Public Statement

Statement on the Commission's Order Approving Exchange Rules Relating to Board Diversity

Commissioner Elad L. Roisman

Aug. 6, 2021

A Goal for All

Today, the Commission approved rule changes proposed by The Nasdaq Stock Market LLC ("Nasdaq" or the "Exchange") relating to board diversity.[1] One will offer certain listed companies free access, for a limited time, to a board recruitment service with access "to a network of board-ready diverse candidates."[2] The other will "require each Nasdaq-listed company, subject to certain exceptions, to publicly disclose in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender and racial characteristics and LGBTQ+ status (all terms defined [in the Approval Order]) of the company's board of directors."[3] It will also "require each Nasdaq-listed company, subject to certain exceptions, to have, or explain why it does not have, at least two members of its board of directors who are Diverse, including at least one director who self-identifies as female and at least one director who self-identifies as an Underrepresented Minority or LGBTQ+ [all terms are defined in the Approval Order]."[4] Failure to comply could eventually, after a specified period, subject companies to delisting.

Nasdaq's commitment to diversity and inclusion, demonstrated through its work to promote a financial industry that includes, at the highest levels of leadership, more women, individuals from underrepresented minority communities, and people identifying as LGBTQ+ is commendable. Throughout history, there have been too many barriers preventing deserving individuals from participating fully in our economy. Not only have those individuals been denied opportunities, but society at large has missed out on the value their talents offer. As I have said before, it is important for all of us to assess the causes for such barriers and move to address them; and the SEC has a critical role to play in identifying barriers that its own regulations have created over the years preventing people from participating in our capital markets.[5]

Public company boards of directors should not be private clubs with membership limited to narrow social circles. Regardless of intentions, it appears that existing board members' social and business networks can be a predominant source for companies seeking new director candidates.[6] This presents a barrier to entry to individuals outside those networks and could yield director candidates with similar backgrounds and experiences as those of current board members. The specter of "groupthink" is a serious risk for governing bodies that are supposed to keep watch over, and act as a critical check on, the management of companies they oversee.

I have voted to support Nasdaq's proposal to offer listed companies recruiting services that may identify new candidates outside these companies' go-to networks, and I applaud Nasdaq for this effort. I am keenly interested to see the impact this will have over the next several years at Nasdaq-listed companies and think

we will have a lot to learn from how this service is utilized. I also applaud the New York Stock Exchange for its work in this area, specifically establishing the NYSE Board Advisory Council, which was "launched to address the critical need for inclusive leadership by connecting diverse candidates with companies seeking new directors."[7] The more companies can recruit people on boards who think differently and have different backgrounds from one another, the more they can hopefully foster environments where directors engage in critical reasoning and consider broader ranges of possible consequences and solutions than any of them could if each were operating in his or her own echo chamber. Such diversity and inclusiveness is a worthy goal to have for businesses across our capital markets, and I have yet to meet a person who does not aspire to that objective.

Supporting the Goal but Not This Proposal

Today, however, I cannot join some of my colleagues in supporting the portion of the Commission's order that approves Nasdaq's proposed disclosure requirements for listed companies (the "Proposal"). While I support the goal of having more diverse and inclusive boards of directors, a noble goal does not justify short-changing the agency's legal obligations. Regrettably, I do not believe that the Commission has fulfilled its obligations to find that this Proposal, which has delisting implications for companies, meets the legal standards that we are required to apply in evaluating rules proposed by self-regulatory organizations ("SROs").[8]

The Approval Order rests in large part on the idea that investors, as evidenced by the Proposal's comment file and the Exchange's own assertions, are demanding the type of categorical diversity information the Proposal aims to elicit from Nasdaq's listed companies. Based largely on this demand, the Commission appears to conclude that the Proposal would "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."[9] I can see a logical connection between providing information to investors and improving investor protection.[10] But I have a harder time with respect to the Approval Order's analysis as to how the Commission found that the Proposal satisfies the Act's other criteria. The Commission mostly reiterates the Exchange's assertions and then in places summarily finds that the Proposal is consistent with the Exchange Act.[11] Almost four years ago, Judge Merrick Garland of the D.C. Circuit Court of Appeals wrote an opinion holding that the Commission had not fulfilled its obligations under the Act when approving another SRO rule proposal because the Commission did not undertake its own "reasoned analysis" to evaluate the merits of the proposal at issue.[12] I believe the Approval Order today suffers from the same failing and could set a troubling precedent for SRO oversight.

Similarly, I believe the Approval Order should have included a more thorough discussion of whether the Proposal could be considered state action, warranting analysis under the Constitutional standards of scrutiny. The Commission has stated that "[N]umerous courts (and the Commission) have repeatedly held that SROs *generally* are not state actors [emphasis added]" and reaches a conclusion that Constitutional concerns are not implicated.[13] However, I am not sure this Proposal fits into the general archetype of SRO actions, and it could raise novel issues for the Commission. A serious concern is that the SEC—without any doubt, a state actor—may need to take future action in which the agency must consider disclosure of the racial, ethnic, gender, or LGTBQ+ status of individual directors. After all, the Commission is the adjudicating body for exchange delisting decisions. I think that the Approval Order should have included more analysis of whether the Proposal could implicate state action through the Commission's downstream enforcement responsibilities, or why the Commission believes this is unlikely. Instead, the Approval Order gives short shrift to this point, quickly concluding that even if the Proposal were to amount to state action, it "would survive constitutional scrutiny because the objectives set forth in the Proposal are not mandates, and the disclosures that the Proposal requires are factual in nature and advance important interests as described throughout this order."[14]

Conclusion

In sum, I share the interest and desire in ensuring that our public companies have truly diverse leadership—and not just at the board level—to innovate and think creatively. I have found that diverse perspectives and backgrounds have brought about better analysis, thinking, and ultimately results. I have seen it at every job I have ever had and continue to see it today. While this has been a decision with which I have struggled, I do

not believe the Commission has fulfilled its obligations in its approval of the Exchange's Proposal, and therefore I respectfully dissent from this portion of the Approval Order.

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[1] 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, Rel No. 34-92590 (Aug. 6, 2021) (hereinafter the "Approval Order"), https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf.

[2] *Id*. at 4.

[3] *Id*. at 3-4.

[4] *Id*. at 4.

[5] *See*, *e.g.*, Commissioner Elad L. Roisman, "Statement on Amending the 'Accredited Investor' Definition" (Aug. 26, 2020), https://www.sec.gov/news/public-statement/roisman-statement-amendments-accredited-investor-definition; "Statement at the Meeting of the Asset Management Advisory Committee" (July 16, 2020), https://www.sec.gov/news/public-statement/roisman-statement-amac-2020-07-16.

[6] Amendment No. 1 of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, File No. SR-NASDAQ-2020-081 (Feb. 26, 2021), at 41-43, https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081_Amendment_1.pdf.

[7] *See* The New York Stock Exchange, "Initiative to Advance Board Diversity," https://www.nyse.com/boardadvisory/about-the-council.

[8] Section 19(b)(2)(C) of the Securities and Exchange Act of 1934 (the "Exchange Act" or the "Act")[15 U.S.C. 78s(b)(2)(C)] provides that the Commission "shall approve" a proposal if it finds that the rule is consistent with the requirements of the Act and the rules and regulations applicable to the SRO—including requirements in Section 6(b). As indicated by the Approval Order, I do not think the Commission has analyzed the Proposal or the Exchange's assertions sufficiently to make those findings, which the Act requires.

[9] *See*, *e.g.*, Approval Order at 7.

[10] However, as I have raised before, I am not convinced that responding to investors' demands for any information necessarily equates to serving investor protection. I see no limiting principle to such a rationale, and I believe, when developing our *own* rules, we must continue to consider the materiality of information companies must disclose. *See* Commissioner Elad L. Roisman, "Can the SEC Make ESG Rules that are Sustainable?" (June 22, 2021), https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable ("In developing any new disclosure requirements, including those related to ESG, I believe that the Commission should act consistently with our historic approach by focusing on what information is material to an investment decision.").

[11] *See*, *e.g.*, Approval Order at 25-26.

[12] *Susquehanna International Group, LLP, et al. v. SEC* (DC Cir.) (Aug. 8, 2017), https://www.cadc.uscourts.gov/internet/opinions.nsf/88E0BCE087554C0B8525817600508F2A/$file/16-1061-1687695.pdf.

[13] *See* Approval Order at 61-62.

[14] *See* Approval Order at 62.