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NASDAQ BOARD DIVERSITY PROPOSAL FACES BACKLASH

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Nasdaq's recent proposal mandating board diversity faces backlash, as 12 Republican senators on the U.S. Senate Banking Committee last week urged the SEC **not** to approve the proposed rules, which would require all U.S. Nasdaq-listed companies to disclose board diversity statistics and to have, or explain why they do not have, at least two diverse directors: one woman and one who self-identifies as either an underrepresented minority or LGBTQ.

While many anticipated that the SEC's approval of the proposed rules would be a "slam dunk" given the current social climate, certain recent events suggest that approval may not necessarily be guaranteed. These events include the senators' disapproval and the SEC's extension of the end of the comment period from January 25, 2021 to March 11, 2021. Nasdaq and others, however, continue to fervently support the proposed rules. In a letter dated February 5, 2021 to the SEC, counsel for Nasdaq reported that, by its count, 86% of the comment letters then submitted had supported adoption of the rules. As reported in our December 2, 2020 post, Nasdaq believes its proposal would benefit investors and the public interest and cites in its SEC filing numerous empirical studies as support for its finding that diverse boards "are positively associated with improved corporate governance and financial performance." Nasdaq also noted calls for diversity from institutional investors, corporate stakeholders and legislators.

In the letter urging the SEC **not** to approve the proposed rules, the senators noted that Nasdaq appears to them to be motivated by an inappropriate desire to influence social policy, and that the senators do not believe that it is Nasdaq's role to "act as an arbiter of social policy or force a prescriptive one-size-fits-all solution." The senators further explained that "[w]hile we think America's corporations benefit from boards that avoid groupthink and offer a diversity of perspective, and commend firms that look to increase diversity among their boards, we do not think Nasdaq should be using its quasi-regulatory authority to impose social policies." The senators argue that the proposed rules would benefit neither investors nor the public interest. The reasons they cite for reaching that conclusion include, among others:

- The proposed rules would not improve corporate financial performance and could even harm it.

- By prioritizing board diversity over individual merit, the proposed rules would interfere with a board's fiduciary duty to nominate individuals for the board who will serve in the best interests of the company and its shareholders.
- The proposed rules violate the fundamental principle of materiality governing securities law disclosures, because the required disclosures would not help a reasonable investor evaluate a company's performance.
- The proposed rules define diversity too narrowly and exclude other types of diversity that could improve board performance, such as diversity based on religion, age, political affiliation, geographic location, educational background, veteran's status and physical disability.
- The proposed rules are unnecessary, because companies already want diversity on their boards.
- Nasdaq has not sufficiently addressed research results that, according to the senators, show that gender diversity on boards correlates very little, if at all, with corporate performance.
- Companies would likely meet the proposed membership requirements by increasing board size, which could create less effective board oversight and governance due to the larger size.
- Companies could be held liable for false statements in reporting their directors' diversity information if the directors have misrepresented themselves; on the other hand, a company would avoid that liability if the information is not material and, in that case, the SEC should reject the proposal for requiring non-material information.
- The proposed rules would harm economic growth by introducing unnecessary regulatory costs, thereby decreasing the attractiveness of U.S. capital markets and discouraging private companies from going or staying public.
- The alternative to satisfying the diversity requirements – i.e., explaining why a company is not in compliance – could make a company a target for activist investors.
- The senators do not believe that Nasdaq has made a serious effort to quantify the costs and benefits of the proposed rules, and believe that prevents the SEC from properly evaluating the rules.

After the extended comment period ends on March 11th, we expect that the SEC will make its delayed decision on the proposed rules. The outcome, however, remains to be seen.

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