

Senate Republicans Attack NASDAQ's Board Diversity Rule

Corporate Defense and Disputes Blog on February 22, 2021

On February 12, 2021, the Republican members of the Senate Committee on Banking, Housing, and Urban Affairs [wrote a letter](#) to the Acting Chair of the SEC bashing a [recently proposed rule](#) of Nasdaq that would promote corporate diversity for listed companies.

Nasdaq's proposed listing rule has two main functions:

- To require Nasdaq-listed companies, subject to certain exceptions, to either (a) have at least one director who self-identifies as female, and (b) one director who self-identifies and 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 LGBTQ+, or (c) explain why the company does not have two such directors; and
- To require Nasdaq-listed companies to publicly disclose diversity information about their boards of directors.

While acknowledging that board diversity “increases ... creativity” and may help “improve corporate operations and growth,” the letter attacked the rule change as “imposing costs on public corporations and discouraging private corporations from going public.” The Republicans behind the letter claim that Nasdaq's rule interferes with a board's duty to follow its legal obligations to govern in the best interests of the corporation and shareholders, and violates “central principles of materiality.”

The six-page letter contains numerous other reasons why its authors think the rule is unnecessary. First, they assert the proposed rule is on shaky legal ground because it is inconsistent with Section 6(b)(5) of the Securities Exchange Act of 1934, which maintains that rules for an exchange must be designed “to remove impediments to and perfect the mechanism of a free and open market and a national market system.” The rule violates this statutory mandate, the letter says, because the arbitrary diversity requirement does not demonstrably improve corporate performance, and could sometimes harm it.” The letter also claims that the proposed rule’s reliance on self-identification for board diversity disclosures “poses unique liability concerns under the antifraud and reporting provisions” of federal securities laws if a board member somehow conveyed a misleading self-identification.

Perhaps most notably, the Senators claim that Nasdaq “has ... not proven that board diversity causes improved corporate performance. In fact, some evidence suggests that ‘the interaction of gender diversity and ethnic minority diversity do not impact financial performance.’”

The letter comes as more and more corporations [face legal action](#) for their alleged failure to promote diversity within. In 2020, multiple securities derivative actions were filed alleging that public corporations violated their fiduciary duties to their shareholders for failing to follow through on internal diversity initiatives.

The senators, however, claim that the proposed rule would not be material to a reasonable investor’s investment decision.

Under SEC regulations, self-regulatory organizations (“SROs”) such as Nasdaq must formally submit proposed rule changes to the Commission. Because SROs have some degree of regulatory influence over industry, yet are private organizations, the SEC maintains authority to approve or deny any changes. In these “19b-4 filings” to the Commission, the organization must attest that its new rules meet SEC requirements. All 19b-4 filings are publicly available.

It remains to be seen – particularly with the [change in leadership](#) at the SEC – what the Commission will do with the proposed rule. Check back here for additional updates.

[View Original](#)