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CLIENT ALERT

# New ESG Development: NASDAQ Proposes Board Diversity Requirements

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**AUTHORS**

**William J. Stellmach | Todd G. Cosenza | Shaimaa M. Hussein | John L. Brennan**


On Tuesday, December 1, Nasdaq Inc. ("Nasdaq") filed a proposal with the U.S. Securities and Exchange Commission (the "SEC") to adopt rules that would require most companies listed on Nasdaq's stock exchange to include on each of their boards at least one woman and at least one director who is either an "underrepresented minority" or a person who self-identifies as lesbian, gay, bisexual, transgender or queer ("LGBTQ"). The proposed rules would also require companies listed on Nasdaq's exchange to make public disclosures regarding board diversity. This proposal is not the first time that the SEC has been asked to consider measures intended to address diversity and inclusion in the private sector. In July, for example, panelists at a public meeting of an SEC advisory committee urged the SEC to attempt to remedy the underrepresentation of women and racial minorities in the asset management industry, and SEC Chairman Jay Clayton indicated that the SEC is considering how to improve diversity and inclusion in the industry. Nasdaq's proposal is indicative of what may be a rising wave of required disclosures and prescriptive rules regarding environmental, social, and governance ("ESG") factors. And in light of Nasdaq's ability to regulate the nearly 3,000 corporations listed on its exchange, its proposed rules could have a meaningful impact on this broader trend.

The proposal defines "underrepresented minorities" as individuals who self-identify as Black, Hispanic, Asian, Native American, Alaska Native, or Pacific Islander, or belonging to two or more races or ethnicities. If the proposed rules go into effect, companies will have between four and five years to meet Nasdaq's board diversity requirements. A company that does not meet these requirements must provide justification for its failure to do so. Accordingly, while it is unlikely at this time that companies will actually be delisted from Nasdaq's exchange as a result of these requirements, the requirements will, at the very least, force companies to seriously confront the issue of board diversity and arguably will also incentivize companies to meet the requirements so as to avoid attempting to explain the failure to do so.

Similarly, the proposed rules' disclosure requirements are likely to influence the listed companies' board composition. If approved, the rules will require listed companies to disclose board diversity statistics within a year. Companies are already facing pressure from investors to improve diversity among their directors and executives. For example, this summer, a slew of virtually identical shareholder derivative lawsuits were filed against current and former directors of several corporations, based on allegations that the companies' boards and executive teams consist largely of white men despite public statements emphasizing the importance of, and the companies' dedication to, diversity and inclusion. In light of the increasing investor focus on board diversity and other ESG factors, Nasdaq's proposed disclosure requirements could meaningfully impact the way in which investors and analysts approach the listed companies and, in turn, the way in which listed companies approach the issue of board diversity.

Nasdaq's proposal is the most recent of several measures taken by public and private actors worldwide to increase the diversity of corporate boards. For example, on September 30, 2020, California Governor Gavin Newsom signed into law a bill requiring companies with securities listed on U.S. exchanges and that are headquartered in California to include representatives of "underrepresented communities" on their boards. The statute calls for companies to comply with its requirements by the end of 2021 and authorizes California's secretary of state to impose fines for violations of the requirements. In 2019, Illinois enacted a similar law requiring publicly listed companies that are headquartered in Illinois to make certain disclosures regarding board diversity. And in November 2020, Germany—which in 2015 imposed mandatory gender diversity quotas on supervisory boards for listed German companies—announced that it will also impose similar quotas on management boards for listed companies.

The SEC's public comment process for Nasdaq's proposal will likely last months, and the decision as to whether to approve the proposal will likely be made under a Biden administration. Current SEC Chairman Jay Clayton is expected to resign by the end of 2020, likely enabling a Biden administration to appoint a new chairperson to lead the SEC. More broadly, Nasdaq's proposal represents a significant step in the direction of uniformly mandating board diversity, and Nasdaq's rules, together with state and local laws like those enacted in California and Illinois, could serve as stepping stones for a Biden administration to take even more far-reaching measures regarding board diversity and other ESG issues.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.


| William J. Stellmach | Todd G. Cosenza | Shaimaa M. Hussein | John L. Brennan |
|---|---|---|---|
| 202 303 1130 | 212 728 8677 | 212 728 8638 | 212 728 8187 |
| wstellmach@willkie.com | tcosenza@willkie.com | shussein@willkie.com | jbrennan@willkie.com |




Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Palo Alto, San Francisco, Chicago, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.