[29] but, after consultation with "stakeholders," determined to include only the LGBTQ+ category, as "adopting a broad definition of Diverse would maintain the status quo of inconsistent, noncomparable disclosures, whereas a narrower definition of Diverse focused on race, ethnicity, sexual orientation and gender identity will promote the public interest by improving transparency and comparability."[30] Nowhere does the Exchange explain why the urgent need for consistent and comparable disclosures justifies including LGBTQ+ (a category the definition of which is fluid across communities and through time) in the Proposal while excluding veteran status, disability status, or national origin from it. The Exchange's rationale suggests an unusual view of diversity, one that assumes that "the more underrepresented groups that you permit into that conversation, potentially you start to water it down and have less diversity."[31] How do more categories of people undermine diversity? Why do directors who are veterans, disabled, of foreign national origin, or non-binary[32] not result in a diversity "credit" under the rule? If a female director changes her self-identification to non-binary, why should that director no longer count as diverse?

- *The Exchange arbitrarily excludes historically protected groups from its Diversity characteristics.* The Exchange asserts that it has designed the Proposal to "ensure that board diversity is occurring across *all protected* groups."[33] The Exchange does not define the phrase "protected groups," which is used only once in its filing, but assuming that it is using it in a manner consistent with common usage, its Proposal manifestly does *not* do this, as it excludes several groups that are protected under federal anti-discrimination laws, including some that commenters suggested be included (such as veteran or disability status) or some that the Exchange is permitting foreign (but not American) issuers to include (such as religion or language).
- *The Exchange's accommodation for foreign issuers highlights the arbitrariness of its selected Diversity characteristics.* The Proposal permits foreign issuers to use different metrics because "it is challenging to apply a consistent definition of minorities to all countries globally."[34] Although this concern for the practicability of the rule for certain issuers is certainly understandable, the Exchange fails to grapple with how this exception undermines its argument that disclosures must be consistent and comparable. Not only does this exception render the disclosures of U.S. and foreign issuers inconsistent and non-comparable with each other, the Exchange fails to explain how someone could reasonably compare disclosures made, say, by an issuer in Spain with those made by an issuer in Japan, two countries with very different demographics. Moreover, this exception heightens the arbitrariness of its requirements for U.S. issuers. If the four additional categories applicable to foreign firms do not, in the Exchange's view, render the disclosures inconsistent or non-comparable, it is difficult to see why using the three additional characteristics requested by commenters in the U.S. context would do so.

To summarize the discussion thus far, these arbitrary inclusions and exclusions show that the Exchange's definition of "diverse" is not reasonably tied (1) to board compositions purportedly shown to increase corporate performance, or (2) to categories that firms already report, or (3) to groups historically protected under federal law, or (4) to conditions necessary to obtain consistent and comparable disclosures, or indeed (5) to ensuring that boards are composed of people with diverse cognitive diversity[35] and backgrounds.

Finally, the Board Diversity Proposal will subject directors and would-be directors to intense pressure to disclose personal information, and this pressure will fall disproportionately on women, underrepresented minorities, and LBGTQ+ individuals. The Board Diversity Proposal would permit directors to choose not to disclose their gender, race, ethnicity, or LGBTQ+ status. In reality, however, the pressure on directors, particularly those who "count" toward the "diversity objectives," to disclose these characteristics will be strong. Imagine an Asian-American director who chooses to opt out of self-identifying his ethnicity. His last name might suggest that he is Asian-American, so the company may ask whether the company can simply report an Asian director in its matrix. Will willingness to self-identify become a prerequisite for board service? What about a female director who is considering transitioning to male? Will she be permitted to change her self-identification to male as part of the transition process? What about a bisexual director who marries and wishes to renounce his or her self-identification as bisexual in order to underscore his or her commitment to an exclusive relationship with his or her spouse? What about a director who was adopted as a child and honestly believes that he has African American ancestry, but a genetic test reveals that all of his ancestors are southern Italian?

If he chooses to change his self-identification from African American, will the company protest? If he chooses to retain his African American self-identification, but discloses to management the results of the test, will the company face legal or reputational consequences for reporting his self-identification as African American if the arguably contradictory evidence later becomes public? What about a director on the board of a foreign issuer who is LBGTQ+, but only his closest friends on the board and in management are aware of this fact. Public self-identification could expose him to persecution or even death. Even though the disclosures are aggregated, reverse engineering may reveal his identity. Will he feel pressure to self-identify?

All of these situations are intensely personal. Pressuring self-identification, expressly or implicitly, would be inhumane, yet the Board Diversity Proposal creates incentives to force directors to acquiesce to the revelation of personal characteristics. How easy will it really be for a board member who knows that her ethnicity can save the company from having to explain why it does not meet the Exchange's "diversity objectives" to say, "No, put me down as 'Did not disclose demographic background'"?[36] Will she be violating her fiduciary duty to the company by not disclosing her ethnicity—because she prefers not to do so—even though it may expose the company to public opprobrium and perhaps a costly activist campaign? Could a company require its director candidates to undergo genetic testing to check for qualification in one of the Exchange's racial or ethnic categories? Perhaps these scenarios will be rare, in large part because many people are happy to disclose their race, ethnicity, gender, or LGBTQ+ status, but even infrequent instances of forced self-identification are serious and ought to have been taken into account as part of the consideration of this Proposal.

II. The Board Diversity Proposal addresses issues outside the scope and purposes of the Exchange Act.

The Exchange finds it so difficult to fit the Board Diversity Proposal to any of the criteria of Section 6(b)(5) because the rule is not actually intended or designed to address any matter relevant to the scope or purposes of the Exchange Act. The Proposal in fact reflects the Exchange's efforts to address matters of grave social concern by using its authority as a listing exchange to create incentives for issuers to make changes that the Exchange believes will bring about socially desirable results. Recognizing that it cannot impose requirements in either capacity without seeking Commission approval, the Exchange has attempted to articulate a rationale that fits within the limitations prescribed by the Exchange Act, but that effort fails.

As already noted, Section 6(b)(5) provides that an exchange's rules not only need to be designed to satisfy certain affirmative criteria, as described above, but that they must not "regulate by virtue of any authority conferred by [the Exchange Act] matters not related to the purposes of [the Act] or the administration of the exchange." Section 2 of the Act describes in general terms the purposes of the Act as a whole, which boil down to regulating securities transactions with an eye toward protecting interstate commerce and the financial system and ensuring the maintenance of fair and honest markets in securities transactions.[37]

The Board Diversity Proposal does not advance any of these purposes. Merely because the Exchange has identified a societal problem that it believes it can address through its power to set listing standards or regulate its members does not bring the proposed solution within the scope of the Exchange Act.[38] This limitation is important: As a nation, we face myriad societal, economic, and political challenges. But the notion that Congress—which has not given exchanges and other SROs, or even the Commission, a mandate to address these challenges and remedy these injustices—expected them to attempt to do so merely because they have leverage over market participants through the authority granted them in the Exchange Act, is fanciful.[39]

Our political and civil institutions, which are directly responsive to the American people, are charged with wrestling with these problems.[40] Cloaking attempted solutions in the language of the Exchange Act leads the Exchange and thus the Commission where it does not belong—to tackling thorny societal and cultural issues that properly belong in the political and civil arena. Moreover, focusing on issues that belong in the political and civil arenas diminishes the capacity of both the Commission and self-regulatory organizations to focus on their respective missions and weakens rather than strengthens market integrity.

III. The Board Diversity Proposal conflicts with core Constitutional principles.

The objectives and disclosure requirements imposed by the Board Diversity Proposal encourage discrimination and effectively compel speech by both individuals[41] and issuers[42] in a way that offends protected Constitutional interests. Courts will allow the government to interfere with these interests only if it can show a compelling interest and the requirement is narrowly tailored to achieve that interest.

The Commission's Order and the Exchange both dismiss this concern out of hand on the basis that courts have generally held that self-regulatory organizations like exchanges are not state actors. Courts appear to be divided on this question,[43] though here the Exchange justifies the standard in part on its conclusion that the Commission has not taken steps to foster board diversity, which may weigh in favor of treating it as a state actor.[44] If the Exchange is a state actor, the Exchange's rule, which encourages companies to make distinctions among directors and director candidates based on race, ethnicity, gender, and LGBTQ+ status, likely would face careful scrutiny in a court challenge.

However, neither the Commission's Order nor the Exchange gives due consideration to a more important question, namely the Commission's own role in this rule, which extends beyond approving the rule, as the Commission is doing here, to a significant role in its administration and enforcement by the Exchange. Once the Proposal is approved, the Exchange will have an obligation to comply with its own rules by initiating delisting proceedings against an issuer that does not comply with the new listing standard. The Commission, in turn, is required by the Exchange Act both to ensure that the Exchange complies with its own rules (by initiating such delisting proceedings),[45] and, in the event of a delisting, potentially to hear appeals from the delisted issuer challenging the Exchange's decision.[46]

Commission action in either context could involve the Commission in making factual determinations[47] that a government body should not be able to—and, under our Constitutional order, cannot—make. These determinations may, depending on the context of the action, involve questions about the validity of an individual's self-identification or the adequacy of a firm's "philosophy regarding diversity."[48] Either type of inquiry by a government agency should trouble every American, and a rule, like the Board Diversity Proposal, that could require the Commission to engage in such determinations is inconsistent with key principles that our founding charter upholds.

IV. Conclusion

Our society is increasingly recognizing the urgency of ensuring that people are not shut out of opportunities on the basis of characteristics irrelevant to their ability to excel. The unique value of each individual is able to shine brightest when the individual's personal, educational, and professional opportunities are as broad as possible. Families, neighborhoods, communities, companies, governments, and civil society institutions in turn benefit from the dynamism created when members with complementary talents and diverse backgrounds, perspectives, skills, and experiences are all able to contribute to those institutions.

Unfortunately, the Proposal will not help to achieve greater opportunity for all members of society to exercise their talents. Nor will it advance the Exchange's stated objectives of more accurate and comparable board diversity data and less "groupthink." It is more likely to do the opposite because it relies on crude categorizations of people into racial, gender, ethnic, and LGBTQ+ status boxes that deprive the people being categorized of their individuality and their professional, educational, experiential, and personal complexity.

The Exchange speaks in the language of choice—a company can choose not to meet the Exchange's "diversity objectives" and a director can choose not to self-identify—but there is no real choice here. The Exchange's focus on the disclosure option as a key element that prevents the rule from being a mandate disregards the current political context: No issuer will consider disclosure (rather than compliance) a realistic option in the current environment. No director who qualifies as "diverse" will consider non-disclosure a realistic option.

The Exchange's Board Diversity Proposal, rather than contributing to the work of breaking down barriers to entry into the boardroom, raises new arbitrary barriers. The Proposal furthers the growing trend by private and

public institutions of classifying people by gender, racial, ethnic, and LGBTQ+ categories. Such classifications strip people of their individuality, their ability to focus on what makes them uniquely valuable to society, their freedom to think and speak for themselves, and their right to decide when and with whom to share their personal attributes. The Proposal should be disapproved because it is inconsistent with the Act, outside the scope of the Act, and offensive to important Constitutional principles.

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[1] *See* Securities Exchange Act Release No. 92600 ("Approval Order") (August 6, 2021) (SR-NASDAQ-2020-081). This proposed rule change would adopt listing rules related to board diversity. Specifically, the rule would require each Nasdaq-listed company, subject to certain exceptions, to have, or explain why it does not have, at least one director who self-identifies as a female; to have, or explain why it does not have, at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LGBTQ+; and to provide statistical information in a proposed uniform format on the company's board of directors related to a director's self-identified gender, race, and self-identification as LGBTQ+. *See* Amendment No. 1 to the Board Diversity Proposal ("Amendment No. 1"), available at https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8425992-229601.pdf. For the Exchange's initial filing, see Securities Exchange Act Release No. 90574 (December 4, 2020), 85 FR 80472 (SR-NASDAQ-2020-081).

[2] *See* Commissioner Hester M. Peirce, "Prosperity's Door," Remarks at the FINRA Certified Regulatory and Compliance Professional Program at Georgetown University (July 21, 2021), https://www.sec.gov/news/speech/peirce-prosperity-door-072121.

[3] I do not object to the approval of the Board Recruiting Service Proposal, which would offer certain listed companies access to a complimentary board recruiting service to help advance diversity on company boards.

[4] 15 U.S.C. 78s(b)(1).

[5] 15 U.S.C. 78s(b)(2)(C)(i).

[6] 15 U.S.C. 78f(b)(5).

[7] *See* Amendment No. 1 at 21-29.

[8] Amendment No. 1 at 123 (positing that issuers would benefit from "including diverse directors with a broader range of skills, perspectives and experiences [which] may help detect and prevent fraudulent and manipulative acts and practices by mitigating 'groupthink'").

[9] The Exchange notes, for example, that "[a]t a minimum . . . the academic and empirical studies support the conclusion that board diversity does not have adverse effects on company performance." Amendment No. 1 at 28.

[10] *See*, *e.g.*, letter from Publius Oeconomicis to Vanessa Countryman, Secretary, Commission, dated Dec. 28, 2020 ("Publius Letter"); letter from David Burton, Heritage Foundation, to J. Matthew DesLesDernier, Assistant Secretary, Commission, dated Jan. 4, 2021; letter from Boyden Gray & Associates PLLC on behalf of Alliance for Fair Board Recruitment, dated January 4, 2021 ("Boyden Gray Letter").

[11] Boyden Gray, writing on behalf of the Alliance for Fair Board Recruitment, submitted a review of the literature on corporate board diversity by Jonathan Klick of the American Enterprise Institute and a paper by Harvard Law Professor Jesse M. Fried that assessed the quality of the studies relied upon by the Exchange in the course of discussing the likely effect of the Exchange's Proposal on investors. *See* Boyden Gray Letter; letter from Boyden Gray & Associates PLLC on behalf of Alliance for Fair Board Recruitment, dated April 9, 2021). The original papers are available online. *See* Jonathan Klick, American Enterprise Institute, "Review of the Literature on Diversity on Corporate Boards" (Apr. 6, 2021), https://www.aei.org/research-products/report/review-of-the-literature-on-diversity-on-corporate-boards/; Jesse M. Fried, "Will Nasdaq's Diversity Rules Harm Investors?," European Corporate Governance Institute – Law Working Paper No. 579/2021 (Mar. 31, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3812642. Professor Fried concludes his analysis by stating that "Nasdaq's proposed diversity rules may well have desirable social effects, but we should not pretend that, conveniently, these rules will also benefit investors. High quality

scholarship, including a study Nasdaq itself cites and several studies that Nasdaq ignores, tends to point in the opposite direction." Fried, "Will Nasdaq's Diversity Rules Harm Investors?" at 8.

[12] Although the Board Diversity Proposal now refers to an "objective" instead of a "requirement", it is essentially designed to work like a requirement, which is why it allows for a phase-in period ("consistent with the phase-in periods for Nasdaq's other board composition requirements") and accommodations for certain types of issuers. *See* Amendment No. 1 at 81. *See also* Amendment No. 1 at 331 (setting out a "Diversity Objective": "Each Company . . . must have, or explain why it does not have, at least two members of its board of directors who are Diverse, including (i) at least one Diverse director who self-identifies as a Female; and (ii) at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+.").

[13] Approval Order at 6.

[14] *Id*. at 7.

[15] *Id*.

[16] *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017).

[17] *Id*.

[18] *See* 15 U.S.C. 78b.

[19] I am not endorsing an approach that would require proof of fitting into a particular Diversity category, which is objectionable in a society that values each individual equally without regard to ethnicity, race, gender, or LGBTQ+ status. I am merely pointing out that the Exchange's approach will not result in comparability.

[20] Yes, the company could put both candidates on the board, but the company may be loathe to make too many simultaneous changes to a board that is performing well and, for a small company, the cost of an additional director is not negligible.

[21] *Susquehanna*, 866 F.3d at 448.

[22] Diversity-related shareholder litigation is already occurring, and there is no reason to believe that the Exchange's Proposal will mitigate, rather than exacerbate, this phenomenon. *See*, e.g., *Foot, et al v. Mehrotra et al, and Micron Technology, Inc.*, D. Del (1:21-cv-00169-UNA) filed 02/09/21.

[23] *See*, *e.g.*, letter from John Richter dated December 12, 2020, at 2 ("Relying on self-declaration encourages unassailable false claims.").

[24] *See*, *e.g.*, Amendment No. 1 at 8-9 (stating that the Exchange "believes that the national market system and the public interest would be well-served by a 'disclosure-based, business-driven' framework for companies to embrace meaningful and multi-dimensional diversification of their boards"); *id*. at 12-13 (stating that the Exchange "believes that the lack of reliable and consistent data creates a barrier to measuring and improving diversity in the boardroom"); *id*. at 41 (stating that the Exchange "has concluded that a disclosure-based approach to encouraging greater diversity and data transparency would be beneficial").

[25] The empirical research supporting the Proposal is equivocal, but even if it were definitive, it is dangerous to rely solely on this type of data or on supposed demands from investors, as both may lead us to places we do not want to go. For example, what if empirical research showed that having more than two women on a board led to worse corporate performance? Would we approve a listing rule that required companies to have no more than two women or explain why they were not in compliance with that limit? I would hope not as such a rule would be detrimental to issuers, investors, and the public.

[26] Some of the comments suggest that it is already difficult to raise questions about the merits of this proposal in the financial industry, which may indicate that groupthink is a problem not limited to corporate boards. *See*, *e.g.*, Publius Letter at 1, n.1 (writing in opposition to the Proposal "anonymously because I fear that my opposition to the Proposed Rule will adversely impact my career").

[27] Even with respect to women's participation on boards, some of the studies cited looked at women with business or financial expertise, so the results may not be relevant for female directors without such expertise. See, e.g., Amendment No. 1 at 31 (discussing two studies).

[28] This rationale echoes that of the Commission in adopting the transaction fee pilot. The D.C. Circuit vacated that rule in part because the rule was adopted "to secure information that may or may not indicate . . . whether there is a problem worthy of regulation." N.Y. Stock Exch. LLC v. SEC, 962 F.3d 541, 555 (D.C. Cir. 2020).

[29] Amendment No. 1, at 106.

[30] *Id*. at 107.

[31] Interview with Jeff Thomas, Senior Vice President, Nasdaq Corporate Services Business Unit, Nasdaq, Axios podcast, December 1, 2020

[32] See Amendment No. 1, at n. 173 ("Although non-binary is included as a category in the proposed Matrix, a company would not satisfy the "diversity objectives" proposed by Rule 5605(f)(2) if a director self-identifies solely as non-binary.").

[33] Amendment No. 1, at 117 (emphasis added).

[34] Amendment No. 1, at 140.

[35] The Exchange acknowledges that cognitive diversity is not the objective it is trying to achieve. *See*, *e .g.*, Amendment No. 1 at 107 ("Nasdaq also is concerned that the broader definitions of diversity utilized by some companies may result in Diverse candidates being overlooked, and may be hindering meaningful progress on improving diversity related to race, ethnicity, sexual orientation and gender identity. For example, a company may consider diversity to include age, education, and board tenure. While such characteristics may provide laudable cognitive diversity, this focus may result in a homogenous board with respect to race, ethnicity, sexual orientation, and gender identity that, by extension, does not reflect the diversity of a company's communities, employees, investors, or other stakeholders.").

[36] How could a company explain its non-compliance with the Diversity requirements in such a situation? "We do actually have the requisite number of Diverse directors, but one of them refuses to self-identify"?

[37] 15 U.S.C. 78b.

[38] As one commenter noted, the Exchange's proposal to address concerns about diversity through regulation of corporate boards is a novel exercise of exchange authority under the Act and is distinguishable from its prior intervention into corporate governance issues. *See* Boyden Gray Letter at 49-50.

[39] Would the Commission approve a rule filing by an exchange that sought to address concerns about wealth inequality by requiring companies either to adopt a sliding scale for the compensation of managers and executives tied to their net worth or to explain their philosophy on issues related to wealth inequality?

[40] *See*, *e.g.*, letter from Christopher A. Iacovella, American Securities Association to Vanessa Countryman, Secretary, Commission, dated Dec. 31, 2020, at 1 (explaining that the Board Diversity Proposal is "another example of self-regulatory organization (SRO) 'mission creep' that has serious long-term consequences for our markets and investors across America. If SROs can use the listing rule process to effectively dictate the composition of company boards without the express authorization of Congress, what can't they do?").

[41] Individuals will be under pressure to disclose to the company their diversity characteristics. Diverse individuals will be under particular pressure to speak, as their presence on the board will count toward the Exchange's "diversity objectives" only if they disclose their self-identification. Other candidates will not face the same pressure.

[42] Issuers will be required to disclose aggregated data on board composition and those that do not meet the "diversity objectives" will be required to explain why they do not, including by explaining their "philosophy related to board diversity." *See, e.g.*, Amendment No. 1 at 19 ("Nasdaq believes that additional disclosure regarding a board's composition and philosophy related to board diversity will improve transparency and accountability into corporate decision making.").

[43] Compare *D. L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155 (2d. Cir. 2002) (holding that NASD Regulation was not a state actor) with *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995) (holding that rule

promulgated by the Municipal Standards Rulemaking Board and approved by the Commission constituted government action).

[44] Amendment No. 1 at 48-52 and 111.

[45] 15 U.S.C. 78s(h) (authorizing the Commission to bring an enforcement action against a self-regulatory organization that, among other things, fails to comply with "its own rules").

[46] See 15 U.S.C.78s(d). The Exchange does not indicate how it plans to enforce the rule, and it is unclear whether the Exchange will, as a practical matter, enforce it beyond ensuring that issuers publish a diversity matrix and, if needed, a reason for not achieving the Exchange's "diversity objectives." Indeed, it promises not to administer a "truth test" regarding directors' self-identification. *See* Nasdaq Response Letter at 19. Given the inherent weaknesses in the rule described above, perhaps it is more appropriate to view the rule as a marketing ploy designed to show the Exchange's commitment to diversity and inclusion without commitment to potentially awkward (and inappropriate) inquiries on the Exchange's part.

On the other hand, the Exchange may be drawn unwittingly into truth testing if shareholders or others cast doubt on the self-identification of a director who has publicly self-identified in one of the Exchange's categories. For example, shareholders and other interested parties could check the matrix against information derived from other sources and, if the matrix appeared inaccurate, pressure the Exchange to look into the discrepancy and perhaps delist the company. If the company appealed, the Commission also might be drawn into assessing the accuracy of a company's reporting matrix, as discussed further below.

[47] *See*, *e.g.*, In the Matter of the Application of Cleantech Innovations, Inc., Exch. Act Rel. No 69968 at 10 (July 11, 2013) (stating that the legal standard applicable to Commission review of exchange delisting determinations includes, among other things, inquiry into whether "the specific grounds on which the delisting is based exist *in fact*" (emphasis added)).

[48] Amendment No. 1 at 19, 59, 100, 107-108. Compelling disclosure of a company's philosophy on a topic that is hotly contested in society (and passing judgment on the acceptability of that disclosure) is very different from compelling disclosure of facts and runs counter to the core protections guaranteed by the First Amendment.