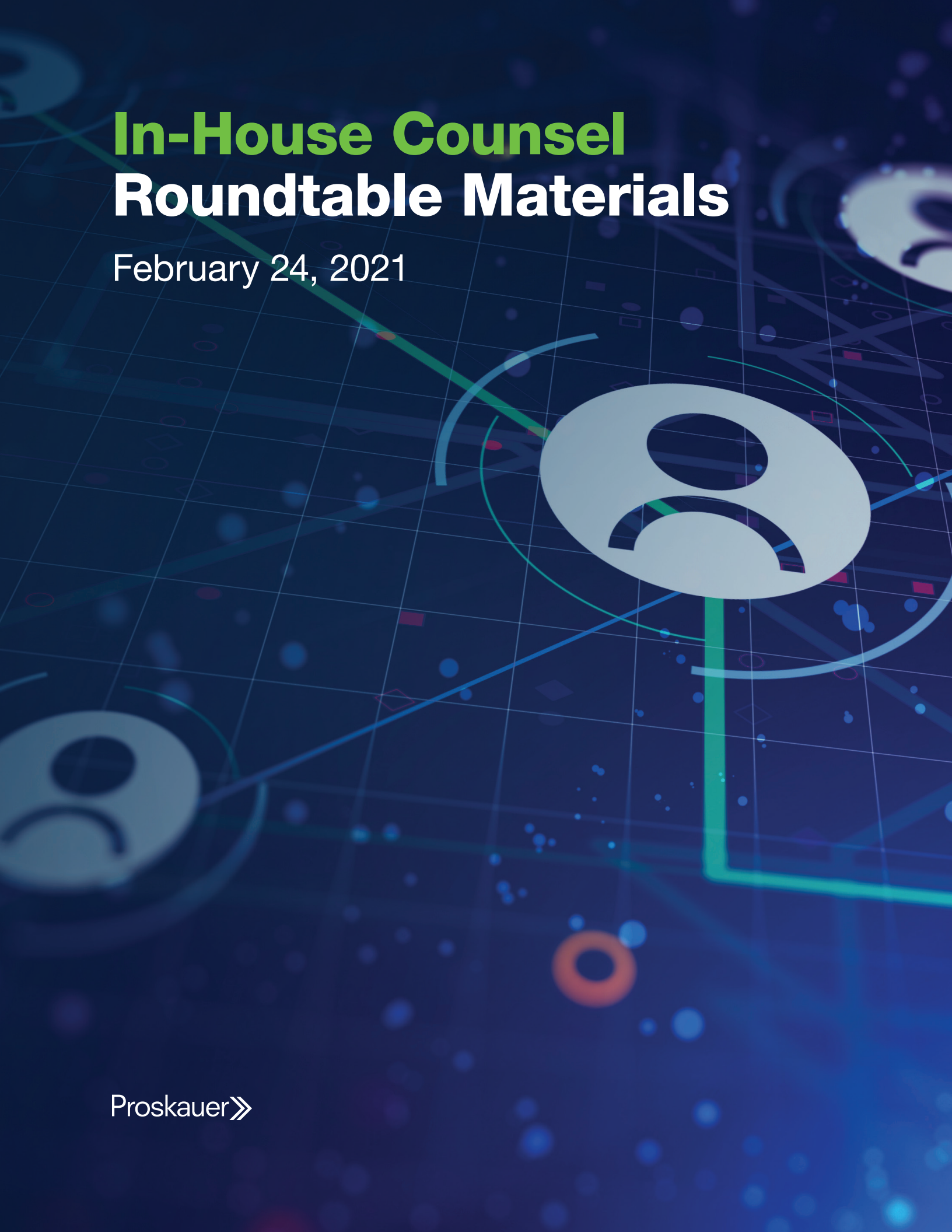

In-House Counsel Roundtable Materials

February 24, 2021

Proskauer

Proskauer

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Sample Letter to Companies Regarding Securities Offerings During Times of Extreme Price Volatility[1]

The Division of Corporation Finance recognizes the importance of capital formation, including during times of market volatility and when an issuer's own securities are experiencing extreme price volatility. The Division also cautions that such market and stock volatility can create risks for both companies and investors. These risks can be particularly acute when companies seek to raise capital during periods with:

- recent stock run-ups or recent divergences in valuation ratios relative to those seen during traditional markets,
- high short interest or reported short squeezes, and
- reports of strong and atypical retail investor interest (whether on social media or otherwise).

Risks can also be more acute when companies are in distress, face "going concern" or liquidity challenges or have smaller public floats.

The Division believes that when a company seeks to raise capital under these types of circumstances, specific, tailored disclosure about market events and conditions, the company's situation and the potential impact on investors is warranted to provide investors with the information they need to make informed investment decisions and comply with the company's disclosure obligations under the federal securities laws.

The following illustrative letter contains sample comments that, depending on the particular facts and circumstances, the Division may issue to companies seeking to raise capital in securities offerings amid market and price volatility. The sample comments do not constitute an exhaustive list of the issues that companies should consider. Any comments issued would be appropriately tailored to the specific company and offering, and would take into consideration the disclosure that a company has provided in its offering documents and other Commission filings. The Division urges companies to take these sample comments into consideration as they prepare disclosure documents that may not typically be subject to review by the Division before their use, such as automatically effective registration statements and prospectus supplements for takedowns from existing shelf registration statements. The Division encourages companies experiencing extreme

price volatility to contact the industry office responsible for the company's filings with any questions regarding the company's proposed disclosure.

February 2021

Name
ABC Corporation
Address

Dear Issuer:

We have reviewed your filing and have the following comments. Please revise or update your disclosure in response to our comments.

Prospectus Cover Page

1. Describe the recent price volatility in your stock and briefly disclose any known risks of investing in your stock under these circumstances.
2. Add, for comparison purposes, disclosure of the market price of your common stock prior to the recent price volatility in your stock. For example, disclose the price at which your stock was trading XX days prior to your filing.
3. Describe any recent change in your financial condition or results of operations, such as your earnings, revenues or other measure of company value that is consistent with the recent change in your stock price. If no such change to your financial condition or results of operations exists, disclose that fact.

Risk Factors

4. Include a risk factor addressing the recent extreme volatility in your stock price. Your disclosure should include intra-day stock price range information and should cover a period of time sufficient to demonstrate the recent price volatility and should address the impact on investors. Your disclosure should also address the potential for rapid and substantial decreases in your stock price, including decreases unrelated to your operating performance or prospects. To the extent recent increases in your stock price are significantly inconsistent with improvements in actual or expected operating performance, financial condition or other indicators of value, discuss the inconsistencies and where relevant quantify them. If you lack information to do so, explain why.
5. Include a risk factor addressing the effects of a potential "short squeeze" due to a sudden increase in demand for your stock. Among other things, your disclosure should describe what typically happens following a short squeeze and address the impact on investors that purchase shares during this time.

6. We note the significant number of shares you are offering relative to the number currently outstanding. Include a risk factor that addresses the impact that the offering could have on your stock price and on investors.
7. To the extent you expect to conduct additional offerings in the future to fund your operations or provide liquidity, include a risk factor that addresses the dilutive impact of those offerings on investors that purchase shares in this offering at a significantly higher price.

Use of Proceeds

8. We note that you are seeking to raise up to $XX in this offering but the number of shares you may sell is limited to XX shares. We also note that unless your sales price exceeds $XX per share (which significantly exceeds your historical average price per share) you will not be able to raise the maximum offering amount. Disclose that information and, to the extent applicable, include a discussion of your priorities for the proceeds received in this offering in the event you raise less than the maximum aggregate offering amount.

We remind you that the company and its management are responsible for the accuracy and adequacy of their disclosures, notwithstanding any review, comments, action or absence of action by the staff.

Sincerely,

Division of Corporation Finance

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[1] The statements in this guidance represent the views of the staff of the Division of Corporation Finance. This guidance is not a rule, regulation, or statement of the Securities and Exchange Commission ("Commission"). The Commission has neither approved nor disapproved its content. This guidance, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

Modified: Feb. 8, 2021

Nasdaq Proposes New Board Diversity Requirements for Listed Companies

December 3, 2020

On December 1, 2020, Nasdaq proposed new listing rules that, if approved by the SEC following a public comment period,[1] would require Nasdaq-listed companies either to have, or explain why they do not have, at least two diverse directors and disclose information about the diversity of their directors on an annual basis. The new rules, if adopted, would be the first federal rules that effectively require companies to retain diverse board members.[2] The release filed with the SEC is available here.

Specifically, Nasdaq-listed companies would be required to

- have at least one director who self-identifies as a female, and at least one director who self-identifies as an underrepresented minority (which means Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities), or as LGBTQ+; or

- explain, in either the company's annual meeting proxy statement or on the company's website, why the company does not have two diverse directors.

If approved by the SEC without modification, the new requirements would be phased in over a two to five-year period following SEC approval as follows:

- within two calendar years, every Nasdaq-listed company must have, or explain why it does not have, one diverse director;

- within four calendar years, each company listed on the Nasdaq Global Select or Global Market tiers must have, or explain why it does not have, two diverse directors; and

- within five calendar years, each company listed on the Nasdaq Capital Market tier must have, or explain why it does not have, two diverse directors.

As proposed, this rule is subject to certain exceptions, including:

- following the transition period described above, newly listed companies, including IPOs, will have one year from the listing date to comply;

- smaller reporting companies can satisfy the requirement to have two diverse directors by having two female directors; and

- foreign issuers can satisfy the second diverse director requirement by having a second female director, an individual who self-identifies as LGBTQ+, or an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction.

Nasdaq also proposed a new listing rule that would require listed companies, within one year following SEC approval of the rule, to disclose statistical information in a uniform format about the self-identified gender, race and LGBTQ+ status of their directors in either the company's annual meeting proxy statement or on the company's website. Implementation of this listing rule would require more detailed diversity information than what is required under existing SEC rules, which only address how diversity is considered in identifying board nominees.[3]

The proposal comes at a time of increasing focus on board diversity among companies, investors, state legislatures, and other stakeholders, and more broadly we expect the discussion of diversity, ESG, and human capital to intensify under the new Administration. We expect the SEC to address this proposal following the appointment of a new SEC Chairman.

If you have questions about these new proposed rules, please contact your Proskauer attorney or one of the capital markets attorneys listed on this alert.

[1] According to Nasdaq, the SEC will provide a minimum of 21 days from the time the proposed rule changes are published in the Federal Register for the public (including investors,

companies, and their representatives) to have an opportunity to comment on the proposal, and the SEC will have 30 to 240 calendar days to approve the proposal.

[2] To date, eleven states have passed or proposed legislation related to board diversity. For example, California requires companies headquartered in the state to have at least one director who self-identifies as a female and at least one director from an underrepresented community. See Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept. 30, 2020).

[3] Pursuant to Item 407(c)(2)(vi) of Regulation S-K, companies must describe how the nominating committee (or the board) considers diversity in identifying nominees for director (including information about any related policies). However, the Regulation S-K Compliance & Disclosure Interpretations (Question 116.11) state the SEC staff's "expectation" that self-identified diversity characteristics of a director relevant to the director's qualifications or experience would, with the director's consent, be disclosed.

OMB APPROVAL
OMB Number: 3235-0045 Estimated average burden hours per response.....38

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 271

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2020 - * 081
Amendment No. (req. for Amendments *)

Filing by The Nasdaq Stock Market LLC

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☑ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☑ Section 19(b)(3)(A) * ☐ Section 19(b)(3)(B) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule
- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

A proposal to advance board diversity and enhance transparency of diversity statistics through new proposed listing requirements

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Jeffrey S. Last Name * Davis

Title * Senior Vice President, Senior Deputy General Counsel

E-mail * jeffrey.davis@nasdaq.com

Telephone * (301) 978-8484 Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 12/01/2020

By John Zecca

(Name *)

(Title *)

EVP and Chief Legal Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

john.zecca@nasdaq.com

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information *

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) The Nasdaq Stock Market LLC ("Nasdaq" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended ("Act"),[1] and Rule 19b-4 thereunder,[2] is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposal to adopt listing rules related to board diversity, as described in more detail below:

(i) to adopt Rule 5605(f) (Diverse Board Representation), which would require Nasdaq-listed companies, subject to certain exceptions, (A) to have at least one director who self-identifies as a female, and (B) to 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+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the categories listed above;

(ii) to adopt Rule 5606 (Board Diversity Disclosure), which would require Nasdaq-listed companies, subject to certain exceptions, 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+; and

(iii) to update Rule 5615 and IM-5615-3 (Foreign Private Issuers) and Rule 5810(c) (Types of Deficiencies and Notifications) to incorporate references to proposed Rule 5605(f) and Rule 5606; and

(iv) to make certain other non-substantive conforming changes.

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1 15 U.S.C. § 78s(b)(1).

2 17 C.F.R. § 240.19b-4.

A notice of the proposed rule change for publication in the Federal Register is attached as Exhibit 1. A proposed Board Diversity Matrix form is attached as Exhibit 3 and the text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange on November 5, 2020. No other action is necessary for the filing of the rule change.

Questions and comments on the proposed rule change may be directed to:

Jeffrey S. Davis
Senior Vice President, Senior Deputy General Counsel
Nasdaq, Inc.
(301) 978-8484

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

I. The Diversity Imperative for Corporate Boards

Over the past year, the social justice movement has brought heightened attention to the commitment of public companies to diversity and inclusion. Controversies arising from corporate culture and human capital management challenges, as well as technology-driven changes to the business landscape, already underscored the need for enhanced board diversity—diversity in the boardroom is good corporate governance. The benefits to stakeholders of increased diversity are becoming more apparent and include an increased variety of fresh perspectives, improved decision making and oversight, and strengthened internal controls. Nasdaq believes that the

heightened focus on corporate board diversity by companies,[3] investors,[4] corporate governance organizations,[5] and legislators[6] demonstrates that investor confidence is enhanced when boardrooms are comprised of more than one demographic group. Nasdaq has also observed recent calls from SEC commissioners[7] and investors[8] for companies to provide more transparency regarding board diversity.

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3 See Deloitte and the Society for Corporate Governance, *Board Practices Quarterly: Diversity, equity, and inclusion* (Sept. 2020), available at: https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/diversity-equity-and-inclusion.html (finding, in a survey of over 200 companies, that "most companies and/or their boards have taken, or intend to take, actions in response to recent events surrounding racial inequality and inequity; 71% of public companies and 65% of private companies answered this question affirmatively").

4 See ISS Governance, *2020 Global Benchmark Policy Survey, Summary of Results* 6 (Sept. 24, 2020), available at: https://www.issgovernance.com/wp-content/uploads/publications/2020-iss-policy-survey-results-report-1.pdf (finding that "a significant majority of investors (61 percent) indicated that boards should aim to reflect the company's customer base and the broader societies in which they operate by including directors drawn from racial and ethnic minority groups").

5 See International Corporate Governance Network, *ICGN Guidance on Diversity on Boards* 5 (2016), available at: https://www.icgn.org/sites/default/files/ICGN%20Guidance%20on%20Diversity%20on%20Boards%20-%20Final.pdf ("The ICGN believes that diversity is a core attribute of a well-functioning board which supports greater long-term value for shareholders and companies.").

6 See, e.g., John J. Cannon et al., Sherman & Sterling LLP, *Washington State Becomes Next to Mandate Gender Diversity on Boards* (May 28, 2020), available at: https://www.shearman.com/perspectives/2020/05/washington-state-becomes-next-to-mandate-gender-diversity-on-boards; Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept. 30, 2020) (California legislation requiring companies headquartered in the state to have at least one director who self-identifies as a Female and one from an Underrepresented Community).

7 See Commissioner Allison Herren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence* (Aug. 26, 2020), available at: https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26#_ftnref15 ("There is ever-growing recognition of the importance of diversity from all types of investors . . . [a]nd large numbers of commenters on this [SEC] rule proposal emphasized the need for specific diversity disclosure requirements."); see also Commissioner Caroline Crenshaw, *Statement on the "Modernization" of Regulation S-K Items 101, 103, and 105* (August 26, 2020), available at: https://www.sec.gov/news/public-statement/crenshaw-statement-modernization-regulation-s-k ("As Commissioner Lee noted in her statement, the final [SEC] rule is also silent on diversity, an issue that is extremely important to investors and to the national conversation. The failure to grapple with these issues is, quite simply, a failure to modernize."); Mary Jo White, *Keynote Address, International Corporate Governance Network Annual Conference: Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability* (June 27, 2016), available at: https://www.sec.gov/news/speech/chair-white-icgn-speech.html ("Companies' disclosures on board diversity in reporting under our current requirements have generally been vague and have changed little since the rule was adopted… Our lens of board diversity disclosure needs to be re-focused in order to better serve and inform investors.").

Nasdaq conducted an internal study of the current state of board diversity among Nasdaq-listed companies based on public disclosures, and found that while some companies already have made laudable progress in diversifying their boardrooms, the national market system and the public interest would best be served by an additional regulatory impetus for companies to embrace meaningful and multi-dimensional diversification of their boards. It also found that current reporting of board diversity data was not provided in a consistent manner or on a sufficiently widespread basis. As such, investors are not able to readily compare board diversity statistics across companies.

Accordingly, Nasdaq is proposing to require each of its listed companies, subject to certain exceptions, to: (i) provide statistical information regarding diversity among the members of the company's board of directors under proposed Rule 5606; and (ii) have, or explain why it does not have, at least two "Diverse" directors on its board under proposed rule 5605(f)(2). "Diverse" means a director who self-identifies as: (i) Female, (ii) an Underrepresented Minority, or (iii) LGBTQ+. Each listed company must have, or explain why it does not have, at least one Female director and at least one director who is either an Underrepresented Minority or LGBTQ+. Foreign Issuers (including Foreign Private Issuers) and Smaller Reporting

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[8] See Vanguard, *Investment Stewardship 2019 Annual Report* (2019), available at: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019_investment_stewardship_annual_report.pdf ("We want companies to disclose the diversity makeup of their boards on dimensions such as gender, age, race, ethnicity, and national origin, at least on an aggregate basis."); see also State Street Global Advisors, *Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies* (Aug. 27, 2020) https://www.ssga.com/us/en/individual/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies (announcing expectation that State Street's portfolio companies (including US companies "and, to the greatest extent possible, non-US companies") provide board level "[d]iversity characteristics, including racial and ethnic makeup, of the board of directors").

Companies, by contrast, have more flexibility and may satisfy the requirement by having two Female directors. "Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth. "Underrepresented Minority" means, consistent with the categories reported to the Equal Employment Opportunity Commission ("EEOC") through the Employer Information Report EEO-1 Form ("EEO-1 Report"), an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities. "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.

Under proposed Rule 5606, Nasdaq proposes to provide each company with one calendar year from the date that the Commission approves this proposal (the "Approval Date") to comply with the requirement for statistical information regarding diversity. Under proposed Rule 5605(f)(2), no later than two calendar years after the Approval Date, each company must have, or explain why it does not have, one Diverse director. Further, each company must have, or explain why it does not have, two Diverse directors no later than: (i) four calendar years after the Approval Date for companies listed on the Nasdaq Global Select or Global Market tiers; or (ii) five calendar years after the Approval Date for companies listed on the Nasdaq Capital Market tier.

Nasdaq undertook extensive research and analysis and has concluded that the proposal will fulfill the objectives of the Act in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, to prevent fraudulent and manipulative acts and practices, and to

protect investors and the public interest. In addition to conducting its own internal analysis as described above, Nasdaq reviewed a substantial body of third-party research and interviewed leaders representing a broad spectrum of market participants and other stakeholders to:

- determine whether empirical evidence demonstrates an association between board diversity, shareholder value, investor protection and board decision-making;
- understand investors' interest in, and impediments to obtaining, information regarding the state of board diversity at public companies;
- review the current state of board diversity and disclosure, both among Nasdaq-listed companies and more broadly within the U.S.;
- gain a better understanding of the causes of underrepresentation on boards;
- obtain the views of leaders representing public companies, investment banks, corporate governance organizations, investors, regulators and civil rights groups on the value of more diverse corporate boards, and on various approaches to encouraging more diversity on corporate boards; and
- evaluate the success of approaches taken by exchanges, regulators, and governments in both the U.S. and foreign jurisdictions to remedy underrepresentation on boards.

While gender diversity has improved among U.S. company boards in recent years, the pace of change has been gradual, and the U.S. still lags behind other jurisdictions that have imposed requirements related to board diversity. **Moreover, progress toward bringing underrepresented racial and ethnic groups into the boardroom has been even slower**. Nasdaq is unable to provide definitive estimates regarding the number of listed companies that will be affected by the proposal due to the inconsistent disclosures and definitions of diversity across companies and the extremely limited disclosure of race and ethnicity information – an information gap the proposed rule addresses. Based on the limited information that is available, Nasdaq believes a supermajority of listed companies have made notable strides to improve gender diversity

in the boardroom and have at least one woman on the board. Nasdaq also believes that listed companies are diligently working to add directors with other diverse attributes, although consistent with other studies of U.S. companies, Nasdaq believes the pace of progress, in this regard, is happening more gradually. While studies suggest that current candidate selection processes may result in diverse candidates being overlooked, Nasdaq also believes that the lack of reliable and consistent data creates a barrier to measuring and improving diversity in the boardroom.

Nasdaq reviewed dozens of empirical studies and found that an extensive body of academic research demonstrates that diverse boards are positively associated with improved corporate governance and financial performance. For example, as discussed in detail below in *Section II, Academic Research: The Relationship between Diversity and Shareholder Value, Investor Protection and Decision Making***,** studies have found that companies with gender-diverse boards or audit committees are associated with: more transparent public disclosures and less information asymmetry; better reporting discipline by management; a lower likelihood of manipulated earnings through earnings management; an increased likelihood of voluntarily disclosing forward-looking information; a lower likelihood of receiving audit qualifications due to errors, non-compliance or omission of information; and a lower likelihood of securities fraud. In addition, studies found that having at least one woman on the board is associated with a lower likelihood of material weaknesses in internal control over financial reporting and a lower likelihood of material financial restatements. Studies also identified positive relationships between board diversity and commonly used financial metrics, including

higher returns on invested capital, returns on equity, earnings per share, earnings before interest and taxation margin, asset valuation multiples and credit ratings.

Nasdaq believes there are additional compelling reasons to support the diversification of company boards beyond a link to improved corporate governance and financial performance:

- Investors are calling in greater numbers for diversification of boardrooms. Vanguard, State Street Advisors, BlackRock, and the NYC Comptroller's Office include board diversity expectations in their engagement and proxy voting guidelines.[9] The heightened investor focus on corporate diversity and inclusion efforts demonstrates that investor confidence is undermined when a company's boardroom is homogenous and when transparency about such efforts is lacking. Investors frequently lack access to information about corporate board diversity that could be material to their decision making, and they might divest from companies that fail to take into consideration the demographics of their corporate stakeholders when they refresh their boards. Nasdaq explores these investor

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[9] Vanguard announced in 2020 it would begin asking companies about the race and ethnicity of directors. See Vanguard, *Investment Stewardship 2020 Annual Report* (2020), available at: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2020_investment_stewardship_annual_report.pdf. Starting in 2020, State Street Global Advisors will vote against the entire nominating committee of companies that do not have at least one woman on their boards and have not addressed questions on gender diversity within the last three years. See State Street Global Advisors, *Summary of Material Changes to State Street Global Advisors' 2020 Proxy Voting and Engagement Guidelines* (2020), available at: https://www.ssga.com/library-content/pdfs/global/proxy-voting-and-engagement-guidelines.pdf. Beginning in 2018, BlackRock stated in proxy voting guidelines they "would normally expect to see at least 2 women directors on every board." See BlackRock Investment Stewardship, *Corporate governance and proxy voting guidelines for U.S. securities* (Jan. 2020), available at: https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. The NYC Comptroller's Office in 2019 asked companies to adopt policies to ensure women and people of color are on the initial list for every open board seat. See Scott M. Stringer, *Remarks at the Bureau of Asset Management 'Emerging Managers and MWBE Managers Conference* (Oct. 11, 2019), available at: https://comptroller.nyc.gov/wp-content/uploads/2019/10/10.11.19-SMS-BAM-remarks_distro.pdf.

sentiments in *Section III, Current State of Board Diversity and Causes of Underrepresentation on Boards*.

- Nasdaq believes, consistent with SEC disclosure requirements in other contexts,[10] that management's vision on key issues impacting the company should be communicated with investors in a clear and straightforward manner. Indeed, transparency is the bedrock of federal securities laws regarding disclosure, and this sentiment is reflected in the broad-based support for uniform disclosure requirements regarding board diversity that Nasdaq observed during the course of its outreach to the industry. In addition, organizational leaders representing every category of corporate stakeholders Nasdaq spoke with (including business, investor, governance, regulatory and civil rights communities) were overwhelmingly in favor of diversifying boardrooms. Nasdaq summarizes the findings of its stakeholder outreach in *Section IV, Stakeholder Perspectives.*
- Legislators at the federal and state level increasingly are taking action to encourage or mandate corporations to diversify their boards and improve diversity disclosures. Congress currently is considering legislation requiring each SEC-registered company to provide board diversity statistics and disclose whether it has a board diversity policy. To date, eleven states have passed or proposed

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[10] See Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, 68 Fed. Reg. 75,056 (Dec. 29, 2003) ("We believe that management's most important responsibilities include communicating with investors in a clear and straightforward manner. MD&A is a critical component of that communication. The Commission has long sought through its rules, enforcement actions and interpretive processes to elicit MD&A that not only meets technical disclosure requirements but generally is informative and transparent."); see also Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Release No. 33-10890 (Nov. 19, 2020) (citing the 2003 MD&A Interpretative Release and stating that the purpose of the MD&A section is to enable investors to see a company "through the eyes of management").

legislation related to board diversity.[11] SEC regulations require companies to disclose whether diversity is considered when identifying director nominees and, if so, how. Nasdaq explores various state and federal initiatives in *Section V, U.S. Regulatory Framework and Section VI, Nasdaq Proposal***.**

In considering the merits and shaping the substance of the proposed listing rule, Nasdaq also sought and received valuable input from corporate stakeholders. During those discussions, Nasdaq found consensus across every constituency in the inherent value of board diversity. Business leaders also expressed concern that companies – and particularly smaller companies – would prefer an approach that allows flexibility to comply in a manner that fits their unique circumstances and stakeholders. Nasdaq recognizes that the operations, size, and current board composition of each Nasdaq-listed company are unique, and Nasdaq therefore endeavored to provide a regulatory impetus to enhance board diversity that balances the need for flexibility with each company's particular circumstances.

The Exchange also considered the experience of its parent company, Nasdaq, Inc., as a public company.[12] In 2002, Nasdaq, Inc. met the milestone of welcoming its first woman, Mary Jo White, who later served as SEC Chair, to its board of directors. In her own words, "I was the first and only woman to serve on the board when I started, but,

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11 See Michael Hatcher and Weldon Latham, *States are Leading the Charge to Corporate Boards: Diversify!*, Harv. L. Sch. Forum on Corp. Governance (May 12, 2020), available at: https://corpgov.law.harvard.edu/2020/05/12/states-are-leading-the-charge-to-corporate-boards-diversify/.

12 While the Exchange recognizes that it is only one part of an ecosystem in which multiple stakeholders are advocating for board diversity, that part is meaningful: the United Nations Sustainable Stock Exchanges Initiative, of which Nasdaq, Inc., is an official supporter, recognized that "[s]tock exchanges are uniquely positioned to influence their market in a way few other actors can." See United Nations Sustainable Stock Exchanges Initiative, *How Stock Exchanges Can Advance Gender Equality* 2 (2017), available at: https://sseinitiative.org/wp-content/uploads/2019/12/How-stock-exchanges-can-advance-gender-equality.pdf.

happily, I was joined by another woman during my tenure…And then there were two. Not enough, but better than one."[13] In 2019, Nasdaq, Inc. also welcomed its first Black director. As a Charter Pledge Partner of The Board Challenge, Nasdaq supports The Board Challenge's goal of "true and full representation on all boards of directors."[14]

As a self-regulatory organization, Nasdaq also is cognizant of its role in advancing diversity within the financial industry, as outlined in the Commission's diversity standards issued pursuant to Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Standards").[15] Authored jointly by the Commission and five other financial regulators, the Standards seek to provide a framework for exchanges and financial services organizations "to create and strengthen [their] diversity policies and practices." Through these voluntary Standards, the Commission and other regulators "encourage each entity to use the[] Standards in a manner appropriate to its unique characteristics."[16] To that end, the proposed rule leverages the Exchange's unique ability to influence corporate governance in furtherance of the goal of Section 342, which is to address the lack of diversity in the financial services industry.[17] Finally, while the Exchange recognizes the importance of maximizing shareholder value, its role as a listing venue is to establish and enforce

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13 See Mary Jo White, Completing the Journey: Women as Directors of Public Companies (Sept. 16, 2014), available at: https://www.sec.gov/news/speech/2014-spch091614-mjw#.VBiLMhaaXDo.

14 See The Board Challenge, https://theboardchallenge.org/. See also Nasdaq, Inc., *Notice of 2020 Annual Meeting of Shareholders and Proxy Statement* 52 (Mar. 31, 2020), available at: https://ir.nasdaq.com/static-files/ce5519d4-3a0b-48ac-8441-5376ccbad4e5 (Nasdaq, Inc. believes that "[d]iverse backgrounds lead to diverse perspectives. We are committed to ensuring diverse backgrounds are represented on our board and throughout our organization to further the success of our business and best serve the diverse communities in which we operate.").

15 See Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, 80 Fed. Reg. 33,016 (June 10, 2015).

16 Id. at 33,023.

17 156 Cong. Rec. H5233-61 (June 30, 2010).

substantive standards that promote investor protection. As a self-regulatory organization, the Exchange must demonstrate to the Commission that any proposed rule is consistent with Section 6(b) of the Act because, among other things, it is designed to protect investors, promote the public interest, prevent fraudulent and manipulative acts and practices, and remove impediments to the mechanism of a free and open market. The Exchange must also balance promoting capital formation, efficiency, and competition, among other things, alongside enhancing investor confidence.

With these objectives in mind, Nasdaq believes that a listing rule designed to enhance transparency related to board diversity will increase consistency and comparability of information across Nasdaq-listed companies, thereby increasing transparency and decreasing information collection costs. Nasdaq further believes that a listing rule designed to encourage listed companies to increase diverse representation on their boards will result in improved corporate governance, thus strengthening the integrity of the market, enhancing capital formation, efficiency, and competition, and building investor confidence. To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2), Nasdaq believes that the proposal will provide investors with additional transparency through disclosure explaining the company's reasons for not doing so. For example, the company may choose to disclose that it does not meet the diversity objectives of Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to meet that standard instead, or has a board philosophy regarding diversity that differs from the diversity objectives set forth in Rule 5605(f)(2). Nasdaq believes that such disclosure will improve the quality of information available to investors who rely on this information to make

informed investment and voting decisions, thereby promoting capital formation and efficiency.

Nasdaq observed that studies suggest that certain groups may be underrepresented on boards because the traditional director nomination process is limited by directors looking within their own social networks for candidates with previous C-suite experience.[18] Leaders from across the spectrum of stakeholders with whom Nasdaq spoke reinforced the notion that if companies recruit by skill set and expertise rather than title, they will find there is more than enough diverse talent to satisfy demand. In order to assist companies that strive to meet the diversity objectives of Rule 5605(f)(2), Nasdaq is proposing to provide listed companies that have not yet met its diversity objectives with free access to a network of board-ready diverse candidates and a tool to support board evaluation, benchmarking and refreshment. Nasdaq is contemporaneously submitting a rule filing to the Commission regarding the provision of such services. Nasdaq also plans to publish FAQs on its Listing Center to provide guidance to companies on the application of the proposed rules, and to establish a dedicated mailbox for companies and their counsel to email additional questions to Nasdaq regarding the application of the proposed rule. Nasdaq believes that these services will help to ease the compliance burden on companies whether they choose to meet the listing rule's diversity objectives or provide an explanation for not doing so.

II. Academic Research: The Relationship between Diversity and Shareholder Value, Investor Protection and Decision Making

A company's board of directors plays a critical role in formulating company strategy; appointing, advising and overseeing management; and protecting investors.

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[18] See infra Section III.

Nasdaq has recognized the importance of varied perspectives on boards since 2003, when the Exchange adopted a listing rule intended to enhance investor confidence by requiring listed companies, subject to certain exceptions and cure periods, to have a majority independent board.[19] Accompanying the rule are interpretive materials recognizing that independent directors "play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to *maximize shareholder value* in the Companies they oversee and guard against conflicts of interest."[20]

a. Diversity and Shareholder Value

There is a significant body of research suggesting a positive association between diversity and shareholder value.[21] In the words of SEC Commissioner Allison Herren Lee: "to the extent one seeks economic support for diversity and inclusion (instead of requiring economic support for the lack of diversity and exclusion), the evidence is in."[22]

The Carlyle Group (2020) found that its portfolio companies with two or more diverse directors had average earnings growth of 12.3% over the previous three years, compared to 0.5% among portfolio companies with no diverse directors, where diverse

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19 See Nasdaq Stock Market Rulebook, Rules 5605(b), 5615(a), and 5605(b)(1)(A).

20 Id., IM-5605-1 (emphasis added).

21 Some companies recently have expressed the belief that a company must consider the impact of its activities on a broader group of stakeholders beyond shareholders. See Business Roundtable, *Statement on the Purpose of a Corporation* (Aug. 19, 2019), available at: https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationOctober2020.pdf. Commentators articulated this view as early as 1932. See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145, 1153 (1932).

22 See Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More: Remarks at the Council of Institutional Investors Fall 2020 Conference* (September 22, 2020), available at: https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

directors were defined as female, Black, Hispanic or Asian.[23] "After controlling for industry, fund, and vintage year, companies with diverse boards generate earnings growth that's five times faster, on average, with each diverse board member associated with a 5% increase in annualized earnings growth."[24]

Several other studies also found a positive association between diverse boards and company performance. FCLTGlobal (2019) found that "the most diverse boards (top 20 percent) added 3.3 percentage points to [return on invested capital], as compared to their least diverse peers (bottom 20 percent)."[25] McKinsey (2015) found that "companies in the top quartile for racial/ethnic diversity were 35 percent more likely to have financial returns above their national industry median."[26] Carter, Simkins and Simpson (2003) found among Fortune 1000 companies "statistically significant positive relationships between the presence of women or minorities on the board and firm value."[27] Bernile, Bhagwat and Yonker (2017) found that greater diversity on boards—including gender, ethnicity, educational background, age, financial expertise and board experience—is

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23 See Jason M. Thomas and Megan Starr, The Carlyle Group, *Global Insights: From Impact Investing to Investing for Impact* 5 (Feb. 24, 2020), available at: https://www.carlyle.com/sites/default/files/2020-02/From%20Impact%20Investing%20to%20Investing%20for%20Impact_022420.pdf (analyzing Carlyle U.S. portfolio company data, February 2020).

24 Id.

25 See FCLTGlobal, *The Long-term Habits of a Highly Effective Corporate Board* 11 (March 2019), available at: https://www.fcltglobal.org/wp-content/uploads/long-term-habits-of-highly-effective-corporate-boards.pdf (analyzing 2017 MSCI ACWI constituents from 2010 to 2017 using Bloomberg data).

26 See Vivian Hunt et al., McKinsey & Company, *Diversity Matters* (February 2, 2015), available at: https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/why%20diversity%20matters/diversity%20matters.pdf (analyzing 366 public companies in the United Kingdom, Canada, the United States, and Latin America in industries for the years 2010 to 2013, using the ethnic and racial categories African ancestry, European ancestry, Near Eastern, East Asian, South Asian, Latino, Native American, and other).

27 See David A. Carter et al., *Corporate Governance, Board Diversity, and Firm Value*. 38(1) Fin. Rev. 33 (analyzing 638 Fortune 1000 firms in 1997, measuring firm value by Tobin's Q, with board diversity defined as the percentage of women, African Americans, Asians and Hispanics on the board of directors).

associated with increased operating performance, higher asset valuation multiples, lower stock return volatility, reduced financial leverage, increased dividend payouts to shareholders, higher investment in R&D and better innovation.[28] The authors observed that "[t]his is in line with the results in Carter, Simkins, and Simpson (2003), which show a positive association between local demographic diversity and firm value."[29]

Several studies have found a positive association between gender diversity and financial performance. Credit Suisse (2014) found companies with at least one woman on the board had an average sector-adjusted return on equity ("ROE") of 12.2%, compared to 10.1% for companies with no female directors, and average sector-adjusted ROEs of 14.1% and 11.2%, respectively, for the previous nine years.[30] MSCI (2016) found that U.S. companies with at least three women on the board in 2011 experienced median gains in ROE of 10% and earnings per share ("EPS") of 37% over a five year period, whereas companies that had no female directors in 2011 showed median changes of -1% in ROE and -8% in EPS over the same five-year period.[31] Catalyst (2011) found that the ROE of Fortune 500 companies with at least three women on the board (in at least four of five years) was 46% higher than companies with no women on the board,

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28 See Gennaro Bernile et al., *Board Diversity, Firm Risk, and Corporate Policies* (March 6, 2017), available at: https://ssrn.com/abstract=2733394 (analyzing 21,572 firm-year observations across non-financial, non-utility firms for the years 1996 to 2014, based on the ExecuComp, RiskMetrics, Compustat and CRSP databases).

29 Id. at 32.

30 See Credit Suisse, *The CS Gender 3000: Women in Senior Management* 16 (Sept. 2014), available at: https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/the-cs-gender-3000-women-in-senior-management.pdf (analyzing 3,000 companies across 40 countries from the period from 2005 to 2013).

31 See Meggin Thwing Eastman et al., MSCI, *The tipping point: Women on boards and financial performance* 3 (December 2016), available at: https://www.msci.com/documents/10199/fd1f8228-cc07-4789-acee-3f9ed97ee8bb (analyzing of U.S. companies that were constituents of the MSCI World Index for the entire period from July 1, 2011 to June 30, 2016).

and return on sales and return on invested capital was 84% and 60% higher, respectively.[32]

Credit Suisse (2016) found an association between LGBTQ+ diversity and stock performance, finding that a basket of 270 companies "supporting and embracing LGBT employees" outperformed the MSCI ACWI index by an average of 3.0% per year over the past 6 years.[33] Further, "[a]gainst a custom basket of companies in North America, Europe and Australia, the LGBT 270 has outperformed by 140 bps annually."[34] Nasdaq acknowledges that this study focused on LGBTQ+ employees as opposed to directors, and that there is a lack of published research on the issue of LGBTQ+ representation on boards. However, Out Leadership (2019) suggests that the relationship between board gender diversity and corporate performance may extend to LGBTQ+ diversity:

> While the precise reason for the positive correlation between gender diversity and better corporate performance is unknown, many of the reasons that gender diversity is considered beneficial are also applicable to LGBT+ diversity. LGBT+ diversity in the boardroom may create a dynamic that enables better decisionmaking, and it brings to the boardroom the perspective of a community that is a critical component of the company's consumer population and organizational talent.[35]

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32 See Harvey M. Wagner, Catalyst, *The Bottom Line: Corporate Performance and Women's Representation on Boards (2004–2008)* (March 1, 2011), available at: https://www.catalyst.org/research/the-bottom-line-corporate-performance-and-womens-representation-on-boards-2004-2008/ (analyzing gender diversity data from Catalyst's annual Fortune 500 Census of Women Board Directors report series for the years 2005 to 2009, and corresponding financial data from S&P's Compustat database for the years 2004 to 2008).

33 See Credit Suisse ESG Research, *LGBT: the value of diversity* 1 (April 15, 2016), available at: https://research-doc.credit-suisse.com/docView?language=ENG&source=emfromsendlink&format=PDF&document_id=807075590&extdocid=807075590_1_eng_pdf&serialid=evu4wNcHexx7kusNLaZQphUkT9naxi1PvptZQvPjr1k%3d.

34 Id.

35 See Quorum, *Out Leadership's LGBT+ Board Diversity and Disclosure Guidelines* 3 (2019), available at: https://outleadership.com/content/uploads/2019/01/OL-LGBT-Board-Diversity-Guidelines.pdf.

McKinsey (2020) found "a positive, statistically significant correlation between company financial outperformance and [board] diversity, on the dimensions of both gender and ethnicity," with companies in the top quartile for board gender diversity "28 percent more likely than their peers to outperform financially," and a statistically significant correlation between board gender diversity and outperformance on earnings before interest and taxation margin.[36] Moody's (2019) found that greater board gender diversity is associated with higher credit ratings, with women accounting for an average of 28% of board seats at Aaa-rated companies but less than 5% of board seats at Ca-rated companies.[37]

While the overwhelming majority of studies on the association between economic performance and board diversity, including gender diversity, present a compelling case that board diversity is positively associated with financial performance, the results of some other studies on gender diversity are mixed. For example, Pletzer et al. (2015) found that board gender diversity alone has a "small and non-significant" relationship with a company's financial performance.[38] Post and Byron (2014) found a "near zero" relationship with a company's market performance, but a positive relationship with a

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36 See McKinsey & Company, *Diversity wins: How inclusion matters* 13 (May 2020), available at: https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Diversity%20and%20Inclusion/Diversity%20wins%20How%20inclusion%20matters/Diversity-wins-How-inclusion-matters-vF.pdf (analyzing 1,039 companies across 15 countries for the period from December 2018 to November 2019).

37 See Moody's Investors Service, *Gender diversity is correlated with higher ratings, but mandates pose short-term risk* 2 (Sept. 11, 2019), available at: https://www.moodys.com/research/Moodys-Corporate-board-gender-diversity-associated-with-higher-credit-ratings--PBC_1193768 (analyzing 1,109 publicly traded North American companies rated by Moody's).

38 See Jan Luca Pletzer et al., *Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Performance – A Meta-Analysis* 1, PLOS One (June 18, 2015); see also Alice H. Eagly (2016), *When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?*, 72 J. Social Issues 199 (2016), available at https://doi.org/10.1111/josi.12163 (concluding that the "research findings are mixed, and repeated meta-analyses have yielded average correlational findings that are null or extremely small" with respect to board gender diversity and company performance).

company's accounting returns.[39] Carter, D'Souza, Simkins and Simpson (2010) found that "[w]hen Tobin's Q is used as the measure of financial performance, we find no relationship to gender diversity or ethnic minority diversity, neither positive nor negative."[40] A study conducted by Campbell and Minguez-Vera (2007) "suggests, at a minimum, that increased gender diversity can be achieved without destroying shareholder value."[41] Adams and Ferreira (2009) found that "gender diversity has beneficial effects in companies with weak shareholder rights, where additional board monitoring could enhance firm value, but detrimental effects in companies with strong shareholder rights."[42] Carter et al. (2010)[43] and the U.S. Government Accountability Office ("GAO") (2015)[44] concluded that the mixed nature of various academic studies may be due to differences in methodologies, data samples and time periods.

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39 See Corinne Post and Kris Byron, *Women on Boards and Firm Financial Performance: A Meta-Analysis* 1 (2014). In 2016, the same authors, based on a review of the results for 87 studies, "found that board gender diversity is weakly but significantly positively correlated with [corporate social responsibility]," although they noted that "a significant correlational relationship does not prove causality." See Corinne Post and Kris Byron, *Women on Boards of Directors and Corporate Social Performance: A Meta-Analysis*, 24(4) Corp. Governance: An Int'l Rev. 428 (July 2016), available at http://dx.doi.org/10.1111/corg.12165.

40 See David A. Carter et al., *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance*, 18(5) Corp. Governance 396, 410 (2010) (analysis of 541 S&P 500 companies for the years 1998-2002).

41 See Kevin Campbell and Antonio Minguez-Vera, *Gender Diversity in the Boardroom and Firm Financial Performance*, 83(3) J. Bus. Ethics 13 (Feb. 2008) (analyzing 68 non-financial companies listed on the continuous market in Madrid during the period from January 1995 to December 2000, measuring firm value by an approximation of Tobin's Q defined as the sum of the market value of stock and the book value of debt divided by the book value of total assets).

42 See Renee B. Adams and Daniel Ferreira, *Women in the boardroom and their impact on governance and performance*, 94 J. Fin. Econ. 291 (2009) (analyzing 1,939 S&P 500, S&P MidCaps, and S&P SmallCap companies for the period 1996 to 2003, measuring company performance by a proxy for Tobin's Q (the ratio of market value to book value) and return on assets).

43 See Carter et al., supra note 40, at 400 (observing that the different "statistical methods, data, and time periods investigated vary greatly so that the results are not easily comparable.").

44 See United States Government Accountability Office, Report to the Ranking Member, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, House of Representatives, *Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements* 5 (Dec. 2015) (the "GAO

While there are studies drawing different conclusions, Nasdaq believes that there is a compelling body of credible research on the association between economic performance and board diversity. At a minimum, Nasdaq believes that the academic studies support the conclusion that board diversity does not have adverse effects on company financial performance. This is not the first time Nasdaq has considered whether, on balance, various studies finding mixed results related to board composition and company performance are a sufficient rationale to propose a listing rule. For example, in 2003, notwithstanding the varying findings of studies at the time regarding the relationship between company performance and board independence,[45] Nasdaq adopted listing rules requiring a majority independent board that were "intended to enhance investor confidence in the companies that list on Nasdaq."[46] In its Approval Order, the SEC stated that "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets."[47]

Report"), available at: https://www.gao.gov/assets/680/674008.pdf ("Some research has found that gender diverse boards may have a positive impact on a company's financial performance, but other research has not. These mixed results depend, in part, on differences in how financial performance was defined and what methodologies were used").

45 See, e.g., Benjamin E. Hermalin and Michael S. Weisbach, *The Effects of Board Composition and Direct Incentives on Firm Performance*, 20 Fin. Mgmt. 101, 111 (1991) (finding that "there appears to be no relation between board composition and performance"); Sanjai Bhagat and Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54(3) Bus. Law. 921, 950 (1999) ("At the very least, there is no convincing evidence that increasing board independence, relative to the norms that currently prevail among large American firms, will improve firm performance. And there is some evidence suggesting the opposite—that firms with supermajority-independent boards perform worse than other firms, and that firms with more inside than independent directors perform about as well as firms with majority- (but not supermajority-) independent boards.").

46 See Order Approving Proposed Rule Changes, 68 Fed. Reg. 64,154, 64,161 (Nov. 12, 2003) (approving SR-NASD-2002-77, SR-NASD-2002-80, SR-NASD-2002-138, SR-NASD-2002-139, and SR-NASD-2002-141).

47 Id. at 64,176.

Along the same lines, even without clear consensus among studies related to board diversity and company performance, the heightened focus on corporate board diversity by investors demonstrates that investor confidence is undermined when data on board diversity is not readily available and when companies do not explain the reasons for the apparent absence of diversity on their boards. Therefore, Nasdaq believes that the proposal will enhance investor confidence that all listed companies are considering diversity in the context of selecting directors, either by including at least two Diverse directors on their boards or by explaining their rationale for not meeting that objective. Further, Nasdaq believes that the proposal is consistent with the Act because it will not negatively impact capital formation, competition or efficiency among its public companies, and will promote investor protection and the public interest.[48]

b. Diversity and Investor Protection

There is substantial evidence that board diversity enhances the quality of a company's financial reporting, internal controls, public disclosures and management oversight. In reaching this conclusion, Nasdaq evaluated the results of more than a dozen studies spanning more than two decades that found a positive association between gender diversity and important investor protections, and the assertions by some academics that such findings may extend to other forms of diversity, including racial and ethnic diversity. The findings of the studies reviewed by Nasdaq are summarized below.

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48 See also Lee, supra note 22 ("I could never quite buy in to the view that some 40 percent of the population in our country (if we're talking about minorities) or over half the country (if we're talking about women) must rationalize their inclusion in corporate boardrooms and elsewhere in economic terms instead of the reverse. How can one possibly justify—in economic terms—the systematic exclusion of a major portion of our talent base from the corporate pool?").

Adams and Ferreira (2009) found that women are "more likely to sit on" the audit committee,[49] and a subsequent study by Srinidhi, Gul and Tsui (2011) found that companies with women on the audit committee are associated with "higher earnings quality" and "better reporting discipline by managers,"[50] leading the authors to conclude that "including female directors on the board and the audit committee are plausible ways of improving the firm's reporting discipline and increasing investor confidence in financial statements."[51]

A study conducted in 2016 by Pucheta-Martínez et al. concluded that gender diversity on the audit committee "improves the quality of financial information."[52] They found that "the percentage of females on [audit committees] reduces the probability of [audit] qualifications due to errors, non-compliance or the omission of information,"[53] and found a positive association between gender diverse audit committees and disclosing audit reports with uncertainties and scope limitations. This suggests that gender diverse audit committees "ensure that managers do not seek to pressure auditors into issuing a

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49 See Adams and Ferreira, supra note 42, at 292.

50 See Bin Srinidhi et al., *Female Directors and Earnings Quality*, 28(5) Contemporary Accounting Research 1610, 1612-16 (Winter 2011) (analyzing 3,132 firm years during the period from 2001 to 2007 based on S&P COMPUSTAT, Corporate Library's Board Analyst, and IRRC databases; "choos[ing] the accruals quality as the metric that best reflects the ability of current earnings to reflect future cash flows" (noting that it "best predicts the incidence and magnitude of fraud relative to other commonly used measures of earnings quality") and analyzing surprise earnings results that exceeded previous earnings or analyst forecasts, because "managers of firms whose unmanaged earnings fall marginally below the benchmarks have [an] incentive to manage earnings upwards so as to meet or beat previous earnings").

51 Id. at 1612.

52 See Maria Consuelo Pucheta-Martínez et al., *Corporate governance, female directors and quality of financial information.* 25(4) Bus. Ethics: A European Rev. 363, 378 (2016) (analyzing a sample of non-financial companies listed on the Madrid Stock Exchange during 2004-2011).

53 Id. at 363.

clean opinion instead of a qualified opinion" when any uncertainties or scope limitations are identified.[54]

More recently, a study by Gull in 2018 found that the presence of female audit committee members with business expertise is associated with a lower magnitude of earnings management,[55] and a study conducted in 2019 by Bravo and Alcaide-Ruiz found a positive association between women on the audit committee with financial or accounting expertise and the voluntary disclosure of forward-looking information.[56] Bravo and Alcaide-Ruiz concluded that "female [audit committee] members with financial expertise play an important role in influencing disclosure strategies that provide forward-looking information containing projections and financial data useful for investors."[57]

While the above studies demonstrate a positive association between gender diverse audit committees and the quality of a company's earnings, financial information and public disclosures, other studies found a positive association between board gender diversity and important investor protections regardless of whether or not women are on the audit committee.

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54 Id. at 368.

55 See Ammar Gull et al., *Beyond gender diversity: How specific attributes of female directors affect earnings management*, 50(3) British Acct. Rev. 255 (Sept. 2017), available at: https://ideas.repec.org/a/eee/bracre/v50y2018i3p255-274.html (analyzing 394 French companies belonging to the CAC All-Shares index listed on Euronext Paris from 2001 to 2010, prior to the implementation of France's gender mandate law that required women to comprise 20% of a company's board of directors by 2014 and 40% by 2016).

56 See Francisco Bravo and Maria Dolores Alcaide-Ruiz, *The disclosure of financial forward-looking information*, 34(2) Gender in Mgmt. 140, 142-44 (2019) (analyzing companies included in the S&P 100 Index in 2016, "focus[ing] on the disclosure of financial forward-looking information (which is likely to require financial expertise), such as earnings forecasts, expected revenues, anticipated cash flows or any other financial indicator").

57 Id. at 150.

Abbott, Parker & Persley (2012) found, within a sample of non-Fortune 1000 companies, "a significant association between the presence of at least one woman on the board and a lower likelihood of [a material financial] restatement."[58] Their findings are consistent with a subsequent study by Wahid (2017), which concluded that "gender-diverse boards commit fewer financial reporting mistakes and engage in less fraud."[59] Specifically, companies with female directors have "fewer irregularity-type [financial] restatements, which tend to be indicative of financial manipulation."[60] Wahid suggested that the implications of her study extend beyond gender diversity:

> If you're going to introduce perspectives, those perspectives might be coming not just from male versus female. They could be coming from people of different ages, from different racial backgrounds . . . [and] [i]f we just focus on one, we could be essentially taking away from other dimensions of diversity and decreasing perspective.[61]

Cumming, Leung and Rui (2015) also examined the relationship between gender diversity and fraud, and found that the presence of women on boards is associated with a lower likelihood of securities fraud; indeed, they found "strong evidence of a negative and diminishing effect of women on boards and the probability of being in our fraud

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58 See Lawrence J. Abbott et al., *Female Board Presence and the Likelihood of Financial Restatement*, 26(4) Accounting Horizons 607, 626 (2012) (analyzing a sample of 278 pre-SOX annual financial restatements and 187 pre-SOX quarterly financial restatements of U.S. companies from January 1, 1997 through June 30, 2002 identified by the U.S. General Accounting Office restatement report 03-138 (which only included "material misstatements of financial results"), and 75 post-SOX annual financial restatements from July 1, 2002, to September 30, 2005 identified by U.S. General Accounting Office restatement report 06-678 (which only included "restatements that were being made to correct material misstatements of previously reported financial information"), consisting almost exclusively of non-Fortune 1000 companies).

59 See Aida Sijamic Wahid, The *Effects and the Mechanisms of Board Gender Diversity: Evidence from Financial Manipulation*, J. Bus. Ethics (forthcoming) (Dec. 2017) Rotman School of Management Working Paper No. 2930132 at 1, available at: https://ssrn.com/abstract=2930132 (analyzing 6,132 U.S. public companies during the period from 2000 to 2010, for a total of 38,273 firm-year observations).

60 Id. at 23.

61 See Barbara Shecter, *Diverse boards tied to fewer financial 'irregularities,' Canadian study finds*. Financial Post (Feb. 5, 2020), https://business.financialpost.com/news/fp-street/diverse-boards-tied-to-fewer-financial-irregularities-canadian-study-finds (last accessed Nov. 27, 2020).

sample."[62] The authors suggested that "other forms of board diversity, including but not limited to gender diversity, may likewise reduce fraud."[63]

Chen, Eshleman and Soileau (2016) suggested that the relationship between gender diversity and higher earnings quality observed by Srinidhi, Gul and Tsui (2011) is ultimately driven by reduced weaknesses in internal control over financial reporting, noting that "prior literature has established a negative relationship between internal control weaknesses and earnings quality."[64] The authors found that having at least one woman on the board (regardless of whether or not she is on the audit committee) "may lead to [a] reduced likelihood of material weaknesses [in internal control over financial reporting]."[65]

Board gender diversity also was found to be positively associated with more transparent public disclosures. Gul, Srinidhi & Ng (2011) concluded that "gender diversity improves stock price informativeness by increasing voluntary public disclosures in large firms and increasing the incentives for private information collection in small firms."[66] Abad et al. (2017) concluded that companies with gender diverse boards are

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62 See Douglas J. Cumming et al., *Gender Diversity and Securities Fraud*, Academy of Management Journal 34 (forthcoming) (Feb. 2, 2015), available at https://ssrn.com/abstract=2562399 (analyzing China Securities Regulatory Commission data from 2001 to 2010, including 742 companies with enforcement actions for fraud, and 742 non-fraudulent companies for a control group).

63 Id. at 33.

64 See Yu Chen et al., *Board Gender Diversity and Internal Control Weaknesses*, 33 Advances in Acct. 11 (2016) (analyzing a sample of 4267 firm-year observations during the period from 2004 to 2013, beginning "the first year internal control weaknesses were required to be disclosed under section 404 of SOX").

65 Id. at 18.

66 See Ferdinand A. Gul et al., *Does board gender diversity improve the informativeness of stock prices?*, 51(3) J. Acct. & Econ. 314 (April 2011) (analyzing 4,084 firm years during the period from 2002 to 2007, excluding companies in the utilities and financial industries, measuring public information disclosure using "voluntary continuous disclosure of 'other' events in 8K reports" and measuring stock price informativeness by "idiosyncratic volatility," or volatility that cannot be explained to systematic factors and can be diversified away).

associated with lower levels of information asymmetry, suggesting that increasing board gender diversity is associated with "reducing the risk of informed trading and enhancing stock liquidity."[67]

Other studies have found that diverse boards are better at overseeing management. Adams and Ferreira (2009) found "direct evidence that more diverse boards are more likely to hold CEOs accountable for poor stock price performance; CEO turnover is more sensitive to stock return performance in firms with relatively more women on boards."[68] Lucas-Perez et al. (2014) found that board gender diversity is positively associated with linking executive compensation plans to company performance,[69] which may be an effective mechanism to deter opportunistic behavior by management and align their interests with shareholders.[70] A lack of diversity has been found to have the opposite effect. Westphal and Zajac (1995) found that "increased demographic similarity between CEOs and the board is likely to result in more generous CEO compensation contracts."[71]

c. Diversity and Decision Making

Wahid (2017) suggests that "at a minimum, gender diversity on corporate boards has a neutral effect on governance quality, and at best, it has positive consequences for boards' ability to monitor firm management."[72] Nasdaq reviewed studies suggesting that

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67 See David Abad et al., *Does Gender Diversity on Corporate Boards Reduce Information Asymmetry in Equity Markets?* 20(3) BRQ Business Research Quarterly 192, 202 (July 2017) (analyzing 531 company-year observations from 2004 to 2009 of non-financial companies traded on the electronic trading platform of the Spanish Stock Exchange (SIBE)).

68 See Adams and Ferreira, supra note 42, at 292.

69 See Maria Encarnacion Lucas-Perez et al., *Women on the Board and Managers' Pay: Evidence from Spain*, 129 J. Bus. Ethics 285 (April 2014).

70 Id.

71 See James D. Westphal and Edward J. Zajac, *Who Shall Govern? CEO/Board Power, Demographic Similarity, and New Director Selection*, 40(1) Admin. Sci. Q. 60, 77 (March 1995).

72 See Wahid, supra note 59, at 5.

board diversity can indeed enhance a company's ability to monitor management by reducing "groupthink" and improving decision making.

In 2009, the Commission, in adopting rules requiring proxy disclosure describing whether a company considers diversity in identifying director nominees, recognized the impact of diversity on decision making and corporate governance:

> A board may determine, in connection with preparing its disclosure, that it is beneficial to disclose and follow a policy of seeking diversity. Such a policy may encourage boards to conduct broader director searches, evaluating a wider range of candidates and potentially improving board quality. To the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management and are, consequently, more independent. To the extent that a more independent board is desirable at a particular company, the resulting increase in board independence could potentially improve governance. In addition, in some companies a policy of increasing board diversity may also improve the board's decision making process by encouraging consideration of a broader range of views.[73]

Nasdaq agrees with the Commission's suggestion that board diversity improves board quality, governance and decision making. Nasdaq is concerned that boards lacking diversity can inadvertently suffer from "groupthink," which is "a dysfunctional mode of group decision making characterized by a reduction in independent critical thinking and a relentless striving for unanimity among members."[74] The catastrophic financial consequences of groupthink became evident in the 2008 global financial crisis, after which the IMF's Independent Evaluation Office concluded that "[t]he IMF's ability to correctly identify the mounting risks [as the crisis developed] was hindered by a high

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73 See Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,355 (Dec. 23, 2009).

74 See Daniel P. Forbes and Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24(3) Acad. Mgmt. Rev. 489, 496 (Jul. 1999).

degree of groupthink."[75]

Other studies suggest that increased diversity reduces groupthink and leads to robust dialogue and better decision making. Dallas (2002) observed that "heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of a wide range of interpretations, alternatives, and consequences."[76] Bernile et al. (2017) found that "diversity in the board of directors reduces stock return volatility, which is consistent with diverse backgrounds working as a governance mechanism, moderating decisions, and alleviating problems associated with 'groupthink.'"[77] Dhir (2015) concluded that gender diversity may "promote cognitive diversity and constructive conflict in the boardroom."[78] After interviewing 23 directors about their experience with Norway's board gender mandate, he observed:

> First, many respondents contended that gender diversity promotes enhanced dialogue. Interviewees frequently spoke of their belief that heterogeneity has resulted in: (1) higher quality boardroom discussions; (2) broader discussions that consider a wide range of angles or viewpoints; (3) deeper or more thorough discussions; (4) more frequent and lengthier discussions; (5) better informed discussions; (6) discussions that are more frequently brought inside the boardroom (as opposed to being held in spaces outside the boardroom, either exclusively or in addition to inside the boardroom); or (7) discussions in which items that directors previously took for granted are drawn out and addressed—where the implicit becomes explicit. Second, and intimately related, many

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75 See International Monetary Fund, *IMF Performance in the Run-Up to the Financial and Economic Crisis* (August 2011), available at: https://www.elibrary.imf.org/view/IMF017/11570-9781616350789/11570-9781616350789/ch04.xml?language=en&redirect=true ("The evaluation found that incentives were not well aligned to foster the candid exchange of ideas that is needed for good surveillance—many staff reported concerns about the consequences of expressing views contrary to those of supervisors, [m]anagement, and country authorities.").

76 See Lynne L. Dallas, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders?: The New Managerialism and Diversity on Corporate Boards of Directors*, 76 Tul. L. Rev. 1363, 1391 (June 2002).

77 See Bernile et al., supra note 28, at 38.

78 See Aaron A. Dhir, CHALLENGING BOARDROOM DIVERSITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY 150 (2015) (emphasis removed) (sample included 23 directors of Norwegian corporate boards, representing an aggregate of 95 board appointments at more than 70 corporations).

> interviewees indicated that diversification has led to (or has the potential to lead to) better decision making processes and/or final decisions.[79]

Investors also have emphasized the importance of diversity in decision making. A group of institutional investors charged with overseeing state investments and the retirement savings of public employees asserted that "board members who possess a variety of viewpoints may raise different ideas and encourage a full airing of dissenting views. Such a broad pool of talent can be assembled when potential board candidates are not limited by gender, race, or ethnicity."[80]

Nasdaq believes that cognitive diversity is particularly important on boards because in their advisory role, especially related to corporate strategy, "the 'output' that boards produce is entirely cognitive in nature."[81] While in 1999, Forbes and Milliken characterized boards as "large, elite, and episodic decision making groups that face complex tasks pertaining to strategic-issue processing,"[82] over the past two decades, their role has evolved; boards are now more active, frequent advisors on areas such as cybersecurity, social media, and environmental, social and governance ("ESG") issues such as climate change and racial and gender inequality. Nasdaq believes that boards comprised of directors from diverse backgrounds enhance investor confidence by ensuring that board deliberations include the perspectives of more than one demographic group, leading to more robust dialogue and better decision making.

III. Current State of Board Diversity and Causes of Underrepresentation on Boards

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79 Id. at 124 (emphasis removed).

80 See Petition for Amendment of Proxy Rule (March 31, 2015), available at: https://www.sec.gov/rules/petitions/2015/petn4-682.pdf.

81 See Forbes and Milliken, supra note 74, at 492.

82 Id.

While the above studies suggest a positive association between board diversity, company performance, investor protections, and decision making, there is a noticeable lack of diversity among U.S. public companies. Nasdaq is a global organization and operates in many countries around the world that already have implemented diversity-focused directives. In fact, Nasdaq-listed companies in Europe already are subject to diversity requirements.[83] This first-hand experience provides Nasdaq with a unique perspective to incorporate global best practices into its proposal to advance diversity on U.S. corporate boards. Given that the U.S. ranks 53rd in board gender diversity, according to the World Economic Forum in its 2020 Global Gender Gap Report, Nasdaq believes advancing board diversity in the U.S. is a critical business and market imperative. This same report also found that "American women still struggle to enter the very top business positions: only 21.7% of corporate managing board members are women."[84] As of 2019, women directors held 19% of Russell 3000 seats (up from 16% in 2018).[85] In comparison, women hold more than 30% of board seats in Norway,

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83 On Nasdaq's Nordic and Baltic exchanges, large companies must comply with EU Directive 2014/95/EU (the "EU Directive"), as implemented by each member state, which requires companies to disclose a board diversity policy with measurable objectives (including gender), or explain why they do not have such a policy. On Nasdaq Vilnius, companies are also required to comply with the Nasdaq Corporate Governance Code for Listed Companies or explain why they do not, which requires companies to consider diversity and seek gender equality on the board. Similarly, on Nasdaq Copenhagen, companies are required to comply with the Danish Corporate Governance Recommendations or explain why they do not, which requires companies to adopt and disclose a diversity policy that considers gender, age and international experience. On Nasdaq Iceland, listed companies must have at least 40% women on their board (a government requirement) and comply with the EU Directive.

84 See World Economic Forum, *Global Gender Gap Report 2020* 33 (2019), available at: http://www3.weforum.org/docs/WEF_GGGR_2020.pdf.

85 See Kosmas Papadopoulos, ISS Analytics, *U.S. Board Diversity Trends in 2019* 4-5 (May 31, 2019), available at: https://www.issgovernance.com/file/publications/ISS_US-Board-Diversity-Trends-2019.pdf.

France, Sweden and Finland.[86] At the current pace, the U.S. GAO estimates that it could take up to 34 years for U.S. companies to achieve gender parity on their boards.[87]

Progress toward greater racial and ethnic diversity in U.S. company boardrooms has been even slower. Over the past ten years, the percentage of African American/Black directors at Fortune 500 companies has remained between 7 and 9%, while the percentage of women directors has grown from 16 to 23%.[88] In 2019, only 10% of board seats at Russell 3000 companies were held by racial minorities, reflecting an incremental increase from 8% in 2008.[89] Among Fortune 500 companies in 2018, there were fewer than 20 directors who publicly self-identified as LGBT+, and only nine companies reported considering sexual orientation and/or gender identity when identifying director nominees.[90]

Women and minority directors combined accounted for 34% of Fortune 500 board seats in 2018.[91] While women of color represent 18% of the U.S. population, they held only 4.6% of Fortune 500 board seats in 2018.[92] Male underrepresented minorities held 11.5% of board seats at Fortune 500 companies in 2018, compared to 66% of board seats held by Caucasian/White men. Overall in 2018, 83.9% of board seats among

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86 See Deloitte, *Women in the Boardroom: A global perspective* (6th ed. 2019), available at: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-risk-women-in-the-boardroom-sixth-edition.pdf.

87 See GAO Report, supra note 44.

88 See Russell Reynolds, *Ethnic & Gender Diversity on US Public Company Boards* 6 (September 8, 2020).

89 See Papadopoulous, supra note 85, at 5.

90 See Out Leadership, supra note 35.

91 See Deloitte, *Missing Pieces Report: The 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards* 9 (2018), available at: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-cbe-missing-pieces-report-2018-board-diversity-census.pdf.

92 See Catalyst, *Too Few Women of Color on Boards: Statistics and Solutions* (Jan. 31, 2020), https://www.catalyst.org/research/women-minorities-corporate-boards/.

Fortune 500 companies were held by Caucasian/White individuals (who represent 60.1% of the U.S. population), 8.6% by African American/Black individuals (who represent 13% of the U.S. population), 3.8% by Hispanic/Latino(a) individuals (who represent 19% of the U.S. population) and 3.7% by Asian/Pacific Islander individuals (who represent 6% of the U.S. population).[93] In its analysis of Russell 3000 companies, 2020 Women on Boards concluded that "larger companies do better with their diversity efforts than smaller companies."[94]

Based on the limited information that is available, Nasdaq believes a supermajority of listed companies have made notable strides to improve gender diversity in the boardroom and have at least one woman on the board. Nasdaq also believes that listed companies are diligently working to add directors with other diverse attributes, although consistent with other studies of U.S. companies, Nasdaq believes the pace of progress, in this regard, is happening more gradually. Thus, and for the reasons discussed in this Section 3.a.III, Nasdaq has concluded that a regulatory approach to encouraging greater diversity and data transparency would be beneficial.

Nasdaq reviewed academic studies on the causes of underrepresentation on boards and the approaches taken by other jurisdictions to remedy underrepresentation. Those studies suggest that the traditional director candidate selection process may create barriers to considering qualified diverse candidates for board positions. Dhir (2015) explains that "[t]he presence of unconscious bias in the board appointment process,

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93 See Deloitte, *Missing Pieces Report*, supra note 91; United States Census Bureau, *QuickFacts*, available at: https://www.census.gov/quickfacts/fact/table/US/PST045219.

94 See *2020 Women On Boards Gender Diversity Index* 4 (2019), available at: https://2020wob.com/wp-content/uploads/2019/10/2020WOB_Gender_Diversity_Index_Report_Oct2019.pdf.

coupled with closed social networks, generates a complex set of barriers for diverse directors; these are the 'phantoms' that prevent entry."[95] In 2011, the Davies Review found that "informal networks influential in board appointments" contribute to the underrepresentation of women in the boardrooms of U.K. listed companies.[96] In 2017, the Parker Review acknowledged that "as is the case with gender, people of colour within the UK have historically not had the same opportunities as many mainstream candidates to develop the skills, networks and senior leadership experience desired in a FTSE Boardroom."[97] In 2020, the United Kingdom Financial Reporting Council commissioned a report to analyze barriers to LGBTQ+ inclusion and promotion in the workplace. Leaders who self-identified as LGBTQ+ expressed concerns about the current board nomination process, which includes "relying on personal recommendations without transparent competition or due process [and] informal 'interviewing' outside the selection process."[98]

These concerns are not unique to the United Kingdom. The U.S. GAO (2015) found that women's representation on corporate boards may be hindered by directors' tendencies to "rely on their personal networks to identify new board candidates."[99] Vell (2017) found that "92% of board seats [of public U.S. and Canadian technology companies] are filled through networking, and women have less access to these

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95 See Dhir, supra note 78, at 47.

96 See *Women on Boards* 17 (Feb. 2011), available at: https://ftsewomenleaders.com/wp-content/uploads/2015/08/women-on-boards-review.pdf.

97 See Sir John Parker, *A Report into the Ethnic Diversity of UK Boards* 38 (Oct. 12, 2017), available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2017-report-final.pdf.

98 See Catriona Hay et al., The Financial Reporting Council, *Building more open business* 25 (2020), available at: https://www.frc.org.uk/getattachment/19f3b216-bd45-4d46-af2f-f191f5bf4a07/The-Good-Side-x-Financial-Reporting-Council-1811-AMENDED.pdf.

99 See GAO Report, supra note 44, at 15.

networks."[100] Deloitte and the Society for Corporate Governance (2019) found that this is also common in other industries including media, communications, energy, consumer products, financial services and life sciences.[101] They observed that although 94% of companies surveyed were looking to increase diversity among their boards, 77% of those boards looked to referrals from current directors when identifying diverse director candidates, suggesting that "networking is still key to board succession."[102] Dhir (2015), in a qualitative study of Norwegian directors, observed that "[b]oard seats tend to be filled by directors engaging their networks, and the resulting appointees tend to be of the same socio-demographic background."[103]

Another contributing factor may be the traditional experience sought in director nominees. Rhode & Packel (2014) observed that:

> One of the most common reasons for the underrepresentation of women and minorities on corporate boards is their underrepresentation in the traditional pipeline to board service. The primary route to board directorship has long been through experience as a CEO of a public corporation. . . . Given the low representation of women and minorities in top executive positions, their talents are likely to be underutilized if selection criteria are not broadened.[104]

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100 See Vell Executive Search, *Women Board Members in Tech Companies: Strategies for Building High Performing Diverse Boards* 6 (2017), available at: https://www.vell.com/images/pdf/VELL%20Report%20Women%20Board%20Members%20on%20Tech%20Boards%202017%203%2029.pdf.

101 See Deloitte and the Society of Corporate Governance, *Board Practices Report: Common threads across boardrooms* 5 (2019), available at: https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/1202241_2018_Board_Practices_Report_FINAL.pdf.

102 Id. at 6.

103 See Dhir, supra note 78, at 52.

104 See Deborah Rhode and Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39(2) Del. J. Corp. L. 377, 402-403 (2014); see also Dhir, supra note 78, at 39 ("[T]here is an apparent preference for either CEOs (whether current or retired) or senior management who have experience at the helm of a particular business stream or unit…. The fact that far fewer women than men have been CEOs has a potentially devastating effect on access to the boardroom, which in turn can have an effect on the number of women who rise to the level of CEO and to the executive suite.").

Hillman et al. (2002) found that while white male directors of public companies were more likely to have current or former experience as a CEO, senior manager or director, African-American and white women directors were more likely to have specialized expertise in law, finance, banking, public relations or marketing, or community influence from positions in politics, academia or clergy.[105] Dhir (2015) suggests that "[c]onsidering persons from other, non-management pools, such as academia, legal and accounting practice, the not-for-profit sector and politics, may help create a broader pool of diverse candidates."[106] Directors surveyed by the U.S. GAO also "suggested, for example, that boards recruit high performing women in other senior executive level positions, or look for qualified female candidates in academia or the nonprofit and government sectors. . . . [I]f boards were to expand their director searches beyond CEOs more women might be included in the candidate pool."[107]

Investors have begun calling for greater transparency surrounding ethnic diversity on company boards, and in the past several months as the U.S. has seen an uprising in the racial justice movement, there has been an increase in the number of African Americans appointed to Russell 3000 corporate boards.[108] In a five-month span, 130 directors appointed were African American, in comparison to the 38 African American directors who were appointed in the preceding five months.[109] Although tracking the acceleration in board diversity is feasible for some Russell 3000 companies, many of the companies

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105 See Amy J. Hillman et al., *Women and Racial Minorities in the Boardroom: How Do Directors Differ?*, 28(6) J. Mgmt. 747, 749, 754 (2002).

106 See Dhir, supra note 78, at 42.

107 See GAO Report supra note 44, at 18.

108 See Leslie P. Norton, *The Number of Black Board Members Surged After George Floyd's Death*, Barron's, Oct. 27, 2020, available at: https://www.barrons.com/articles/after-george-floyds-death-the-number-of-black-board-members-surges-51603809011.

109 Id.

do not disclose the racial makeup of the board, making it impossible to more broadly assess the impact of recent events on board diversity.

IV. Stakeholder Perspectives

To gain a better understanding of the current state of board diversity, benefits of diversity, causes of underrepresentation on boards and potential remedies to address underrepresentation, Nasdaq spoke with leaders representing a broad spectrum of market participants and other stakeholders. Nasdaq sought their perspectives to inform its analysis of whether the proposed rule changes would promote the public interest and protection of investors without unduly burdening competition or conflicting with existing securities laws. The group included representatives from the investor, regulatory, investment banking, venture capital and legal communities. Nasdaq also spoke with leaders of civil rights and corporate governance organizations, and organizations representing the interests of private and public companies, including Nasdaq-listed companies. Specifically, Nasdaq obtained their views on:

- the current state of board diversity in the U.S.;
- the inherent value of board diversity;
- increasing pressure from legislators and investors to improve diverse representation on boards and board diversity disclosure;
- whether a listing rule related to board diversity is in the public interest;
- how to define a "diverse" director; and
- the benefits and challenges of various approaches to improving board diversity disclosures and increasing diverse representation on boards, including mandates and disclosure-based models.

The discussions revealed strong support for disclosure requirements that would standardize the reporting of board diversity statistics. The majority of organizations also

were in agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, and that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. While many organizations recognized that mandates can accelerate the rate of change, they expressed that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Business leaders also expressed concern that smaller companies would require flexibility and support to comply with any time-sensitive requirements to add diverse directors. Some stakeholders highlighted additional challenges that smaller companies, and companies in certain industries, may face finding diverse board members. Leaders from across the spectrum of stakeholders that Nasdaq surveyed reinforced the notion that if companies recruit by skill set and expertise rather than title, then they will find there is more than enough diverse talent to satisfy demand. Leaders from the legal community emphasized that any proposed rule that imposed additional burdens beyond, or is inconsistent with, existing securities laws—by, for example, requiring companies to adopt a diversity policy or include disclosure solely in their proxy statements—would present an additional burden and potentially more legal liability for listed companies.

V. U.S. Regulatory Framework

As detailed above, diversity has been the topic of a growing number of studies over the past decade and, in recent years, some investors have been increasingly advocating for greater diversity among directors of public companies.[110] Over the past

[110] In 2009, when the Commission proposed enhancements to proxy disclosures, including addressing board diversity disclosures, the Commission received over 130 comment letters related to its proposal, including from corporations, pension funds, professional associations, trade unions, accounting firms, law firms, consultants, academics, individual investors and other interested

year, the social justice movement has underscored the importance of having diverse perspectives and representation at all levels of decision-making, including on public company boards. In recent years, diversity has become increasingly important to the public, including institutional investors, pension funds and other stakeholders who believe that board diversity enhances board performance and is an important factor in the voting decisions of some investors.[111] Legislators increasingly are taking action to encourage corporations to diversify their boards and improve diversity disclosures.[112]

a. SEC Diversity Disclosure Requirements – Background

In 2009, the Commission sought comment on whether to amend Item 407(c)(2)(vi) of Regulation S-K to require disclosure of whether a nominating committee considers diversity when selecting a director for a position on the board.[113] The Commission received more than 130 comment letters on its proposal. According to a University of Dayton Law Review analysis of those comment letters, most were

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parties. See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,335; see also David A. Katz and Laura McIntosh, *Raising the Stakes for Board Diversity*, Law.com (July 22, 2020), available at: https://www.law.com/newyorklawjournal/2020/07/22/raising-the-stakes-for-board-diversity/?slreturn=20201017021522; Office of the Illinois State Treasurer, *The Investment Case For Board Diversity: A Review of the Academic and Practitioner Research on the Value of Gender and Racial/Ethnic Board Diversity for Investors* 7 (Oct. 2020), available at: https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/il%20treasurer%20white%20paper%20-%20the%20investment%20case%20for%20board%20diversity%20(oct%202020).pdf.

111 See Comments on Proposed Rule: Proxy Disclosure and Solicitation Enhancements, available at: https://www.sec.gov/comments/s7-13-09/s71309.shtml. See also CGLytics, *Diversity on the Board? Metrics Used by Fortune 100 Companies* (June 29, 2020), available at: https://www.cglytics.com/diversity-on-the-board-metrics-of-fortune-100-companies/; Office of the Illinois State Treasurer, supra note 110.

112 For example, California requires companies headquartered in the state to have at least one director who self-identifies as a Female and one director from an Underrepresented Community. See Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept. 30, 2020). Washington requires companies headquartered in the state to have at least 25% women on the board by 2022 or provide certain disclosures. See Wash. Subst. S.B. 6037 (June 11, 2020). At least eleven states have proposed diversity-related requirements. See Hatcher and Latham, supra note 11.

113 See Proxy Disclosure and Solicitation Enhancements, 74 Fed. Reg. 35,076, 35,084 (July 17, 2009) (proposed rule).

submitted by groups with a specific interest in diversity, or by institutional investors, including mutual funds, pension funds, and socially responsible investment funds.[114] Further, the analysis showed that 56 commenters addressed the issue of diversity disclosures, and only 5 of those 56 commenters did not favor such disclosure.[115] Twenty-seven of the 56 mentioned gender diversity, 18 mentioned racial diversity, and 13 mentioned ethnic diversity. However, neither the proposed rule nor the final rule defined diversity.[116]

Ten years after its adoption of board diversity disclosure rules, the Commission revisited the rules by establishing new Compliance and Disclosure Interpretations ("C&DI"). However, the Commission did not provide a definition of diversity, and therefore issuers currently are not required to disclose the race, ethnicity or gender of their directors or nominees.

Currently, Item 401(e)(1) of Regulation S-K requires a company to "briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director."[117] The C&DI clarifies that if a board considered a director's self-identified diversity characteristics (*e.g.*, race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) during the nomination process, and the individual consents to disclose those diverse characteristics, the Commission "would expect that the company's discussion required by

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114 See Thomas Lee Hazen and Lissa Lamkin Broome, *Board Diversity and Proxy Disclosure*, 37:1 Univ. Dayton L. Review 41, 51, n. 82 (citing the comment letters).

115 In the five comments that opposed diversity disclosure, three stated that diversity was an important value. See Comments on Proposed Rule, supra note 111; see also Hazen and Broome, supra note 114, at 54 n.88 (citing the 56 comment letters).

116 See Hazen and Broome, supra note 114, at 53 n. 84-86.

117 See 17 C.F.R. § 229.401(e)(1).

Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered."[118]

Rather than providing a specific definition of diversity, the C&DI provides a non-exhaustive list of examples of diverse characteristics that a company could consider for purposes of Item 401(e)(1), including "race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background."[119] Additionally, the Commission stated that any description of a company's diversity policy would be expected to include "a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics."[120]

Item 407(c)(2)(vi) of Regulation S-K requires proxy disclosure regarding whether diversity is considered when identifying director nominees and, if so, how. In addition, if the board or nominations committee has adopted a diversity policy, the company must describe how the policy is implemented and its effectiveness is assessed.[121] When adopting Item 407(c)(2)(vi), the Commission explained:

> We recognize that companies may define diversity in various ways, reflecting different perspectives. For instance, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin. We believe that for purposes of this disclosure requirement, companies should be allowed to define diversity in ways that they

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118 See Securities and Exchange Commission, Regulation S-K Compliance & Disclosure Interpretations (Sept. 21, 2020), available at: https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.

119 Id.

120 Id.

121 See 17 C.F.R. § 229.407(c)(2)(vi).

> consider appropriate. As a result we have not defined diversity in the amendments.[122]

Moreover, Item 407(c)(2)(vi) does not require companies to adopt a formal policy and does not require them to explain why they have not. It also does not require public disclosure of board-level diversity statistics.

b. Complaints Surrounding Current Diversity Disclosure Requirements

Given the broad latitude afforded to companies by the Commission's rules related to board diversity and proxy disclosure, current reporting of board-level diversity statistics has been significantly unreliable and unusable to investors. This has been due to myriad data collection challenges, including the scarcity of reported information, the lack of uniformity in the information that is disclosed and inconsistencies in the definitions of diversity characteristics across companies.[123] The heightened national discourse around diversity and mounting grievances from investors surrounding transparency on board diversity prompted Nasdaq to examine the state of board diversity among its listed companies. While conducting that research, Nasdaq identified a number of key challenges, such as: (1) inconsistent disclosure and definitions of diversity across companies; (2) limited data on diverse characteristics outside of gender; (3) inconsistent or no disclosure of a director's race, ethnicity, or other diversity attributes (*e.g.*, nationality); (4) difficult-to-extract data because statistics are often embedded in graphics; and (5) aggregation of information, making it difficult to separate gender from other categories of diversity. Investors and data analysts have raised similar criticisms.

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122 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,344.

123 See Petition for Rulemaking (July 6, 2017), available at: https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.

As the Illinois Treasurer observed, the paucity of data on race and ethnicity creates barriers to investment analysis, due diligence and academic study.[124] For example, the scarcity of such data is an impediment to academics who want to study the performance impact of racially diverse boards.[125] Nasdaq is concerned that investors also face the many data collection challenges Nasdaq encountered, rendering current diversity disclosures unreliable, unusable, and insufficient to inform investment and voting decisions. Commissioner Allison Herren Lee expressed similar concerns, stating that the current SEC disclosure requirements have "led to spotty information that is not standardized, not consistent period to period, not comparable across companies, and not necessarily reliable. . . . And the current state of disclosure reveals the shortcomings of a principles-based materiality regime in this area."[126]

Some stakeholders believe there is a correlation between companies that disclose the gender, racial and ethnic composition of their board and the number of diverse directors on those companies' boards.[127] Currently, the lack of reliable and consistent data makes it difficult to measure diversity in the boardroom, and a common set of standards for diversity definitions and disclosure format is greatly needed. At present, U.S. companies must navigate a complex patchwork of federal and state regulations and disclosure requirements. The limited disclosure currently provided voluntarily, which is

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124 See Press Release, *Illinois State Treasurer Frerichs Calls on Russell 3000 Companies to Disclose Diversity Data* (Oct. 28, 2020), available at https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/october2020_russell3000.pdf.

125 See Office of Illinois State Treasurer, supra note 110, at 3-4.

126 See Lee, supra note 22.

127 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355 ("Although the[se] amendments are not intended to steer behavior, diversity policy disclosure may also induce beneficial changes in board composition. A board may determine, in connection with preparing its disclosure, that it is beneficial to disclose and follow a policy of seeking diversity."); see also Office of Illinois State Treasurer, supra note 110, at 3.

primarily focused on gender (due in part to that data being the most readily available), fails to provide the full scope of a board's diverse characteristics.[128] It is difficult to improve what one cannot accurately measure. This lack of transparency is impacting investors who are increasingly basing public advocacy, proxy voting and direct shareholder-company engagement decisions on board diversity considerations.[129]

c. Support for Updating Diversity Disclosure Requirements

Nasdaq's surveys of investors and reviews of their disclosed policies and actions show that board diversity is a priority when assessing companies, and investors report, in some cases, relying on intuition when there is a lack of empirical, evidenced-based data. Furthermore, the continued growth of ESG investing raises the importance of quality data, given the data-driven nature of investment products such as diversity-specific indices and broader ESG funds.

Investors have a unique platform from which to engage and influence a company's position on important topics like diversity. Similarly, Nasdaq, like other self-regulatory organizations, is uniquely positioned to establish practices that will assist in carrying out Nasdaq's mandate to protect investors and remove impediments from the market. Various stakeholders, including Nasdaq, believe that clear and concise annual disclosure of board diversity information that disaggregates the data by race, ethnicity, gender identity and sexual orientation will provide the public, including key stakeholders, with a better sense of a company's approach to improving corporate diversity and the

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128 See, e.g., CGLytics, supra note 111, at https://www.cglytics.com/diversity-on-the-board-metrics-of-fortune-100-companies/; Petition for Amendment of Proxy Rule, supra note 80; Office of Illinois State Treasurer, supra note 110.

129 See Office of the Illinois State Treasurer, *Russell 3000 Board Diversity Disclosure Initiative*, https://www.illinoistreasurer.gov/Financial_Institutions/Equity,_Diversity__Inclusion/Russell_3000_Board_Diversity_Disclosure_Initiative (last accessed Nov. 25, 2020).

support needed to effectuate any changes. Required disclosures also would eliminate the number of shareholder proposals asking for these key metrics and the need for companies to respond to multiple investor requests for information.[130] Moreover, companies manage issues more closely and demonstrate greater progress when data is available.[131]

In 2015, nine large public pension funds who collectively supervised $1.12 trillion in assets at the time petitioned the Commission to require registrants to disclose information related to, among other things, the gender, racial, and ethnic diversity of the registrant's board nominees.[132] In 2017, Human Capital Management Coalition, which described itself as a group of institutional investors with $2.8 trillion in assets at the time, made a similar petition to the Commission.[133] More recently, in October 2020, the Illinois Treasurer spearheaded an initiative along with twenty other investor organizations, asking for all companies in the Russell 3000 Index to disclose the composition of their board, including each board member's gender, race and ethnicity.[134]

The largest proxy advisory firms have aligned their voting policies to encourage increased board diversity disclosure. Institutional Shareholder Services ("ISS"), recently adopted a new voting policy under which it will identify boards of companies in the Russell 3000 or S&P 1500 that "lack racial and ethnic diversity (or lack disclosure of such)" in 2021 and, beginning in 2022, will recommend voting against the chair of the nominating committee of such companies. The stated goal of the policy is "helping

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130 See Petition for Rulemaking, supra note 123, at 2.

131 See, e.g., Gwen Le Berre, Parametric, *Investors Need Data to Make Diversity a Reality* (Aug. 24, 2020), https://www.parametricportfolio.com/blog/investors-need-data-to-make-diversity-a-reality.

132 See Petition for Amendment of Proxy Rule, supra note 80.

133 See Petition for Rulemaking, supra note 123.

134 See Press Release, supra note 124.

investors identify companies with which they may wish to engage and to foster dialogue between investors and companies on this topic."[135] In 2017, proxy advisory firm Glass Lewis announced a policy regarding board gender diversity that took effect in 2019. Glass Lewis generally recommends voting against the nominating committee chair of a board that has no female members, and when making such a recommendation, the firm closely examines the company's disclosure of its board diversity considerations and other relevant contextual factors.[136] On November 24, 2020, Glass Lewis announced the publication of its 2021 Proxy Voting Policy Guidelines, which expand its board gender diversity policy to vote against nominating chairs if there are fewer than two female directors, beginning in 2022.[137] Most notably, beginning with the 2021 proxy season, the company will include an assessment report of company proxy disclosures relating to board diversity, skills and the director nomination process for companies in the S&P 500 index. According to Glass Lewis, it "will reflect how a company's proxy statement presents: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (iii) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (aka 'Rooney Rule'); and (iv) board skills disclosure."[138]

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135 See ISS Governance, *ISS Announces 2021 Benchmark Policy Updates* (November 12, 2020), available at: https://www.issgovernance.com/iss-announces-2021-benchmark-policy-updates/.

136 See Glass Lewis, *2019 Policy Guideline Updates* (Oct. 24, 2018), available at: https://www.glasslewis.com/2019-policy-guideline-updates-united-states-canada-shareholder-initiatives-israel/.

137 See Glass Lewis, *2021 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice - United States* (2020), available at: https://www.glasslewis.com/wp-content/uploads/2020/11/US-Voting-Guidelines-GL.pdf?hsCtaTracking=7c712e31-24fb-4a3a-b396-9e8568fa0685%7C86255695-f1f4-47cb-8dc0-e919a9a5cf5b.

138 Id.

Congress and members of the Commission also have weighed in on the importance of improving board transparency. In 2017, Representative Carolyn Maloney introduced the "Gender Diversity in Corporate Leadership Act of 2017," which proposed requiring public companies to provide proxy disclosure regarding the gender diversity of the board of directors and nominees.[139] In November 2019, the U.S. House of Representatives, with bipartisan support, passed the "Corporate Governance Through Diversity Act of 2019," which requires certain registrants annually to disclose the racial, ethnic, and gender composition of their boards and executive officers, as well as the veteran status of any of those directors and officers, in their proxy statements.[140] The bill also requires the disclosure of any policy, plan or strategy to promote racial, ethnic, and gender diversity among these groups. Legislators have proposed a companion bill in the U.S. Senate.[141]

The Council of Institutional Investors ("CII"), U.S. Chamber of Commerce,[142] National Urban League, Office of New York State Comptroller and the National Association for the Advancement of Colored People praised the House of Representatives' for passing the 2019 legislation. According to the U.S. Chamber of Commerce's members and associations, it has become increasingly important to see improvements in board diversity.[143] Additionally, CII's General Counsel stated that the

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139 Gender Diversity in Corporate Leadership Act of 2017, H.R. 1611, 115th Cong. (2017).

140 Improving Corporate Governance Through Diversity Act of 2019, H.R. 5084, 116th Cong. (2019).

141 Improving Corporate Governance Through Diversity Act of 2019, S. 360, 116th Cong. (2019).

142 See Letter from Various U.S. Chamber of Commerce Associations and Members to Chairman Mike Crapo and Ranking Member Sherrod Brown, U.S. House Committee on Banking, Housing, and Urban Affairs (July 27, 2020), available at: https://www.uschamber.com/sites/default/files/200727_coalition_h.r._5084_senatesmallbusiness.pdf.

143 Id.

proxy statement disclosure requirement in the legislation "could contribute to enhancing U.S. public company board consideration of diversity."[144]

More recently, SEC Commissioners have called for greater transparency surrounding ethnic diversity on company boards. In a September 2020 speech titled "Diversity Matters, Disclosure Works, and the SEC Can Do More" given at the CII Fall Conference, Commissioner Lee advocated advancing corporate diversity and for various approaches by which the Commission could promote diversity, including among other things, strengthening the C&DI's guidance related to disclosure of board candidate diversity characteristics.[145] Commissioner Lee stated:

> [The SEC has] largely declined to require diversity-related disclosure. In 2009, we adopted a requirement for companies to disclose if and how diversity is considered as a factor in the process for considering candidates for board positions, including any policies related to the consideration of diversity. In 2018, we issued guidance encouraging the disclosure of self-identified characteristics of board candidates. While I appreciate these measures, given that women of color hold just 4.6% of Fortune 500 board seats and less than one percent of Fortune 500 CEOs are Black, it's time to consider how to get investors the diversity information they need to allocate their capital wisely.[146]

VI. Nasdaq Proposal

a. Overview of Disclosure Requirements

Disclosure of information material to an investor's voting and investment decision is the bedrock of federal securities laws. The Exchange's listing rules require companies to comply with federal securities laws, including the registration requirements under the Securities Act of 1933. Once listed, companies are obligated to solicit proxies and file all

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144 See Joe Mont, *SEC, Congress seek better diversity disclosures*, Compliance Week (Feb. 20, 2019), https://www.complianceweek.com/sec-congress-seek-better-diversity-disclosures/24802.article.

145 See Lee, supra note 22.

146 Id. Commissioner Crenshaw also expressed disappointment with the Commission's silence on diversity. See Crenshaw, supra note 7.

annual and periodic reports with the Commission under the Act at the prescribed times.[147] In discharging its obligation to protect investors, Nasdaq monitors listed companies for compliance with those disclosure obligations, and the failure to do so results in a notice of deficiency or delisting.

Nasdaq believes it is well within the Exchange's delegated regulatory authority to propose listing rules designed to enhance transparency so long as they do not conflict with existing federal securities laws. For example, Nasdaq requires listed companies to publicly disclose compensation or other payments by third parties to a company's directors or nominees, notwithstanding that such disclosure is not required by federal securities laws. In approving that proposed rule, the Commission noted:

> To the extent there are certain factual scenarios that would require disclosure not otherwise required under Commission rules, we believe that it is within the purview of a national securities exchange to impose heightened governance requirements, consistent with the Act, that are designed to improve transparency and accountability into corporate decision making and promote investor confidence in the integrity of the securities markets.[148]

Nasdaq is concerned that while investors have increasingly emphasized that they consider board diversity information to be material, the current lack of transparency and consistency makes it difficult for Nasdaq and investors to determine the state of diversity among listed companies as well as each board's philosophy regarding diversity. Investors also have voiced dissatisfaction about having to independently collect board-level data about race, ethnicity and gender identity because such investigations can be time consuming, expensive, and fraught with inaccuracies.[149] Moreover, in some

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147 See Nasdaq Stock Market Rulebook, Rules 5250(c) and (d).

148 See Order Granting Accelerated Approval of a Proposed Rule Change, 81 Fed. Reg. 44,400, 44,403 (July 7, 2016).

149 See Petition for Amendment of Proxy Rule, supra note 80, at 2.

instances, based on Nasdaq's own investigation, such information is either unavailable, or, if available, not comparable across companies. To the extent investors must obtain this information on their own through an imperfect process, Nasdaq is concerned that it increases information asymmetries between larger stakeholders, who are able to collect this data directly from companies, and smaller investors, who must rely on incomplete public disclosures. For all investors who take on the burden of independently obtaining the current information, there is a cost and time burden related to the data collection.

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. Nasdaq proposes to improve transparency regarding board diversity by requiring all listed companies to publicly disclose unbundled, consistent data utilizing a uniform, transparent framework on their website or in their proxy statement under Rule 5606. Similarly, Nasdaq proposes to promote accountability in corporate decision-making by requiring companies who do not have at least two Diverse directors on their board to provide investors with a public explanation of the board's reasons for not doing so under Rule 5605(f)(3). Nasdaq designed the proposal to avoid a conflict with existing disclosure requirements under Regulation S-K and to mitigate additional burdens for companies by providing them with flexibility to provide such disclosure on their website or in their proxy statement, and not requiring them to adopt a formal diversity policy.

Nasdaq proposes to foster consistency in board diversity data disclosure by defining "Diverse" under Rule 5605(f)(1) as "an individual who self-identifies in one or

more of the following categories: Female, Underrepresented Minority or LGBTQ+," and by adopting the following definitions under Rule 5605(f)(1):

- "Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth.
- "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.
- "Underrepresented Minority" means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities.

The terms in the proposed definition of "Underrepresented Minority" reflect the EEOC's categories and are construed in accordance with the EEOC's definitions.[150] The terms in the proposed definition of LGBTQ+ are similar to the identities defined in California's A.B. 979, described below, but have been expanded to include the queer community based on Nasdaq's consultation with stakeholders, including human rights organizations.[151]

In constructing its proposed definition of "Diverse," Nasdaq considered various state and federal legislation, stakeholder sentiments and academic studies. For example, California requires public companies headquartered in the state to have at least one

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150 While the EEO-1 report refers to "Hispanic or Latino" rather than Latinx, Nasdaq proposes to use the term Latinx to apply broadly to all gendered and gender-neutral forms that may be used by individuals of Latin American heritage, including individuals who self-identify as Latino/a/e.

151 Further, Nasdaq agrees with the United Kingdom Financial Reporting Council that the acronym LGBTQ+ "does not attempt to exclude other groups, nor does it imply that the experiences of people under its umbrella are the same." See Hay et al., supra note 98, at 14.

individual who self-identifies as a female on the board by 2019 under S.B. 826[152] and at least one director who is a member of an "underrepresented community" by 2021 under A.B. 979.[153] S.B. 826 defines "Female" as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth," consistent with legislation proposed by New Jersey, Michigan and Hawaii related to board gender diversity.[154] A.B. 979 considers directors from underrepresented communities to be individuals who self-identify as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaska Native, or as gay, lesbian, bisexual or transgender. Since S.B. 826 was passed, 669 women have joined public company boards in the state and the number of public companies with all male boards has declined from 30% in 2018 to 3% in 2020.[155]

The state of Washington requires public companies whose boards are not comprised of at least 25% directors who self-identify as women by January 1, 2022 to provide public disclosures related to the board's consideration of "diverse groups" during the director nomination process. The state considers "diverse groups" to include "women, racial minorities, and historically underrepresented groups."[156]

As discussed above, Congress has proposed legislation relating to disclosure of racial, ethnic, gender and veteran status among the company's directors. Section 342 of

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152 See Cal. S.B. 826, supra note 112.

153 See Cal. A.B. 979, supra note 112.

154 See Cal. S.B. 826, supra note 112. See also N.J. Senate No. 3469, § 3(b)(2) (2019); Mich. S.B. 115, § 505a(2)(b) (2019); Haw. H.B. 2720, § 414-1(b)(2) (2020).

155 See California Partners Project, *Claim Your Seat: A Progress Report on Women's Representation on California Corporate Boards* 4 (2020), available at: https://www.calpartnersproject.org/claimyourseat.

156 See Wash. Subst. S.B. 6037, supra note 112. At least 11 states have proposed diversity-related requirements. See Hatcher and Latham, supra note 11.

the Dodd-Frank Act defines "minority" as "Black American, Native American, Hispanic American, and Asian American,"[157] and the Diversity Assessment Report for Entities Regulated by the SEC requires the Exchange to report workforce composition data to the SEC based on the EEOC's categories.[158] Most companies are required by law to provide similar workforce data to the EEOC through the EEO-1 Report, which requires employers to report statistical data related to race, ethnicity and gender to the EEOC.[159]

Nasdaq has designed the proposed rule to require all companies to provide consistent, comparable data under Rule 5606 by utilizing the existing EEO-1 reporting categories that companies are already familiar with, and by requiring companies to have, or publicly explain why they do not have, at least two directors who are diverse in terms of race, ethnicity, sexual orientation or gender identity under Rule 5605(f)(2). While the EEO-1 report does not currently include sexual orientation or gender identity, Nasdaq believes it is reasonable and in the public interest to include a reporting category for LGBTQ+ status in recognition of the U.S. Supreme Court's recent decision in *Bostock v. Clayton County* that sexual orientation and gender identity are "inextricably" intertwined with sex.[160]

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157 See 12 U.S.C. § 5452(g)(3) and Pub. L. 101-73 § 1204(c)(3).

158 See Securities and Exchange Commission, Diversity Assessment Report for Entities Regulated by the SEC, available at: https://www.sec.gov/files/OMWI-DAR-FORM.pdf.

159 All companies with 100 or more employees are required to complete the EEO-1 Report. See U.S. Equal Employment Opportunity Commission, EEO-1: Who Must File, https://www.eeoc.gov/employers/eeo-1-survey/eeo-1-who-must-file (last accessed Nov. 27, 2020).

160 See Bostock v. Clayton Cty., 140 S. Ct. 1731, 1742 (2020) ("But unlike any of these other traits or actions, homosexuality and transgender status are inextricably bound up with sex. Not because homosexuality or transgender status are related to sex in some vague sense or because discrimination on these bases has some disparate impact on one sex or another, but because to discriminate on these grounds requires an employer to intentionally treat individual employees differently because of their sex.").

The proposal does not preclude companies from considering additional diverse attributes, such as nationality, disability, or veteran status in selecting board members; however, the company would still have to provide the required disclosure under Rule 5605(f)(3) if the company does not also have at least two directors who are otherwise considered Diverse under Rule 5605(f)(1). Nor would the proposal prevent companies from disclosing information related to other diverse attributes of board members beyond those highlighted in the rule if they felt such disclosure would benefit investors. Nasdaq believes such disclosure would provide investors with additional information about the company's philosophy regarding broader diversity characteristics.

Overall, Nasdaq believes the proposal will enhance investor confidence that all listed companies are considering diversity of race, ethnicity, sexual orientation and gender identity in the context of selecting directors. Investors will be confident that board discussions at listed companies with at least two Diverse directors include the perspectives of more than one demographic group. They will also be confident that boardrooms without at least two Diverse directors are having a thoughtful discussion about their reasons for not doing so and publicly explaining those reasons. On balance, the proposal will advance the public interest and enhance investor confidence in the integrity of the securities markets by ensuring investors that Nasdaq is monitoring all listed companies to verify that they have at least two Diverse directors or explain why they do not, and by requiring all listed companies to provide consistent, comparable diversity disclosures.

b. Board Statistical Disclosure

Given the increased interest in, and advocacy for, improvements in board transparency related to diversity disclosure information, the Exchange is proposing to adopt new Rule 5606(a), which would require each company to publicly disclose, to the extent permitted by applicable law, information on each director's voluntary self-identified gender and racial characteristics and LGBTQ+ status.

All Nasdaq-listed companies that are subject to proposed Rule 5605(f), whether they choose to meet the diversity objectives of proposed Rule 5605(f)(2) or to explain why they do not, would be required to make the proposed Rule 5606 disclosure. This proposed rule also will assist the Exchange in assessing whether companies meet the diversity objectives of proposed Rule 5605(f). Under Rule 5606(e), Nasdaq proposes to make proposed Rule 5606 operative for listed companies one year after the SEC Approval Date of this proposal.

Pursuant to proposed Rule 5606(a), each company would be instructed to annually provide its board-level diversity data in a format substantially similar to the Board Diversity Matrix in proposed Rule 5606(a) and attached as Exhibit 3. The company would be required to provide the total number of directors on its board. If a director voluntarily self-identifies, each company, other than a Foreign Issuer (as defined under Rule 5605(f)(1)), would include the following in a table titled "Board Diversity Matrix," in accordance with the instructions accompanying the proposed disclosure format: (1) the number of directors based on gender identity (male, female or non-

binary[161]); (2) the number of directors based on race and ethnicity (African American or Black, Alaskan Native or American Indian, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, White, or Two or More Races or Ethnicities); and (3) the number of directors who self-identify as LGBTQ+.

Any director who chooses not to disclose a gender would be included under "Gender Undisclosed" and any director who chooses not to identify as any race or not to identify as LGBTQ+ would be included in the "Undisclosed" category at the bottom of the table. The defined terms for the race and ethnicity categories in the instructions to the Board Diversity Matrix disclosure format are substantially similar to the terms and definitions used in the EEO-1 Report.[162] LGTBQ+ is defined similarly to proposed Rule 5605(f)(1) as a person who identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.

Below is an example of a Board Diversity Matrix that companies may use, which is also attached as Exhibit 3:

Board Diversity Matrix (As of [DATE])				
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Gender Undisclosed**

161 Although non-binary is included as a category in the proposed Board Diversity Matrix, a company would not satisfy the diversity requirement proposed by Rule 5605(f)(2) if a director self-identifies solely as non-binary.

162 See supra note 159. Additionally, the EEOC does not categorize LGBTQ+ or any other sexual orientation identifier on its EEO-1 Report. The definitions of the EEO-1 race and ethnicity categories may be found in the appendix to the EEO-1 Report instructional booklet, available at https://www.eeoc.gov/employers/eeo-1-survey/eeo-1-instruction-booklet.

Board Diversity Matrix (As of [DATE])				
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
African American or Black	#	#	#	#
Alaskan Native or American Indian	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Undisclosed	#			

Nasdaq recognizes that some Foreign Issuers, including Foreign Private Issuers as defined by the Act,[163] may have their principal executive offices located outside of the United States and in jurisdictions that may impose laws limiting or prohibiting self-identification questionnaires, particularly as they relate to race, ethnicity or LGBTQ+ status. In such countries, a Foreign Issuer may be precluded by law from requesting diversity data from its directors. Moreover, Nasdaq's definition of Underrepresented Minority proposed in Rule 5606(f)(1) may be inapplicable to a Foreign Issuer, making this Board Matrix data less relevant for such companies and not useful for investors.

163 See 17 C.F.R. § 240.3b-4.

As a result of these limitations, Nasdaq is proposing the option of a separate Board Diversity Matrix for Foreign Issuers. Similar to other companies, a Foreign Issuer would be required to provide the total number of directors on its board. If a director voluntarily self-identifies, the company would include the following in a table titled "Board Diversity Matrix": (1) the number of directors based on gender identity (male, female or non-binary[164]); (2) the number of directors who are considered underrepresented in the company's home country jurisdiction; [165] and (3) the number of directors who self-identify as LGBTQ+. An "Underrepresented Individual in Home Country Jurisdiction" is defined in the instructions to the Board Diversity Matrix as a person who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in a Foreign Issuer's home country jurisdiction. Rule 5605(f)(2)(B)(i) also proposes the same definition for Diverse directors of Foreign Issuers.

Nasdaq is also proposing new Rule 5606(b), which would require each company to provide the disclosure required under Rule 5606(a) in either the company's proxy statement or information statement for its annual meeting for shareholders, or on the company's website. If the company elects to disclose the information on its website, the company must also submit such disclosure along with a URL link to the information through the Nasdaq Listing Center within 15 calendar days of the company's annual shareholder meeting. The proposed time period to submit the information to the Nasdaq

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164 Although non-binary is included as a category in the proposed Board Diversity Matrix, a company would not satisfy any aspect of the diversity requirement proposed by Rule 5605(f)(2) if a director self-identifies solely as non-binary.

165 To clarify, although a Foreign Issuer may disclose directors that meet the requirement of Underrepresented Minority pursuant to new Rule 5605(f)(1), such disclosure may not meet the diversity objectives of new Rule 5605(f)(2)(B)(ii).

Listing Center is aligned with the time period provided in proposed Rule 5605(f)(3) for a company to submit its explanation for why it does not have at least two Diverse directors. Disclosure of the statistical data is not in lieu of any SEC requirements for a company to disclose any required information pursuant to Regulation S-K or any other federal, state or foreign laws or regulations. As described in the instructions to the Board Diversity Matrix and Rule 5606(a), each year following the first year that a company publishes its annual Board Diversity Matrix, the company would be required to publish its data for the current and immediately prior years.

Additionally, Nasdaq is proposing Rule 5606(c), which exempts the following types of companies from proposed Rule 5606(a): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. The exemption of these companies is consistent with the approach taken by Nasdaq in Rule 5615 as it relates to certain Nasdaq corporate governance standards for board composition.

Nasdaq is also proposing Rule 5606(d) to allow for a company newly listing on Nasdaq, including a company listing in connection with a business combination under IM-5101-2, to satisfy the requirement of Rule 5606 within one year of listing on Nasdaq. The disclosure required by proposed Rule 5606(d) would be required to be included in the company's annual proxy statement or information statement for its annual meeting of

shareholders or on the company's website. If the company provides such disclosure on its website, the company must also submit the disclosure and a URL link to the disclosure through the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholder meeting.

When a company does not timely provide the required disclosure, Nasdaq will notify the company that it is not in compliance with a listing requirement and allow the company to provide a plan to regain compliance. Consistent with deficiencies from most other rules that allow a company to submit a plan to regain compliance,[166] Nasdaq proposes to allow companies deficient under proposed Rule 5606 45 calendar days to submit a plan in accordance with Rule 5810(c)(2) to regain compliance and, based on that plan, Nasdaq can provide the company with up to 180 days to regain compliance. If the company does not do so, it would be issued a Staff Delisting Determination, which the company could appeal to a Hearings Panel pursuant to Rule 5815. Although proposed Rule 5606 is not identical to the current Commission requirements, it is similar to, and does not deviate from, the Commission's CD&I related to Items 401(e)(1) and 407(c)(2)(vi) of Regulation S-K. Moreover, the proposed rule strengthens the Commission's requirements by providing clarity to the definition of diversity and streamlining investors' desire for clear, complete and consistent disclosures. Nasdaq believes that the format of the Board Diversity Matrix and the information that it will

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166 Pursuant to Nasdaq Rule 5810(c)(2)(A)(iii), a company is provided 45 days to submit a plan to regain compliance with Rules 5620(a) (Meetings of Shareholders), 5620(c) (Quorum), 5630 (Review of Related Party Transactions), 5635 (Shareholder Approval), 5250(c)(3) (Auditor Registration), 5255(a) (Direct Registration Program), 5610 (Code of Conduct), 5615(a)(4)(D) (Partner Meetings of Limited Partnerships), 5615(a)(4)(E) (Quorum of Limited Partnerships), 5615(a)(4)(G) (Related Party Transactions of Limited Partnerships), and 5640 (Voting Rights). Pursuant to Nasdaq Rule 5810(c)(2)(A)(iv), a company is also provided 45 days to submit a plan to regain compliance with Rule 5250(b)(3)(Disclosure of Third Party Director and Nominee Compensation). A company is generally provided 60 days to submit a plan to regain compliance with the requirement to timely file periodic reports contained in Rule 5250(c)(1).

provide offers greater transparency into a company's board composition and will enable the data to be easily aggregated across issuers.[167] Nasdaq also believes that requiring annual disclosure of the data will ensure that the information remains current and easy for investors, data analysts and other parties to track.

c. Diverse Board Representation or Explanation

Nasdaq is proposing to adopt new Rule 5605(f)(2) to require each listed company 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 who self-identifies as Female and one who self-identifies as an Underrepresented Minority or LGBTQ+.[168] A company does not need to provide additional public disclosures if the company discloses under Rule 5606 that it has at least two Diverse directors satisfying this requirement. The terms in the proposed definition of "Underrepresented Minority" reflect the EEOC's categories and are construed in accordance with the EEOC's definitions. Nasdaq has provided additional flexibility for Smaller Reporting Companies and Foreign Issuers (including Foreign Private Issuers).

Under proposed Rule 5605(f)(3), if a company satisfies the requirements of Rule 5605(f)(2) by explaining why it does not have two Diverse directors, the company must: (i) specify the requirements of Rule 5605(f)(2) that are applicable (*e.g.*, the applicable subparagraph, the applicable diversity objectives, and the timeframe applicable to the company's market tier); and (ii) explain the reasons why it does not have two Diverse

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167 Various stakeholders have requested easier aggregation. See Petition for Amendment of Proxy Rule, supra note 80, at 1.

168 Nasdaq plans to publish an FAQ on the Listing Center clarifying that "two members of its board of directors who are Diverse" would exclude emeritus directors, retired directors and members of an advisory board.

directors. Such disclosure must be provided: (i) in the company's proxy statement or information statement for its annual meeting of shareholders; or (ii) on the company's website. If the company provides such disclosure on its website, the company must also notify Nasdaq of the location where the information is available by submitting the URL link through the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholder meeting.

Nasdaq would not assess the substance of the company's explanation, but would verify that the company has provided one. If the company has not provided any explanation, or has provided an explanation that does not satisfy subparagraphs (i) and (ii) of Rule 5605(f)(3), the explanation will not satisfy the requirements of Rule 5605(f)(3). For example, it would not satisfy Rule 5605(f)(3) merely to state that "the Company does not comply with Nasdaq's diversity rule." As described above, the company must specify the requirements of Rule 5605(f)(2) that are applicable and explain the reasons why it does not have two Diverse directors. For example, a company could disclose the following to satisfy subparagraph (i) of Rule 5605(f)(3): "As a Smaller Reporting Company listed on the Nasdaq Capital Market tier, the Company is subject to Nasdaq Rule 5605(f)(2)(C), which requires the company to have, or explain why it does not have, at least two Diverse directors, including at least one director who self-identifies as Female. Under Rule 5605(f)(7), the Company is required to have at least one Diverse director by March 10, 2023, and a second Diverse director by March 10, 2026. The Company has chosen to satisfy Rule 5605(f)(2)(C) by explaining its reasons for not meeting the diversity objectives of Rule 5605(f)(2)(C), which the Company has set forth below."

i. Effective Dates and Phase-in Period

Proposed Rule 5605(f)(7) provides a transition period before companies must fully satisfy the requirement to have two Diverse directors or explain why they do not upon the initial implementation of the rule. Under this transition rule, each company must have, or explain why it does not have, one Diverse director no later than two calendar years after SEC approval of the proposed rule (the "Approval Date"), and two Diverse directors no later than (i) four calendar years after the Approval Date for companies listed on the Nasdaq Global Select ("NGS") or Global Market ("NGM") tiers, or (ii) five calendar years after the Approval Date for companies listed on the Nasdaq Capital Market ("NCM") tier. For example, if the Approval Date is March 10, 2021, all companies would be required to have, or explain why they do not have, one Diverse director by March 10, 2023 and two Diverse directors by March 10, 2025 (for NGS/NGM companies) or March 10, 2026 (for NCM companies).

Under proposed Rule 5605(f)(5)(A), a newly listed company that was not previously subject to a substantially similar requirement of another national securities exchange will be allowed one year from the date of listing to satisfy the requirement described above. This "phase-in" period applies to companies listing in connection with an initial public offering, a direct listing, a transfer from another exchange or the over-the-counter market, or through a business combination with an acquisition company listed under IM-5101-2, such that the company is no longer subject to IM-5101-2 after the combination. This phase-in period will apply after the end of the transition period provided in Rule 5605(f)(7). As a result, companies listing after the expiration of the phase-in periods provided by Rule 5605(f)(7) would be provided with one year from the

date of listing to satisfy the applicable requirement of Rule 5605(f)(2) to have, or explain why they do not have, at least two Diverse directors. Companies listing after the Approval Date, but prior to the expiration of the phase-in periods provided by Rule 5605(f)(7), would be provided with the latter of the periods set forth in Rule5605(f)(7) or one year from the date of listing.

Nasdaq believes this proposed period is consistent with the phase-in periods granted to companies for Nasdaq's other board composition requirements. For example, Rule 5615(b)(1) provides a company listing in connection with its initial public offering one year to fully comply with the compensation and nomination committee requirements of Rules 5605(d) and (e), and with the majority independent board requirement of Rule 5605(b). Similarly, SEC Rule 10A-3(b)(1)(iv)(A) allows a company up to one year from the date its registration statement is effective to fully comply with the applicable audit committee composition requirements. Nasdaq Rule 5615(b)(3) provides a one-year timeframe for compliance with the board composition requirements for companies transferring from other listed markets that do not have a substantially similar requirement.

ii. Foreign Issuers

Nasdaq recognizes that the EEOC categories of race and ethnicity may not extend to all countries globally because each country has its own unique demographic composition. However, Nasdaq observed that on average, women tend to be underrepresented in boardrooms across the globe, holding an estimated 16.9% of board seats in 2018.[169] As an official supporter of the United Nations Sustainable Stock

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169 See Deloitte, *Women in the Boardroom*, supra note 86.

Exchanges Initiative, Nasdaq recognizes that ensuring women have equal opportunities for leadership in economic decision making is one of the United Nations Sustainable Development Goals to be accomplished by 2030.[170] However, studies estimate that at current rates, it could take 18[171] to 34 years[172] for U.S. companies to achieve gender parity on their boards.

Accordingly, under proposed Rule 5605(f)(2)(B), each Foreign Issuer must have, or explain why it does not have, at least two Diverse directors on its board, including at least one Female. Nasdaq proposes to provide Foreign Issuers with additional flexibility in that Foreign Issuers may satisfy the diversity requirement by having two Female directors. In addition, Foreign Issuers may also satisfy the diversity requirement by having one Female director, and an individual who self identifies as (i) LGBTQ+ or (ii) an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. Alternatively, a company could satisfy Rule 5605(f)(2)(B) by publicly explaining the company's reasons for not meeting the diversity objectives of the rule.

Nasdaq proposes to define a Foreign Issuer under Rule 5605(f)(1) as (a) a Foreign Private Issuer (as defined in Rule 5005(a)(19)) or (b) a company that: (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Act;[173] and (ii) has its principal executive

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170 See United Nations Sustainable Stock Exchanges Initiative, *Gender Equality*, https://www.un.org/sustainabledevelopment/gender-equality/ (last accessed Nov. 24, 2020).

171 See McKinsey & Company, supra note 36, at 17.

172 See GAO Report, supra note 44, at 9 (estimating "it could take about 10 years from 2014 for women to comprise 30 percent of board directors and more than 40 years for the representation of women on boards to match that of men").

173 See 17 C.F.R. § 240.3b-4(b) ("The term foreign issuer means any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.").

offices located outside of the United States. This definition will include all Foreign Private Issuers (as defined in Rule 5005(a)(19)),[174] and any foreign issuers that are not foreign private issuers so long as they are also headquartered outside of the United States. This is designed to recognize that companies that are not Foreign Private Issuers but are headquartered outside of the United States are foreign companies notwithstanding the fact that they file domestic SEC reports. It is also designed to exclude companies that are domiciled in a foreign jurisdiction without having a physical presence in that country. Proposed Rule 5605(f)(5)(B) will allow any company that ceases to be a Foreign Issuer one year from the date that the company no longer qualifies as a Foreign Issuer to satisfy the requirements of Rule 5605(f).

Nasdaq also proposes to revise Rule 5615 and IM-5615-3, which currently permit a Foreign Private Issuer to follow home country practices in lieu of the requirements set forth in the Rule 5600 Series, subject to several exclusions. Nasdaq proposes to revise Rule 5615 and IM-5615-3 to add Rules 5605(f) and 5606 to the list of excluded corporate governance rules. As a result, Foreign Private Issuers must satisfy the requirements of Rule 5605(f) and 5606 and may not follow home country practices in lieu of such requirements. However, Foreign Private Issuers that elect to follow an alternative diversity objective in accordance with home country practices, or are located in jurisdictions that restrict the collection of personal data, may satisfy the requirements of Rule 5605(f) by explaining their reasons for doing so instead of meeting the diversity objectives of the rule.

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174 Under Nasdaq Rule 5005(a)(19), the term Foreign Private Issuer has "the same meaning as under Rule 3b-4 under the Act."

iii. Smaller Reporting Companies

Nasdaq also recognizes that smaller companies, especially pre-revenue companies that depend on the capital markets to fund ground-breaking research and technological advancements, may not have the resources necessary to compensate an additional director or engage a search firm to search outside of directors' networks. In recognition of the resource constraints faced by smaller companies, Nasdaq proposes to provide each Smaller Reporting Company with additional flexibility. Specifically, these companies could satisfy the two Diverse directors objective under Rule 5605(f)(2)(C) by having two Female directors.

Like other companies, Smaller Reporting Companies could also satisfy the two Diverse directors by having one Female director and one director who self-identifies as either (i) an Underrepresented Minority, or (ii) a member of the LGBTQ+ community. Alternatively, a company could satisfy Rule 5605(f)(2)(C) by publicly explaining the company's reasons for not meeting the diversity objectives of the rule. Under Rule 5605(f)(1), Nasdaq proposes to define a Smaller Reporting Company as set forth in Rule 12b-2 under the Act.[175] Proposed Rule 5605(f)(5)(B) will allow any company that ceases to be a Smaller Reporting Company one year from the date that the company no longer qualifies as a Smaller Reporting Company to satisfy the requirements of Rule 5605(f).

iv. Cure Period

Nasdaq proposes to adopt Rule 5605(f)(6) and a new Rule 5810(c)(3)(F) to specify what happens if a company does not have at least two Diverse directors as set

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[175] Under 12b-2 of the Act, a Smaller Reporting Company "means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than $250 million; or (2) Had annual revenues of less than $100 million and either: (i) No public float; or (ii) A public float of less than $700 million." See 17 C.F.R. § 240.12b-2.

forth under Rule 5605(f)(2) and fails to provide the disclosure required by Rule 5605(f)(3).[176] Under those provisions, the Listing Qualifications Department will promptly notify the company that it has until the latter of its next annual shareholders meeting, or 180 days from the event that caused the deficiency, to cure the deficiency. The company can cure the deficiency either by nominating additional directors so that it satisfies the Diversity requirement of Rule 5605(f)(2) or by providing the disclosure required by Rule 5605(f)(3). If a company does not regain compliance within the applicable cure period, the Listings Qualifications Department would issue a Staff Delisting Determination Letter. A company that receives a Staff Delisting Determination can appeal the determination to the Hearings Panel through the process set forth in Rule 5815. Nasdaq also proposes revising Rule 5810(c)(2)(A)(iv) to make a non-substantive change clarifying that Rule 5250(b)(3) is related to "Disclosure of Third Party Director and Nominee Compensation."

v. Exempt Companies

Under proposed Rule 5605(f)(4), Nasdaq proposes to exempt the following types of companies from the requirements of Rule 5605(f) ("Exempt Companies"): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. Proposed Rule 5605(f)(5)(B) will allow any company that

176 Nasdaq proposes that existing Rules 5810(c)(3)(F) and (G) be renumbered as Rules 5810(c)(3)(G) and (H) respectively.

ceases to be an Exempt Company one year from the date that the company no longer qualifies as an Exempt Company to satisfy the requirements of Rule 5605(f).

Nasdaq believes it is appropriate to exempt these types of companies from the proposed rule because such companies do not have boards, do not list equity securities, or are not operating companies. These companies are already exempt from certain of Nasdaq's corporate governance standards related to board composition, as described in Rule 5615.

d. Alternatives Considered

Nasdaq considered whether requiring listed companies to have, or explain why they do not have, two Diverse directors would better promote the public interest than an alternative threshold or approach. Nasdaq's reasoned decision-making process included considering: (i) mandate and disclosure-based approaches; (ii) higher and lower diversity objectives; (iii) longer and shorter timeframes; and (iv) broader and narrower definitions of "Diverse."

i. Mandate vs. Disclosure Based Approach

Globally, gender mandates range from requiring at least one woman on the board,[177] requiring two or more women based on board size,[178] or requiring 30 to 50%

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177 For example, the Securities and Exchange Board of India requires public companies to have at least one woman on the board. See Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, Regulation 17(1)(a) (2015), available at: https://www.sebi.gov.in/legal/regulations/jan-2020/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-regulations-2015-last-amended-on-january-10-2020-_37269.html. Similarly, the Israeli Companies Law requires public companies to have at least one woman on the board. See Paul Hastings, *Breaking the Glass Ceiling: Women in the Boardroom* 139 (2018), available at: https://www.paulhastings.com/genderparity/. In the United States, California's S.B. 826 requires public companies headquartered in California to have at least one woman on the board. See Cal. S.B. 826, supra note 112, at § 301.3(b)(3).

178 For example, California's S.B. 826 requires public companies headquartered in California to have at least two women on the board if their board is comprised of five directors, and at least three women on the board if their board is comprised of six or more directors. See Cal. S.B. 826, supra

women on the board.[179] Some mandates vary by board size—for example, Norway imposes different standards for boards of two to three directors, four to five directors, six to eight directors, nine directors and ten or more directors.[180] California imposes a higher standard for gender diversity that boards with five directors or six or more directors must satisfy by the end of 2021 under S.B. 826, and a higher standard for underrepresented communities that boards with five to eight directors and nine or more directors must satisfy by the end of 2022 under A.B. 979. Nasdaq did not observe a common denominator among the mandates applicable to varying board sizes. However, Nasdaq considered criticism that a model based on various board sizes could subject companies to a higher threshold by virtue of adding directors.[181] Based on Nasdaq data, the average

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note 112, at § 301.3(b)(1) and (2). Similar legislation has been proposed in New Jersey, Michigan and Hawaii. See N.J. Senate No. 3469, § 3(b)(2) (2019); Mich. S.B. 115, § 505a(2)(b) (2019); Haw. H.B. 2720, § 414-1(b)(2) (2020).

179 For example, Norway imposes a gender quota ranging from 33%-50% depending on board size. See Paul Hastings, supra note 177, at 103. Portugal requires listed companies to have at least 33.3% women on boards by 2020. See Deloitte, *Women in the Boardroom*, supra note 86, at 143. Germany requires public companies with co-determined boards (at least 50% employee representation) to have at least 30% women, and all other listed companies to establish a company-defined target. See Ulrike Binder and Guido Zeppenfeld, Mayer Brown, *Germany Introduces Rules on Female Quota for Supervisory Boards and Leadership Positions* (March 13, 2015), available at https://www.mayerbrown.com/en/perspectives-events/publications/2015/03/germany-introduces-rules-on-female-quota-for-super. Belgium requires listed companies to have at least 33% women on the board. See Deloitte, *Women in the Boardroom*, supra note 86, at 85. Austria requires listed companies with more than 1,000 employees to have at least 30% women on the board. See id. at 81. Iceland requires public companies with more than 50 employees to have at least 40% women on the board. See Act respecting Public Limited Companies No. 2/199, Article 63, available at: https://www.government.is/publications/legislation/lex/2018/02/06/TRANSLATION-OF-RECENT-AMENDMENTS-OF-ICELANDIC-PUBLIC-AND-PRIVATE-LIMITED-COMPANIES-LEGISLATION-2008-2010-including-Acts-13-2010-sex-ratios-and-68-2010-minority-protection-remuneration/. France and Italy both require public companies to have at least 40% women on their boards. See Paul Hastings, supra note 177, at 91; White & Case, *Italy increases gender quotas in corporate boards of listed companies* (Jan. 29, 2020), available at: https://www.whitecase.com/publications/alert/italy-increases-gender-quotas-corporate-boards-listed-companies).

180 See Paul Hastings, supra note 177, at 103.

181 See David A. Katz and Laura A. McIntosh, Wachtell, Lipton, Rosen & Katz, *Gender Diversity and Board Quotas*, New York Law Journal (July 25, 2018), available at: https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.26150.18.pdf ("California

board size of its listed companies is eight directors.

Soft targets ranging from 25% to 40% women on boards have been suggested by various corporate governance codes and corporate governance organizations. For example, Rule 4.1 of the Swedish Corporate Governance Code (the "Code") provides that listed companies are to "strive for gender balance on the board."[182] Each company's nominations committee is to publish a statement on its website at the time it issues notice of its shareholders meeting "with regard to the requirement in rule 4.1, that the proposed composition of the board is appropriate according to the criteria set out in the Code and that the company is to strive for gender balance."[183] Companies are not required to comply with the Code, "but are allowed the freedom to choose alternative solutions which they feel are better suited to their particular circumstances, as long as they openly report every deviation, describe the alternative solution they have chosen and explain their reasons for doing so."[184] Signifying progress, in 2019, 7% of nominations committees did not issue a statement on board gender balance, compared to 58% in 2013.[185]

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legislators dispute that the bill requires men to be displaced by women, noting that boards can simply increase their size. This may be easier said than done, however: Because the required quota increases with board size, a company with a four-man board that did not wish to force out a current director would need to add three women to accommodate the requirements of the law by 2021.").

182 See Swedish Corporate Governance Board, *The Swedish Corporate Governance Code* §4.1 17 (eff. Jan. 1, 2020), available at: http://www.bolagsstyrning.se/UserFiles/Koden/The_Swedish_Corporate_Governance_Code_1_January_2020.pdf.

183 See Swedish Corporate Governance Board, *Annual Report 2020* 22 (August 2020), available at: http://www.bolagsstyrning.se/userfiles/archive/3930/kodkoll_arsrapport-2020_eng.pdf.

184 See Swedish Corporate Governance Board, *Gender balance on boards of listed companies: The Swedish Corporate Governance Board assesses the situation ahead of this year's AGMs* (February 3, 2015), available at: http://www.bolagsstyrning.se/userfiles/archive/3856/pressrelease_gender_2014-02-03.pdf.

185 See Swedish Corporate Governance Board, *Annual Report 2020*, supra note 183, at 22.

In 2015, the Swedish Corporate Governance Board, which is responsible for administering the Code, established a goal to achieve representation of women on boards of small/mid cap (and Swedish companies listed on NGM Equity) and large cap companies of 30% and 35%, respectively, by 2017. Further, the Board aimed to achieve 40% representation of women on boards of all listed Swedish companies by 2020.[186] Based on data as of June 30, 2020, among listed companies, women accounted for 32.7% of board seats on small/mid cap companies and NGM Equity, 38.6% of large cap companies and 34.7% of all listed companies.[187]

In the United Kingdom, the Financial Conduct Authority requires companies with a premium listing on the London Stock Exchange to publicly disclose whether or not they comply with the Financial Reporting Council's U.K. Corporate Governance Code (the "U.K. Code"), and if not, to explain their reasons for non-compliance.[188] Provision 23 of the U.K. Code requires each company to publicly describe "the work of the nomination committee, including . . . the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the

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186 See Swedish Corporate Governance Board, *Gender balance*, supra note 184.

187 See Swedish Corporate Governance Board, *Statistics regarding gender balance* (July 15, 2020), available at: http://www.bolagsstyrning.se/userfiles/archive/3922/200715_gender_balance_on_boards.pdf; see also *Sammanfattning*, available at http://www.bolagsstyrning.se/userfiles/archive/3922/statistik_konsfordelning_2020.pdf.

188 See Financial Conduct Authority, LR 9.8.6(6), available at: https://www.handbook.fca.org.uk/handbook/LR/9/8.html; see also Financial Reporting Council, *The UK Corporate Governance Code* 3 (July 2018), available at https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF. In addition, "[i]n 2016, the [UK] Government also implemented the relevant provision of the EU Non-Financial Reporting Directive with a new reporting requirement in the FCA's Disclosure and Transparency Rules. This requires issuers (excluding [small and medium-sized enterprises]) admitted to trading on an EU regulated market to disclose their diversity policy in the corporate governance statement." See Financial Reporting Council, *Board Diversity Reporting* 5 (September 2018), available at: https://www.frc.org.uk/getattachment/62202e7d-064c-4026-bd19-f9ac9591fe19/Board-Diversity-Reporting-September-2018.pdf.

objectives,"[189] and Principle J states that board appointments and succession planning should, among other things, "promote diversity of gender, social and ethnic backgrounds."[190] In addition, the Companies Act requires companies to disclose gender diversity statistics among the board, management and employees.[191] In 2018, the Financial Reporting Council reported that 83% of FTSE 100 and 74% of FTSE 250 companies had established a board diversity policy specifying gender, with approximately 1/3 specifying ethnicity.[192] More recently, a report commissioned by the Financial Reporting Council concluded that there is a lack of public disclosure regarding the LGBTQ+ status among directors and executives of public companies. While the report did not recommend amending Principle J of the U.K. Code to consider sexual orientation or gender identity, it emphasized that the U.K. Code "seeks to promote diversity and inclusion of all minority groups within business"[193] and suggested that the government "update corporate reporting requirements to require companies to demonstrate how they intend to capture data on the sexual orientation and gender identity of staff."[194]

In 2011, the Davies Review called on FTSE 100 boards to achieve 25% women on boards by 2015.[195] After that milestone was achieved, the Hampton Alexander Review encouraged FTSE 350 boards to have 1/3 women by 2020, and it has been

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189 See Financial Reporting Council, *The UK Corporate Governance Code*, supra note 188, at 9.

190 Id. at 8.

191 See UK Companies Act 2006, § 414C.

192 See Financial Reporting Council, Board Diversity Reporting, supra note 188, at 9.

193 See Hay et al., supra note 98, at 37.

194 Id.

195 See *Women on boards*, supra note 96.

achieved by FTSE 100 companies.[196] In 2017, the Parker Review called on FTSE 100 and 250 companies to have at least one director of color by 2021 and 2024, respectively.[197] As of February 2020, approximately 37% of FTSE 100 companies surveyed and 59% of FTSE 350 companies surveyed did not have one director of color on their board.[198]

Australian Securities Exchange ("ASX")-listed companies must comply with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (the "ASX Recommendations") or explain why they do not. The ASX Recommendations require companies to have and disclose a diversity policy with measurable objectives and report on progress towards meeting those objectives. If the company is in the ASX/S&P 300, its objective for achieving gender diversity should be at least 30%.[199] The Australian government also requires companies with 100 or more employees to provide an annual report about gender equality indicators, including the gender composition of the board and the rest of the workforce.[200] In 2015, the ASX and KPMG found that 99% of S&P/ASX 200 companies and 88% of ASX 201-500 companies disclosed establishing a diversity policy rather than explaining why they do

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196 See *Hampton-Alexander Review: FTSE Women Leaders* (November 2016), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/613085/ftse-women-leaders-hampton-alexander-review.pdf.

197 See Parker, supra note 97.

198 See Sir John Parker, *Ethnic Diversity Enriching Business Leadership* 19 (Feb. 5, 2020), available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2020-report-final.pdf.

199 See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* 9 (4th ed. Feb. 2019), available at: https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf.

200 Workplace Gender Equality Act 2012, Part IV § 13 (March 25, 2015), available at: https://www.legislation.gov.au/Details/C2015C00088.

not have one.[201] As of July 2020, women account for 28.4% and 31.8% of board seats among ASX 300 and ASX 100 companies, respectively.[202]

Nasdaq observed that women account for at least 30% of the boards of the largest companies in Australia, Sweden and the United Kingdom, and in three other countries that have implemented disclosure requirements or suggested milestones on a comply-or-explain basis: Finland, New Zealand, and Canada.[203] Nasdaq considered that countries that have implemented mandates have also seen progress in women's representation on boards, including, for example, Austria, Iceland, Belgium, France, Germany, Italy and Portugal.[204] On average, women account for 31% of board seats in countries with gender mandates.[205]

Nasdaq discussed the benefits and challenges of mandate and comply-or-explain models with over a dozen stakeholders, and while the majority of organizations were in

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201 See KPMG and ASX, *ASX Corporate Governance Council Principles and Recommendations on Diversity: Analysis of disclosures for financial years ended 1 January 2015 and 31 December 2015* 4 (2016) available at: https://www.asx.com.au/documents/asx-compliance/asx-corp-governance-kpmg-diversity-report.pdf.

202 See KPMG and 30% Club, *Building Gender Diversity on ASX 300 Boards: Seven Learnings from the ASX 200* 4 (July 2020), available at: https://assets.kpmg/content/dam/kpmg/au/pdf/2020/building-gender-diversity-asx-300-boards.pdf. The report also noted that diversity counteracts groupthink and that ASX 201-299 companies with at least 30% female directors "are more likely than not to [have seen] market capitalisation increases over the past 12 months." Id. at 6.

203 See The Conference Board of Canada, *Data Dashboard* (Sept. 23, 2020), available at: https://www.conferenceboard.ca/focus-areas/inclusion/2020/aob-comparisons-around-the-world-table?AspxAutoDetectCookieSupport=1; Andrew MacDougall et al., Osler, *Diversity Disclosure Practices* 4 (2020), available at https://www.osler.com/osler/media/Osler/reports/corporate-governance/Diversity-and-Leadership-in-Corporate-Canada-2020.pdf. But see Heike Mensi-Klarbach et al., *The Carrot or the Stick: Self-Regulation for Gender-Diverse Boards via Codes of Good Governance*, J. Bus. Ethics 11 (2019), available at: https://doi.org/10.1007/s10551-019-04336-z (reviewing longitudinal data from 2006 to 2016 on listed and state-owned companies in Austria and concluding that "self-regulation of gender diversity on boards is ineffective if merely based on recommendations in codes of good governance"). Mensi-Klarbach recommends setting concrete targets and providing public monitoring to improve the effectiveness of comply-or-explain frameworks.

204 See Paul Hastings, supra note 177; see also Deloitte, *Women in the Boardroom*, supra note 86.

205 See Paul Hastings, supra note 177; The Conference Board of Canada, supra note 203.

agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, the majority also stated that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. Most organizations Nasdaq spoke with expressed general discomfort with mandates, although they acknowledged that opposition is lessening in the wake of California's S.B. 826[206] and A.B. 979.[207] While many recognized that mandates can force boards to act more quickly and accelerate the rate of change, they believe that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Some stakeholders also highlighted additional challenges that smaller companies and companies in certain industries may face finding diverse board members. In contrast, a disclosure-based framework that provides companies with flexibility would empower companies to maintain decision-making authority over their board's composition while providing stakeholders with a better understanding of the company's current board composition and its philosophy regarding diversity. This approach would better inform the investment community and enable more informed analysis of, and conversations with, companies. Nasdaq believes that these goals will be achieved through the disclosure of consistent, comparable data across companies, as would be required by the Exchange's proposed definition of Diverse.

For example, if, under Israeli law regarding board diversity, an Israeli company is required only to have a minimum of one woman on the board and such Israeli company chooses to comply with Israeli home country law in lieu of meeting the diversity objectives of Rule 5605(f)(2)(B), it may choose to disclose that "the Company is

206 See Cal. S.B. 826, supra note 112.

207 See Cal. A.B. 979, supra note 112.

incorporated in Israel and required by Israeli law to have a minimum of one woman on the board, and satisfies home country requirements in lieu of Nasdaq Rule 5605(f)(2)(B), which requires each Foreign Issuer to have at least two Diverse directors." If a U.S. company had two Diverse directors but one resigned due to unforeseen circumstances, it could disclose, for example: "Due to the unexpected resignation of Ms. Smith this year, the Company does not have at least one director who self-identifies as Female and one director who self-identifies as an Underrepresented Minority or LGBTQ+. We intend to undertake reasonable efforts to meet the diversity objectives of Rule 5605(f)(2)(A) prior to our next annual shareholder meeting and have engaged a search firm to identify qualified Diverse candidates. However, due to unforeseen circumstances, we may not achieve this goal." Or a U.S. company may disclose that it chooses to define diversity more broadly than Nasdaq's definition by considering national origin, veteran status or individuals with disabilities when identifying nominees for director because it believes such diversity brings a wide range of perspectives and experiences to the board. In each case, investors will have a better understanding of the company's reasons for not having at least two Diverse directors and can use that information to make an informed investment or voting decision.

ii. Higher vs. Lower Diversity Objectives

Nasdaq observed that existing empirical research spanned companies across several countries, including the United States, Spain, China, Canada, France and Norway. Nasdaq considered that the studies related to company performance and board diversity found positive associations at various levels and measures of board diversity, including

having at least one woman on the board,[208] two or more diverse directors (with diverse considered female, Black, Hispanic or Asian),[209] at least three women on the board[210] and being in the top quartile for gender and ethnic diversity.[211]

Nasdaq considered that the academic studies related to investor protection and board diversity found positive associations at various levels and measures of board diversity, including having at least one woman on the board[212] or up to 50% women on the board, and the assertions of certain academics that their findings may extend to other forms of diversity, including racial and ethnic diversity.[213] Nasdaq also reviewed academic research suggesting that "critical mass" is achieved by having three or more women on the board, and that having only one diverse director on the board risks "tokenism."[214] Nasdaq considered that although the legislation enacted by Norway and California, and proposed by several other states, varies based on board size, the academic research considered companies across a spectrum of sizes and board sizes, including Fortune 100, S&P 500, Fortune 1000 and smaller (non-Fortune 1000) companies.

Nasdaq concluded that there is no "one-size fits all" approach to promoting board diversity and that the academic literature regarding the relationship between board diversity, company performance and investor protections is continuing to evolve.

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208 See Credit Suisse, supra note 30, at 16.

209 See Thomas and Starr, supra note 23, at 5.

210 See Eastman et al., supra note 31, at 3; Wagner, supra note 32.

211 See McKinsey, supra note 36.

212 See Abbott et al., supra note 58; Chen et al., supra note 64.

213 See Wahid, supra note 59; Cumming et al., supra note 62, at 34.

214 See Alison M. Konrad et al., *Critical Mass: The Impact of Three or More Women on Corporate Boards*, 37(2) Org. Dynamics 145 (April 2008); Miriam Schwartz-Ziv, *Gender and Board Activeness: The Role of a Critical Mass*, 52(2) J. Fin. & Quant. Analysis 751 (April 2017); Mariateresa Torchia et al., *Women Directors on Corporate Boards: From Tokenism to Critical Mass*, 102(2) J. Bus. Ethics. 299 (Feb. 25, 2011), available at https://ssrn.com/abstract=1858347.

However, in Nasdaq's survey of academic studies described above—and of the targets or mandates promulgated by regulatory bodies and organizations worldwide—Nasdaq observed a common denominator of having at least one woman on the board. Similarly, Nasdaq observed a common denominator of having at least one director who is diverse in terms of race, ethnicity or sexual orientation among the requirements related to, and academic research considering, board diversity beyond gender identity. Nasdaq therefore believes that a diversity objective of at least two Diverse directors provides a reasonable baseline for comparison across companies. Companies are not precluded from meeting a higher or lower alternative measurable objective. For example, a company may choose to disclose that it does not meet the diversity objectives under Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to satisfy that diversity objective instead. On the other hand, many firms may strive to achieve even greater diversity than the objectives set forth in Nasdaq's proposed rule. Nasdaq believes that providing flexibility and clear disclosure when the company determines to follow a different path will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions.

iii. Longer vs. Shorter Timeframes

Nasdaq considered whether an alternative timeframe for satisfying the diversity objectives of Rule 5605(f)(2) would better promote the public interest than the timeframe Nasdaq has proposed under Rule 5605(f)(7). While companies are not precluded from adding additional directors to their boards to satisfy Rule 5605(f)(2) by having two Diverse directors sooner than contemplated by the proposed rule, Nasdaq understands that some companies may need to obtain shareholder approval to amend their governing

documents to allow for board expansion. Other companies may choose to replace an existing director on the board with a Diverse director, and board turnover may be low.[215] Nasdaq recognizes that it also takes substantial lead time to identify, interview and select board nominees. To provide companies with sufficient time to satisfy Rule 5605(f) by having two Diverse directors, while recognizing that investors are calling for expedient change, Nasdaq has structured its proposal similarly to the approach taken by California, where companies must achieve one target by an earlier date and satisfy the entire diversity objective at a later date. Nasdaq also considered the approaches taken by foreign jurisdictions to implement diversity objectives. For example, Belgium and France implemented diversity objectives under a phased approach that provided companies with at least five years to fully satisfy the objectives,[216] whereas Iceland and Portugal provided companies with three years or less.[217]

While companies may choose to satisfy Rule 5605(f)(2) on an alternative timeframe, a company that chooses a timeframe that is longer than the timeframes set forth in Rule 5605(f)(7) also must publicly explain its reasons for doing so. For example, an NGM-listed company that, while not technically a Smaller Reporting Company, views itself as similarly situated to a NCM-listed Smaller Reporting Company may disclose the following: "While the Company is listed on NGM and technically qualifies as a Smaller Reporting Company, it does not file its SEC reports utilizing the Smaller Reporting Company designation. However, the Company believes that it is similarly situated to

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215 See Matteo Tonello, *Corporate Board Practices in the Russell 3000 and S&P 500*, Harv. L. Sch. Forum on Corp. Governance (Oct. 18, 2020), https://corpgov.law.harvard.edu/2020/10/18/corporate-board-practices-in-the-russell-3000-and-sp-500/ (last accessed Nov. 24, 2020).

216 See Paul Hastings, supra note 177, at 79 and 90; see also supra note 179.

217 See Deloitte, Women in the Boardroom, supra note 86, at 115 and 143; see also supra note 179.

other Smaller Reporting Companies listed on NCM in terms of its annual revenues and public float, and therefore has chosen to satisfy Rule 5605(f)(2)(C) in lieu of Rule 5605(f)(2)(A) and has satisfied this requirement by having at least two Diverse directors on the board who self-identify as Female within the timeframe provided under Rule 5605(f)(7) applicable to NCM-listed companies."

iv. Broader vs. Narrower Definition of Diverse

Nasdaq considered whether the definition of Diverse should include broader characteristics than those reported on the EEO-1 report, such as the examples provided by the Commission's CD&I, including LGBTQ+, nationality, veteran status, and individuals with disabilities. During its stakeholder outreach, Nasdaq inquired whether a broad definition of Diversity would promote the public interest. While recognizing the diverse perspectives that different backgrounds can provide, most stakeholders supported a narrower definition of Diversity focused on gender, race and ethnicity, with several supporting broadening the definition to include the LGBTQ+ community.

As discussed above, companies currently are permitted to define diversity "in ways they consider appropriate" under federal securities laws. One of the challenges of this principles-based approach has been the disclosure of inconsistent and noncomparable data across companies. However, most companies are required by law to report data on race, ethnicity and gender to the EEOC through the EEO-1 Report. Nasdaq believes that 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. 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.

Nasdaq also believes that a transparent, consistent definition of Diverse would provide stakeholders with a better understanding of the company's current board composition and its philosophy regarding diversity if it does not have two Diverse directors. This would enable the investment community to conduct more informed analysis of, and have more informed conversations with, companies. To the extent a company chooses to satisfy the requirement of Rule 5605(f)(2) by having at least two Diverse directors on its board, it will have the ancillary benefit of making meaningful progress in improving board diversity related to race, ethnicity, sexual orientation and gender identity.

Nasdaq's review of academic research on board diversity revealed a dearth of empirical analysis on the relationship between investor protection or company performance and broader diversity characteristics such as veteran status or individuals with disabilities.[218] Nasdaq acknowledges that there also is a lack of published research

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[218] KPMG (2020) states that veterans are underrepresented in boardrooms, with retired General and Flag Officers ("GFOs") occupying less than 1% of Fortune 500 board seats. See KPMG, *The value of veterans in the boardroom* 1 (2020), available at: https://boardleadership.kpmg.us/content/dam/boardleadership/en/pdf/2020/the-value-of-veterans-

on the issue of LGBTQ+ representation on boards.[219] This may be due to a lack of consistent, transparent data on broader diverse attributes, or because there is no voluntary self-disclosure workforce reporting requirements for LGBTQ+ status, such as the EEO-1 reporting framework for race, ethnicity, and gender. In any event, it is evident that while "[b]oardroom diversity is a topic that has gained significant traction . . . LGBT+ diversity, however, has largely been left out of the conversation."[220]

Nonetheless, Nasdaq believes it is reasonable and in the public interest to include a reporting category for LGBTQ+ in recognition of the U.S. Supreme Court's recent affirmation that sexual orientation and gender identity are "inextricably" intertwined with sex,[221] and based on studies demonstrating a positive association between board diversity and decision making, company performance and investor protections. Nasdaq also believes that the proposed rule would foster the development of data to conduct meaningful assessments of the association between LGBTQ+ board diversity, company performance and investor protections.

As noted above, the proposal does not preclude companies from considering additional diverse attributes, such as nationality, disability, or veteran status in selecting board members; however, company would still have to provide the required disclosure under Rule 5605(f)(3) if the company does not also have at least two directors who are

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in-the-boardroom.pdf (noting that "[r]etired GFOs who have honed their leadership and critical decision-making skills in a high-threat environment can bring extensive risk oversight experience to the board, which may be especially valuable in the context of today's risk landscape"). Accenture (2018) observed that companies that offered inclusive working environments for employees with disabilities achieved an average of 28% higher revenue, 30% higher economic profit margins, and 2x net income than their industry peers. See Accenture, *Getting to Equal: The Disability Inclusion Advantage* (2018), available at: https://www.accenture.com/_acnmedia/PDF-89/Accenture-Disability-Inclusion-Research-Report.pdf.

219 See Credit Suisse ESG Research, supra note 33, at 1; see also Out Leadership, supra note 35.

220 See Out Leadership, supra note 35, at 3.

221 See Bostock v. Clayton Cnty., supra note 160.

Diverse. Nor would the proposal prevent companies from disclosing information related to other diverse attributes of board members beyond those highlighted in the rule if they felt such disclosure would benefit investors. Nasdaq believes such disclosure would help inform the evolving body of research on the relationship between broader diverse attributes, company performance and investor protection and provide investors with additional information about the company's philosophy regarding broader diversity characteristics.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[222] in general, and furthers the objectives of Section 6(b)(5) of the Act,[223] in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, to prevent fraudulent and manipulative acts and practices, and, in general, to protect investors and the public interest, for the reasons set forth below. Further, Nasdaq believes the proposal is not designed to permit unfair discrimination between issuers or to regulate by virtue of any authority conferred by the Act matters not related to the purposes of the Act or the administration of the Exchange, for the reasons set forth below.

I. Board Statistical Disclosure

Nasdaq has proposed what it believes to be a straightforward and clear approach for companies to publish their statistical data pursuant to proposed Rule 5606. The disclosure will assist investors in making more informed decisions by making meaningful, consistent, and reliable data readily available and in a clear and

222 See 15 U.S.C. § 78f(b).

223 Id. § 78f(b)(5).

comprehensive format prescribed by the proposed rule. Nasdaq also believes that the disclosure format required by proposed Rule 5606 protects investors by eliminating data collection inaccuracies and decreasing costs, while enhancing investors' ability to utilize the information.

As a threshold matter, as discussed above, diversity has become an increasingly important subject and, in recent years, investors increasingly have been advocating for greater board diversity and for the disclosure of board diversity statistics. The current board diversity disclosure regime is lacking in several respects, and Nasdaq believes that its proposed Rule 5606 addresses many of the current concerns and responds to investors' demands for greater transparency into the diversity characteristics of a company's board composition by mandating disclosure and curing certain deficiencies that exist within the current SEC disclosure requirements.

Investors have expressed their dissatisfaction with having to independently collect board-level data about race, ethnicity and gender identity because such investigations can be time consuming, expensive, and fraught with inaccuracies.[224] The lack of consistency and specificity in Regulation S-K has been a major impediment for many investors and data collectors. As a general matter, the Commission's requirements have not addressed the concerns expressed by commenters that "disclosure about board diversity was important information to investors."[225] Nasdaq believes that its proposed Rule 5606 addresses many of the concerns that have been raised.

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224 See Petition for Amendment of Proxy Rule, supra note 80, at 2.

225 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,343-44 (amending Item 407(c)(2)(vi) of Regulation S-K, codified at 17 C.F.R. § 229.407(c)(2)(vi)).

Nasdaq believes that requiring the annual disclosure of a company's board diversity, as proposed in Rule 5606(a), will provide consistent information to the public and will enable investors to continually review the board composition of a company to track trends and simplify or eliminate the need for a company to respond to multiple investor requests for information about the diverse characteristics of the company's board. Requiring annual disclosures also would make information available to investors who otherwise would not be able to obtain individualized disclosures.[226] Moreover, consistent disclosures may encourage boards to consider a wider range of board candidates in the nomination process, including candidates with fewer ties to the current board.[227]

The Commission's 2009 amendments to Regulation S-K provide no definition for diversity and do not explicitly require disclosures specifically related to details about the board's gender, racial, ethnic and LGBTQ+ composition. Additionally, the Commission's CD&I does not address the definition of diversity, and it requires a registrant to disclose diversity information only in certain limited circumstances. Investors have expressed that current regulations and accompanying interpretations impair their ability to obtain clear and consistent data.[228] As a result, Nasdaq believes that proposed Rule 5606(a) protects investors and the public interest by making clear that a company's annual diversity data disclosure must include information related to gender

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226 See Petition for Rulemaking, supra note 123.

227 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355 ("To the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management and are, consequently, more independent."); Hazen and Broome, supra note 114, at 57-58.

228 See Petition for Amendment of Proxy Rule, supra note 80, at 2; Petition for Rulemaking, supra note 123, at 7.

identity, race, ethnicity and LGBTQ+ status, thereby leaving less discretion for companies to selectively disclose certain diversity information and enhancing the comparability of such data across companies. Moreover, it is in the public interest to provide clear requirements for diversity disclosure, and Nasdaq's proposed Board Diversity Matrix format provides such clarity.

Nasdaq does not intend to obligate directors to self-identify in any of the categories related to gender identity, race, ethnicity and LGBTQ+. Nasdaq believes that a director should have autonomy to decide whether to provide such information to their company. Therefore, Nasdaq believes that it is reasonable and in the public interest to allow directors to opt out of disclosing the information required by proposed Rule 5606(a) by permitting a company to identify such directors in the "Undisclosed" category.

Nasdaq believes that it is in the public interest to utilize the Board Diversity Matrix format for all companies as proposed in Rule 5606(a). Additionally, Nasdaq believes that the format removes any impediments to aggregating and analyzing data across all companies by requiring each company to disclose separately the number of male, female, and non-binary directors, the number of male, female, and non-binary directors that fall into certain racial and ethnic categories, and the number of directors that identify as LGBTQ+. The format allows investors to easily disaggregate the data and track directors with multiple diversity characteristics.

As discussed above, most listed companies are required by law to complete an EEOC Employer Information Report EEO-1 Form. Although outside directors generally

are not employees and therefore are not covered in the EEO-1,[229] Nasdaq believes that collecting the information required by proposed Rule 5606(a) is familiar to most companies, and that it is reasonable to require disclosure of the additional board information.

Nasdaq also believes that requiring currently listed companies to comply with proposed Rule 5606 within one year from the date of Commission approval is a reasonable amount of time, given that most companies already collect similar information for certain employees. Moreover, most companies are required to prepare an annual proxy statement and update the Commission within four business days when a new director is appointed to the board.[230]

Further, Nasdaq believes that the disclosure required by proposed Rule 5606(a) will remove impediments to shareholders by making available information related to board-level diversity in a standardized manner, thereby enhancing the consistency and comparability of the information and helping to better protect investors. The proposed disclosure will also help protect investors and the public interest by enabling investors to determine the total number of diverse directors, which is information that is not consistently available in existing proxy disclosures in cases where a single director has multiple diverse characteristics. While companies can elect to make this information available either in a proxy statement or on the company's website, Nasdaq believes it is in the public interest to allow companies the option to provide the disclosure in a way they believe will be most meaningful to their shareholders.

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229 The EEO-1 Form does not require a company to disclose data for outside directors because such directors are not company employees.

230 See SEC Form 8-K, available at: https://www.sec.gov/files/form8-k.pdf.

Nasdaq recognizes that the proposed definition of Underrepresented Minority in Rule 5605(f)(1) may not apply to companies outside of the United States because each country has its own unique demographic composition. Moreover, Nasdaq's definition of Underrepresented Minority proposed in Rule 5606(f)(1) may be inapplicable to a Foreign Issuer, making this Board Matrix data less relevant for such companies and not useful for investors. Therefore, Nasdaq believes that offering Foreign Issuers the option of a separate template that requires different disclosure categories will provide investors with more accurate disclosures related to the diversity of directors among the board of a Foreign Issuer. Additionally, Nasdaq believes that providing an "Underrepresented Individual in Home Country Jurisdiction" category provides Foreign Issuers with more flexibility to identify and disclose diverse directors within their home countries.

The annual requirement in the proposed rule will guarantee that the information is available to the public on a continuous and consistent basis. As described in the instructions to the Board Diversity Matrix disclosure form and Rule 5606(a), each year following the first year that a company publishes the Board Diversity Matrix, the company will be required to publish its data for the current and immediately prior years. Nasdaq believes that disclosing at least two years of data allows the public to view any changes and track a board's diversity progress.

In addition to providing a means for shareholders to assess a company's board-level diversity and measure its progress in improving that diversity over time, Nasdaq believes that proposed Rule 5606 will provide a means for Nasdaq to assess whether companies meet the diversity objectives of proposed Rule 5605(f). The ability to

determine satisfaction of the proposed listing rule's diversity objectives will protect investors and the public interest.

Moreover, the proposed rule provides transparency into diversity based not only on race, ethnicity, and gender identity, but also on a director's self-identified sexual orientation. Nasdaq believes that expanding the diversity characteristics beyond those which are commonly reported by companies currently will broaden the way boards view diversity, and ensure that board diversity is occurring across all protected groups.

Finally, Nasdaq believes that the proposal is not unfairly discriminatory because proposed Rule 5606 will apply to all Nasdaq-listed companies, except for the following companies: acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non- voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series—which meet the definition of Exempt Companies as defined under proposed Rule 5605(f)(4). Nasdaq believes it is reasonable and not unfairly discriminatory to exempt these companies from the proposed rule because the exemption of these companies is consistent with the approach taken by Nasdaq in Rule 5615 as it relates to certain Nasdaq corporate governance standards for board composition.

Nasdaq further believes it is reasonable to provide companies with a one-year phase-in period to comply with proposed Rule 5606. Nasdaq believes there is only a *de minimis* burden placed on companies to collect the board data and prepare the Board

Diversity Matrix. Moreover, as discussed above, companies already are required to gather similar information for certain employees. Therefore, Nasdaq believes that one year is sufficient time for companies to incorporate their directors into their data collection. Furthermore, newly listed companies have many obligations to meet under Nasdaq listing rules. Therefore, Nasdaq believes that it is reasonable under proposed Rule 5606(d) to provide newly listed Nasdaq companies, including companies listing in connection with a business combination under IM-5101-2, with one year from the time of listing to comply with the proposed rule.

II. Diverse Board Representation or Explanation

a. Removes Impediments to and Perfects the Mechanism of a Free and Open Market and a National Market System

As discussed above, studies suggest that the traditional director candidate selection process may create barriers to considering qualified diverse candidates for board positions by limiting the search for director nominees to existing directors' social networks and candidates with C-suite experience.[231] In analyzing Norway's experience in implementing a gender mandate, Dhir (2015) observed that "[b]oard seats tend to be filled by directors engaging their networks, and the resulting appointees tend to be of the same socio-demographic background."[232] Dhir concluded that broadening the search for directors outside of traditional networks "is unlikely to occur without some form of regulatory intervention, given the prevalence of homogenous social networks and in-

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231 See GAO Report, supra note 44; Vell, supra note 100; Rhode & Packel, supra note 104, at 39; Deloitte, *Women in the Boardroom*, supra note 86; see also Parker, supra note 97, at 38 (acknowledging that, "as is the case with gender, people of colour within the UK have historically not had the same opportunities as many mainstream candidates to develop the skills, networks and senior leadership experience desired in a FTSE Boardroom").

232 See Dhir, supra note 78, at 52.

group favoritism."[233] Regulatory action was effective in increasing the representation of women on boards in Norway by "democratiz[ing] access to a space previously unavailable to women."[234] The number of public company board seats held by women in Norway increased from 6% in 2002 to 42% in 2020.[235] One Norwegian director "grudgingly accept[ed] that the free market principles she held so dearly had disappointed her—and that the [mandate] was a necessary correction of market failure."[236]

In contrast, Nasdaq observed that other countries have made comparable progress using a disclosure-based model. Women account for at least 30% of the largest boards of companies in six countries using comply-or-explain models:[237] Australia, Finland, Sweden, New Zealand, Canada and the United Kingdom.[238] Nasdaq discussed the benefits and challenges of mandate and disclosure-based models with over a dozen stakeholders, and the majority of organizations were in agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, and that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. While many organizations recognized that

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233 Id. at 51. See also Albertine d'Hoop-Azar et al., *Gender Parity on Boards Around the World*, Harv. L. Sch. Forum on Corp. Governance (January 5, 2017), available at: https://corpgov.law.harvard.edu/2017/01/05/gender-parity-on-boards-around-the-world/ (comparing gender diversity on boards in countries with varying requirements and enforcement measures and concluding that external pressures—"progressive societal norms" and regulations—are needed to increase board diversity).

234 See Dhir, supra note 78, at 101.

235 See Marianne Bertrand et al., *Breaking the Glass Ceiling? The Effect of Board Quotas on Female Labor Market Outcomes in Norway*, Nat'l Bureau of Econ. Rsch. Working Paper 20256 (June 2017), available at https://www.nber.org/papers/w20256; Statistics Norway, *Board and management in limited companies* (Mar. 6, 2020), https://www.ssb.no/en/styre (last accessed Nov. 27, 2020).

236 See Dhir, supra note 78, at 116.

237 See Paul Hastings, supra note 177; Deloitte, *Women in the Boardroom*, supra note 86.

238 See Conference Board of Canada, supra note 201; Osler, supra note 203, at 4.

mandates can force boards to act more quickly and accelerate the rate of change, they believe that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Some stakeholders also highlighted additional challenges that smaller companies and companies in certain industries may face finding diverse board members. However, leaders from across the spectrum of stakeholders with whom Nasdaq spoke reinforced the notion that if companies recruit by skill set and expertise rather than title, then they will find there is more than enough diverse talent to satisfy demand.

Nasdaq also considered Commissioner Lee's observation that disclosure "gets investors the information they need to make investment decisions based on their own judgment of what indicators matter for long-term value. Importantly, it can also drive corporate behavior." Specifically, she observed that:

> For one thing, when companies have to formulate disclosure on topics it can influence their treatment of them, something known as the "what gets measured, gets managed" phenomenon. Moreover, when companies have to be transparent, it creates external pressure from investors and others who can draw comparisons company to company. The Commission has long-recognized that influencing corporate behavior is an appropriate aim of our regulations, noting that "disclosure may, depending on determinations made by a company's management, directors and shareholders, influence corporate conduct" and that "[t]his sort of impact is clearly consistent with the basic philosophy of the disclosure provisions of the federal securities laws.[239]

Nasdaq believes that a disclosure-based framework may influence corporate conduct if a company chooses to meet the diversity objective of Rule 5605(f)(2) by having two Diverse directors on the board. A company may satisfy that objective by broadening the search for qualified candidates and considering candidates from other professional pathways that bring a wider range of skills and perspectives beyond

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239 See Lee, supra note 22.

traditional C-suite experience.[240] Nasdaq believes that this will help increase opportunities for Diverse candidates that otherwise may be overlooked due to the impediments of the traditional director recruitment process, which will thereby remove impediments to a free and open market and a national market system. Further, boards that choose to have at least two Diverse directors may experience other benefits from diversity that perfect the mechanism of a free and open market and national market system. As discussed above in Section 3.a.II.b (*Diversity and Investor Protection*), and further discussed below in Section 3.b.II.b (*Prevent Fraudulent and Manipulative Acts and Practices*), studies suggest that diversity is positively associated with reduced stock volatility,[241] more transparent public disclosures,[242] and less information asymmetry,[243] leading to stock prices that better reflect public information, and further removing impediments to and perfecting a free and open market and a national market system. Importantly, Nasdaq believes that the disclosure-based framework proposed under Rule 5605(f) will not create additional impediments to a free and open market and a national market system because it will empower companies to maintain decision-making authority over the composition of their boards.

To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2) to have at least two Diverse directors, Nasdaq believes that proposed Rule 5605(f)(3) will provide analysts and investors with a better understanding about the company's reasons for not doing so and its philosophy regarding diversity. Rule 5605(f)

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240 See, e.g., Hillman et al., supra note 105 (finding that African-American and white women directors were more likely to have specialized expertise in law, finance, banking, public relations or marketing, or community influence from positions in politics, academia or clergy).

241 See Bernile et al., supra note 28.

242 See Gul et al., supra note 66; Bravo and Alcaide-Ruiz, supra note 56.

243 See Abad et al., supra note 67.

will thus remove impediments to a free and open market and a national market system by enabling the investment community to conduct more informed analyses of, and have more informed conversations with, companies. Nasdaq believes that such analyses and conversations will be better informed by consistent, comparable data across companies, which Nasdaq proposes to achieve by adopting a consistent definition of "Diverse" under Rule 5605(f)(1). Nasdaq further believes that providing such disclosure will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, thereby promoting capital formation and efficiency and perfecting the mechanism of a free and open market and a national market system.

b. Prevent Fraudulent and Manipulative Acts and Practices

Nasdaq's analysis discussed above in Section 3.a.II raises the concern that the failure of homogenous boards to consider a broad range of viewpoints can result in suboptimal decisions that have adverse effects on company performance, board performance and stakeholders. Nasdaq believes that including diverse directors with a broader range of skills, perspectives and experiences may help detect and prevent fraudulent and manipulative acts and practices by mitigating "groupthink." Increased board diversity also may reduce the likelihood of insider trading and other fraudulent and manipulative acts and practices.

Nasdaq reached this conclusion by reviewing public statements by investors and organizations regarding the impact of groupthink on decision making processes, as well as academic studies on the relationship between diversity, groupthink and fraud. Nasdaq

observed that groupthink can result in "self-censorship"[244] and failure to voice dissenting viewpoints in pursuit of "consensus without critical evaluation and without considering different possibilities."[245] In contrast, "board members who possess a variety of viewpoints may raise different ideas and encourage a full airing of dissenting views. Such a broad pool of talent can be assembled when potential board candidates are not limited by gender, race, or ethnicity."[246]

Dhir (2015) concluded that gender diversity may "promote cognitive diversity and constructive conflict in the boardroom" and may be more effective at overseeing management.[247] One respondent in Dhir's survey of Norwegian directors observed that:

> I've seen situations where the women were more willing to dig into the difficult questions and really go to the bottom even if it was extremely painful for the rest of the board, but mostly for the CEO . . . when it comes to the really difficult situations, [where] you think that the CEO has . . . done something criminal . . . [o]r you think that he has done something negligent, something that makes it such that you . . . are unsure whether he's the suitable person to be in the driving seat.[248]

Another director observed that "[i]f you have different experiences and a more diversified board, you will have different questions asked."[249] Dhir concluded that "women directors may be particularly adept at critically questioning, guiding and advising management without disrupting the overall working relationship between the board and management."[250]

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244 See Forbes and Milliken, supra note 74, at 496.

245 See Dhir, supra note 78, at 124.

246 See Petition for Amendment of Proxy Rule, supra note 80, at 4.

247 See Dhir, supra note 78, at 150.

248 Id. at xiv.

249 Id. at 120.

250 Id. at 35.

Pucheta-Martínez et al. (2016) reasoned that questioning management is a critical part of the audit committee's oversight role, along with ensuring that management does not pressure the external auditor to issue a clean audit opinion notwithstanding the identification of any uncertainties or scope limitations.[251] Otherwise, "[a]uditors may accept the demands of management for a clean audit report when the firm deserves a scope limitation and an uncertainty qualification."[252] The authors found that "the percentage of female [directors] on [audit committees] reduces the probability of [audit] qualifications due to errors, non-compliance or the omission of information,"[253] and further found a positive association between gender-diverse audit committees and disclosing audit reports with uncertainties and scope limitations. This suggests that gender-diverse audit committees better "ensure that managers do not seek to pressure auditors into issuing a clean opinion instead of a qualified opinion" when any uncertainties or scope limitations are identified.[254]

Nasdaq also reviewed other studies that found a positive association between board gender diversity and important investor protections regardless of whether women are on the audit committee, and considered the assessment of some academics that their findings may extend to other forms of diversity, including racial and ethnic diversity. Nasdaq therefore believes that such findings with respect to audit committees would be expected to be more broadly applicable to the quality of the broader board's decision-

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251 See Pucheta-Martínez et al., supra note 52, at 368.

252 Id. at 364.

253 Id. at 363.

254 Id. at 368.

making process, and to other forms of diversity, including diversity of race, ethnicity and sexual orientation.

In examining the association between broader board gender diversity and fraud, Cumming, et al. observed that "[g]ender diversity in particular facilitates more effective monitoring by the board and protection of shareholder interests by broadening the board's expertise, experience, interests, perspectives and creativity."[255] They observed that the presence of women on boards is associated with a lower likelihood of securities fraud; indeed, they found "strong evidence of a negative and diminishing effect of women on boards and the probability of being in our fraud sample."[256] The authors suggested that "other forms of board diversity, including but not limited to gender diversity, may likewise reduce fraud."[257]

Similarly, Wahid (2017) noted that board gender diversity may "lead to less biased and superior decision-making" because it "has a potential to alter group dynamics by affecting cognitive conflict and cohesion."[258] Wahid (2017) concluded that "gender-diverse boards commit fewer financial reporting mistakes and engage in less fraud,"[259] finding that companies with female directors have "fewer irregularity-type [financial] restatements, which tend to be indicative of financial manipulation."[260] Wahid also suggested that other forms of diversity, including racial diversity, could introduce

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255 See Cumming et al., supra note 62, at 34.

256 Id. at 12-14.

257 Id. at 33.

258 See Wahid, supra note 59, at 6.

259 Id. at 1.

260 Id. at 23.

additional perspectives to the boardroom,[261] which Nasdaq believes could further mitigate groupthink.

Abbott, Parker and Persley (2012) posited that "a female board presence contribut[es] to the board's ability to maintain an attitude of mental independence, diminish[es] the extent of groupthink and enhance[es] the ability of the board to monitor financial reporting."[262] They noted that "poorer [internal] controls and the lack of an independent and questioning board-level attitude toward accounting judgments can create an opportunity for fraud."[263] They observed a lower likelihood of a material financial restatements stemming from fraud or error in companies with at least one woman on the board.[264]

Nasdaq believes that these studies provide substantial evidence suggesting an association between gender diverse boards or audit committees and a lower likelihood of fraud; a lower likelihood of receiving audit qualifications due to errors, non-compliance or omission of information; and a greater likelihood of disclosing audit reports with uncertainties and scope limitations. Moreover, academics have suggested that other forms of diversity, including racial and ethnic diversity, may reduce fraud and mitigate groupthink. Further, while homogenous boards may unwittingly fall into the trap of

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261 Id. at 24-25; see also Shecter, supra note 61 (quoting Wahid as saying that "[i]f you're going to introduce perspectives, those perspectives might be coming not just from male versus female. They could be coming from people of different ages, from different racial backgrounds…. If we just focus on one, we could be essentially taking away from other dimensions of diversity and decreasing perspective.").

262 See Abbott et al., supra note 58, at 607.

263 Id. at 610.

264 Id. at 613 ("The previously discussed lines of research lead us to form our hypothesis. In summary, restatements may stem from error or fraud. In either instance, the internal control system (to which the board of directors contributes by setting the overall tone at the top) has failed to detect or prevent a misstatement. Ineffective internal controls may stem from insufficient questioning of assumptions underlying financial reporting, inadequate attention to the internal control systems, or insufficient support for the audit committee's activities.").

groupthink due to a lack of diverse perspectives, "heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of a wide range of interpretations, alternatives, and consequences."[265] Nasdaq therefore believes that the proposed rule is designed to reduce groupthink, and otherwise to enhance the functioning of boards, and thereby to prevent fraudulent and manipulative acts and practices.

Further, the Commission has suggested that in seeking board diversity, "[t]o the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management and are, consequently, more independent."[266] Nasdaq believes that the benefits of the proposed rule are analogous to the benefits of Nasdaq's rules governing and requiring director independence. In 2003, Nasdaq adopted listing rules requiring, among other things, that independent directors comprise a majority of listed companies' boards, which were "intended to enhance investor confidence in the companies that list on Nasdaq."[267] The Commission observed that self-regulatory organizations "play an important role in assuring that their listed issuers establish good governance practices," and concluded that the proposed rule changes would secure an "objective oversight role" for issuers' boards of directors, and "foster greater transparency, accountability, and objectivity" in that role."[268] Along the same lines, in approving Nasdaq's application for registration as a national securities exchange, the Commission found Nasdaq's rules governing the

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265 See Dallas, supra note 76, at 1391.

266 See Proxy Disclosure Enhancements, supra note 73, 74 Fed. Reg. at 68,355.

267 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

268 Id. at 64, 175.

independence of members of boards and certain committees to be consistent with Section 6(b)(5) of the Act because they advanced the "interests of shareholders" in "greater transparency, accountability, and objectivity" in oversight and decision-making by corporate boards.[269] Nasdaq proposes to promote accountability in corporate decision-making by requiring companies who do not have at least two Diverse directors on their board to provide investors with a public explanation of the board's reasons for not doing so under Rule 5605(f)(3).

Nasdaq believes it is critical to the detection and prevention of fraudulent and manipulative acts and practices to have directors on the board who are willing to critically question management and air dissenting views. Nasdaq believes that boards comprised of directors from Diverse backgrounds enhance investor confidence by ensuring that board deliberations consider the perspectives of more than one demographic group, leading to robust dialogue and better decision making. However, Nasdaq recognizes that directors may bring diverse perspectives, skills and experiences to the board, notwithstanding that they have similar attributes. Nasdaq therefore believes it is in the public interest to permit a company that chooses not to meet the diversity objectives of Rule 5605(f)(2) to explain why it does not, in accordance with Rule 5605(f)(3)—for example, if it believes that defining diversity more broadly than Nasdaq, for example by considering national origin, veteran status and disabilities, brings a wide range of perspectives and experiences to the board. Nasdaq believes such disclosure will provide investors with a better understanding of the company's philosophy regarding diversity.

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269 See In re Nasdaq Stock Market, 71 Fed. Reg. 3550, 3565 (Jan. 23, 2006). See also 68 Fed. Reg. 18,788, 18,815 (April 16, 2003) (in adopting Rule 10A-3, setting standards for the independence of audit committee members, the Commission concluded that such standards would "enhance the quality and accountability of the financial reporting process and may help increase investor confidence, which implies increased efficiency and competitiveness of the U.S. capital markets").

This would better inform the investment community and enable more informed analyses of, and conversations with, companies. Therefore, Nasdaq believes satisfying Rule 5605(f)(2) through disclosure pursuant to Rule 5605(f)(3) is consistent with Section 6(b)(5) of the Act because it advances the "interests of shareholders" in "greater transparency, accountability, and objectivity" of boards and their decision-making processes.[270] In addition, as discussed further in Section 3.b.II.c (*Promotes Investor Protection and the Public Interest*) below, Nasdaq believes that the proposed diversity requirement could help to reduce information asymmetry, and thereby reduce the risk of insider trading or other opportunistic insider behavior.

c. Promotes Investor Protection and the Public Interest

Nasdaq has found substantial evidence that board diversity is positively associated with more transparent public disclosures and higher quality financial reporting, thereby promoting investor protection. Specifically, studies have concluded that companies with gender-diverse boards are associated with more transparent public disclosures and less information asymmetry, leading to stock prices that better reflect public information. Gul, Srinidhi & Ng (2011) found that "gender diversity improves stock price informativeness by increasing voluntary public disclosures in large firms and increasing the incentives for private information collection in small firms."[271] Bravo and Alcaide-Ruiz (2019) found a positive association between women on the audit committee with financial or accounting expertise and the voluntary disclosure of forward-looking information.[272] Abad et al. (2017) concluded that companies with gender-diverse boards

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270 Id.

271 See Gul et al., supra note 66, at 2.

272 See Bravo and Alcaide-Ruiz, supra note 56, at 151.

are associated with lower levels of information asymmetry, suggesting that "the policies recently implemented in several European countries to increase the presence of female directors in company boards could have beneficial effects on stock markets by reducing the risk of informed trading and enhancing stock liquidity."[273]

Nasdaq believes that one consequence of information asymmetry is that insiders may engage in opportunistic behavior prior to a public announcement of financial results and before the market incorporates the new information into the company's stock price. This can result in unfair gains or an avoidance of losses at the expense of shareholders who did not have access to the same information. This may exacerbate the principal-agent problem, in which the interests of a company's board and shareholders are not aligned. Lucas-Perez et al. (2014) found that board gender diversity is positively associated with linking executive compensation plans to company performance,[274] which may be an effective mechanism to deter opportunistic behavior by management and better align their interests with those of their company's shareholders.[275]

Another concern is that "[w]hen information asymmetry is high, stakeholders do not have sufficient resources, incentives, or access to relevant information to monitor managers' actions, which gives rise to the practice of earnings management."[276] Earnings management "is generally defined as the practice of using discretionary accounting methods to attain desired levels of reported earnings."[277] Manipulating

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273 See Abad et al., supra note 67, at 202.

274 See Lucas-Perez et al., supra note 69.

275 Id.

276 See Vernon J. Richardson, *Information Asymmetry and Earnings Management: Some Evidence*, 15 Rev. Quantitative Fin. and Acct. 325 (2000).

277 See Gull et al., supra note 55, at 2.

earnings is particularly concerning to investors because "[i]f users of financial data are 'misled' by the level of reported income, then investors' allocation of resources may be inappropriate when based on the financial statements provided by management,"[278] thereby undermining the efficacy of the capital formation process for investors who rely on such information to make informed investment and voting decisions.

Gull et al. (2018)[279] observe that overseeing management is a crucial component of investor protection, particularly with regard to earnings management:

> The role of the board of directors and board characteristics (*i.e.* board independence and gender diversity) is usually associated with the protection of shareholder interests…. This role is particularly crucial with regard to the issue of earnings management, in that one of the responsibilities of boards is to monitor management.[280]

The authors of that study found that the presence of female audit committee members with business expertise is associated with a lower magnitude of earnings management. Srinidhi, Gul and Tsui (2011) observed that better oversight of management combined with lower information asymmetry leads to better earnings quality. They noted that "[e]arnings quality is an important outcome of good governance demanded by investors and therefore its improvement constitutes an important objective of the board."[281] They found that companies with women on the board, specifically on the audit committee, exhibit "higher earnings quality" and "better reporting discipline by managers."[282] They concluded that "including female directors on the board and the

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278 Id.

279 See generally id.

280 Id. at 6 (citations omitted).

281 See Srinidhi et al., supra note 50, at 1638.

282 Id. at 1612.

audit committee are plausible ways of improving the firm's reporting discipline and increasing investor confidence in financial statements."[283]

Chen, Eshleman and Soileau (2016) suggested that the relationship between gender diversity and higher earnings quality observed by Srinidhi, Gul and Tsui (2011) is ultimately driven by reduced internal control weaknesses, noting that "prior literature has established a negative relationship between internal control weaknesses and earnings quality."[284] Internal control over financial reporting are procedures designed "to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP."[285] Weaknesses in internal controls can "lead to poor financial reporting quality" and "more severe insider trading"[286] or failure to detect a material misstatement. According to the PCAOB:

> A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.[287]

A material misstatement can occur "as a result of some type of inherent risk, whether fraud or error (*e.g.*, management's aggressive accounting practices, erroneous application of GAAP)."[288] The failure to prevent or detect a material misstatement before financial statements are issued can require the company to reissue its financial statements and potentially face costly shareholder litigation. Chen et al. found that

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283 Id.

284 See Chen et al., supra note 64, at 18.

285 See Public Company Accounting Oversight Board, *Auditing Standard No. 5: Appendix A*, A5 available at: https://pcaobus.org/oversight/standards/archived-standards/details/Auditing_Standard_5_Appendix_A.

286 See Chen et al., supra note 64, at 12.

287 See Public Company Accounting Oversight Board, supra note 285, at A7.

288 See Abbott et al., supra note 58, at 609-10.

having at least one woman on the board (regardless of whether or not she is on the audit committee) "may lead [a] to reduced likelihood of material weaknesses [in internal control over financial reporting],"[289] and Abbott, Parker and Persley (2012) found "a significant association between the presence of at least one woman on the board and a lower likelihood of [a material financial] restatement."[290] Notably, while the Sarbanes-Oxley Act ("SOX") implemented additional measures to ensure that a company has robust internal controls, the findings of Abbott et al. were consistent among a sample of pre- and post-SOX restatements, suggesting that "an additional, beneficial layer of independence in group decision-making is associated with gender diversity."[291]

Nasdaq believes that the proposal to require listed companies to have at least two Diverse directors under Rule 5605(f) could help to lower information asymmetry and reduce the risk of insider trading or other opportunistic insider behavior, which would help to increase stock price informativeness and enhance stock liquidity, thereby protecting investors and promoting capital formation and efficiency. Nasdaq believes that information asymmetry could also be reduced by permitting companies to satisfy Rule 5605(f)(2) by publicly disclosing their reasons for not meeting its diversity objectives in accordance with Rule 5605(f)(3), because the requirement will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, which will further protect investors and promote capital formation and efficiency.

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289 See Chen et al., supra note 64, at 18.

290 See Abbott et al., supra note 58, at 607.

291 Id. at 609.

Moreover, Nasdaq believes that proposed Rule 5605(f) could foster more transparent public disclosures, higher quality financial reporting, and stronger internal control over financial reporting and mechanisms to monitor management. This could be particularly beneficial for Smaller Reporting Companies that are not subject to the SOX 404(b) requirement to obtain an independent auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting, thereby promoting investor protection.

Nasdaq believes that the body of research on the relationship between economic performance and board diversity summarized under Section 3.a.II.a above provides substantial evidence supporting the conclusion that board diversity does not have adverse effects on company financial performance, and therefore Nasdaq believes the proposal will not negatively impact capital formation, competition or efficiency among its public companies.[292] Nasdaq considered that some studies on gender diversity alone have had mixed results,[293] and that the U.S. GAO (2015) and Carter et al. (2010) concluded that the mixed results are due to differences in methodologies, data samples and time periods.[294] This is not the first time Nasdaq has considered whether, on balance, various

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292 See Alexandre Di Miceli and Angela Donaggio, *Women in Business Leadership Boost ESG Performance: Existing Body of Evidence Makes Compelling Case*, 42 International Finance Corporation World Bank Group, Private Sector Opinion at 11 n.15 (2018), available at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/private+sector+opinion/women+in+business+leadership+boost+esg+performance ("The overwhelming majority of empirical studies conclude that a higher ratio of women in business leadership does not impair corporate performance (virtually all studies find positive or non-statistically significant results)"). See also Wahid, supra note 59, at 6 (suggesting that "at a minimum, gender diversity on corporate boards has a neutral effect on governance quality, and at best, it has positive consequences for boards' ability to monitor firm management").

293 See, e.g., Pletzer et al., supra note 38; Post and Byron, supra note 39; Adams and Ferreira, supra note 42.

294 See GAO Report, supra note 44, at 5 ("Some research has found that gender diverse boards may have a positive impact on a company's financial performance, but other research has not. These mixed results depend, in part, on differences in how financial performance was defined and what

studies finding mixed results related to board composition and company performance are sufficient rationale to propose a listing rule. For example, in 2003, notwithstanding the mixed results of studies regarding the relationship between company performance and board independence,[295] Nasdaq adopted listing rules requiring a majority independent board that were "intended to enhance investor confidence in the companies that list on Nasdaq."[296] In its Approval Order, the SEC noted that "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets;" the Commission concluded that the independence rules would secure an "objective oversight role" for issuers' boards, and "foster greater transparency, accountability, and objectivity" in that role.[297] Nasdaq believes this reasoning applies to the current proposed rule as well. Even without clear consensus among studies related to board diversity and company performance, the heightened focus on corporate board diversity by investors demonstrates that investor confidence is undermined when data on board diversity is not readily available and when companies do not explain the reasons for the apparent absence of diversity on their boards.[298] Legislators are increasingly taking action to encourage corporations to diversify their boards and improve diversity disclosures.[299] Moreover, during its discussions with stakeholders, Nasdaq found

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methodologies were used"); Carter (2010), supra note 40, at 400 (observing that the different "statistical methods, data, and time periods investigated vary greatly so that the results are not easily comparable.").

295 See supra note 45.

296 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

297 Id. at 64,176.

298 See supra notes 4 and 8.

299 See supra note 112.

consensus across every constituency that there is inherent value in board diversity. Lastly, it has been a longstanding principle that "Nasdaq stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process."[300]

For all the foregoing reasons, Nasdaq believes that proposed Rule 5605(f) will promote investor protection and the public interest by enhancing investor confidence that all listed companies are considering diversity in the context of selecting directors, either by including at least two Diverse directors on their boards or by explaining their rationale for not meeting that objective. To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2), Nasdaq believes that the proposal will provide investors with additional disclosure about the company's reasons for doing so under Rule 5605(f)(3). For example, the company may choose to disclose that it does not meet the diversity objectives of Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to satisfy that diversity objective instead. On the other hand, many firms may strive to achieve even greater diversity than the objectives set forth in our proposed rule. Nasdaq believes that providing such flexibility and clear disclosure where the company determines to follow a different path will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, thereby promoting capital formation and efficiency, and further promoting the public interest.

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300 See Nasdaq Rulebook, Rule 5101.

d. Not Designed to Permit Unfair Discrimination between Customers, Issuers, Brokers, or Dealers

Nasdaq believes that proposed Rule 5605(f) is not designed to permit unfair discrimination among companies because it requires all companies subject to the rule to have at least two Diverse directors or explain why they do not. Further, the proposal requires at least one of the two Diverse directors to be an individual who self-identifies as Female. While the proposal provides different requirements for the second Diverse director among Smaller Reporting Companies, Foreign Issuers and other companies, Nasdaq believes that the rule is not designed to permit unfair discrimination among companies. In all cases, a company can choose to meet the diversity objectives of the entire rule or to satisfy only certain elements of the rule. Further, the proposed rule does not limit board sizes—if a board chooses to nominate a Diverse individual to the board to meet the diversity objectives of the proposed rule, it is not precluded from also nominating a non-Diverse director for an additional board seat.

i. Rule 5605(f)(2)(B): Foreign Issuers

Similar to all other companies subject to Rule 5605(f), the proposal requires all Foreign Issuers to have, or explain why they do not have, at least two Diverse directors, including one director who self-identifies as Female. However, Nasdaq proposes to provide Foreign Issuers with additional flexibility with regard to the second Diverse director. Foreign Issuers could satisfy the second director objective by including another Female director, or an individual who self-identifies as LGBTQ+ or as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. While the proposal provides a different requirement for the second Diverse director for Foreign

Issuers, Nasdaq believes it is not designed to permit unfair discrimination between Foreign Issuers and other companies because it recognizes that the unique demographic composition of the United States, and its historical marginalization of Underrepresented Minorities and the LGBTQ+ community, may not extend to all countries outside of the United States. Further, Nasdaq believes that it is challenging to apply a consistent definition of minorities to all countries globally because "[t]here is no internationally agreed definition as to which groups constitute minorities."[301] Similarly, "there is no universally accepted international definition of indigenous peoples."[302] Rather, the United Nations *Declaration on the Rights of Indigenous Peoples* recognizes "that the situation of indigenous peoples varies from region to region and from country to country and that the significance of national and regional particularities and various historical and cultural backgrounds should be taken into consideration."[303] Accordingly, Nasdaq believes that it is not unfairly discriminatory to allow an alternative mechanism for Foreign Issuers to satisfy Rule 5605(f)(2) in recognition that the U.S.-based EEOC definition of Underrepresented Minorities is not appropriate for every Foreign Issuer. In addition, Foreign Issuers have the ability to satisfy Rule 5605(f)(2)(B) by explaining that they do not satisfy this alternative definition. Similarly, any company that is not a

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301 See United Nations, *Minority Rights: International Standards and Guidance for Implementation* 2 (2010), available at: https://www.ohchr.org/Documents/Publications/MinorityRights_en.pdf. See also G.A. Res. 47/135. art. 1.1 (Dec. 18, 1992) ("States shall protect the existence and the national or ethnic, cultural, religious and linguistic identity of minorities within their respective territories and shall encourage conditions for the promotion of that identity."). The preamble to the Declaration also "[r]eaffirm[s] that one of the basic aims of the United Nations, as proclaimed in the Charter, is to promote and encourage respect for human rights and for fundamental freedoms for all, without distinction as to race, sex, language or religion."

302 See United Nations, *Minority Rights*, supra note 301, at 3.

303 See G.A. Res. 61/295 (Sept. 13, 2007).

Foreign Issuer, but that prefers the alternative definition available for Foreign Issuers, could follow Rule 5605(f)(2)(B) and disclose its reasons for doing so.

Under the proposal, Foreign Issuer means (a) a Foreign Private Issuer (as defined in Rule 5005(a)(19)) or (b) a company that (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Act, and (ii) has its principal executive offices located outside of the United States. For example, a company that is considered a "foreign issuer" under Rule 3b-4(b) under the Act and has its principal executive offices located in Ireland would qualify as a Foreign Issuer for purposes of Rule 5605(f)(2), even if it is not considered a Foreign Private Issuer under Nasdaq or SEC rules.

Nasdaq recognizes that Foreign Issuers may be located in jurisdictions that impose privacy laws limiting or prohibiting self-identification questionnaires, particularly as they relate to race or ethnicity. In such countries, a company may not be able to determine each director's self-identified Diverse attributes due to restrictions on the collection of personal information. The company may instead publicly disclose pursuant to Rule 5605(f)(3) that "Due to privacy laws in the company's home country jurisdiction limiting its ability to collect information regarding a director's self-identified Diverse attributes, the company is not able to determine that it has two Diverse directors as set forth under Rule 5605(f)(2)(B)(ii)."

ii. Rule 5605(f)(2)(C): Smaller Reporting Companies

While the proposal provides a different requirement for the second Diverse director for Smaller Reporting Companies, Nasdaq believes that this distinction is not designed to permit unfair discrimination among companies. Nasdaq has designed the proposed rule to ensure it does not have a disproportionate economic impact on Smaller

Reporting Companies by imposing undue costs or burdens. Nasdaq recognizes that Smaller Reporting Companies, especially pre-revenue companies that depend on the capital markets to fund ground-breaking research and technological advancements, may not have the resources to compensate an additional director or engage a search firm to find director candidates outside of the directors' traditional networks. Nasdaq believes that this is a reasonable basis to distinguish Smaller Reporting Companies from other companies subject to the rule.

Smaller Reporting Companies already are provided certain exemptions from Nasdaq's listing rules. For example, under Rule 5605(d)(3), Smaller Reporting Companies must have a compensation committee comprised of at least two independent directors and a formal written compensation committee charter or board resolution that specifies the committee's responsibilities and authority, but such companies are not required to grant authority to the committee to retain or compensate consultants or advisors or consider certain independence factors before selecting such advisors, consistent with Rule 10C-1 of the Act.[304] In its approval order, the SEC concluded as follows:

> The Commission believes that these provisions are consistent with the Act and do not unfairly discriminate between issuers. The Commission believes that, for similar reasons to those for which Smaller Reporting Companies are exempted from the Rule 10C-1 requirements, it makes sense for Nasdaq to provide some flexibility to Smaller Reporting Companies regarding whether the compensation committee's responsibilities should be set forth in a formal charter or through board resolution. Further . . . in view of the potential additional costs of an annual review, it is reasonable not to require a Smaller Reporting Company to conduct an annual assessment of its charter or board resolution.[305]

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304 See Nasdaq Rulebook, Rule 5605(d)(3).

305 See Order Granting Accelerated Approval of Proposed Rule Change, 78 Fed. Reg. 4,554, 4,567 (Jan. 22, 2013).

The Commission also makes accommodations for Smaller Reporting Companies based on their more limited resources, allowing them to comply with scaled disclosure requirements in certain SEC reports rather than the more rigorous disclosure requirements for larger companies. For example, Smaller Reporting Companies are not required to include a compensation discussion and analysis in their proxy or Form 10-K describing the material elements of the compensation of its named executive officers.[306] Eligible Smaller Reporting Companies also are relieved from the SOX 404(b) requirement to obtain an independent auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting.[307] In each case, companies may choose to comply with the more rigorous requirements in lieu of relying on the exemptions.

Any company that is not a Smaller Reporting Company, but prefers the alternative rule available for Smaller Reporting Companies, could follow Rule 5605(f)(2)(C) and disclose their reasons for doing so. As such, Nasdaq believes that the proposed alternative rule for Smaller Reporting Companies is not designed to, and does not, unfairly discriminate among companies. Lastly, Nasdaq believes that Rule 5605(f)(2)(C) is not designed to permit unfair discrimination among companies because it requires Smaller Reporting Companies to have at least one director who self-identifies as Female, similar to other companies subject to Rule 5065(f).

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306 See 17 C.F.R. § 229.402(l).

307 See Accelerated Filer and Large Accelerated Filer Definitions, 85 Fed. Reg. 17,178 (March 26, 2020).

iii. Rule 5605(f)(3): Public Disclosure of Non-Diverse Board

Under proposed Rule 5605(f)(3), if a company determines not to meet the diversity objectives of Rule 5605(f) in its entirety, it must specify the applicable requirements of the Rule and explain its reasons for not having at least two Diverse directors. Nasdaq designed the proposal to avoid unduly burdening competition or efficiency, or conflicting with existing securities laws, by providing all companies subject to Rule 5605(f) with the option to make the public disclosure required under Rule 5605(f)(3) in the company's proxy statement or information statement for its annual meeting of shareholders or, alternatively on the company's website, provided that the company submits a URL link to such disclosure to Nasdaq through the Listing Center no later than 15 calendar days after the company's annual shareholder meeting. Nasdaq believes Rule 5605(f)(3) is not designed to permit unfair discrimination among companies because the proposed rule provides all companies subject to Rule 5605(f) the option to disclose an explanation rather than meet the diversity objectives of Rule 5605(f)(2).

Certain federal securities laws similarly permit companies to satisfy corporate governance requirements through disclosure of reasons for not meeting the applicable requirement. For example, under Regulation S-K, Item 407 requires a company to disclose whether or not its board of directors has determined that the company has at least one audit committee financial expert. If a company does not have a financial expert on the audit committee, it must provide an explanation.[308] Item 406 requires a company to disclose whether it has adopted a written code of ethics that applies to the chief executive

308 See 17 C.F.R. § 229.407(d)(5).

officer and senior financial or accounting officers. If a company has not adopted such a code of ethics, it must disclose the reasons why not.[309] Item 402 regarding pay ratio disclosure defines how total compensation for employees should be calculated, but permits companies to use a different measure as long as they explain their approach.[310]

Furthermore, Nasdaq rules and SEC guidance already recognize that website disclosure can be a method of disseminating information to the public. For example, Nasdaq listing rules permit companies to provide website disclosures related to third party director compensation,[311] foreign private issuer home country practices,[312] and reliance on the exception relating to independent compensation committee members.[313] The SEC has recognized that "[a] company's web site is an obvious place for investors to find information about the company"[314] and permits companies to make public disclosure of material information through website disclosures if, among other things, the company's website is "a recognized channel of distribution of information."[315]

iv. Rule 5605(f)(4): Exempt Companies

Under proposed Rule 5605(f)(4), Nasdaq proposes to exempt the following types of companies from the requirements of Rule 5605(f) (defined as "Exempt Companies"): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive

309 Id. § 229.406(a).

310 Id. § 229.402.

311 See Nasdaq Rulebook, Rule 5250(b)(3)(A).

312 Id., Rule 5615(a)(3)(B) and IM-5615-3.

313 Id., Rules 5605(d)(2)(B) (non-independent compensation committee member under exceptional and limited circumstances) and 5605(e)(3) (non-independent nominations committee member under exceptional and limited circumstances).

314 See Commission Guidance on the Use of Company Websites, 73 Fed. Reg. 45,862, 45,864 (Aug. 7, 2008).

315 Id. at 45,867.

issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. Each of the types of Exempt Companies either has no board of directors, lists only securities with no voting rights towards the election of directors, or is not an operating company, and the holders of the securities they issue do not expect to have a say in the composition of their boards. As such, Nasdaq believes the proposal is not designed to permit unfair discrimination by excluding Exempt Companies from the application of proposed Rule 5605(f). These companies already are exempt from certain of Nasdaq's corporate governance standards related to board composition, as described in Rule 5615.

v. Rule 5605(f)(5): Phase-in Period

Proposed Rule 5605(f)(5)(A) will allow any newly listing company that was not previously subject to a substantially similar requirement of another national securities exchange one year from the date of listing to satisfy the requirements of Rule 5605(f). Proposed Rule 5605(f)(5)(B) also will allow any company that ceases to be a Foreign Issuer, a Smaller Reporting Company or an Exempt Company one year from the date that the company no longer qualifies as a Foreign Issuer, a Smaller Reporting Company or an Exempt Company, respectively, to satisfy the requirements of Rule 5605(f). This phase-in period will apply after the end of the transition period provided in Rule 5605(f)(7).

Nasdaq believes this approach is not designed to permit unfair discrimination because it provides all companies that become newly subject to the rule the same time

period within which to comply. In addition, this approach is similar to other phase-in periods granted to companies listing on or transferring to Nasdaq. For example, Rule 5615(b)(1) provides a company listing in connection with its initial public offering one year to fully comply with the compensation and nomination committee requirements of Rules 5605(d) and (e), and the majority independent board requirement of Rule 5605(b). Similarly, SEC Rule 10A-3(b)(1)(iv)(A) allows a company up to one year from the date its registration statement is effective to fully comply with the applicable audit committee composition requirements. Nasdaq Rule 5615(b)(3) provides a one-year timeframe for compliance with the board composition requirements for companies transferring from other listed markets that do not have a substantially similar requirement.

vi. Rule 5605(f)(7): Effective Dates/Transition

Under proposed Rule 5605(f)(7), each company must have, or explain why it does not have, one Diverse director no later than two calendar years after the Approval Date,[316] and two Diverse directors no later than (i) four calendar years after the Approval Date for companies listed on the NGS or NGM tiers, or (ii) five calendar years after the Approval Date for companies listed on the NCM tier.

Nasdaq believes this approach is not designed to permit unfair discrimination because it recognizes that companies listed on the Nasdaq Capital Market may not have the resources necessary to compensate an additional director or engage a search firm to search for director candidates outside of the directors' traditional networks. Therefore, Nasdaq believes it is in the public interest to provide such companies with one additional year to meet the diversity objectives of Rule 5605(f), should they choose to do so.

316 The "Approval Date" is the date that the SEC approves the proposed rule.

Nasdaq notes that all companies may choose to follow a timeframe applicable to a different market tier, provided they publicly describe their explanation for doing so. They also may construct their own timeframe for meeting the diversity objectives of Rule 5605(f), provided they publicly disclose their reasons for not abiding by Nasdaq's timeframe.

e. Not Designed to Regulate by Virtue of any Authority Conferred by the Act Matters Not Related to the Purposes of the Act or the Administration of the Exchange

Nasdaq believes that the proposal is not designed to regulate by virtue of any authority conferred by the Act matters not related to the purposes of the Act or the administration of the Exchange.[317] The proposal relates to the Exchange's corporate governance standards for listed companies. As discussed above, "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets."[318] And because "it is not always feasible to define . . . every practice which is inconsistent with the public interest or with the protection of investors," the Act leaves to SROs "the necessary work" of rulemaking pursuant to Section 6(b)(5).[319]

Nasdaq recognizes that U.S. states are increasingly proposing and adopting board diversity requirements, and because corporations are creatures of state law, some market participants may believe that such regulation is best left to states. However, Nasdaq considered that certain of its listing rules related to corporate governance currently relate to areas that are also regulated by states. For example, states impose standards related to

317 See 15 U.S.C. § 78f(b)(5).

318 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

319 See Heath v. SEC, 586 F.3d 122, 132 (2d Cir. 2009) (citing Avery v. Moffat, 55 N.Y.S.2d 215, 228 (Sup. Ct. 1945)).

quorums[320] and shareholder approval of certain transactions,[321] which also are regulated under Nasdaq's listing rules.[322] Nasdaq has adopted rules relating to such matters to ensure uniformity of such rules among its listed companies. Similarly, Nasdaq believes that the proposed rule will create uniformity among listed companies by helping to assure investors that all non-exempt companies have at least two Diverse directors on their board or publicly describe why they do not.

Further, Nasdaq believes the proposal will enhance investor confidence that listed companies that have two Diverse directors are considering the perspectives of more than one demographic group, leading to robust dialogue and better decision making, as well as the other corporate governance benefits of diverse boards discussed above in Section 3.a.II. To the extent companies choose to disclose their reasons for not meeting the diversity objectives of Rule 5605(f)(2) pursuant to Rule 5605(f)(3), Nasdaq believes that such disclosure will improve the quality of information available to investors who rely on this information to make an informed voting decision, thereby promoting capital formation and efficiency. It has been the Exchange's longstanding principle that "Nasdaq stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process."[323]

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320 See, e.g., 8 Del. Code § 216 (providing that a quorum at a shareholder's meeting shall consist of no less than 1/3 of the shares entitled to vote at such meeting).

321 See, e.g., id. §§ 251, 271 (providing that shareholder approval by a majority of the outstanding voting shares entitled to vote is required for mergers and the sale of all or substantially all of a corporation's assets).

322 See, e.g., Nasdaq Rulebook, Rules 5620(c) and 5635(a).

323 Id., Rule 5101.

In addition, as discussed in Section 3.a.I, in passing Section 342 of the Dodd-Frank Act, Congress recognized the need to respond to the lack of diversity in the financial services industry, and the Standards designed by the Commission and other financial regulators provide a framework for addressing that industry challenge. The Standards themselves identify several focus areas, including the importance of "Organizational Commitment," which speaks to the critical role of senior leadership—including boards of directors—in promoting diversity and inclusion across an organization. In addition, like the proposed rule, the Standards also consider "Practice to Promote Transparency," and recognize that transparency is a key component of any diversity initiative. Specifically, the Standards provide that the "transparency of an entity's diversity and inclusion program promotes the objectives of Section 342," and also is important because it provides the public with necessary information to assess an entity's diversity policies and practices.[324]

4. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq reviewed requirements related to board diversity in two dozen foreign jurisdictions, and almost every jurisdiction imposes diversity-focused requirements on listed companies, either through a securities exchange, financial regulator or the government. Nasdaq competes for listings globally, including in countries that have implemented a more robust regulatory reporting framework for diversity and ESG disclosures. Currently in the U.S., the Long Term Stock Exchange ("LTSE"), which

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[324] Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, 80 Fed. Reg. 33,016 (June 10, 2015).

includes a number of sponsors which have investment businesses, has communicated to institutional investors that it that it seeks to distinguish itself by focusing on corporate governance, including, for example, diversity and inclusion. Under Rule 14.425, companies listed on LTSE must adopt and publish a long-term stakeholder policy that explains, among other things, "the Company's approach to diversity and inclusion."[325]

I. Board Statistical Disclosure

The Exchange does not believe that proposed Rule 5606 will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the Exchange believes that the adoption of Rule 5606 will not impose any undue burden on competition among listed companies for the reasons set forth below.

With a few exceptions, all companies would be required to make the same disclosure of their board-level statistical information. The average board size of a company that is currently listed on the Exchange is eight directors. Although a company would be required to disclose its board-level statistical data, directors may choose to opt out rather than reveal their diversity characteristics to their company. A company would identify such directors in the "Undisclosed" category. For directors who voluntarily disclose their diversity characteristics, the company would collect their responses and disclose the information in either the company's proxy statement, information statement of shareholder meeting or on the company's website, using Nasdaq's required format. While the time and economic burden may vary based on a company's board size, Nasdaq does not believe there is any significant burden associated with gathering, preparing and

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325 See Long-Term Stock Exchange Rule Book, Rule 14.425.

reporting this data. Therefore, Nasdaq believes that there will be a *de minimis* time and economic burden on listed companies to collect and disclose the diversity statistical data.

Some investors value demographic diversity, and list it as an important factor influencing their director voting decisions.[326] Investors have stated that consistent data would make its collection and analysis easier and more equitable for investors that are not large enough to demand or otherwise access individualized disclosures.[327] Therefore, Nasdaq believes that any burden placed on companies to gather and disclose their board-level diversity statistics is counterbalanced by the benefits that the information will provide to a company's investors.

Moreover, as discussed above, most listed companies are required to submit an annual EEO-1 Report, which provides statistical data related to race and gender data among employees similar to the data required under proposed Rule 5606(a). Because most companies are already collecting similar information annually to satisfy their EEOC requirement, Nasdaq does not believe that adding directors to the collection will place a significant burden on these companies. Additionally, the information requested from Foreign Issuers is limited in scope and therefore does not impose a significant burden on them.

Nasdaq faces competition in the market for listing services. Proposed Rule 5606 reflects that competition, but it does not impose any burden on competition with other exchanges. As discussed above, investors have made clear their desire for greater transparency into public companies' board-level diversity as it relates to gender identity, race, and ethnicity. Nasdaq believes that the proposed rule will enhance the competition

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326 See Hunt et al., supra note 26.

327 See Petition for Rulemaking, supra note 123, at 2.

for listings. Other exchanges can set similar requirements for their listed companies, thereby increasing competition to the benefit of those companies and their shareholders. Accordingly, Nasdaq does not believe the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

II. Diverse Board Representation or Explanation

Nasdaq believes that proposed Rule 5605(f) will not impose burdens on competition among listed companies because the Exchange has constructed a framework for similarly-situated companies to satisfy similar requirements (*i.e.*, Foreign Issuers, Smaller Reporting Companies and other companies), and has provided all companies with the choice of satisfying the requirements of Rule 5605(f)(2) by having at least two Diverse directors, or by explaining why they do not. Nasdaq believes that this will avoid imposing undue costs or burdens on companies that, for example, cannot afford to compensate an additional director or believe it is not appropriate, feasible or desirable to meet the diversity objectives of Rule 5605(f) based on the company's particular circumstances (for example, the company's size, operations or current board composition). Rather than requiring a company to divert resources to compensate an additional director, and place the company at a competitive disadvantage with its peers, the rule provides the flexibility for such company to explain why it does not meet the diversity objective.

The cost of identifying director candidates can range from nothing or a nominal fee (via personal, work or school-related networks, or board affinity organizations, as well as internal research by the corporate secretary's team) to amounts that can vary

widely depending on the specific search firm and the size of the company. Some industry observers estimate board searches for independent directors cost about one-third of a director's annual compensation, while others estimate it costs between $75,000 and $150,000. The underlying figures vary; for example, one search firm generally charges $25,000 to $50,000. Nasdaq observes that total annual director compensation can range widely; median director pay is estimated at $134,000 for Russell 3000 companies and $232,000 for S&P 500 companies. Moreover, there is a wider range of underlying compensation amounts. For example, Russell 3000 directors may receive approximately $32,600 (10th percentile), or up to $250,000 (90th percentile) or more. S&P 500 directors may receive approximately $100,000 (10th percentile) or up to $310,000 (90th percentile) or more.[328] Most, if not all, of these costs would be borne in any event in the search for new directors regardless of the proposed rule. While the proposed rule might lead some companies to search for director candidates outside of already established networks, the incremental costs of doing so would be tied directly to the benefit of a broader search.

To reduce costs for companies that do not currently meet the diversity objectives of Rule 5605(f)(2), Nasdaq is proposing to provide listed companies that have not yet met their diversity objectives with free access to a network of board-ready diverse candidates and a tool to support board evaluation, benchmarking and refreshment. This offering is designed to ease the search for diverse nominees and reduce the costs on companies that choose to meet the diversity objectives of Rule 5605(f)(2). Nasdaq is contemporaneously

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328 Total annual director compensation varies by compensation elements and structure as well as amount, which is generally based on the size, sector, maturity of the company, and company specific situation. See Mark Emanuel et al., Semler Brossy and the Conference Board, *Director Compensation Practices in the Russell 3000 and S&P 500* (2020 ed.), available at https://conferenceboard.esgauge.org/directorcompensation/report.

submitting a rule filing to the Commission regarding the provision of such services. Nasdaq also plans to publish FAQs on its Listing Center to provide guidance to companies on the application of the proposed rules, and to establish a dedicated mailbox for companies and their counsel to email additional questions to Nasdaq regarding the application of the proposed rule. Nasdaq believes that these services will help to ease the compliance burden on companies whether they choose to meet the listing rule's diversity objectives or provide an explanation for not doing so.

Nasdaq also has structured the proposed rule to provide companies with at least four years from the Approval Date to satisfy Rule 5605(f)(2) so that companies do not incur immediate costs striving to meet the diversity objectives of Rule 5605(f)(2). Nasdaq also has reduced the compliance burden on Smaller Reporting Companies and Foreign Issuers by providing them with additional flexibility when satisfying the requirement related to the second Diverse director. Smaller Reporting Companies could satisfy the proposed diversity objective to have two Diverse directors under Rule 5605(f)(2)(C) with two Female directors. Like other companies, Smaller Reporting Companies also could satisfy the second director objective by including an individual who self-identifies as an Underrepresented Minority or a member of the LGBTQ+ community. Foreign Issuers could satisfy the second director objective by including another Female director, or an individual who self-identifies as LGBTQ+ or an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. Nasdaq has further reduced the compliance burdens on companies listed on the Nasdaq Capital Market tier by providing them with five years from the Approval Date to satisfy Rule

5605(f)(2), recognizing that such companies may face additional challenges and resource constraints when identifying additional director nominees who self-identify as Diverse.

For the foregoing reasons, Nasdaq does not believe that proposed Rule 5605(f) will impose any burden on competition among issuers that is not necessary or appropriate in furtherance of the purposes of the Act. Further, Nasdaq does not believe the proposed rule will impose any burden on competition among listing exchanges. As described above, Nasdaq competes with other exchanges globally for listings, including exchanges based in jurisdictions that have implemented disclosure requirements related to diversity. Within the United States, LTSE requires listed companies to adopt and publish a long-term stakeholder policy that explains, among other things, "the Company's approach to diversity and inclusion."[329] Other listing venues within the United States may propose to adopt rules similar to LTSE's requirements or the Exchange's proposal if they believe companies would prefer to list on an exchange with diversity-related listing standards.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

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329 See Long-Term Stock Exchange Rule Book, Rule 14.425.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of Proposed Rule Change for publication in the Federal Register.

3. Disclosure Template - Instructions.

5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-NASDAQ-2020-081)

December__, 2020

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1], and Rule 19b-4 thereunder,[2] notice is hereby given that on December 1, 2020, The Nasdaq Stock Market LLC ("Nasdaq" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt listing rules related to board diversity, as described in more detail below:

(i) to adopt Rule 5605(f) (Diverse Board Representation), which would require Nasdaq-listed companies, subject to certain exceptions, (A) to have at least one director who self-identifies as a female, and (B) to 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

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1 15 U.S.C. § 78s(b)(1).

2 17 C.F.R. § 240.19b-4.

LGBTQ+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the categories listed above;

(ii) to adopt Rule 5606 (Board Diversity Disclosure), which would require Nasdaq-listed companies, subject to certain exceptions, 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+; and

(iii) to update Rule 5615 and IM-5615-3 (Foreign Private Issuers) and Rule 5810(c) (Types of Deficiencies and Notifications) to incorporate references to proposed Rule 5605(f) and Rule 5606; and

(iv) to make certain other non-substantive conforming changes.

The text of the proposed rule change is available on the Exchange's Website at https://listingcenter.nasdaq.com/rulebook/nasdaq/rules, at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

I. The Diversity Imperative for Corporate Boards

Over the past year, the social justice movement has brought heightened attention to the commitment of public companies to diversity and inclusion. Controversies arising from corporate culture and human capital management challenges, as well as technology-driven changes to the business landscape, already underscored the need for enhanced board diversity—diversity in the boardroom is good corporate governance. The benefits to stakeholders of increased diversity are becoming more apparent and include an increased variety of fresh perspectives, improved decision making and oversight, and strengthened internal controls. Nasdaq believes that the heightened focus on corporate board diversity by companies,[3] investors,[4] corporate governance organizations,[5] and legislators[6] demonstrates that investor confidence is

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3 See Deloitte and the Society for Corporate Governance, *Board Practices Quarterly: Diversity, equity, and inclusion* (Sept. 2020), available at: https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/diversity-equity-and-inclusion.html (finding, in a survey of over 200 companies, that "most companies and/or their boards have taken, or intend to take, actions in response to recent events surrounding racial inequality and inequity; 71% of public companies and 65% of private companies answered this question affirmatively").

4 See ISS Governance, *2020 Global Benchmark Policy Survey, Summary of Results* 6 (Sept. 24, 2020), available at: https://www.issgovernance.com/wp-content/uploads/publications/2020-iss-policy-survey-results-report-1.pdf (finding that "a significant majority of investors (61 percent) indicated that boards should aim to reflect the company's customer base and the broader societies in which they operate by including directors drawn from racial and ethnic minority groups").

5 See International Corporate Governance Network, *ICGN Guidance on Diversity on Boards* 5 (2016), available at: https://www.icgn.org/sites/default/files/ICGN%20Guidance%20on%20Diversity%20on%20Boards%20-%20Final.pdf ("The ICGN believes that diversity is a core attribute of a well-functioning board which supports greater long-term value for shareholders and companies.").

6 See, e.g., John J. Cannon et al., Sherman & Sterling LLP, *Washington State Becomes Next to Mandate Gender Diversity on Boards* (May 28, 2020), available at: https://www.shearman.com/perspectives/2020/05/washington-state-becomes-next-to-mandate-gender-diversity-on-boards; Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept. 30, 2020)

enhanced when boardrooms are comprised of more than one demographic group. Nasdaq has also observed recent calls from SEC commissioners[7] and investors[8] for companies to provide more transparency regarding board diversity.

Nasdaq conducted an internal study of the current state of board diversity among Nasdaq-listed companies based on public disclosures, and found that while some companies already have made laudable progress in diversifying their boardrooms, the national market system and the public interest would best be served by an additional regulatory impetus for companies to embrace meaningful and multi-dimensional diversification of their boards. It also found that current reporting of board diversity data was not provided in a consistent manner or on a

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(California legislation requiring companies headquartered in the state to have at least one director who self-identifies as a Female and one from an Underrepresented Community).

7 See Commissioner Allison Herren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence* (Aug. 26, 2020), available at: https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26#_ftnref15 ("There is ever-growing recognition of the importance of diversity from all types of investors . . . [a]nd large numbers of commenters on this [SEC] rule proposal emphasized the need for specific diversity disclosure requirements."); see also Commissioner Caroline Crenshaw, *Statement on the "Modernization" of Regulation S-K Items 101, 103, and 105* (August 26, 2020), available at: https://www.sec.gov/news/public-statement/crenshaw-statement-modernization-regulation-s-k ("As Commissioner Lee noted in her statement, the final [SEC] rule is also silent on diversity, an issue that is extremely important to investors and to the national conversation. The failure to grapple with these issues is, quite simply, a failure to modernize."); Mary Jo White, *Keynote Address, International Corporate Governance Network Annual Conference: Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability* (June 27, 2016), available at: https://www.sec.gov/news/speech/chair-white-icgn-speech.html ("Companies' disclosures on board diversity in reporting under our current requirements have generally been vague and have changed little since the rule was adopted… Our lens of board diversity disclosure needs to be re-focused in order to better serve and inform investors.").

8 See Vanguard, *Investment Stewardship 2019 Annual Report* (2019), available at: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019_investment_stewardship_annual_report.pdf ("We want companies to disclose the diversity makeup of their boards on dimensions such as gender, age, race, ethnicity, and national origin, at least on an aggregate basis."); see also State Street Global Advisors, *Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies* (Aug. 27, 2020) https://www.ssga.com/us/en/individual/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies (announcing expectation that State Street's portfolio companies (including US companies "and, to the greatest extent possible, non-US companies") provide board level "[d]iversity characteristics, including racial and ethnic makeup, of the board of directors").

sufficiently widespread basis. As such, investors are not able to readily compare board diversity statistics across companies.

Accordingly, Nasdaq is proposing to require each of its listed companies, subject to certain exceptions, to: (i) provide statistical information regarding diversity among the members of the company's board of directors under proposed Rule 5606; and (ii) have, or explain why it does not have, at least two "Diverse" directors on its board under proposed rule 5605(f)(2). "Diverse" means a director who self-identifies as: (i) Female, (ii) an Underrepresented Minority, or (iii) LGBTQ+. Each listed company must have, or explain why it does not have, at least one Female director and at least one director who is either an Underrepresented Minority or LGBTQ+. Foreign Issuers (including Foreign Private Issuers) and Smaller Reporting Companies, by contrast, have more flexibility and may satisfy the requirement by having two Female directors. "Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth. "Underrepresented Minority" means, consistent with the categories reported to the Equal Employment Opportunity Commission ("EEOC") through the Employer Information Report EEO-1 Form ("EEO-1 Report"), an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities. "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.

Under proposed Rule 5606, Nasdaq proposes to provide each company with one calendar year from the date that the Commission approves this proposal (the

"Approval Date") to comply with the requirement for statistical information regarding diversity. Under proposed Rule 5605(f)(2), no later than two calendar years after the Approval Date, each company must have, or explain why it does not have, one Diverse director. Further, each company must have, or explain why it does not have, two Diverse directors no later than: (i) four calendar years after the Approval Date for companies listed on the Nasdaq Global Select or Global Market tiers; or (ii) five calendar years after the Approval Date for companies listed on the Nasdaq Capital Market tier.

Nasdaq undertook extensive research and analysis and has concluded that the proposal will fulfill the objectives of the Act in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, to prevent fraudulent and manipulative acts and practices, and to protect investors and the public interest. In addition to conducting its own internal analysis as described above, Nasdaq reviewed a substantial body of third-party research and interviewed leaders representing a broad spectrum of market participants and other stakeholders to:

- determine whether empirical evidence demonstrates an association between board diversity, shareholder value, investor protection and board decision-making;
- understand investors' interest in, and impediments to obtaining, information regarding the state of board diversity at public companies;
- review the current state of board diversity and disclosure, both among Nasdaq-listed companies and more broadly within the U.S.;
- gain a better understanding of the causes of underrepresentation on boards;
- obtain the views of leaders representing public companies, investment banks, corporate governance organizations, investors, regulators and civil rights groups on the value of more diverse corporate boards, and on various approaches to encouraging more diversity on corporate boards; and

- evaluate the success of approaches taken by exchanges, regulators, and governments in both the U.S. and foreign jurisdictions to remedy underrepresentation on boards.

While gender diversity has improved among U.S. company boards in recent years, the pace of change has been gradual, and the U.S. still lags behind other jurisdictions that have imposed requirements related to board diversity. **Moreover, progress toward bringing underrepresented racial and ethnic groups into the boardroom has been even slower**. Nasdaq is unable to provide definitive estimates regarding the number of listed companies that will be affected by the proposal due to the inconsistent disclosures and definitions of diversity across companies and the extremely limited disclosure of race and ethnicity information – an information gap the proposed rule addresses. Based on the limited information that is available, Nasdaq believes a supermajority of listed companies have made notable strides to improve gender diversity in the boardroom and have at least one woman on the board. Nasdaq also believes that listed companies are diligently working to add directors with other diverse attributes, although consistent with other studies of U.S. companies, Nasdaq believes the pace of progress, in this regard, is happening more gradually. While studies suggest that current candidate selection processes may result in diverse candidates being overlooked, Nasdaq also believes that the lack of reliable and consistent data creates a barrier to measuring and improving diversity in the boardroom.

Nasdaq reviewed dozens of empirical studies and found that an extensive body of academic research demonstrates that diverse boards are positively associated with improved corporate governance and financial performance. For example, as discussed in detail below in *Section II, Academic Research: The Relationship between Diversity and Shareholder Value, Investor Protection and Decision Making***,**

studies have found that companies with gender-diverse boards or audit committees are associated with: more transparent public disclosures and less information asymmetry; better reporting discipline by management; a lower likelihood of manipulated earnings through earnings management; an increased likelihood of voluntarily disclosing forward-looking information; a lower likelihood of receiving audit qualifications due to errors, non-compliance or omission of information; and a lower likelihood of securities fraud. In addition, studies found that having at least one woman on the board is associated with a lower likelihood of material weaknesses in internal control over financial reporting and a lower likelihood of material financial restatements. Studies also identified positive relationships between board diversity and commonly used financial metrics, including higher returns on invested capital, returns on equity, earnings per share, earnings before interest and taxation margin, asset valuation multiples and credit ratings.

Nasdaq believes there are additional compelling reasons to support the diversification of company boards beyond a link to improved corporate governance and financial performance:

- Investors are calling in greater numbers for diversification of boardrooms. Vanguard, State Street Advisors, BlackRock, and the NYC Comptroller's Office include board diversity expectations in their engagement and proxy voting guidelines.[9] The heightened investor focus on corporate diversity and inclusion

[9] Vanguard announced in 2020 it would begin asking companies about the race and ethnicity of directors. See Vanguard, *Investment Stewardship 2020 Annual Report* (2020), available at: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2020_investment_stewardship_annual_report.pdf. Starting in 2020, State Street Global Advisors will vote against the entire nominating committee of companies that do not have at least one woman on their boards and have not addressed questions on gender diversity within the last three years. See State Street Global Advisors, *Summary of Material Changes to State Street Global Advisors' 2020 Proxy Voting and Engagement Guidelines* (2020), available at: https://www.ssga.com/library-content/pdfs/global/proxy-voting-and-engagement-guidelines.pdf.

efforts demonstrates that investor confidence is undermined when a company's boardroom is homogenous and when transparency about such efforts is lacking. Investors frequently lack access to information about corporate board diversity that could be material to their decision making, and they might divest from companies that fail to take into consideration the demographics of their corporate stakeholders when they refresh their boards. Nasdaq explores these investor sentiments in *Section III, Current State of Board Diversity and Causes of Underrepresentation on Boards*.

- Nasdaq believes, consistent with SEC disclosure requirements in other contexts,[10] that management's vision on key issues impacting the company should be communicated with investors in a clear and straightforward manner. Indeed, transparency is the bedrock of federal securities laws regarding disclosure, and this sentiment is reflected in the broad-based support for uniform disclosure requirements regarding board diversity that Nasdaq observed during the course of its outreach to the industry. In addition, organizational leaders representing every

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Beginning in 2018, BlackRock stated in proxy voting guidelines they "would normally expect to see at least 2 women directors on every board." See BlackRock Investment Stewardship, *Corporate governance and proxy voting guidelines for U.S. securities* (Jan. 2020), available at: https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. The NYC Comptroller's Office in 2019 asked companies to adopt policies to ensure women and people of color are on the initial list for every open board seat. See Scott M. Stringer, *Remarks at the Bureau of Asset Management 'Emerging Managers and MWBE Managers Conference* (Oct. 11, 2019), available at: https://comptroller.nyc.gov/wp-content/uploads/2019/10/10.11.19-SMS-BAM-remarks_distro.pdf.

[10] See Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, 68 Fed. Reg. 75,056 (Dec. 29, 2003) ("We believe that management's most important responsibilities include communicating with investors in a clear and straightforward manner. MD&A is a critical component of that communication. The Commission has long sought through its rules, enforcement actions and interpretive processes to elicit MD&A that not only meets technical disclosure requirements but generally is informative and transparent."); see also Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Release No. 33-10890 (Nov. 19, 2020) (citing the 2003 MD&A Interpretative Release and stating that the purpose of the MD&A section is to enable investors to see a company "through the eyes of management").

category of corporate stakeholders Nasdaq spoke with (including business, investor, governance, regulatory and civil rights communities) were overwhelmingly in favor of diversifying boardrooms. Nasdaq summarizes the findings of its stakeholder outreach in *Section IV, Stakeholder Perspectives.*

- Legislators at the federal and state level increasingly are taking action to encourage or mandate corporations to diversify their boards and improve diversity disclosures. Congress currently is considering legislation requiring each SEC-registered company to provide board diversity statistics and disclose whether it has a board diversity policy. To date, eleven states have passed or proposed legislation related to board diversity.[11] SEC regulations require companies to disclose whether diversity is considered when identifying director nominees and, if so, how. Nasdaq explores various state and federal initiatives in *Section V, U.S. Regulatory Framework and Section VI, Nasdaq Proposal***.**

In considering the merits and shaping the substance of the proposed listing rule, Nasdaq also sought and received valuable input from corporate stakeholders. During those discussions, Nasdaq found consensus across every constituency in the inherent value of board diversity. Business leaders also expressed concern that companies – and particularly smaller companies – would prefer an approach that allows flexibility to comply in a manner that fits their unique circumstances and stakeholders. Nasdaq recognizes that the operations, size, and current board composition of each Nasdaq-listed company are unique, and Nasdaq therefore endeavored to provide a

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[11] See Michael Hatcher and Weldon Latham, *States are Leading the Charge to Corporate Boards: Diversify!*, Harv. L. Sch. Forum on Corp. Governance (May 12, 2020), available at: https://corpgov.law.harvard.edu/2020/05/12/states-are-leading-the-charge-to-corporate-boards-diversify/.

regulatory impetus to enhance board diversity that balances the need for flexibility with each company's particular circumstances.

The Exchange also considered the experience of its parent company, Nasdaq, Inc., as a public company.[12] In 2002, Nasdaq, Inc. met the milestone of welcoming its first woman, Mary Jo White, who later served as SEC Chair, to its board of directors. In her own words, "I was the first and only woman to serve on the board when I started, but, happily, I was joined by another woman during my tenure…And then there were two. Not enough, but better than one."[13] In 2019, Nasdaq, Inc. also welcomed its first Black director. As a Charter Pledge Partner of The Board Challenge, Nasdaq supports The Board Challenge's goal of "true and full representation on all boards of directors."[14]

As a self-regulatory organization, Nasdaq also is cognizant of its role in advancing diversity within the financial industry, as outlined in the Commission's diversity standards issued pursuant to Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Standards").[15] Authored jointly by the Commission and five other financial regulators, the Standards seek to provide a

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12 While the Exchange recognizes that it is only one part of an ecosystem in which multiple stakeholders are advocating for board diversity, that part is meaningful: the United Nations Sustainable Stock Exchanges Initiative, of which Nasdaq, Inc., is an official supporter, recognized that "[s]tock exchanges are uniquely positioned to influence their market in a way few other actors can." See United Nations Sustainable Stock Exchanges Initiative, *How Stock Exchanges Can Advance Gender Equality* 2 (2017), available at: https://sseinitiative.org/wp-content/uploads/2019/12/How-stock-exchanges-can-advance-gender-equality.pdf.

13 See Mary Jo White, Completing the Journey: Women as Directors of Public Companies (Sept. 16, 2014), available at: https://www.sec.gov/news/speech/2014-spch091614-mjw#.VBiLMhaaXDo.

14 See The Board Challenge, https://theboardchallenge.org/. See also Nasdaq, Inc., *Notice of 2020 Annual Meeting of Shareholders and Proxy Statement* 52 (Mar. 31, 2020), available at: https://ir.nasdaq.com/static-files/ce5519d4-3a0b-48ac-8441-5376ccbad4e5 (Nasdaq, Inc. believes that "[d]iverse backgrounds lead to diverse perspectives. We are committed to ensuring diverse backgrounds are represented on our board and throughout our organization to further the success of our business and best serve the diverse communities in which we operate.").

15 See Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, 80 Fed. Reg. 33,016 (June 10, 2015).

framework for exchanges and financial services organizations "to create and strengthen [their] diversity policies and practices." Through these voluntary Standards, the Commission and other regulators "encourage each entity to use the[] Standards in a manner appropriate to its unique characteristics."[16] To that end, the proposed rule leverages the Exchange's unique ability to influence corporate governance in furtherance of the goal of Section 342, which is to address the lack of diversity in the financial services industry.[17] Finally, while the Exchange recognizes the importance of maximizing shareholder value, its role as a listing venue is to establish and enforce substantive standards that promote investor protection. As a self-regulatory organization, the Exchange must demonstrate to the Commission that any proposed rule is consistent with Section 6(b) of the Act because, among other things, it is designed to protect investors, promote the public interest, prevent fraudulent and manipulative acts and practices, and remove impediments to the mechanism of a free and open market. The Exchange must also balance promoting capital formation, efficiency, and competition, among other things, alongside enhancing investor confidence.

With these objectives in mind, Nasdaq believes that a listing rule designed to enhance transparency related to board diversity will increase consistency and comparability of information across Nasdaq-listed companies, thereby increasing transparency and decreasing information collection costs. Nasdaq further believes that a listing rule designed to encourage listed companies to increase diverse representation on their boards will result in improved corporate governance, thus strengthening the integrity of the market, enhancing capital formation, efficiency, and

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16 Id. at 33,023.

17 156 Cong. Rec. H5233-61 (June 30, 2010).

competition, and building investor confidence. To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2), Nasdaq believes that the proposal will provide investors with additional transparency through disclosure explaining the company's reasons for not doing so. For example, the company may choose to disclose that it does not meet the diversity objectives of Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to meet that standard instead, or has a board philosophy regarding diversity that differs from the diversity objectives set forth in Rule 5605(f)(2). Nasdaq believes that such disclosure will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, thereby promoting capital formation and efficiency.

Nasdaq observed that studies suggest that certain groups may be underrepresented on boards because the traditional director nomination process is limited by directors looking within their own social networks for candidates with previous C-suite experience.[18] Leaders from across the spectrum of stakeholders with whom Nasdaq spoke reinforced the notion that if companies recruit by skill set and expertise rather than title, they will find there is more than enough diverse talent to satisfy demand. In order to assist companies that strive to meet the diversity objectives of Rule 5605(f)(2), Nasdaq is proposing to provide listed companies that have not yet met its diversity objectives with free access to a network of board-ready diverse candidates and a tool to support board evaluation, benchmarking and refreshment. Nasdaq is contemporaneously submitting a rule filing to the Commission regarding the provision of

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[18] See infra Section III.

such services. Nasdaq also plans to publish FAQs on its Listing Center to provide guidance to companies on the application of the proposed rules, and to establish a dedicated mailbox for companies and their counsel to email additional questions to Nasdaq regarding the application of the proposed rule. Nasdaq believes that these services will help to ease the compliance burden on companies whether they choose to meet the listing rule's diversity objectives or provide an explanation for not doing so.

II. Academic Research: The Relationship between Diversity and Shareholder Value, Investor Protection and Decision Making

A company's board of directors plays a critical role in formulating company strategy; appointing, advising and overseeing management; and protecting investors. Nasdaq has recognized the importance of varied perspectives on boards since 2003, when the Exchange adopted a listing rule intended to enhance investor confidence by requiring listed companies, subject to certain exceptions and cure periods, to have a majority independent board.[19] Accompanying the rule are interpretive materials recognizing that independent directors "play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to *maximize shareholder value* in the Companies they oversee and guard against conflicts of interest."[20]

a. Diversity and Shareholder Value

There is a significant body of research suggesting a positive association between diversity and shareholder value.[21] In the words of SEC Commissioner Allison Herren

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19 See Nasdaq Stock Market Rulebook, Rules 5605(b), 5615(a), and 5605(b)(1)(A).

20 Id., IM-5605-1 (emphasis added).

21 Some companies recently have expressed the belief that a company must consider the impact of its activities on a broader group of stakeholders beyond shareholders. See Business Roundtable, *Statement on the Purpose of a Corporation* (Aug. 19, 2019), available at:

Lee: "to the extent one seeks economic support for diversity and inclusion (instead of requiring economic support for the lack of diversity and exclusion), the evidence is in."[22]

The Carlyle Group (2020) found that its portfolio companies with two or more diverse directors had average earnings growth of 12.3% over the previous three years, compared to 0.5% among portfolio companies with no diverse directors, where diverse directors were defined as female, Black, Hispanic or Asian.[23] "After controlling for industry, fund, and vintage year, companies with diverse boards generate earnings growth that's five times faster, on average, with each diverse board member associated with a 5% increase in annualized earnings growth."[24]

Several other studies also found a positive association between diverse boards and company performance. FCLTGlobal (2019) found that "the most diverse boards (top 20 percent) added 3.3 percentage points to [return on invested capital], as compared to their least diverse peers (bottom 20 percent)."[25] McKinsey (2015) found that "companies in the top quartile for racial/ethnic diversity were 35 percent more likely to have financial

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https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationOctober2020.pdf. Commentators articulated this view as early as 1932. See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145, 1153 (1932).

22 See Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More: Remarks at the Council of Institutional Investors Fall 2020 Conference* (September 22, 2020), available at: https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

23 See Jason M. Thomas and Megan Starr, The Carlyle Group, *Global Insights: From Impact Investing to Investing for Impact* 5 (Feb. 24, 2020), available at: https://www.carlyle.com/sites/default/files/2020-02/From%20Impact%20Investing%20to%20Investing%20for%20Impact_022420.pdf (analyzing Carlyle U.S. portfolio company data, February 2020).

24 Id.

25 See FCLTGlobal, *The Long-term Habits of a Highly Effective Corporate Board* 11 (March 2019), available at: https://www.fcltglobal.org/wp-content/uploads/long-term-habits-of-highly-effective-corporate-boards.pdf (analyzing 2017 MSCI ACWI constituents from 2010 to 2017 using Bloomberg data).

returns above their national industry median."[26] Carter, Simkins and Simpson (2003) found among Fortune 1000 companies "statistically significant positive relationships between the presence of women or minorities on the board and firm value."[27] Bernile, Bhagwat and Yonker (2017) found that greater diversity on boards—including gender, ethnicity, educational background, age, financial expertise and board experience—is associated with increased operating performance, higher asset valuation multiples, lower stock return volatility, reduced financial leverage, increased dividend payouts to shareholders, higher investment in R&D and better innovation.[28] The authors observed that "[t]his is in line with the results in Carter, Simkins, and Simpson (2003), which show a positive association between local demographic diversity and firm value."[29]

Several studies have found a positive association between gender diversity and financial performance. Credit Suisse (2014) found companies with at least one woman on the board had an average sector-adjusted return on equity ("ROE") of 12.2%, compared to 10.1% for companies with no female directors, and average sector-adjusted ROEs of 14.1% and 11.2%, respectively, for the previous nine years.[30] MSCI (2016)

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26 See Vivian Hunt et al., McKinsey & Company, *Diversity Matters* (February 2, 2015), available at: https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/why%20diversity%20matters/diversity%20matters.pdf (analyzing 366 public companies in the United Kingdom, Canada, the United States, and Latin America in industries for the years 2010 to 2013, using the ethnic and racial categories African ancestry, European ancestry, Near Eastern, East Asian, South Asian, Latino, Native American, and other).

27 See David A. Carter et al., *Corporate Governance, Board Diversity, and Firm Value*. 38(1) Fin. Rev. 33 (analyzing 638 Fortune 1000 firms in 1997, measuring firm value by Tobin's Q, with board diversity defined as the percentage of women, African Americans, Asians and Hispanics on the board of directors).

28 See Gennaro Bernile et al., *Board Diversity, Firm Risk, and Corporate Policies* (March 6, 2017), available at: https://ssrn.com/abstract=2733394 (analyzing 21,572 firm-year observations across non-financial, non-utility firms for the years 1996 to 2014, based on the ExecuComp, RiskMetrics, Compustat and CRSP databases).

29 Id. at 32.

30 See Credit Suisse, *The CS Gender 3000: Women in Senior Management* 16 (Sept. 2014), available at: https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/the-

found that U.S. companies with at least three women on the board in 2011 experienced median gains in ROE of 10% and earnings per share ("EPS") of 37% over a five year period, whereas companies that had no female directors in 2011 showed median changes of -1% in ROE and -8% in EPS over the same five-year period.[31] Catalyst (2011) found that the ROE of Fortune 500 companies with at least three women on the board (in at least four of five years) was 46% higher than companies with no women on the board, and return on sales and return on invested capital was 84% and 60% higher, respectively.[32]

Credit Suisse (2016) found an association between LGBTQ+ diversity and stock performance, finding that a basket of 270 companies "supporting and embracing LGBT employees" outperformed the MSCI ACWI index by an average of 3.0% per year over the past 6 years.[33] Further, "[a]gainst a custom basket of companies in North America, Europe and Australia, the LGBT 270 has outperformed by 140 bps annually."[34] Nasdaq acknowledges that this study focused on LGBTQ+ employees as opposed to directors,

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cs-gender-3000-women-in-senior-management.pdf (analyzing 3,000 companies across 40 countries from the period from 2005 to 2013).

31 See Meggin Thwing Eastman et al., MSCI, *The tipping point: Women on boards and financial performance* 3 (December 2016), available at: https://www.msci.com/documents/10199/fd1f8228-cc07-4789-acee-3f9ed97ee8bb (analyzing of U.S. companies that were constituents of the MSCI World Index for the entire period from July 1, 2011 to June 30, 2016).

32 See Harvey M. Wagner, Catalyst, *The Bottom Line: Corporate Performance and Women's Representation on Boards (2004–2008)* (March 1, 2011), available at: https://www.catalyst.org/research/the-bottom-line-corporate-performance-and-womens-representation-on-boards-2004-2008/ (analyzing gender diversity data from Catalyst's annual Fortune 500 Census of Women Board Directors report series for the years 2005 to 2009, and corresponding financial data from S&P's Compustat database for the years 2004 to 2008).

33 See Credit Suisse ESG Research, *LGBT: the value of diversity* 1 (April 15, 2016), available at: https://research-doc.credit-suisse.com/docView?language=ENG&source=emfromsendlink&format=PDF&document_id=807075590&extdocid=807075590_1_eng_pdf&serialid=evu4wNcHexx7kusNLaZQphUkT9naxi1PvptZQvPjr1k%3d.

34 Id.

and that there is a lack of published research on the issue of LGBTQ+ representation on boards. However, Out Leadership (2019) suggests that the relationship between board gender diversity and corporate performance may extend to LGBTQ+ diversity:

> While the precise reason for the positive correlation between gender diversity and better corporate performance is unknown, many of the reasons that gender diversity is considered beneficial are also applicable to LGBT+ diversity. LGBT+ diversity in the boardroom may create a dynamic that enables better decisionmaking, and it brings to the boardroom the perspective of a community that is a critical component of the company's consumer population and organizational talent.[35]

McKinsey (2020) found "a positive, statistically significant correlation between company financial outperformance and [board] diversity, on the dimensions of both gender and ethnicity," with companies in the top quartile for board gender diversity "28 percent more likely than their peers to outperform financially," and a statistically significant correlation between board gender diversity and outperformance on earnings before interest and taxation margin.[36] Moody's (2019) found that greater board gender diversity is associated with higher credit ratings, with women accounting for an average of 28% of board seats at Aaa-rated companies but less than 5% of board seats at Ca-rated companies.[37]

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35 See Quorum, *Out Leadership's LGBT+ Board Diversity and Disclosure Guidelines* 3 (2019), available at: https://outleadership.com/content/uploads/2019/01/OL-LGBT-Board-Diversity-Guidelines.pdf.

36 See McKinsey & Company, *Diversity wins: How inclusion matters* 13 (May 2020), available at: https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Diversity%20and%20Inclusion/Diversity%20wins%20How%20inclusion%20matters/Diversity-wins-How-inclusion-matters-vF.pdf (analyzing 1,039 companies across 15 countries for the period from December 2018 to November 2019).

37 See Moody's Investors Service, *Gender diversity is correlated with higher ratings, but mandates pose short-term risk* 2 (Sept. 11, 2019), available at: https://www.moodys.com/research/Moodys-Corporate-board-gender-diversity-associated-with-higher-credit-ratings--PBC_1193768 (analyzing 1,109 publicly traded North American companies rated by Moody's).

While the overwhelming majority of studies on the association between economic performance and board diversity, including gender diversity, present a compelling case that board diversity is positively associated with financial performance, the results of some other studies on gender diversity are mixed. For example, Pletzer et al. (2015) found that board gender diversity alone has a "small and non-significant" relationship with a company's financial performance.[38] Post and Byron (2014) found a "near zero" relationship with a company's market performance, but a positive relationship with a company's accounting returns.[39] Carter, D'Souza, Simkins and Simpson (2010) found that "[w]hen Tobin's Q is used as the measure of financial performance, we find no relationship to gender diversity or ethnic minority diversity, neither positive nor negative."[40] A study conducted by Campbell and Minguez-Vera (2007) "suggests, at a minimum, that increased gender diversity can be achieved without destroying shareholder value."[41] Adams and Ferreira (2009) found that "gender diversity has beneficial effects

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38 See Jan Luca Pletzer et al., *Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Performance – A Meta-Analysis* 1, PLOS One (June 18, 2015); see also Alice H. Eagly (2016), *When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?*, 72 J. Social Issues 199 (2016), available at https://doi.org/10.1111/josi.12163 (concluding that the "research findings are mixed, and repeated meta-analyses have yielded average correlational findings that are null or extremely small" with respect to board gender diversity and company performance).

39 See Corinne Post and Kris Byron, *Women on Boards and Firm Financial Performance: A Meta-Analysis* 1 (2014). In 2016, the same authors, based on a review of the results for 87 studies, "found that board gender diversity is weakly but significantly positively correlated with [corporate social responsibility]," although they noted that "a significant correlational relationship does not prove causality." See Corinne Post and Kris Byron, *Women on Boards of Directors and Corporate Social Performance: A Meta-Analysis*, 24(4) Corp. Governance: An Int'l Rev. 428 (July 2016), available at http://dx.doi.org/10.1111/corg.12165.

40 See David A. Carter et al., *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance*, 18(5) Corp. Governance 396, 410 (2010) (analysis of 541 S&P 500 companies for the years 1998-2002).

41 See Kevin Campbell and Antonio Minguez-Vera, *Gender Diversity in the Boardroom and Firm Financial Performance*, 83(3) J. Bus. Ethics 13 (Feb. 2008) (analyzing 68 non-financial companies listed on the continuous market in Madrid during the period from January 1995 to December 2000, measuring firm value by an approximation of Tobin's Q defined as the sum of the market value of stock and the book value of debt divided by the book value of total assets).

in companies with weak shareholder rights, where additional board monitoring could enhance firm value, but detrimental effects in companies with strong shareholder rights."[42] Carter et al. (2010)[43] and the U.S. Government Accountability Office ("GAO") (2015)[44] concluded that the mixed nature of various academic studies may be due to differences in methodologies, data samples and time periods.

While there are studies drawing different conclusions, Nasdaq believes that there is a compelling body of credible research on the association between economic performance and board diversity. At a minimum, Nasdaq believes that the academic studies support the conclusion that board diversity does not have adverse effects on company financial performance. This is not the first time Nasdaq has considered whether, on balance, various studies finding mixed results related to board composition and company performance are a sufficient rationale to propose a listing rule. For example, in 2003, notwithstanding the varying findings of studies at the time regarding the relationship between company performance and board independence,[45] Nasdaq

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42 See Renee B. Adams and Daniel Ferreira, *Women in the boardroom and their impact on governance and performance*, 94 J. Fin. Econ. 291 (2009) (analyzing 1,939 S&P 500, S&P MidCaps, and S&P SmallCap companies for the period 1996 to 2003, measuring company performance by a proxy for Tobin's Q (the ratio of market value to book value) and return on assets).

43 See Carter et al., supra note 40, at 400 (observing that the different "statistical methods, data, and time periods investigated vary greatly so that the results are not easily comparable.").

44 See United States Government Accountability Office, Report to the Ranking Member, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, House of Representatives, *Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements* 5 (Dec. 2015) (the "GAO Report"), available at: https://www.gao.gov/assets/680/674008.pdf ("Some research has found that gender diverse boards may have a positive impact on a company's financial performance, but other research has not. These mixed results depend, in part, on differences in how financial performance was defined and what methodologies were used").

45 See, e.g., Benjamin E. Hermalin and Michael S. Weisbach, *The Effects of Board Composition and Direct Incentives on Firm Performance*, 20 Fin. Mgmt. 101, 111 (1991) (finding that "there appears to be no relation between board composition and performance"); Sanjai Bhagat and Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*,

adopted listing rules requiring a majority independent board that were "intended to enhance investor confidence in the companies that list on Nasdaq."[46] In its Approval Order, the SEC stated that "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets."[47]

Along the same lines, even without clear consensus among studies related to board diversity and company performance, the heightened focus on corporate board diversity by investors demonstrates that investor confidence is undermined when data on board diversity is not readily available and when companies do not explain the reasons for the apparent absence of diversity on their boards. Therefore, Nasdaq believes that the proposal will enhance investor confidence that all listed companies are considering diversity in the context of selecting directors, either by including at least two Diverse directors on their boards or by explaining their rationale for not meeting that objective. Further, Nasdaq believes that the proposal is consistent with the Act because it will not negatively impact capital formation, competition or efficiency among its public companies, and will promote investor protection and the public interest.[48]

54(3) Bus. Law. 921, 950 (1999) ("At the very least, there is no convincing evidence that increasing board independence, relative to the norms that currently prevail among large American firms, will improve firm performance. And there is some evidence suggesting the opposite—that firms with supermajority-independent boards perform worse than other firms, and that firms with more inside than independent directors perform about as well as firms with majority- (but not supermajority-) independent boards.").

46 See Order Approving Proposed Rule Changes, 68 Fed. Reg. 64,154, 64,161 (Nov. 12, 2003) (approving SR-NASD-2002-77, SR-NASD-2002-80, SR-NASD-2002-138, SR-NASD-2002-139, and SR-NASD-2002-141).

47 Id. at 64,176.

48 See also Lee, supra note 22 ("I could never quite buy in to the view that some 40 percent of the population in our country (if we're talking about minorities) or over half the country (if we're talking about women) must rationalize their inclusion in corporate boardrooms and elsewhere in economic terms instead of the reverse. How can one possibly justify—in economic terms—the systematic exclusion of a major portion of our talent base from the corporate pool?").

b. Diversity and Investor Protection

There is substantial evidence that board diversity enhances the quality of a company's financial reporting, internal controls, public disclosures and management oversight. In reaching this conclusion, Nasdaq evaluated the results of more than a dozen studies spanning more than two decades that found a positive association between gender diversity and important investor protections, and the assertions by some academics that such findings may extend to other forms of diversity, including racial and ethnic diversity. The findings of the studies reviewed by Nasdaq are summarized below.

Adams and Ferreira (2009) found that women are "more likely to sit on" the audit committee,[49] and a subsequent study by Srinidhi, Gul and Tsui (2011) found that companies with women on the audit committee are associated with "higher earnings quality" and "better reporting discipline by managers,"[50] leading the authors to conclude that "including female directors on the board and the audit committee are plausible ways of improving the firm's reporting discipline and increasing investor confidence in financial statements."[51]

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49 See Adams and Ferreira, supra note 42, at 292.

50 See Bin Srinidhi et al., *Female Directors and Earnings Quality*, 28(5) Contemporary Accounting Research 1610, 1612-16 (Winter 2011) (analyzing 3,132 firm years during the period from 2001 to 2007 based on S&P COMPUSTAT, Corporate Library's Board Analyst, and IRRC databases; "choos[ing] the accruals quality as the metric that best reflects the ability of current earnings to reflect future cash flows" (noting that it "best predicts the incidence and magnitude of fraud relative to other commonly used measures of earnings quality") and analyzing surprise earnings results that exceeded previous earnings or analyst forecasts, because "managers of firms whose unmanaged earnings fall marginally below the benchmarks have [an] incentive to manage earnings upwards so as to meet or beat previous earnings").

51 Id. at 1612.

A study conducted in 2016 by Pucheta-Martínez et al. concluded that gender diversity on the audit committee "improves the quality of financial information."[52] They found that "the percentage of females on [audit committees] reduces the probability of [audit] qualifications due to errors, non-compliance or the omission of information,"[53] and found a positive association between gender diverse audit committees and disclosing audit reports with uncertainties and scope limitations. This suggests that gender diverse audit committees "ensure that managers do not seek to pressure auditors into issuing a clean opinion instead of a qualified opinion" when any uncertainties or scope limitations are identified.[54]

More recently, a study by Gull in 2018 found that the presence of female audit committee members with business expertise is associated with a lower magnitude of earnings management,[55] and a study conducted in 2019 by Bravo and Alcaide-Ruiz found a positive association between women on the audit committee with financial or accounting expertise and the voluntary disclosure of forward-looking information.[56] Bravo and Alcaide-Ruiz concluded that "female [audit committee] members with

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52 See Maria Consuelo Pucheta-Martínez et al., *Corporate governance, female directors and quality of financial information.* 25(4) Bus. Ethics: A European Rev. 363, 378 (2016) (analyzing a sample of non-financial companies listed on the Madrid Stock Exchange during 2004-2011).

53 Id. at 363.

54 Id. at 368.

55 See Ammar Gull et al., *Beyond gender diversity: How specific attributes of female directors affect earnings management*, 50(3) British Acct. Rev. 255 (Sept. 2017), available at: https://ideas.repec.org/a/eee/bracre/v50y2018i3p255-274.html (analyzing 394 French companies belonging to the CAC All-Shares index listed on Euronext Paris from 2001 to 2010, prior to the implementation of France's gender mandate law that required women to comprise 20% of a company's board of directors by 2014 and 40% by 2016).

56 See Francisco Bravo and Maria Dolores Alcaide-Ruiz, *The disclosure of financial forward-looking information*, 34(2) Gender in Mgmt. 140, 142-44 (2019) (analyzing companies included in the S&P 100 Index in 2016, "focus[ing] on the disclosure of financial forward-looking information (which is likely to require financial expertise), such as earnings forecasts, expected revenues, anticipated cash flows or any other financial indicator").

financial expertise play an important role in influencing disclosure strategies that provide forward-looking information containing projections and financial data useful for investors."[57]

While the above studies demonstrate a positive association between gender diverse audit committees and the quality of a company's earnings, financial information and public disclosures, other studies found a positive association between board gender diversity and important investor protections regardless of whether or not women are on the audit committee.

Abbott, Parker & Persley (2012) found, within a sample of non-Fortune 1000 companies, "a significant association between the presence of at least one woman on the board and a lower likelihood of [a material financial] restatement."[58] Their findings are consistent with a subsequent study by Wahid (2017), which concluded that "gender-diverse boards commit fewer financial reporting mistakes and engage in less fraud."[59] Specifically, companies with female directors have "fewer irregularity-type [financial]

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57 Id. at 150.

58 See Lawrence J. Abbott et al., *Female Board Presence and the Likelihood of Financial Restatement*, 26(4) Accounting Horizons 607, 626 (2012) (analyzing a sample of 278 pre-SOX annual financial restatements and 187 pre-SOX quarterly financial restatements of U.S. companies from January 1, 1997 through June 30, 2002 identified by the U.S. General Accounting Office restatement report 03-138 (which only included "material misstatements of financial results"), and 75 post-SOX annual financial restatements from July 1, 2002, to September 30, 2005 identified by U.S. General Accounting Office restatement report 06-678 (which only included "restatements that were being made to correct material misstatements of previously reported financial information"), consisting almost exclusively of non-Fortune 1000 companies).

59 See Aida Sijamic Wahid, The *Effects and the Mechanisms of Board Gender Diversity: Evidence from Financial Manipulation*, J. Bus. Ethics (forthcoming) (Dec. 2017) Rotman School of Management Working Paper No. 2930132 at 1, available at: https://ssrn.com/abstract=2930132 (analyzing 6,132 U.S. public companies during the period from 2000 to 2010, for a total of 38,273 firm-year observations).

restatements, which tend to be indicative of financial manipulation."[60] Wahid suggested that the implications of her study extend beyond gender diversity:

> If you're going to introduce perspectives, those perspectives might be coming not just from male versus female. They could be coming from people of different ages, from different racial backgrounds . . . [and] [i]f we just focus on one, we could be essentially taking away from other dimensions of diversity and decreasing perspective.[61]

Cumming, Leung and Rui (2015) also examined the relationship between gender diversity and fraud, and found that the presence of women on boards is associated with a lower likelihood of securities fraud; indeed, they found "strong evidence of a negative and diminishing effect of women on boards and the probability of being in our fraud sample."[62] The authors suggested that "other forms of board diversity, including but not limited to gender diversity, may likewise reduce fraud."[63]

Chen, Eshleman and Soileau (2016) suggested that the relationship between gender diversity and higher earnings quality observed by Srinidhi, Gul and Tsui (2011) is ultimately driven by reduced weaknesses in internal control over financial reporting, noting that "prior literature has established a negative relationship between internal control weaknesses and earnings quality."[64] The authors found that having at least one

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60 Id. at 23.

61 See Barbara Shecter, *Diverse boards tied to fewer financial 'irregularities,' Canadian study finds*. Financial Post (Feb. 5, 2020), https://business.financialpost.com/news/fp-street/diverse-boards-tied-to-fewer-financial-irregularities-canadian-study-finds (last accessed Nov. 27, 2020).

62 See Douglas J. Cumming et al., *Gender Diversity and Securities Fraud*, Academy of Management Journal 34 (forthcoming) (Feb. 2, 2015), available at https://ssrn.com/abstract=2562399 (analyzing China Securities Regulatory Commission data from 2001 to 2010, including 742 companies with enforcement actions for fraud, and 742 non-fraudulent companies for a control group).

63 Id. at 33.

64 See Yu Chen et al., *Board Gender Diversity and Internal Control Weaknesses*, 33 Advances in Acct. 11 (2016) (analyzing a sample of 4267 firm-year observations during the period from 2004 to 2013, beginning "the first year internal control weaknesses were required to be disclosed under section 404 of SOX").

woman on the board (regardless of whether or not she is on the audit committee) "may lead to [a] reduced likelihood of material weaknesses [in internal control over financial reporting]."[65]

Board gender diversity also was found to be positively associated with more transparent public disclosures. Gul, Srinidhi & Ng (2011) concluded that "gender diversity improves stock price informativeness by increasing voluntary public disclosures in large firms and increasing the incentives for private information collection in small firms."[66] Abad et al. (2017) concluded that companies with gender diverse boards are associated with lower levels of information asymmetry, suggesting that increasing board gender diversity is associated with "reducing the risk of informed trading and enhancing stock liquidity."[67]

Other studies have found that diverse boards are better at overseeing management. Adams and Ferreira (2009) found "direct evidence that more diverse boards are more likely to hold CEOs accountable for poor stock price performance; CEO turnover is more sensitive to stock return performance in firms with relatively more women on boards."[68] Lucas-Perez et al. (2014) found that board gender diversity is positively associated with

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65 Id. at 18.

66 See Ferdinand A. Gul et al., *Does board gender diversity improve the informativeness of stock prices?*, 51(3) J. Acct. & Econ. 314 (April 2011) (analyzing 4,084 firm years during the period from 2002 to 2007, excluding companies in the utilities and financial industries, measuring public information disclosure using "voluntary continuous disclosure of 'other' events in 8K reports" and measuring stock price informativeness by "idiosyncratic volatility," or volatility that cannot be explained to systematic factors and can be diversified away).

67 See David Abad et al., *Does Gender Diversity on Corporate Boards Reduce Information Asymmetry in Equity Markets?* 20(3) BRQ Business Research Quarterly 192, 202 (July 2017) (analyzing 531 company-year observations from 2004 to 2009 of non-financial companies traded on the electronic trading platform of the Spanish Stock Exchange (SIBE)).

68 See Adams and Ferreira, supra note 42, at 292.

linking executive compensation plans to company performance,[69] which may be an effective mechanism to deter opportunistic behavior by management and align their interests with shareholders.[70] A lack of diversity has been found to have the opposite effect. Westphal and Zajac (1995) found that "increased demographic similarity between CEOs and the board is likely to result in more generous CEO compensation contracts."[71]

c. Diversity and Decision Making

Wahid (2017) suggests that "at a minimum, gender diversity on corporate boards has a neutral effect on governance quality, and at best, it has positive consequences for boards' ability to monitor firm management."[72] Nasdaq reviewed studies suggesting that board diversity can indeed enhance a company's ability to monitor management by reducing "groupthink" and improving decision making.

In 2009, the Commission, in adopting rules requiring proxy disclosure describing whether a company considers diversity in identifying director nominees, recognized the impact of diversity on decision making and corporate governance:

> A board may determine, in connection with preparing its disclosure, that it is beneficial to disclose and follow a policy of seeking diversity. Such a policy may encourage boards to conduct broader director searches, evaluating a wider range of candidates and potentially improving board quality. To the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management and are, consequently, more independent. To the extent that a more independent board is desirable at a particular company, the resulting increase in board independence could potentially improve governance. In addition, in some companies a policy of increasing board diversity may also improve the board's decision making process by encouraging consideration of a broader range of

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69 See Maria Encarnacion Lucas-Perez et al., *Women on the Board and Managers' Pay: Evidence from Spain*, 129 J. Bus. Ethics 285 (April 2014).

70 Id.

71 See James D. Westphal and Edward J. Zajac, *Who Shall Govern? CEO/Board Power, Demographic Similarity, and New Director Selection*, 40(1) Admin. Sci. Q. 60, 77 (March 1995).

72 See Wahid, supra note 59, at 5.

views.[73]

Nasdaq agrees with the Commission's suggestion that board diversity improves board quality, governance and decision making. Nasdaq is concerned that boards lacking diversity can inadvertently suffer from "groupthink," which is "a dysfunctional mode of group decision making characterized by a reduction in independent critical thinking and a relentless striving for unanimity among members."[74] The catastrophic financial consequences of groupthink became evident in the 2008 global financial crisis, after which the IMF's Independent Evaluation Office concluded that "[t]he IMF's ability to correctly identify the mounting risks [as the crisis developed] was hindered by a high degree of groupthink."[75]

Other studies suggest that increased diversity reduces groupthink and leads to robust dialogue and better decision making. Dallas (2002) observed that "heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of a wide range of interpretations, alternatives, and consequences."[76] Bernile et al. (2017) found that "diversity in the board of directors reduces stock return volatility, which is consistent with diverse backgrounds working as a governance mechanism, moderating decisions, and alleviating problems associated with

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73 See Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,355 (Dec. 23, 2009).

74 See Daniel P. Forbes and Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24(3) Acad. Mgmt. Rev. 489, 496 (Jul. 1999).

75 See International Monetary Fund, *IMF Performance in the Run-Up to the Financial and Economic Crisis* (August 2011), available at: https://www.elibrary.imf.org/view/IMF017/11570-9781616350789/11570-9781616350789/ch04.xml?language=en&redirect=true ("The evaluation found that incentives were not well aligned to foster the candid exchange of ideas that is needed for good surveillance—many staff reported concerns about the consequences of expressing views contrary to those of supervisors, [m]anagement, and country authorities.").

76 See Lynne L. Dallas, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders?: The New Managerialism and Diversity on Corporate Boards of Directors*, 76 Tul. L. Rev. 1363, 1391 (June 2002).

'groupthink.'"[77] Dhir (2015) concluded that gender diversity may "promote cognitive diversity and constructive conflict in the boardroom."[78] After interviewing 23 directors about their experience with Norway's board gender mandate, he observed:

> First, many respondents contended that gender diversity promotes enhanced dialogue. Interviewees frequently spoke of their belief that heterogeneity has resulted in: (1) higher quality boardroom discussions; (2) broader discussions that consider a wide range of angles or viewpoints; (3) deeper or more thorough discussions; (4) more frequent and lengthier discussions; (5) better informed discussions; (6) discussions that are more frequently brought inside the boardroom (as opposed to being held in spaces outside the boardroom, either exclusively or in addition to inside the boardroom); or (7) discussions in which items that directors previously took for granted are drawn out and addressed—where the implicit becomes explicit. Second, and intimately related, many interviewees indicated that diversification has led to (or has the potential to lead to) better decision making processes and/or final decisions.[79]

Investors also have emphasized the importance of diversity in decision making. A group of institutional investors charged with overseeing state investments and the retirement savings of public employees asserted that "board members who possess a variety of viewpoints may raise different ideas and encourage a full airing of dissenting views. Such a broad pool of talent can be assembled when potential board candidates are not limited by gender, race, or ethnicity."[80]

Nasdaq believes that cognitive diversity is particularly important on boards because in their advisory role, especially related to corporate strategy, "the 'output' that

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77 See Bernile et al., supra note 28, at 38.

78 See Aaron A. Dhir, CHALLENGING BOARDROOM DIVERSITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY 150 (2015) (emphasis removed) (sample included 23 directors of Norwegian corporate boards, representing an aggregate of 95 board appointments at more than 70 corporations).

79 Id. at 124 (emphasis removed).

80 See Petition for Amendment of Proxy Rule (March 31, 2015), available at: https://www.sec.gov/rules/petitions/2015/petn4-682.pdf.

boards produce is entirely cognitive in nature."[81] While in 1999, Forbes and Milliken characterized boards as "large, elite, and episodic decision making groups that face complex tasks pertaining to strategic-issue processing,"[82] over the past two decades, their role has evolved; boards are now more active, frequent advisors on areas such as cybersecurity, social media, and environmental, social and governance ("ESG") issues such as climate change and racial and gender inequality. Nasdaq believes that boards comprised of directors from diverse backgrounds enhance investor confidence by ensuring that board deliberations include the perspectives of more than one demographic group, leading to more robust dialogue and better decision making.

III. Current State of Board Diversity and Causes of Underrepresentation on Boards

While the above studies suggest a positive association between board diversity, company performance, investor protections, and decision making, there is a noticeable lack of diversity among U.S. public companies. Nasdaq is a global organization and operates in many countries around the world that already have implemented diversity-focused directives. In fact, Nasdaq-listed companies in Europe already are subject to diversity requirements.[83] This first-hand experience provides Nasdaq with a unique perspective to incorporate global best practices into its proposal to advance diversity on

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81 See Forbes and Milliken, supra note 74, at 492.

82 Id.

83 On Nasdaq's Nordic and Baltic exchanges, large companies must comply with EU Directive 2014/95/EU (the "EU Directive"), as implemented by each member state, which requires companies to disclose a board diversity policy with measurable objectives (including gender), or explain why they do not have such a policy. On Nasdaq Vilnius, companies are also required to comply with the Nasdaq Corporate Governance Code for Listed Companies or explain why they do not, which requires companies to consider diversity and seek gender equality on the board. Similarly, on Nasdaq Copenhagen, companies are required to comply with the Danish Corporate Governance Recommendations or explain why they do not, which requires companies to adopt and disclose a diversity policy that considers gender, age and international experience. On Nasdaq Iceland, listed companies must have at least 40% women on their board (a government requirement) and comply with the EU Directive.

U.S. corporate boards. Given that the U.S. ranks 53rd in board gender diversity, according to the World Economic Forum in its 2020 Global Gender Gap Report, Nasdaq believes advancing board diversity in the U.S. is a critical business and market imperative. This same report also found that "American women still struggle to enter the very top business positions: only 21.7% of corporate managing board members are women."[84] As of 2019, women directors held 19% of Russell 3000 seats (up from 16% in 2018).[85] In comparison, women hold more than 30% of board seats in Norway, France, Sweden and Finland.[86] At the current pace, the U.S. GAO estimates that it could take up to 34 years for U.S. companies to achieve gender parity on their boards.[87]

Progress toward greater racial and ethnic diversity in U.S. company boardrooms has been even slower. Over the past ten years, the percentage of African American/Black directors at Fortune 500 companies has remained between 7 and 9%, while the percentage of women directors has grown from 16 to 23%.[88] In 2019, only 10% of board seats at Russell 3000 companies were held by racial minorities, reflecting an incremental increase from 8% in 2008.[89] Among Fortune 500 companies in 2018, there were fewer than 20 directors who publicly self-identified as LGBT+, and only nine companies

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84 See World Economic Forum, *Global Gender Gap Report 2020* 33 (2019), available at: http://www3.weforum.org/docs/WEF_GGGR_2020.pdf.

85 See Kosmas Papadopoulos, ISS Analytics, *U.S. Board Diversity Trends in 2019* 4-5 (May 31, 2019), available at: https://www.issgovernance.com/file/publications/ISS_US-Board-Diversity-Trends-2019.pdf.

86 See Deloitte, *Women in the Boardroom: A global perspective* (6th ed. 2019), available at: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-risk-women-in-the-boardroom-sixth-edition.pdf.

87 See GAO Report, supra note 44.

88 See Russell Reynolds, *Ethnic & Gender Diversity on US Public Company Boards* 6 (September 8, 2020).

89 See Papadopoulous, supra note 85, at 5.

reported considering sexual orientation and/or gender identity when identifying director nominees.[90]

Women and minority directors combined accounted for 34% of Fortune 500 board seats in 2018.[91] While women of color represent 18% of the U.S. population, they held only 4.6% of Fortune 500 board seats in 2018.[92] Male underrepresented minorities held 11.5% of board seats at Fortune 500 companies in 2018, compared to 66% of board seats held by Caucasian/White men. Overall in 2018, 83.9% of board seats among Fortune 500 companies were held by Caucasian/White individuals (who represent 60.1% of the U.S. population), 8.6% by African American/Black individuals (who represent 13% of the U.S. population), 3.8% by Hispanic/Latino(a) individuals (who represent 19% of the U.S. population) and 3.7% by Asian/Pacific Islander individuals (who represent 6% of the U.S. population).[93] In its analysis of Russell 3000 companies, 2020 Women on Boards concluded that "larger companies do better with their diversity efforts than smaller companies."[94]

Based on the limited information that is available, Nasdaq believes a supermajority of listed companies have made notable strides to improve gender diversity in the boardroom and have at least one woman on the board. Nasdaq also believes that

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90 See Out Leadership, supra note 35.

91 See Deloitte, *Missing Pieces Report: The 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards* 9 (2018), available at: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-cbe-missing-pieces-report-2018-board-diversity-census.pdf.

92 See Catalyst, *Too Few Women of Color on Boards: Statistics and Solutions* (Jan. 31, 2020), https://www.catalyst.org/research/women-minorities-corporate-boards/.

93 See Deloitte, *Missing Pieces Report*, supra note 91; United States Census Bureau, *QuickFacts*, available at: https://www.census.gov/quickfacts/fact/table/US/PST045219.

94 See *2020 Women On Boards Gender Diversity Index* 4 (2019), available at: https://2020wob.com/wp-content/uploads/2019/10/2020WOB_Gender_Diversity_Index_Report_Oct2019.pdf.

listed companies are diligently working to add directors with other diverse attributes, although consistent with other studies of U.S. companies, Nasdaq believes the pace of progress, in this regard, is happening more gradually. Thus, and for the reasons discussed in this Section II.A.1.III, Nasdaq has concluded that a regulatory approach to encouraging greater diversity and data transparency would be beneficial.

Nasdaq reviewed academic studies on the causes of underrepresentation on boards and the approaches taken by other jurisdictions to remedy underrepresentation. Those studies suggest that the traditional director candidate selection process may create barriers to considering qualified diverse candidates for board positions. Dhir (2015) explains that "[t]he presence of unconscious bias in the board appointment process, coupled with closed social networks, generates a complex set of barriers for diverse directors; these are the 'phantoms' that prevent entry."[95] In 2011, the Davies Review found that "informal networks influential in board appointments" contribute to the underrepresentation of women in the boardrooms of U.K. listed companies.[96] In 2017, the Parker Review acknowledged that "as is the case with gender, people of colour within the UK have historically not had the same opportunities as many mainstream candidates to develop the skills, networks and senior leadership experience desired in a FTSE Boardroom."[97] In 2020, the United Kingdom Financial Reporting Council commissioned a report to analyze barriers to LGBTQ+ inclusion and promotion in the workplace. Leaders who self-identified as LGBTQ+ expressed concerns about the current board

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95 See Dhir, supra note 78, at 47.

96 See *Women on Boards* 17 (Feb. 2011), available at: https://ftsewomenleaders.com/wp-content/uploads/2015/08/women-on-boards-review.pdf.

97 See Sir John Parker, *A Report into the Ethnic Diversity of UK Boards* 38 (Oct. 12, 2017), available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2017-report-final.pdf.

nomination process, which includes "relying on personal recommendations without transparent competition or due process [and] informal 'interviewing' outside the selection process."[98]

These concerns are not unique to the United Kingdom. The U.S. GAO (2015) found that women's representation on corporate boards may be hindered by directors' tendencies to "rely on their personal networks to identify new board candidates."[99] Vell (2017) found that "92% of board seats [of public U.S. and Canadian technology companies] are filled through networking, and women have less access to these networks."[100] Deloitte and the Society for Corporate Governance (2019) found that this is also common in other industries including media, communications, energy, consumer products, financial services and life sciences.[101] They observed that although 94% of companies surveyed were looking to increase diversity among their boards, 77% of those boards looked to referrals from current directors when identifying diverse director candidates, suggesting that "networking is still key to board succession."[102] Dhir (2015), in a qualitative study of Norwegian directors, observed that "[b]oard seats tend to be

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98 See Catriona Hay et al., The Financial Reporting Council, *Building more open business* 25 (2020), available at: https://www.frc.org.uk/getattachment/19f3b216-bd45-4d46-af2f-f191f5bf4a07/The-Good-Side-x-Financial-Reporting-Council-1811-AMENDED.pdf.

99 See GAO Report, supra note 44, at 15.

100 See Vell Executive Search, *Women Board Members in Tech Companies: Strategies for Building High Performing Diverse Boards* 6 (2017), available at: https://www.vell.com/images/pdf/VELL%20Report%20Women%20Board%20Members%20on%20Tech%20Boards%202017%203%2029.pdf.

101 See Deloitte and the Society of Corporate Governance, *Board Practices Report: Common threads across boardrooms* 5 (2019), available at: https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/1202241_2018_Board_Practices_Report_FINAL.pdf.

102 Id. at 6.

filled by directors engaging their networks, and the resulting appointees tend to be of the same socio-demographic background."[103]

Another contributing factor may be the traditional experience sought in director nominees. Rhode & Packel (2014) observed that:

> One of the most common reasons for the underrepresentation of women and minorities on corporate boards is their underrepresentation in the traditional pipeline to board service. The primary route to board directorship has long been through experience as a CEO of a public corporation. . . . Given the low representation of women and minorities in top executive positions, their talents are likely to be underutilized if selection criteria are not broadened.[104]

Hillman et al. (2002) found that while white male directors of public companies were more likely to have current or former experience as a CEO, senior manager or director, African-American and white women directors were more likely to have specialized expertise in law, finance, banking, public relations or marketing, or community influence from positions in politics, academia or clergy.[105] Dhir (2015) suggests that "[c]onsidering persons from other, non-management pools, such as academia, legal and accounting practice, the not-for-profit sector and politics, may help create a broader pool of diverse candidates."[106] Directors surveyed by the U.S. GAO also "suggested, for example, that boards recruit high performing women in other senior executive level positions, or look for qualified female candidates in academia or the

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103 See Dhir, supra note 78, at 52.

104 See Deborah Rhode and Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39(2) Del. J. Corp. L. 377, 402-403 (2014); see also Dhir, supra note 78, at 39 ("[T]here is an apparent preference for either CEOs (whether current or retired) or senior management who have experience at the helm of a particular business stream or unit…. The fact that far fewer women than men have been CEOs has a potentially devastating effect on access to the boardroom, which in turn can have an effect on the number of women who rise to the level of CEO and to the executive suite.").

105 See Amy J. Hillman et al., *Women and Racial Minorities in the Boardroom: How Do Directors Differ?*, 28(6) J. Mgmt. 747, 749, 754 (2002).

106 See Dhir, supra note 78, at 42.

nonprofit and government sectors. . . . [I]f boards were to expand their director searches beyond CEOs more women might be included in the candidate pool."[107]

Investors have begun calling for greater transparency surrounding ethnic diversity on company boards, and in the past several months as the U.S. has seen an uprising in the racial justice movement, there has been an increase in the number of African Americans appointed to Russell 3000 corporate boards.[108] In a five-month span, 130 directors appointed were African American, in comparison to the 38 African American directors who were appointed in the preceding five months.[109] Although tracking the acceleration in board diversity is feasible for some Russell 3000 companies, many of the companies do not disclose the racial makeup of the board, making it impossible to more broadly assess the impact of recent events on board diversity.

IV. Stakeholder Perspectives

To gain a better understanding of the current state of board diversity, benefits of diversity, causes of underrepresentation on boards and potential remedies to address underrepresentation, Nasdaq spoke with leaders representing a broad spectrum of market participants and other stakeholders. Nasdaq sought their perspectives to inform its analysis of whether the proposed rule changes would promote the public interest and protection of investors without unduly burdening competition or conflicting with existing securities laws. The group included representatives from the investor, regulatory, investment banking, venture capital and legal communities. Nasdaq also spoke with

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107 See GAO Report supra note 44, at 18.

108 See Leslie P. Norton, *The Number of Black Board Members Surged After George Floyd's Death*, Barron's, Oct. 27, 2020, available at: https://www.barrons.com/articles/after-george-floyds-death-the-number-of-black-board-members-surges-51603809011.

109 Id.

leaders of civil rights and corporate governance organizations, and organizations representing the interests of private and public companies, including Nasdaq-listed companies. Specifically, Nasdaq obtained their views on:

- the current state of board diversity in the U.S.;
- the inherent value of board diversity;
- increasing pressure from legislators and investors to improve diverse representation on boards and board diversity disclosure;
- whether a listing rule related to board diversity is in the public interest;
- how to define a "diverse" director; and
- the benefits and challenges of various approaches to improving board diversity disclosures and increasing diverse representation on boards, including mandates and disclosure-based models.

The discussions revealed strong support for disclosure requirements that would standardize the reporting of board diversity statistics. The majority of organizations also were in agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, and that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. While many organizations recognized that mandates can accelerate the rate of change, they expressed that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Business leaders also expressed concern that smaller companies would require flexibility and support to comply with any time-sensitive requirements to add diverse directors. Some stakeholders highlighted additional challenges that smaller companies, and companies in certain industries, may face finding diverse board members. Leaders from across the spectrum of stakeholders that Nasdaq surveyed reinforced the notion that if companies recruit by skill set and expertise rather

than title, then they will find there is more than enough diverse talent to satisfy demand. Leaders from the legal community emphasized that any proposed rule that imposed additional burdens beyond, or is inconsistent with, existing securities laws—by, for example, requiring companies to adopt a diversity policy or include disclosure solely in their proxy statements—would present an additional burden and potentially more legal liability for listed companies.

V. U.S. Regulatory Framework

As detailed above, diversity has been the topic of a growing number of studies over the past decade and, in recent years, some investors have been increasingly advocating for greater diversity among directors of public companies.[110] Over the past year, the social justice movement has underscored the importance of having diverse perspectives and representation at all levels of decision-making, including on public company boards. In recent years, diversity has become increasingly important to the public, including institutional investors, pension funds and other stakeholders who believe that board diversity enhances board performance and is an important factor in the

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110 In 2009, when the Commission proposed enhancements to proxy disclosures, including addressing board diversity disclosures, the Commission received over 130 comment letters related to its proposal, including from corporations, pension funds, professional associations, trade unions, accounting firms, law firms, consultants, academics, individual investors and other interested parties. See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,335; see also David A. Katz and Laura McIntosh, *Raising the Stakes for Board Diversity*, Law.com (July 22, 2020), available at: https://www.law.com/newyorklawjournal/2020/07/22/raising-the-stakes-for-board-diversity/?slreturn=20201017021522; Office of the Illinois State Treasurer, *The Investment Case For Board Diversity: A Review of the Academic and Practitioner Research on the Value of Gender and Racial/Ethnic Board Diversity for Investors* 7 (Oct. 2020), available at: https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/il%20treasurer%20white%20paper%20-%20the%20investment%20case%20for%20board%20diversity%20(oct%202020).pdf.

voting decisions of some investors.[111] Legislators increasingly are taking action to encourage corporations to diversify their boards and improve diversity disclosures.[112]

a. SEC Diversity Disclosure Requirements – Background

In 2009, the Commission sought comment on whether to amend Item 407(c)(2)(vi) of Regulation S-K to require disclosure of whether a nominating committee considers diversity when selecting a director for a position on the board.[113] The Commission received more than 130 comment letters on its proposal. According to a University of Dayton Law Review analysis of those comment letters, most were submitted by groups with a specific interest in diversity, or by institutional investors, including mutual funds, pension funds, and socially responsible investment funds.[114] Further, the analysis showed that 56 commenters addressed the issue of diversity disclosures, and only 5 of those 56 commenters did not favor such disclosure.[115] Twenty-seven of the 56 mentioned gender diversity, 18 mentioned racial diversity, and 13 mentioned ethnic diversity. However, neither the proposed rule nor the final rule defined

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111 See Comments on Proposed Rule: Proxy Disclosure and Solicitation Enhancements, available at: https://www.sec.gov/comments/s7-13-09/s71309.shtml. See also CGLytics, *Diversity on the Board? Metrics Used by Fortune 100 Companies* (June 29, 2020), available at: https://www.cglytics.com/diversity-on-the-board-metrics-of-fortune-100-companies/; Office of the Illinois State Treasurer, supra note 110.

112 For example, California requires companies headquartered in the state to have at least one director who self-identifies as a Female and one director from an Underrepresented Community. See Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept. 30, 2020). Washington requires companies headquartered in the state to have at least 25% women on the board by 2022 or provide certain disclosures. See Wash. Subst. S.B. 6037 (June 11, 2020). At least eleven states have proposed diversity-related requirements. See Hatcher and Latham, supra note 11.

113 See Proxy Disclosure and Solicitation Enhancements, 74 Fed. Reg. 35,076, 35,084 (July 17, 2009) (proposed rule).

114 See Thomas Lee Hazen and Lissa Lamkin Broome, *Board Diversity and Proxy Disclosure*, 37:1 Univ. Dayton L. Review 41, 51, n. 82 (citing the comment letters).

115 In the five comments that opposed diversity disclosure, three stated that diversity was an important value. See Comments on Proposed Rule, supra note 111; see also Hazen and Broome, supra note 114, at 54 n.88 (citing the 56 comment letters).

diversity.[116]

Ten years after its adoption of board diversity disclosure rules, the Commission revisited the rules by establishing new Compliance and Disclosure Interpretations ("C&DI"). However, the Commission did not provide a definition of diversity, and therefore issuers currently are not required to disclose the race, ethnicity or gender of their directors or nominees.

Currently, Item 401(e)(1) of Regulation S-K requires a company to "briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director."[117] The C&DI clarifies that if a board considered a director's self-identified diversity characteristics (*e.g.*, race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) during the nomination process, and the individual consents to disclose those diverse characteristics, the Commission "would expect that the company's discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered."[118]

Rather than providing a specific definition of diversity, the C&DI provides a non-exhaustive list of examples of diverse characteristics that a company could consider for purposes of Item 401(e)(1), including "race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background."[119] Additionally, the Commission stated that any description of a company's diversity policy would be expected to include

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116 See Hazen and Broome, supra note 114, at 53 n. 84-86.

117 See 17 C.F.R. § 229.401(e)(1).

118 See Securities and Exchange Commission, Regulation S-K Compliance & Disclosure Interpretations (Sept. 21, 2020), available at: https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.

119 Id.

"a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics."[120]

Item 407(c)(2)(vi) of Regulation S-K requires proxy disclosure regarding whether diversity is considered when identifying director nominees and, if so, how. In addition, if the board or nominations committee has adopted a diversity policy, the company must describe how the policy is implemented and its effectiveness is assessed.[121] When adopting Item 407(c)(2)(vi), the Commission explained:

> We recognize that companies may define diversity in various ways, reflecting different perspectives. For instance, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin. We believe that for purposes of this disclosure requirement, companies should be allowed to define diversity in ways that they consider appropriate. As a result we have not defined diversity in the amendments.[122]

Moreover, Item 407(c)(2)(vi) does not require companies to adopt a formal policy and does not require them to explain why they have not. It also does not require public disclosure of board-level diversity statistics.

b. Complaints Surrounding Current Diversity Disclosure Requirements

Given the broad latitude afforded to companies by the Commission's rules related to board diversity and proxy disclosure, current reporting of board-level diversity statistics has been significantly unreliable and unusable to investors. This has been due

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120 Id.

121 See 17 C.F.R. § 229.407(c)(2)(vi).

122 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,344.

to myriad data collection challenges, including the scarcity of reported information, the lack of uniformity in the information that is disclosed and inconsistencies in the definitions of diversity characteristics across companies.[123] The heightened national discourse around diversity and mounting grievances from investors surrounding transparency on board diversity prompted Nasdaq to examine the state of board diversity among its listed companies. While conducting that research, Nasdaq identified a number of key challenges, such as: (1) inconsistent disclosure and definitions of diversity across companies; (2) limited data on diverse characteristics outside of gender; (3) inconsistent or no disclosure of a director's race, ethnicity, or other diversity attributes (*e.g.*, nationality); (4) difficult-to-extract data because statistics are often embedded in graphics; and (5) aggregation of information, making it difficult to separate gender from other categories of diversity. Investors and data analysts have raised similar criticisms.

As the Illinois Treasurer observed, the paucity of data on race and ethnicity creates barriers to investment analysis, due diligence and academic study.[124] For example, the scarcity of such data is an impediment to academics who want to study the performance impact of racially diverse boards.[125] Nasdaq is concerned that investors also face the many data collection challenges Nasdaq encountered, rendering current diversity disclosures unreliable, unusable, and insufficient to inform investment and voting decisions. Commissioner Allison Herren Lee expressed similar concerns, stating that the

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123 See Petition for Rulemaking (July 6, 2017), available at: https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.

124 See Press Release, *Illinois State Treasurer Frerichs Calls on Russell 3000 Companies to Disclose Diversity Data* (Oct. 28, 2020), available at https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/october2020_russell3000.pdf.

125 See Office of Illinois State Treasurer, supra note 110, at 3-4.

current SEC disclosure requirements have "led to spotty information that is not standardized, not consistent period to period, not comparable across companies, and not necessarily reliable. . . . And the current state of disclosure reveals the shortcomings of a principles-based materiality regime in this area."[126]

Some stakeholders believe there is a correlation between companies that disclose the gender, racial and ethnic composition of their board and the number of diverse directors on those companies' boards.[127] Currently, the lack of reliable and consistent data makes it difficult to measure diversity in the boardroom, and a common set of standards for diversity definitions and disclosure format is greatly needed. At present, U.S. companies must navigate a complex patchwork of federal and state regulations and disclosure requirements. The limited disclosure currently provided voluntarily, which is primarily focused on gender (due in part to that data being the most readily available), fails to provide the full scope of a board's diverse characteristics.[128] It is difficult to improve what one cannot accurately measure. This lack of transparency is impacting investors who are increasingly basing public advocacy, proxy voting and direct shareholder-company engagement decisions on board diversity considerations.[129]

c. Support for Updating Diversity Disclosure Requirements

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126 See Lee, supra note 22.

127 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355 ("Although the[se] amendments are not intended to steer behavior, diversity policy disclosure may also induce beneficial changes in board composition. A board may determine, in connection with preparing its disclosure, that it is beneficial to disclose and follow a policy of seeking diversity."); see also Office of Illinois State Treasurer, supra note 110, at 3.

128 See, e.g., CGLytics, supra note 111, at https://www.cglytics.com/diversity-on-the-board-metrics-of-fortune-100-companies/; Petition for Amendment of Proxy Rule, supra note 80; Office of Illinois State Treasurer, supra note 110.

129 See Office of the Illinois State Treasurer, *Russell 3000 Board Diversity Disclosure Initiative*, https://www.illinoistreasurer.gov/Financial_Institutions/Equity,_Diversity__Inclusion/Russell_3000_Board_Diversity_Disclosure_Initiative (last accessed Nov. 25, 2020).

Nasdaq's surveys of investors and reviews of their disclosed policies and actions show that board diversity is a priority when assessing companies, and investors report, in some cases, relying on intuition when there is a lack of empirical, evidenced-based data. Furthermore, the continued growth of ESG investing raises the importance of quality data, given the data-driven nature of investment products such as diversity-specific indices and broader ESG funds.

Investors have a unique platform from which to engage and influence a company's position on important topics like diversity. Similarly, Nasdaq, like other self-regulatory organizations, is uniquely positioned to establish practices that will assist in carrying out Nasdaq's mandate to protect investors and remove impediments from the market. Various stakeholders, including Nasdaq, believe that clear and concise annual disclosure of board diversity information that disaggregates the data by race, ethnicity, gender identity and sexual orientation will provide the public, including key stakeholders, with a better sense of a company's approach to improving corporate diversity and the support needed to effectuate any changes. Required disclosures also would eliminate the number of shareholder proposals asking for these key metrics and the need for companies to respond to multiple investor requests for information.[130] Moreover, companies manage issues more closely and demonstrate greater progress when data is available.[131]

In 2015, nine large public pension funds who collectively supervised $1.12 trillion in assets at the time petitioned the Commission to require registrants to disclose information related to, among other things, the gender, racial, and ethnic diversity of the

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130 See Petition for Rulemaking, supra note 123, at 2.

131 See, e.g., Gwen Le Berre, Parametric, *Investors Need Data to Make Diversity a Reality* (Aug. 24, 2020), https://www.parametricportfolio.com/blog/investors-need-data-to-make-diversity-a-reality.

registrant's board nominees.[132] In 2017, Human Capital Management Coalition, which described itself as a group of institutional investors with $2.8 trillion in assets at the time, made a similar petition to the Commission.[133] More recently, in October 2020, the Illinois Treasurer spearheaded an initiative along with twenty other investor organizations, asking for all companies in the Russell 3000 Index to disclose the composition of their board, including each board member's gender, race and ethnicity.[134]

The largest proxy advisory firms have aligned their voting policies to encourage increased board diversity disclosure. Institutional Shareholder Services ("ISS"), recently adopted a new voting policy under which it will identify boards of companies in the Russell 3000 or S&P 1500 that "lack racial and ethnic diversity (or lack disclosure of such)" in 2021 and, beginning in 2022, will recommend voting against the chair of the nominating committee of such companies. The stated goal of the policy is "helping investors identify companies with which they may wish to engage and to foster dialogue between investors and companies on this topic."[135] In 2017, proxy advisory firm Glass Lewis announced a policy regarding board gender diversity that took effect in 2019. Glass Lewis generally recommends voting against the nominating committee chair of a board that has no female members, and when making such a recommendation, the firm closely examines the company's disclosure of its board diversity considerations and other

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132 See Petition for Amendment of Proxy Rule, supra note 80.

133 See Petition for Rulemaking, supra note 123.

134 See Press Release, supra note 124.

135 See ISS Governance, *ISS Announces 2021 Benchmark Policy Updates* (November 12, 2020), available at: https://www.issgovernance.com/iss-announces-2021-benchmark-policy-updates/.

relevant contextual factors.[136] On November 24, 2020, Glass Lewis announced the publication of its 2021 Proxy Voting Policy Guidelines, which expand its board gender diversity policy to vote against nominating chairs if there are fewer than two female directors, beginning in 2022.[137] Most notably, beginning with the 2021 proxy season, the company will include an assessment report of company proxy disclosures relating to board diversity, skills and the director nomination process for companies in the S&P 500 index. According to Glass Lewis, it "will reflect how a company's proxy statement presents: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (iii) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (aka 'Rooney Rule'); and (iv) board skills disclosure."[138]

Congress and members of the Commission also have weighed in on the importance of improving board transparency. In 2017, Representative Carolyn Maloney introduced the "Gender Diversity in Corporate Leadership Act of 2017," which proposed requiring public companies to provide proxy disclosure regarding the gender diversity of the board of directors and nominees.[139] In November 2019, the U.S. House of Representatives, with bipartisan support, passed the "Corporate Governance Through

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136 See Glass Lewis, *2019 Policy Guideline Updates* (Oct. 24, 2018), available at: https://www.glasslewis.com/2019-policy-guideline-updates-united-states-canada-shareholder-initiatives-israel/.

137 See Glass Lewis, *2021 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice - United States* (2020), available at: https://www.glasslewis.com/wp-content/uploads/2020/11/US-Voting-Guidelines-GL.pdf?hsCtaTracking=7c712e31-24fb-4a3a-b396-9e8568fa0685%7C86255695-f1f4-47cb-8dc0-e919a9a5cf5b.

138 Id.

139 Gender Diversity in Corporate Leadership Act of 2017, H.R. 1611, 115th Cong. (2017).

Diversity Act of 2019," which requires certain registrants annually to disclose the racial, ethnic, and gender composition of their boards and executive officers, as well as the veteran status of any of those directors and officers, in their proxy statements.[140] The bill also requires the disclosure of any policy, plan or strategy to promote racial, ethnic, and gender diversity among these groups. Legislators have proposed a companion bill in the U.S. Senate.[141]

The Council of Institutional Investors ("CII"), U.S. Chamber of Commerce,[142] National Urban League, Office of New York State Comptroller and the National Association for the Advancement of Colored People praised the House of Representatives' for passing the 2019 legislation. According to the U.S. Chamber of Commerce's members and associations, it has become increasingly important to see improvements in board diversity.[143] Additionally, CII's General Counsel stated that the proxy statement disclosure requirement in the legislation "could contribute to enhancing U.S. public company board consideration of diversity."[144]

More recently, SEC Commissioners have called for greater transparency surrounding ethnic diversity on company boards. In a September 2020 speech titled "Diversity Matters, Disclosure Works, and the SEC Can Do More" given at the CII Fall Conference, Commissioner Lee advocated advancing corporate diversity and for various

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140 Improving Corporate Governance Through Diversity Act of 2019, H.R. 5084, 116th Cong. (2019).

141 Improving Corporate Governance Through Diversity Act of 2019, S. 360, 116th Cong. (2019).

142 See Letter from Various U.S. Chamber of Commerce Associations and Members to Chairman Mike Crapo and Ranking Member Sherrod Brown, U.S. House Committee on Banking, Housing, and Urban Affairs (July 27, 2020), available at: https://www.uschamber.com/sites/default/files/200727_coalition_h.r._5084_senatesmallbusiness.pdf.

143 Id.

144 See Joe Mont, *SEC, Congress seek better diversity disclosures*, Compliance Week (Feb. 20, 2019), https://www.complianceweek.com/sec-congress-seek-better-diversity-disclosures/24802.article.

approaches by which the Commission could promote diversity, including among other things, strengthening the C&DI's guidance related to disclosure of board candidate diversity characteristics.[145] Commissioner Lee stated:

> [The SEC has] largely declined to require diversity-related disclosure. In 2009, we adopted a requirement for companies to disclose if and how diversity is considered as a factor in the process for considering candidates for board positions, including any policies related to the consideration of diversity. In 2018, we issued guidance encouraging the disclosure of self-identified characteristics of board candidates. While I appreciate these measures, given that women of color hold just 4.6% of Fortune 500 board seats and less than one percent of Fortune 500 CEOs are Black, it's time to consider how to get investors the diversity information they need to allocate their capital wisely.[146]

VI. Nasdaq Proposal

a. Overview of Disclosure Requirements

Disclosure of information material to an investor's voting and investment decision is the bedrock of federal securities laws. The Exchange's listing rules require companies to comply with federal securities laws, including the registration requirements under the Securities Act of 1933. Once listed, companies are obligated to solicit proxies and file all annual and periodic reports with the Commission under the Act at the prescribed times.[147] In discharging its obligation to protect investors, Nasdaq monitors listed companies for compliance with those disclosure obligations, and the failure to do so results in a notice of deficiency or delisting.

Nasdaq believes it is well within the Exchange's delegated regulatory authority to propose listing rules designed to enhance transparency so long as they do not conflict with existing federal securities laws. For example, Nasdaq requires listed companies to

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145 See Lee, supra note 22.

146 Id. Commissioner Crenshaw also expressed disappointment with the Commission's silence on diversity. See Crenshaw, supra note 7.

147 See Nasdaq Stock Market Rulebook, Rules 5250(c) and (d).

publicly disclose compensation or other payments by third parties to a company's directors or nominees, notwithstanding that such disclosure is not required by federal securities laws. In approving that proposed rule, the Commission noted:

> To the extent there are certain factual scenarios that would require disclosure not otherwise required under Commission rules, we believe that it is within the purview of a national securities exchange to impose heightened governance requirements, consistent with the Act, that are designed to improve transparency and accountability into corporate decision making and promote investor confidence in the integrity of the securities markets.[148]

Nasdaq is concerned that while investors have increasingly emphasized that they consider board diversity information to be material, the current lack of transparency and consistency makes it difficult for Nasdaq and investors to determine the state of diversity among listed companies as well as each board's philosophy regarding diversity. Investors also have voiced dissatisfaction about having to independently collect board-level data about race, ethnicity and gender identity because such investigations can be time consuming, expensive, and fraught with inaccuracies.[149] Moreover, in some instances, based on Nasdaq's own investigation, such information is either unavailable, or, if available, not comparable across companies. To the extent investors must obtain this information on their own through an imperfect process, Nasdaq is concerned that it increases information asymmetries between larger stakeholders, who are able to collect this data directly from companies, and smaller investors, who must rely on incomplete public disclosures. For all investors who take on the burden of independently obtaining the current information, there is a cost and time burden related to the data collection.

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148 See Order Granting Accelerated Approval of a Proposed Rule Change, 81 Fed. Reg. 44,400, 44,403 (July 7, 2016).

149 See Petition for Amendment of Proxy Rule, supra note 80, at 2.

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. Nasdaq proposes to improve transparency regarding board diversity by requiring all listed companies to publicly disclose unbundled, consistent data utilizing a uniform, transparent framework on their website or in their proxy statement under Rule 5606. Similarly, Nasdaq proposes to promote accountability in corporate decision-making by requiring companies who do not have at least two Diverse directors on their board to provide investors with a public explanation of the board's reasons for not doing so under Rule 5605(f)(3). Nasdaq designed the proposal to avoid a conflict with existing disclosure requirements under Regulation S-K and to mitigate additional burdens for companies by providing them with flexibility to provide such disclosure on their website or in their proxy statement, and not requiring them to adopt a formal diversity policy.

Nasdaq proposes to foster consistency in board diversity data disclosure by defining "Diverse" under Rule 5605(f)(1) as "an individual who self-identifies in one or more of the following categories: Female, Underrepresented Minority or LGBTQ+," and by adopting the following definitions under Rule 5605(f)(1):

- "Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth.
- "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.
- "Underrepresented Minority" means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian,

Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities.

The terms in the proposed definition of "Underrepresented Minority" reflect the EEOC's categories and are construed in accordance with the EEOC's definitions.[150] The terms in the proposed definition of LGBTQ+ are similar to the identities defined in California's A.B. 979, described below, but have been expanded to include the queer community based on Nasdaq's consultation with stakeholders, including human rights organizations.[151]

In constructing its proposed definition of "Diverse," Nasdaq considered various state and federal legislation, stakeholder sentiments and academic studies. For example, California requires public companies headquartered in the state to have at least one individual who self-identifies as a female on the board by 2019 under S.B. 826[152] and at least one director who is a member of an "underrepresented community" by 2021 under A.B. 979.[153] S.B. 826 defines "Female" as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth," consistent with legislation proposed by New Jersey, Michigan and Hawaii related to board gender diversity.[154] A.B. 979 considers directors from underrepresented communities to be individuals who self-identify as Black, African American, Hispanic, Latino, Asian,

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150 While the EEO-1 report refers to "Hispanic or Latino" rather than Latinx, Nasdaq proposes to use the term Latinx to apply broadly to all gendered and gender-neutral forms that may be used by individuals of Latin American heritage, including individuals who self-identify as Latino/a/e.

151 Further, Nasdaq agrees with the United Kingdom Financial Reporting Council that the acronym LGBTQ+ "does not attempt to exclude other groups, nor does it imply that the experiences of people under its umbrella are the same." See Hay et al., supra note 98, at 14.

152 See Cal. S.B. 826, supra note 112.

153 See Cal. A.B. 979, supra note 112.

154 See Cal. S.B. 826, supra note 112. See also N.J. Senate No. 3469, § 3(b)(2) (2019); Mich. S.B. 115, § 505a(2)(b) (2019); Haw. H.B. 2720, § 414-1(b)(2) (2020).

Pacific Islander, Native American, Native Hawaiian or Alaska Native, or as gay, lesbian, bisexual or transgender. Since S.B. 826 was passed, 669 women have joined public company boards in the state and the number of public companies with all male boards has declined from 30% in 2018 to 3% in 2020.[155]

The state of Washington requires public companies whose boards are not comprised of at least 25% directors who self-identify as women by January 1, 2022 to provide public disclosures related to the board's consideration of "diverse groups" during the director nomination process. The state considers "diverse groups" to include "women, racial minorities, and historically underrepresented groups."[156]

As discussed above, Congress has proposed legislation relating to disclosure of racial, ethnic, gender and veteran status among the company's directors. Section 342 of the Dodd-Frank Act defines "minority" as "Black American, Native American, Hispanic American, and Asian American,"[157] and the Diversity Assessment Report for Entities Regulated by the SEC requires the Exchange to report workforce composition data to the SEC based on the EEOC's categories.[158] Most companies are required by law to provide similar workforce data to the EEOC through the EEO-1 Report, which requires employers to report statistical data related to race, ethnicity and gender to the EEOC.[159]

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155 See California Partners Project, *Claim Your Seat: A Progress Report on Women's Representation on California Corporate Boards* 4 (2020), available at: https://www.calpartnersproject.org/claimyourseat.

156 See Wash. Subst. S.B. 6037, supra note 112. At least 11 states have proposed diversity-related requirements. See Hatcher and Latham, supra note 11.

157 See 12 U.S.C. § 5452(g)(3) and Pub. L. 101-73 § 1204(c)(3).

158 See Securities and Exchange Commission, Diversity Assessment Report for Entities Regulated by the SEC, available at: https://www.sec.gov/files/OMWI-DAR-FORM.pdf.

159 All companies with 100 or more employees are required to complete the EEO-1 Report. See U.S. Equal Employment Opportunity Commission, EEO-1: Who Must File, https://www.eeoc.gov/employers/eeo-1-survey/eeo-1-who-must-file (last accessed Nov. 27, 2020).

Nasdaq has designed the proposed rule to require all companies to provide consistent, comparable data under Rule 5606 by utilizing the existing EEO-1 reporting categories that companies are already familiar with, and by requiring companies to have, or publicly explain why they do not have, at least two directors who are diverse in terms of race, ethnicity, sexual orientation or gender identity under Rule 5605(f)(2). While the EEO-1 report does not currently include sexual orientation or gender identity, Nasdaq believes it is reasonable and in the public interest to include a reporting category for LGBTQ+ status in recognition of the U.S. Supreme Court's recent decision in *Bostock v. Clayton County* that sexual orientation and gender identity are "inextricably" intertwined with sex.[160]

The proposal does not preclude companies from considering additional diverse attributes, such as nationality, disability, or veteran status in selecting board members; however, the company would still have to provide the required disclosure under Rule 5605(f)(3) if the company does not also have at least two directors who are otherwise considered Diverse under Rule 5605(f)(1). Nor would the proposal prevent companies from disclosing information related to other diverse attributes of board members beyond those highlighted in the rule if they felt such disclosure would benefit investors. Nasdaq believes such disclosure would provide investors with additional information about the company's philosophy regarding broader diversity characteristics.

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160 See Bostock v. Clayton Cty., 140 S. Ct. 1731, 1742 (2020) ("But unlike any of these other traits or actions, homosexuality and transgender status are inextricably bound up with sex. Not because homosexuality or transgender status are related to sex in some vague sense or because discrimination on these bases has some disparate impact on one sex or another, but because to discriminate on these grounds requires an employer to intentionally treat individual employees differently because of their sex.").

Overall, Nasdaq believes the proposal will enhance investor confidence that all listed companies are considering diversity of race, ethnicity, sexual orientation and gender identity in the context of selecting directors. Investors will be confident that board discussions at listed companies with at least two Diverse directors include the perspectives of more than one demographic group. They will also be confident that boardrooms without at least two Diverse directors are having a thoughtful discussion about their reasons for not doing so and publicly explaining those reasons. On balance, the proposal will advance the public interest and enhance investor confidence in the integrity of the securities markets by ensuring investors that Nasdaq is monitoring all listed companies to verify that they have at least two Diverse directors or explain why they do not, and by requiring all listed companies to provide consistent, comparable diversity disclosures.

b. Board Statistical Disclosure

Given the increased interest in, and advocacy for, improvements in board transparency related to diversity disclosure information, the Exchange is proposing to adopt new Rule 5606(a), which would require each company to publicly disclose, to the extent permitted by applicable law, information on each director's voluntary self-identified gender and racial characteristics and LGBTQ+ status.

All Nasdaq-listed companies that are subject to proposed Rule 5605(f), whether they choose to meet the diversity objectives of proposed Rule 5605(f)(2) or to explain why they do not, would be required to make the proposed Rule 5606 disclosure. This proposed rule also will assist the Exchange in assessing whether companies meet the diversity objectives of proposed Rule 5605(f). Under Rule 5606(e), Nasdaq proposes to

make proposed Rule 5606 operative for listed companies one year after the SEC Approval Date of this proposal.

Pursuant to proposed Rule 5606(a), each company would be instructed to annually provide its board-level diversity data in a format substantially similar to the Board Diversity Matrix in proposed Rule 5606(a) and attached as Exhibit 3. The company would be required to provide the total number of directors on its board. If a director voluntarily self-identifies, each company, other than a Foreign Issuer (as defined under Rule 5605(f)(1)), would include the following in a table titled "Board Diversity Matrix," in accordance with the instructions accompanying the proposed disclosure format: (1) the number of directors based on gender identity (male, female or non-binary[161]); (2) the number of directors based on race and ethnicity (African American or Black, Alaskan Native or American Indian, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, White, or Two or More Races or Ethnicities); and (3) the number of directors who self-identify as LGBTQ+.

Any director who chooses not to disclose a gender would be included under "Gender Undisclosed" and any director who chooses not to identify as any race or not to identify as LGBTQ+ would be included in the "Undisclosed" category at the bottom of the table. The defined terms for the race and ethnicity categories in the instructions to the Board Diversity Matrix disclosure format are substantially similar to the terms and definitions used in the EEO-1 Report.[162] LGTBQ+ is defined similarly to proposed Rule

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161 Although non-binary is included as a category in the proposed Board Diversity Matrix, a company would not satisfy the diversity requirement proposed by Rule 5605(f)(2) if a director self-identifies solely as non-binary.

162 See supra note 159. Additionally, the EEOC does not categorize LGBTQ+ or any other sexual orientation identifier on its EEO-1 Report. The definitions of the EEO-1 race and ethnicity

5605(f)(1) as a person who identifies as any of the following: lesbian, gay, bisexual, transgender or a member of the queer community.

Below is an example of a Board Diversity Matrix that companies may use, which is also attached as Exhibit 3:

Board Diversity Matrix (As of [DATE])				
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Gender Undisclosed**
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
African American or Black	#	#	#	#
Alaskan Native or American Indian	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Undisclosed	#			

categories may be found in the appendix to the EEO-1 Report instructional booklet, available at https://www.eeoc.gov/employers/eeo-1-survey/eeo-1-instruction-booklet.

Nasdaq recognizes that some Foreign Issuers, including Foreign Private Issuers as defined by the Act,[163] may have their principal executive offices located outside of the United States and in jurisdictions that may impose laws limiting or prohibiting self-identification questionnaires, particularly as they relate to race, ethnicity or LGBTQ+ status. In such countries, a Foreign Issuer may be precluded by law from requesting diversity data from its directors. Moreover, Nasdaq's definition of Underrepresented Minority proposed in Rule 5606(f)(1) may be inapplicable to a Foreign Issuer, making this Board Matrix data less relevant for such companies and not useful for investors.

As a result of these limitations, Nasdaq is proposing the option of a separate Board Diversity Matrix for Foreign Issuers. Similar to other companies, a Foreign Issuer would be required to provide the total number of directors on its board. If a director voluntarily self-identifies, the company would include the following in a table titled "Board Diversity Matrix": (1) the number of directors based on gender identity (male, female or non-binary[164]); (2) the number of directors who are considered underrepresented in the company's home country jurisdiction; [165] and (3) the number of directors who self-identify as LGBTQ+. An "Underrepresented Individual in Home Country Jurisdiction" is defined in the instructions to the Board Diversity Matrix as a person who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in a Foreign Issuer's home

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163 See 17 C.F.R. § 240.3b-4.

164 Although non-binary is included as a category in the proposed Board Diversity Matrix, a company would not satisfy any aspect of the diversity requirement proposed by Rule 5605(f)(2) if a director self-identifies solely as non-binary.

165 To clarify, although a Foreign Issuer may disclose directors that meet the requirement of Underrepresented Minority pursuant to new Rule 5605(f)(1), such disclosure may not meet the diversity objectives of new Rule 5605(f)(2)(B)(ii).

country jurisdiction. Rule 5605(f)(2)(B)(i) also proposes the same definition for Diverse directors of Foreign Issuers.

Nasdaq is also proposing new Rule 5606(b), which would require each company to provide the disclosure required under Rule 5606(a) in either the company's proxy statement or information statement for its annual meeting for shareholders, or on the company's website. If the company elects to disclose the information on its website, the company must also submit such disclosure along with a URL link to the information through the Nasdaq Listing Center within 15 calendar days of the company's annual shareholder meeting. The proposed time period to submit the information to the Nasdaq Listing Center is aligned with the time period provided in proposed Rule 5605(f)(3) for a company to submit its explanation for why it does not have at least two Diverse directors. Disclosure of the statistical data is not in lieu of any SEC requirements for a company to disclose any required information pursuant to Regulation S-K or any other federal, state or foreign laws or regulations. As described in the instructions to the Board Diversity Matrix and Rule 5606(a), each year following the first year that a company publishes its annual Board Diversity Matrix, the company would be required to publish its data for the current and immediately prior years.

Additionally, Nasdaq is proposing Rule 5606(c), which exempts the following types of companies from proposed Rule 5606(a): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth

in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. The exemption of these companies is consistent with the approach taken by Nasdaq in Rule 5615 as it relates to certain Nasdaq corporate governance standards for board composition.

Nasdaq is also proposing Rule 5606(d) to allow for a company newly listing on Nasdaq, including a company listing in connection with a business combination under IM-5101-2, to satisfy the requirement of Rule 5606 within one year of listing on Nasdaq. The disclosure required by proposed Rule 5606(d) would be required to be included in the company's annual proxy statement or information statement for its annual meeting of shareholders or on the company's website. If the company provides such disclosure on its website, the company must also submit the disclosure and a URL link to the disclosure through the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholder meeting.

When a company does not timely provide the required disclosure, Nasdaq will notify the company that it is not in compliance with a listing requirement and allow the company to provide a plan to regain compliance. Consistent with deficiencies from most other rules that allow a company to submit a plan to regain compliance,[166] Nasdaq proposes to allow companies deficient under proposed Rule 5606 45 calendar days to submit a plan in accordance with Rule 5810(c)(2) to regain compliance and, based on that

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166 Pursuant to Nasdaq Rule 5810(c)(2)(A)(iii), a company is provided 45 days to submit a plan to regain compliance with Rules 5620(a) (Meetings of Shareholders), 5620(c) (Quorum), 5630 (Review of Related Party Transactions), 5635 (Shareholder Approval), 5250(c)(3) (Auditor Registration), 5255(a) (Direct Registration Program), 5610 (Code of Conduct), 5615(a)(4)(D) (Partner Meetings of Limited Partnerships), 5615(a)(4)(E) (Quorum of Limited Partnerships), 5615(a)(4)(G) (Related Party Transactions of Limited Partnerships), and 5640 (Voting Rights). Pursuant to Nasdaq Rule 5810(c)(2)(A)(iv), a company is also provided 45 days to submit a plan to regain compliance with Rule 5250(b)(3)(Disclosure of Third Party Director and Nominee Compensation). A company is generally provided 60 days to submit a plan to regain compliance with the requirement to timely file periodic reports contained in Rule 5250(c)(1).

plan, Nasdaq can provide the company with up to 180 days to regain compliance. If the company does not do so, it would be issued a Staff Delisting Determination, which the company could appeal to a Hearings Panel pursuant to Rule 5815. Although proposed Rule 5606 is not identical to the current Commission requirements, it is similar to, and does not deviate from, the Commission's CD&I related to Items 401(e)(1) and 407(c)(2)(vi) of Regulation S-K. Moreover, the proposed rule strengthens the Commission's requirements by providing clarity to the definition of diversity and streamlining investors' desire for clear, complete and consistent disclosures. Nasdaq believes that the format of the Board Diversity Matrix and the information that it will provide offers greater transparency into a company's board composition and will enable the data to be easily aggregated across issuers.[167] Nasdaq also believes that requiring annual disclosure of the data will ensure that the information remains current and easy for investors, data analysts and other parties to track.

c. Diverse Board Representation or Explanation

Nasdaq is proposing to adopt new Rule 5605(f)(2) to require each listed company 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 who self-identifies as Female and one who self-identifies as an Underrepresented Minority or LGBTQ+.[168] A company does not need to provide additional public disclosures if the company discloses under Rule 5606 that it has at least two Diverse directors satisfying this requirement. The terms in the proposed

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167 Various stakeholders have requested easier aggregation. See Petition for Amendment of Proxy Rule, supra note 80, at 1.

168 Nasdaq plans to publish an FAQ on the Listing Center clarifying that "two members of its board of directors who are Diverse" would exclude emeritus directors, retired directors and members of an advisory board.

definition of "Underrepresented Minority" reflect the EEOC's categories and are construed in accordance with the EEOC's definitions. Nasdaq has provided additional flexibility for Smaller Reporting Companies and Foreign Issuers (including Foreign Private Issuers).

Under proposed Rule 5605(f)(3), if a company satisfies the requirements of Rule 5605(f)(2) by explaining why it does not have two Diverse directors, the company must: (i) specify the requirements of Rule 5605(f)(2) that are applicable (*e.g.*, the applicable subparagraph, the applicable diversity objectives, and the timeframe applicable to the company's market tier); and (ii) explain the reasons why it does not have two Diverse directors. Such disclosure must be provided: (i) in the company's proxy statement or information statement for its annual meeting of shareholders; or (ii) on the company's website. If the company provides such disclosure on its website, the company must also notify Nasdaq of the location where the information is available by submitting the URL link through the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholder meeting.

Nasdaq would not assess the substance of the company's explanation, but would verify that the company has provided one. If the company has not provided any explanation, or has provided an explanation that does not satisfy subparagraphs (i) and (ii) of Rule 5605(f)(3), the explanation will not satisfy the requirements of Rule 5605(f)(3). For example, it would not satisfy Rule 5605(f)(3) merely to state that "the Company does not comply with Nasdaq's diversity rule." As described above, the company must specify the requirements of Rule 5605(f)(2) that are applicable and explain the reasons why it does not have two Diverse directors. For example, a company

could disclose the following to satisfy subparagraph (i) of Rule 5605(f)(3): "As a Smaller Reporting Company listed on the Nasdaq Capital Market tier, the Company is subject to Nasdaq Rule 5605(f)(2)(C), which requires the company to have, or explain why it does not have, at least two Diverse directors, including at least one director who self-identifies as Female. Under Rule 5605(f)(7), the Company is required to have at least one Diverse director by March 10, 2023, and a second Diverse director by March 10, 2026. The Company has chosen to satisfy Rule 5605(f)(2)(C) by explaining its reasons for not meeting the diversity objectives of Rule 5605(f)(2)(C), which the Company has set forth below."

i. Effective Dates and Phase-in Period

Proposed Rule 5605(f)(7) provides a transition period before companies must fully satisfy the requirement to have two Diverse directors or explain why they do not upon the initial implementation of the rule. Under this transition rule, each company must have, or explain why it does not have, one Diverse director no later than two calendar years after SEC approval of the proposed rule (the "Approval Date"), and two Diverse directors no later than (i) four calendar years after the Approval Date for companies listed on the Nasdaq Global Select ("NGS") or Global Market ("NGM") tiers, or (ii) five calendar years after the Approval Date for companies listed on the Nasdaq Capital Market ("NCM") tier. For example, if the Approval Date is March 10, 2021, all companies would be required to have, or explain why they do not have, one Diverse director by March 10, 2023 and two Diverse directors by March 10, 2025 (for NGS/NGM companies) or March 10, 2026 (for NCM companies).

Under proposed Rule 5605(f)(5)(A), a newly listed company that was not previously subject to a substantially similar requirement of another national securities exchange will be allowed one year from the date of listing to satisfy the requirement described above. This "phase-in" period applies to companies listing in connection with an initial public offering, a direct listing, a transfer from another exchange or the over-the-counter market, or through a business combination with an acquisition company listed under IM-5101-2, such that the company is no longer subject to IM-5101-2 after the combination. This phase-in period will apply after the end of the transition period provided in Rule 5605(f)(7). As a result, companies listing after the expiration of the phase-in periods provided by Rule 5605(f)(7) would be provided with one year from the date of listing to satisfy the applicable requirement of Rule 5605(f)(2) to have, or explain why they do not have, at least two Diverse directors. Companies listing after the Approval Date, but prior to the expiration of the phase-in periods provided by Rule 5605(f)(7), would be provided with the latter of the periods set forth in Rule5605(f)(7) or one year from the date of listing.

Nasdaq believes this proposed period is consistent with the phase-in periods granted to companies for Nasdaq's other board composition requirements. For example, Rule 5615(b)(1) provides a company listing in connection with its initial public offering one year to fully comply with the compensation and nomination committee requirements of Rules 5605(d) and (e), and with the majority independent board requirement of Rule 5605(b). Similarly, SEC Rule 10A-3(b)(1)(iv)(A) allows a company up to one year from the date its registration statement is effective to fully comply with the applicable audit committee composition requirements. Nasdaq Rule 5615(b)(3) provides a one-year

timeframe for compliance with the board composition requirements for companies transferring from other listed markets that do not have a substantially similar requirement.

ii. Foreign Issuers

Nasdaq recognizes that the EEOC categories of race and ethnicity may not extend to all countries globally because each country has its own unique demographic composition. However, Nasdaq observed that on average, women tend to be underrepresented in boardrooms across the globe, holding an estimated 16.9% of board seats in 2018.[169] As an official supporter of the United Nations Sustainable Stock Exchanges Initiative, Nasdaq recognizes that ensuring women have equal opportunities for leadership in economic decision making is one of the United Nations Sustainable Development Goals to be accomplished by 2030.[170] However, studies estimate that at current rates, it could take 18[171] to 34 years[172] for U.S. companies to achieve gender parity on their boards.

Accordingly, under proposed Rule 5605(f)(2)(B), each Foreign Issuer must have, or explain why it does not have, at least two Diverse directors on its board, including at least one Female. Nasdaq proposes to provide Foreign Issuers with additional flexibility in that Foreign Issuers may satisfy the diversity requirement by having two Female directors. In addition, Foreign Issuers may also satisfy the diversity requirement by

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169 See Deloitte, *Women in the Boardroom*, supra note 86.

170 See United Nations Sustainable Stock Exchanges Initiative, *Gender Equality*, https://www.un.org/sustainabledevelopment/gender-equality/ (last accessed Nov. 24, 2020).

171 See McKinsey & Company, supra note 36, at 17.

172 See GAO Report, supra note 44, at 9 (estimating "it could take about 10 years from 2014 for women to comprise 30 percent of board directors and more than 40 years for the representation of women on boards to match that of men").

having one Female director, and an individual who self identifies as (i) LGBTQ+ or (ii) an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. Alternatively, a company could satisfy Rule 5605(f)(2)(B) by publicly explaining the company's reasons for not meeting the diversity objectives of the rule.

Nasdaq proposes to define a Foreign Issuer under Rule 5605(f)(1) as (a) a Foreign Private Issuer (as defined in Rule 5005(a)(19)) or (b) a company that: (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Act;[173] and (ii) has its principal executive offices located outside of the United States. This definition will include all Foreign Private Issuers (as defined in Rule 5005(a)(19)),[174] and any foreign issuers that are not foreign private issuers so long as they are also headquartered outside of the United States. This is designed to recognize that companies that are not Foreign Private Issuers but are headquartered outside of the United States are foreign companies notwithstanding the fact that they file domestic SEC reports. It is also designed to exclude companies that are domiciled in a foreign jurisdiction without having a physical presence in that country. Proposed Rule 5605(f)(5)(B) will allow any company that ceases to be a Foreign Issuer one year from the date that the company no longer qualifies as a Foreign Issuer to satisfy the requirements of Rule 5605(f).

Nasdaq also proposes to revise Rule 5615 and IM-5615-3, which currently permit a Foreign Private Issuer to follow home country practices in lieu of the requirements set

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173 See 17 C.F.R. § 240.3b-4(b) ("The term foreign issuer means any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.").

174 Under Nasdaq Rule 5005(a)(19), the term Foreign Private Issuer has "the same meaning as under Rule 3b-4 under the Act."

forth in the Rule 5600 Series, subject to several exclusions. Nasdaq proposes to revise Rule 5615 and IM-5615-3 to add Rules 5605(f) and 5606 to the list of excluded corporate governance rules. As a result, Foreign Private Issuers must satisfy the requirements of Rule 5605(f) and 5606 and may not follow home country practices in lieu of such requirements. However, Foreign Private Issuers that elect to follow an alternative diversity objective in accordance with home country practices, or are located in jurisdictions that restrict the collection of personal data, may satisfy the requirements of Rule 5605(f) by explaining their reasons for doing so instead of meeting the diversity objectives of the rule.

iii. Smaller Reporting Companies

Nasdaq also recognizes that smaller companies, especially pre-revenue companies that depend on the capital markets to fund ground-breaking research and technological advancements, may not have the resources necessary to compensate an additional director or engage a search firm to search outside of directors' networks. In recognition of the resource constraints faced by smaller companies, Nasdaq proposes to provide each Smaller Reporting Company with additional flexibility. Specifically, these companies could satisfy the two Diverse directors objective under Rule 5605(f)(2)(C) by having two Female directors.

Like other companies, Smaller Reporting Companies could also satisfy the two Diverse directors by having one Female director and one director who self-identifies as either (i) an Underrepresented Minority, or (ii) a member of the LGBTQ+ community. Alternatively, a company could satisfy Rule 5605(f)(2)(C) by publicly explaining the company's reasons for not meeting the diversity objectives of the rule. Under Rule

5605(f)(1), Nasdaq proposes to define a Smaller Reporting Company as set forth in Rule 12b-2 under the Act.[175] Proposed Rule 5605(f)(5)(B) will allow any company that ceases to be a Smaller Reporting Company one year from the date that the company no longer qualifies as a Smaller Reporting Company to satisfy the requirements of Rule 5605(f).

iv. Cure Period

Nasdaq proposes to adopt Rule 5605(f)(6) and a new Rule 5810(c)(3)(F) to specify what happens if a company does not have at least two Diverse directors as set forth under Rule 5605(f)(2) and fails to provide the disclosure required by Rule 5605(f)(3).[176] Under those provisions, the Listing Qualifications Department will promptly notify the company that it has until the latter of its next annual shareholders meeting, or 180 days from the event that caused the deficiency, to cure the deficiency. The company can cure the deficiency either by nominating additional directors so that it satisfies the Diversity requirement of Rule 5605(f)(2) or by providing the disclosure required by Rule 5605(f)(3). If a company does not regain compliance within the applicable cure period, the Listings Qualifications Department would issue a Staff Delisting Determination Letter. A company that receives a Staff Delisting Determination can appeal the determination to the Hearings Panel through the process set forth in Rule 5815. Nasdaq also proposes revising Rule 5810(c)(2)(A)(iv) to make a non-substantive change clarifying that Rule 5250(b)(3) is related to "Disclosure of Third Party Director and Nominee Compensation."

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175 Under 12b-2 of the Act, a Smaller Reporting Company "means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than $250 million; or (2) Had annual revenues of less than $100 million and either: (i) No public float; or (ii) A public float of less than $700 million." See 17 C.F.R. § 240.12b-2.

176 Nasdaq proposes that existing Rules 5810(c)(3)(F) and (G) be renumbered as Rules 5810(c)(3)(G) and (H) respectively.

v. Exempt Companies

Under proposed Rule 5605(f)(4), Nasdaq proposes to exempt the following types of companies from the requirements of Rule 5605(f) ("Exempt Companies"): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. Proposed Rule 5605(f)(5)(B) will allow any company that ceases to be an Exempt Company one year from the date that the company no longer qualifies as an Exempt Company to satisfy the requirements of Rule 5605(f).

Nasdaq believes it is appropriate to exempt these types of companies from the proposed rule because such companies do not have boards, do not list equity securities, or are not operating companies. These companies are already exempt from certain of Nasdaq's corporate governance standards related to board composition, as described in Rule 5615.

d. Alternatives Considered

Nasdaq considered whether requiring listed companies to have, or explain why they do not have, two Diverse directors would better promote the public interest than an alternative threshold or approach. Nasdaq's reasoned decision-making process included considering: (i) mandate and disclosure-based approaches; (ii) higher and lower diversity objectives; (iii) longer and shorter timeframes; and (iv) broader and narrower definitions of "Diverse."

i. Mandate vs. Disclosure Based Approach

Globally, gender mandates range from requiring at least one woman on the board,[177] requiring two or more women based on board size,[178] or requiring 30 to 50% women on the board.[179] Some mandates vary by board size—for example, Norway imposes different standards for boards of two to three directors, four to five directors, six to eight directors, nine directors and ten or more directors.[180] California imposes a higher

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177 For example, the Securities and Exchange Board of India requires public companies to have at least one woman on the board. See Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, Regulation 17(1)(a) (2015), available at: https://www.sebi.gov.in/legal/regulations/jan-2020/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-regulations-2015-last-amended-on-january-10-2020-_37269.html. Similarly, the Israeli Companies Law requires public companies to have at least one woman on the board. See Paul Hastings, *Breaking the Glass Ceiling: Women in the Boardroom* 139 (2018), available at: https://www.paulhastings.com/genderparity/. In the United States, California's S.B. 826 requires public companies headquartered in California to have at least one woman on the board. See Cal. S.B. 826, supra note 112, at § 301.3(b)(3).

178 For example, California's S.B. 826 requires public companies headquartered in California to have at least two women on the board if their board is comprised of five directors, and at least three women on the board if their board is comprised of six or more directors. See Cal. S.B. 826, supra note 112, at § 301.3(b)(1) and (2). Similar legislation has been proposed in New Jersey, Michigan and Hawaii. See N.J. Senate No. 3469, § 3(b)(2) (2019); Mich. S.B. 115, § 505a(2)(b) (2019); Haw. H.B. 2720, § 414-1(b)(2) (2020).

179 For example, Norway imposes a gender quota ranging from 33%-50% depending on board size. See Paul Hastings, supra note 177, at 103. Portugal requires listed companies to have at least 33.3% women on boards by 2020. See Deloitte, *Women in the Boardroom*, supra note 86, at 143. Germany requires public companies with co-determined boards (at least 50% employee representation) to have at least 30% women, and all other listed companies to establish a company-defined target. See Ulrike Binder and Guido Zeppenfeld, Mayer Brown, *Germany Introduces Rules on Female Quota for Supervisory Boards and Leadership Positions* (March 13, 2015), available at https://www.mayerbrown.com/en/perspectives-events/publications/2015/03/germany-introduces-rules-on-female-quota-for-super. Belgium requires listed companies to have at least 33% women on the board. See Deloitte, *Women in the Boardroom*, supra note 86, at 85. Austria requires listed companies with more than 1,000 employees to have at least 30% women on the board. See id. at 81. Iceland requires public companies with more than 50 employees to have at least 40% women on the board. See Act respecting Public Limited Companies No. 2/199, Article 63, available at: https://www.government.is/publications/legislation/lex/2018/02/06/TRANSLATION-OF-RECENT-AMENDMENTS-OF-ICELANDIC-PUBLIC-AND-PRIVATE-LIMITED-COMPANIES-LEGISLATION-2008-2010-including-Acts-13-2010-sex-ratios-and-68-2010-minority-protection-remuneration/. France and Italy both require public companies to have at least 40% women on their boards. See Paul Hastings, supra note 177, at 91; White & Case, *Italy increases gender quotas in corporate boards of listed companies* (Jan. 29, 2020), available at: https://www.whitecase.com/publications/alert/italy-increases-gender-quotas-corporate-boards-listed-companies).

180 See Paul Hastings, supra note 177, at 103.

standard for gender diversity that boards with five directors or six or more directors must satisfy by the end of 2021 under S.B. 826, and a higher standard for underrepresented communities that boards with five to eight directors and nine or more directors must satisfy by the end of 2022 under A.B. 979. Nasdaq did not observe a common denominator among the mandates applicable to varying board sizes. However, Nasdaq considered criticism that a model based on various board sizes could subject companies to a higher threshold by virtue of adding directors.[181] Based on Nasdaq data, the average board size of its listed companies is eight directors.

Soft targets ranging from 25% to 40% women on boards have been suggested by various corporate governance codes and corporate governance organizations. For example, Rule 4.1 of the Swedish Corporate Governance Code (the "Code") provides that listed companies are to "strive for gender balance on the board."[182] Each company's nominations committee is to publish a statement on its website at the time it issues notice of its shareholders meeting "with regard to the requirement in rule 4.1, that the proposed composition of the board is appropriate according to the criteria set out in the Code and that the company is to strive for gender balance."[183] Companies are not required to

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181 See David A. Katz and Laura A. McIntosh, Wachtell, Lipton, Rosen & Katz, *Gender Diversity and Board Quotas*, New York Law Journal (July 25, 2018), available at: https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.26150.18.pdf ("California legislators dispute that the bill requires men to be displaced by women, noting that boards can simply increase their size. This may be easier said than done, however: Because the required quota increases with board size, a company with a four-man board that did not wish to force out a current director would need to add three women to accommodate the requirements of the law by 2021.").

182 See Swedish Corporate Governance Board, *The Swedish Corporate Governance Code* §4.1 17 (eff. Jan. 1, 2020), available at: http://www.bolagsstyrning.se/UserFiles/Koden/The_Swedish_Corporate_Governance_Code_1_January_2020.pdf.

183 See Swedish Corporate Governance Board, *Annual Report 2020* 22 (August 2020), available at: http://www.bolagsstyrning.se/userfiles/archive/3930/kodkoll_arsrapport-2020_eng.pdf.

comply with the Code, "but are allowed the freedom to choose alternative solutions which they feel are better suited to their particular circumstances, as long as they openly report every deviation, describe the alternative solution they have chosen and explain their reasons for doing so."[184] Signifying progress, in 2019, 7% of nominations committees did not issue a statement on board gender balance, compared to 58% in 2013.[185]

In 2015, the Swedish Corporate Governance Board, which is responsible for administering the Code, established a goal to achieve representation of women on boards of small/mid cap (and Swedish companies listed on NGM Equity) and large cap companies of 30% and 35%, respectively, by 2017. Further, the Board aimed to achieve 40% representation of women on boards of all listed Swedish companies by 2020.[186] Based on data as of June 30, 2020, among listed companies, women accounted for 32.7% of board seats on small/mid cap companies and NGM Equity, 38.6% of large cap companies and 34.7% of all listed companies.[187]

In the United Kingdom, the Financial Conduct Authority requires companies with a premium listing on the London Stock Exchange to publicly disclose whether or not they comply with the Financial Reporting Council's U.K. Corporate Governance Code (the

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184 See Swedish Corporate Governance Board, *Gender balance on boards of listed companies: The Swedish Corporate Governance Board assesses the situation ahead of this year's AGMs* (February 3, 2015), available at: http://www.bolagsstyrning.se/userfiles/archive/3856/pressrelease_gender_2014-02-03.pdf.

185 See Swedish Corporate Governance Board, *Annual Report 2020*, supra note 183, at 22.

186 See Swedish Corporate Governance Board, *Gender balance*, supra note 184.

187 See Swedish Corporate Governance Board, *Statistics regarding gender balance* (July 15, 2020), available at: http://www.bolagsstyrning.se/userfiles/archive/3922/200715_gender_balance_on_boards.pdf; see also *Sammanfattning*, available at http://www.bolagsstyrning.se/userfiles/archive/3922/statistik_konsfordelning_2020.pdf.

"U.K. Code"), and if not, to explain their reasons for non-compliance.[188] Provision 23 of the U.K. Code requires each company to publicly describe "the work of the nomination committee, including . . . the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives,"[189] and Principle J states that board appointments and succession planning should, among other things, "promote diversity of gender, social and ethnic backgrounds."[190] In addition, the Companies Act requires companies to disclose gender diversity statistics among the board, management and employees.[191] In 2018, the Financial Reporting Council reported that 83% of FTSE 100 and 74% of FTSE 250 companies had established a board diversity policy specifying gender, with approximately 1/3 specifying ethnicity.[192] More recently, a report commissioned by the Financial Reporting Council concluded that there is a lack of public disclosure regarding the LGBTQ+ status among directors and executives of public companies. While the report did not recommend amending Principle J of the U.K. Code to consider sexual orientation or gender identity, it emphasized that the U.K. Code "seeks to promote

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188 See Financial Conduct Authority, LR 9.8.6(6), available at: https://www.handbook.fca.org.uk/handbook/LR/9/8.html; see also Financial Reporting Council, *The UK Corporate Governance Code* 3 (July 2018), available at https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF. In addition, "[i]n 2016, the [UK] Government also implemented the relevant provision of the EU Non-Financial Reporting Directive with a new reporting requirement in the FCA's Disclosure and Transparency Rules. This requires issuers (excluding [small and medium-sized enterprises]) admitted to trading on an EU regulated market to disclose their diversity policy in the corporate governance statement." See Financial Reporting Council, *Board Diversity Reporting* 5 (September 2018), available at: https://www.frc.org.uk/getattachment/62202e7d-064c-4026-bd19-f9ac9591fe19/Board-Diversity-Reporting-September-2018.pdf.

189 See Financial Reporting Council, *The UK Corporate Governance Code*, supra note 188, at 9.

190 Id. at 8.

191 See UK Companies Act 2006, § 414C.

192 See Financial Reporting Council, Board Diversity Reporting, supra note 188, at 9.

diversity and inclusion of all minority groups within business"[193] and suggested that the government "update corporate reporting requirements to require companies to demonstrate how they intend to capture data on the sexual orientation and gender identity of staff."[194]

In 2011, the Davies Review called on FTSE 100 boards to achieve 25% women on boards by 2015.[195] After that milestone was achieved, the Hampton Alexander Review encouraged FTSE 350 boards to have 1/3 women by 2020, and it has been achieved by FTSE 100 companies.[196] In 2017, the Parker Review called on FTSE 100 and 250 companies to have at least one director of color by 2021 and 2024, respectively.[197] As of February 2020, approximately 37% of FTSE 100 companies surveyed and 59% of FTSE 350 companies surveyed did not have one director of color on their board.[198]

Australian Securities Exchange ("ASX")-listed companies must comply with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (the "ASX Recommendations") or explain why they do not. The ASX Recommendations require companies to have and disclose a diversity policy with measurable objectives and report on progress towards meeting those objectives. If the company is in the ASX/S&P 300, its objective for achieving gender diversity should be at

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193 See Hay et al., supra note 98, at 37.

194 Id.

195 See *Women on boards*, supra note 96.

196 See *Hampton-Alexander Review: FTSE Women Leaders* (November 2016), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/613085/ftse-women-leaders-hampton-alexander-review.pdf.

197 See Parker, supra note 97.

198 See Sir John Parker, *Ethnic Diversity Enriching Business Leadership* 19 (Feb. 5, 2020), available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2020-report-final.pdf.

least 30%.[199] The Australian government also requires companies with 100 or more employees to provide an annual report about gender equality indicators, including the gender composition of the board and the rest of the workforce.[200] In 2015, the ASX and KPMG found that 99% of S&P/ASX 200 companies and 88% of ASX 201-500 companies disclosed establishing a diversity policy rather than explaining why they do not have one.[201] As of July 2020, women account for 28.4% and 31.8% of board seats among ASX 300 and ASX 100 companies, respectively.[202]

Nasdaq observed that women account for at least 30% of the boards of the largest companies in Australia, Sweden and the United Kingdom, and in three other countries that have implemented disclosure requirements or suggested milestones on a comply-or-explain basis: Finland, New Zealand, and Canada.[203] Nasdaq considered that countries

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199 See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* 9 (4th ed. Feb. 2019), available at: https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf.

200 Workplace Gender Equality Act 2012, Part IV § 13 (March 25, 2015), available at: https://www.legislation.gov.au/Details/C2015C00088.

201 See KPMG and ASX, *ASX Corporate Governance Council Principles and Recommendations on Diversity: Analysis of disclosures for financial years ended 1 January 2015 and 31 December 2015* 4 (2016) available at: https://www.asx.com.au/documents/asx-compliance/asx-corp-governance-kpmg-diversity-report.pdf.

202 See KPMG and 30% Club, *Building Gender Diversity on ASX 300 Boards: Seven Learnings from the ASX 200* 4 (July 2020), available at: https://assets.kpmg/content/dam/kpmg/au/pdf/2020/building-gender-diversity-asx-300-boards.pdf. The report also noted that diversity counteracts groupthink and that ASX 201-299 companies with at least 30% female directors "are more likely than not to [have seen] market capitalisation increases over the past 12 months." Id. at 6.

203 See The Conference Board of Canada, *Data Dashboard* (Sept. 23, 2020), available at: https://www.conferenceboard.ca/focus-areas/inclusion/2020/aob-comparisons-around-the-world-table?AspxAutoDetectCookieSupport=1; Andrew MacDougall et al., Osler, *Diversity Disclosure Practices* 4 (2020), available at https://www.osler.com/osler/media/Osler/reports/corporate-governance/Diversity-and-Leadership-in-Corporate-Canada-2020.pdf. But see Heike Mensi-Klarbach et al., *The Carrot or the Stick: Self-Regulation for Gender-Diverse Boards via Codes of Good Governance*, J. Bus. Ethics 11 (2019), available at: https://doi.org/10.1007/s10551-019-04336-z (reviewing longitudinal data from 2006 to 2016 on listed and state-owned companies in Austria and concluding that "self-regulation of gender diversity on boards is ineffective if merely based on recommendations in codes of good governance"). Mensi-Klarbach recommends setting

that have implemented mandates have also seen progress in women's representation on boards, including, for example, Austria, Iceland, Belgium, France, Germany, Italy and Portugal.[204] On average, women account for 31% of board seats in countries with gender mandates.[205]

Nasdaq discussed the benefits and challenges of mandate and comply-or-explain models with over a dozen stakeholders, and while the majority of organizations were in agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, the majority also stated that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. Most organizations Nasdaq spoke with expressed general discomfort with mandates, although they acknowledged that opposition is lessening in the wake of California's S.B. 826[206] and A.B. 979.[207] While many recognized that mandates can force boards to act more quickly and accelerate the rate of change, they believe that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Some stakeholders also highlighted additional challenges that smaller companies and companies in certain industries may face finding diverse board members. In contrast, a disclosure-based framework that provides companies with flexibility would empower companies to maintain decision-making authority over their board's composition while providing stakeholders with a better understanding of the company's current board

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concrete targets and providing public monitoring to improve the effectiveness of comply-or-explain frameworks.

204 See Paul Hastings, supra note 177; see also Deloitte, *Women in the Boardroom*, supra note 86.

205 See Paul Hastings, supra note 177; The Conference Board of Canada, supra note 203.

206 See Cal. S.B. 826, supra note 112.

207 See Cal. A.B. 979, supra note 112.

composition and its philosophy regarding diversity. This approach would better inform the investment community and enable more informed analysis of, and conversations with, companies. Nasdaq believes that these goals will be achieved through the disclosure of consistent, comparable data across companies, as would be required by the Exchange's proposed definition of Diverse.

For example, if, under Israeli law regarding board diversity, an Israeli company is required only to have a minimum of one woman on the board and such Israeli company chooses to comply with Israeli home country law in lieu of meeting the diversity objectives of Rule 5605(f)(2)(B), it may choose to disclose that "the Company is incorporated in Israel and required by Israeli law to have a minimum of one woman on the board, and satisfies home country requirements in lieu of Nasdaq Rule 5605(f)(2)(B), which requires each Foreign Issuer to have at least two Diverse directors." If a U.S. company had two Diverse directors but one resigned due to unforeseen circumstances, it could disclose, for example: "Due to the unexpected resignation of Ms. Smith this year, the Company does not have at least one director who self-identifies as Female and one director who self-identifies as an Underrepresented Minority or LGBTQ+. We intend to undertake reasonable efforts to meet the diversity objectives of Rule 5605(f)(2)(A) prior to our next annual shareholder meeting and have engaged a search firm to identify qualified Diverse candidates. However, due to unforeseen circumstances, we may not achieve this goal." Or a U.S. company may disclose that it chooses to define diversity more broadly than Nasdaq's definition by considering national origin, veteran status or individuals with disabilities when identifying nominees for director because it believes such diversity brings a wide range of perspectives and experiences to the board. In each

case, investors will have a better understanding of the company's reasons for not having at least two Diverse directors and can use that information to make an informed investment or voting decision.

ii. Higher vs. Lower Diversity Objectives

Nasdaq observed that existing empirical research spanned companies across several countries, including the United States, Spain, China, Canada, France and Norway. Nasdaq considered that the studies related to company performance and board diversity found positive associations at various levels and measures of board diversity, including having at least one woman on the board,[208] two or more diverse directors (with diverse considered female, Black, Hispanic or Asian),[209] at least three women on the board[210] and being in the top quartile for gender and ethnic diversity.[211]

Nasdaq considered that the academic studies related to investor protection and board diversity found positive associations at various levels and measures of board diversity, including having at least one woman on the board[212] or up to 50% women on the board, and the assertions of certain academics that their findings may extend to other forms of diversity, including racial and ethnic diversity.[213] Nasdaq also reviewed academic research suggesting that "critical mass" is achieved by having three or more women on the board, and that having only one diverse director on the board risks

208 See Credit Suisse, supra note 30, at 16.

209 See Thomas and Starr, supra note 23, at 5.

210 See Eastman et al., supra note 31, at 3; Wagner, supra note 32.

211 See McKinsey, supra note 36.

212 See Abbott et al., supra note 58; Chen et al., supra note 64.

213 See Wahid, supra note 59; Cumming et al., supra note 62, at 34.

"tokenism."[214] Nasdaq considered that although the legislation enacted by Norway and California, and proposed by several other states, varies based on board size, the academic research considered companies across a spectrum of sizes and board sizes, including Fortune 100, S&P 500, Fortune 1000 and smaller (non-Fortune 1000) companies.

Nasdaq concluded that there is no "one-size fits all" approach to promoting board diversity and that the academic literature regarding the relationship between board diversity, company performance and investor protections is continuing to evolve. However, in Nasdaq's survey of academic studies described above—and of the targets or mandates promulgated by regulatory bodies and organizations worldwide—Nasdaq observed a common denominator of having at least one woman on the board. Similarly, Nasdaq observed a common denominator of having at least one director who is diverse in terms of race, ethnicity or sexual orientation among the requirements related to, and academic research considering, board diversity beyond gender identity. Nasdaq therefore believes that a diversity objective of at least two Diverse directors provides a reasonable baseline for comparison across companies. Companies are not precluded from meeting a higher or lower alternative measurable objective. For example, a company may choose to disclose that it does not meet the diversity objectives under Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to satisfy that diversity objective instead. On the other hand, many firms may strive to achieve even greater diversity than the objectives set forth in Nasdaq's proposed rule. Nasdaq believes that providing flexibility and clear disclosure when the company determines to

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214 See Alison M. Konrad et al., *Critical Mass: The Impact of Three or More Women on Corporate Boards*, 37(2) Org. Dynamics 145 (April 2008); Miriam Schwartz-Ziv, *Gender and Board Activeness: The Role of a Critical Mass*, 52(2) J. Fin. & Quant. Analysis 751 (April 2017); Mariateresa Torchia et al., *Women Directors on Corporate Boards: From Tokenism to Critical Mass*, 102(2) J. Bus. Ethics. 299 (Feb. 25, 2011), available at https://ssrn.com/abstract=1858347.

follow a different path will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions.

iii. Longer vs. Shorter Timeframes

Nasdaq considered whether an alternative timeframe for satisfying the diversity objectives of Rule 5605(f)(2) would better promote the public interest than the timeframe Nasdaq has proposed under Rule 5605(f)(7). While companies are not precluded from adding additional directors to their boards to satisfy Rule 5605(f)(2) by having two Diverse directors sooner than contemplated by the proposed rule, Nasdaq understands that some companies may need to obtain shareholder approval to amend their governing documents to allow for board expansion. Other companies may choose to replace an existing director on the board with a Diverse director, and board turnover may be low.[215] Nasdaq recognizes that it also takes substantial lead time to identify, interview and select board nominees. To provide companies with sufficient time to satisfy Rule 5605(f) by having two Diverse directors, while recognizing that investors are calling for expedient change, Nasdaq has structured its proposal similarly to the approach taken by California, where companies must achieve one target by an earlier date and satisfy the entire diversity objective at a later date. Nasdaq also considered the approaches taken by foreign jurisdictions to implement diversity objectives. For example, Belgium and France implemented diversity objectives under a phased approach that provided

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215 See Matteo Tonello, *Corporate Board Practices in the Russell 3000 and S&P 500*, Harv. L. Sch. Forum on Corp. Governance (Oct. 18, 2020), https://corpgov.law.harvard.edu/2020/10/18/corporate-board-practices-in-the-russell-3000-and-sp-500/ (last accessed Nov. 24, 2020).

companies with at least five years to fully satisfy the objectives,[216] whereas Iceland and Portugal provided companies with three years or less.[217]

While companies may choose to satisfy Rule 5605(f)(2) on an alternative timeframe, a company that chooses a timeframe that is longer than the timeframes set forth in Rule 5605(f)(7) also must publicly explain its reasons for doing so. For example, an NGM-listed company that, while not technically a Smaller Reporting Company, views itself as similarly situated to a NCM-listed Smaller Reporting Company may disclose the following: "While the Company is listed on NGM and technically qualifies as a Smaller Reporting Company, it does not file its SEC reports utilizing the Smaller Reporting Company designation. However, the Company believes that it is similarly situated to other Smaller Reporting Companies listed on NCM in terms of its annual revenues and public float, and therefore has chosen to satisfy Rule 5605(f)(2)(C) in lieu of Rule 5605(f)(2)(A) and has satisfied this requirement by having at least two Diverse directors on the board who self-identify as Female within the timeframe provided under Rule 5605(f)(7) applicable to NCM-listed companies."

iv. Broader vs. Narrower Definition of Diverse

Nasdaq considered whether the definition of Diverse should include broader characteristics than those reported on the EEO-1 report, such as the examples provided by the Commission's CD&I, including LGBTQ+, nationality, veteran status, and individuals with disabilities. During its stakeholder outreach, Nasdaq inquired whether a broad definition of Diversity would promote the public interest. While recognizing the diverse perspectives that different backgrounds can provide, most stakeholders supported a

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216 See Paul Hastings, supra note 177, at 79 and 90; see also supra note 179.

217 See Deloitte, Women in the Boardroom, supra note 86, at 115 and 143; see also supra note 179.

narrower definition of Diversity focused on gender, race and ethnicity, with several supporting broadening the definition to include the LGBTQ+ community.

As discussed above, companies currently are permitted to define diversity "in ways they consider appropriate" under federal securities laws. One of the challenges of this principles-based approach has been the disclosure of inconsistent and noncomparable data across companies. However, most companies are required by law to report data on race, ethnicity and gender to the EEOC through the EEO-1 Report. Nasdaq believes that 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. 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.

Nasdaq also believes that a transparent, consistent definition of Diverse would provide stakeholders with a better understanding of the company's current board composition and its philosophy regarding diversity if it does not have two Diverse directors. This would enable the investment community to conduct more informed

analysis of, and have more informed conversations with, companies. To the extent a company chooses to satisfy the requirement of Rule 5605(f)(2) by having at least two Diverse directors on its board, it will have the ancillary benefit of making meaningful progress in improving board diversity related to race, ethnicity, sexual orientation and gender identity.

Nasdaq's review of academic research on board diversity revealed a dearth of empirical analysis on the relationship between investor protection or company performance and broader diversity characteristics such as veteran status or individuals with disabilities.[218] Nasdaq acknowledges that there also is a lack of published research on the issue of LGBTQ+ representation on boards.[219] This may be due to a lack of consistent, transparent data on broader diverse attributes, or because there is no voluntary self-disclosure workforce reporting requirements for LGBTQ+ status, such as the EEO-1 reporting framework for race, ethnicity, and gender. In any event, it is evident that while "[b]oardroom diversity is a topic that has gained significant traction . . . LGBT+ diversity, however, has largely been left out of the conversation."[220]

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218 KPMG (2020) states that veterans are underrepresented in boardrooms, with retired General and Flag Officers ("GFOs") occupying less than 1% of Fortune 500 board seats. See KPMG, *The value of veterans in the boardroom* 1 (2020), available at: https://boardleadership.kpmg.us/content/dam/boardleadership/en/pdf/2020/the-value-of-veterans-in-the-boardroom.pdf (noting that "[r]etired GFOs who have honed their leadership and critical decision-making skills in a high-threat environment can bring extensive risk oversight experience to the board, which may be especially valuable in the context of today's risk landscape"). Accenture (2018) observed that companies that offered inclusive working environments for employees with disabilities achieved an average of 28% higher revenue, 30% higher economic profit margins, and 2x net income than their industry peers. See Accenture, *Getting to Equal: The Disability Inclusion Advantage* (2018), available at: https://www.accenture.com/_acnmedia/PDF-89/Accenture-Disability-Inclusion-Research-Report.pdf.

219 See Credit Suisse ESG Research, supra note 33, at 1; see also Out Leadership, supra note 35.

220 See Out Leadership, supra note 35, at 3.

Nonetheless, Nasdaq believes it is reasonable and in the public interest to include a reporting category for LGBTQ+ in recognition of the U.S. Supreme Court's recent affirmation that sexual orientation and gender identity are "inextricably" intertwined with sex,[221] and based on studies demonstrating a positive association between board diversity and decision making, company performance and investor protections. Nasdaq also believes that the proposed rule would foster the development of data to conduct meaningful assessments of the association between LGBTQ+ board diversity, company performance and investor protections.

As noted above, the proposal does not preclude companies from considering additional diverse attributes, such as nationality, disability, or veteran status in selecting board members; however, company would still have to provide the required disclosure under Rule 5605(f)(3) if the company does not also have at least two directors who are Diverse. Nor would the proposal prevent companies from disclosing information related to other diverse attributes of board members beyond those highlighted in the rule if they felt such disclosure would benefit investors. Nasdaq believes such disclosure would help inform the evolving body of research on the relationship between broader diverse attributes, company performance and investor protection and provide investors with additional information about the company's philosophy regarding broader diversity characteristics.

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221 See Bostock v. Clayton Cnty., supra note 160.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[222] in general, and furthers the objectives of Section 6(b)(5) of the Act,[223] in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, to prevent fraudulent and manipulative acts and practices, and, in general, to protect investors and the public interest, for the reasons set forth below. Further, Nasdaq believes the proposal is not designed to permit unfair discrimination between issuers or to regulate by virtue of any authority conferred by the Act matters not related to the purposes of the Act or the administration of the Exchange, for the reasons set forth below.

I. Board Statistical Disclosure

Nasdaq has proposed what it believes to be a straightforward and clear approach for companies to publish their statistical data pursuant to proposed Rule 5606. The disclosure will assist investors in making more informed decisions by making meaningful, consistent, and reliable data readily available and in a clear and comprehensive format prescribed by the proposed rule. Nasdaq also believes that the disclosure format required by proposed Rule 5606 protects investors by eliminating data collection inaccuracies and decreasing costs, while enhancing investors' ability to utilize the information.

As a threshold matter, as discussed above, diversity has become an increasingly important subject and, in recent years, investors increasingly have been advocating for greater board diversity and for the disclosure of board diversity statistics. The current

222 See 15 U.S.C. § 78f(b).

223 Id. § 78f(b)(5).

board diversity disclosure regime is lacking in several respects, and Nasdaq believes that its proposed Rule 5606 addresses many of the current concerns and responds to investors' demands for greater transparency into the diversity characteristics of a company's board composition by mandating disclosure and curing certain deficiencies that exist within the current SEC disclosure requirements.

Investors have expressed their dissatisfaction with having to independently collect board-level data about race, ethnicity and gender identity because such investigations can be time consuming, expensive, and fraught with inaccuracies.[224] The lack of consistency and specificity in Regulation S-K has been a major impediment for many investors and data collectors. As a general matter, the Commission's requirements have not addressed the concerns expressed by commenters that "disclosure about board diversity was important information to investors."[225] Nasdaq believes that its proposed Rule 5606 addresses many of the concerns that have been raised.

Nasdaq believes that requiring the annual disclosure of a company's board diversity, as proposed in Rule 5606(a), will provide consistent information to the public and will enable investors to continually review the board composition of a company to track trends and simplify or eliminate the need for a company to respond to multiple investor requests for information about the diverse characteristics of the company's board. Requiring annual disclosures also would make information available to investors who otherwise would not be able to obtain individualized disclosures.[226] Moreover, consistent disclosures may encourage boards to consider a wider range of board

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224 See Petition for Amendment of Proxy Rule, supra note 80, at 2.

225 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,343-44 (amending Item 407(c)(2)(vi) of Regulation S-K, codified at 17 C.F.R. § 229.407(c)(2)(vi)).

226 See Petition for Rulemaking, supra note 123.

candidates in the nomination process, including candidates with fewer ties to the current board.[227]

The Commission's 2009 amendments to Regulation S-K provide no definition for diversity and do not explicitly require disclosures specifically related to details about the board's gender, racial, ethnic and LGBTQ+ composition. Additionally, the Commission's CD&I does not address the definition of diversity, and it requires a registrant to disclose diversity information only in certain limited circumstances. Investors have expressed that current regulations and accompanying interpretations impair their ability to obtain clear and consistent data.[228] As a result, Nasdaq believes that proposed Rule 5606(a) protects investors and the public interest by making clear that a company's annual diversity data disclosure must include information related to gender identity, race, ethnicity and LGBTQ+ status, thereby leaving less discretion for companies to selectively disclose certain diversity information and enhancing the comparability of such data across companies. Moreover, it is in the public interest to provide clear requirements for diversity disclosure, and Nasdaq's proposed Board Diversity Matrix format provides such clarity.

Nasdaq does not intend to obligate directors to self-identify in any of the categories related to gender identity, race, ethnicity and LGBTQ+. Nasdaq believes that a director should have autonomy to decide whether to provide such information to their company. Therefore, Nasdaq believes that it is reasonable and in the public interest to

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227 See Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355 ("To the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management and are, consequently, more independent."); Hazen and Broome, supra note 114, at 57-58.

228 See Petition for Amendment of Proxy Rule, supra note 80, at 2; Petition for Rulemaking, supra note 123, at 7.

allow directors to opt out of disclosing the information required by proposed Rule 5606(a) by permitting a company to identify such directors in the "Undisclosed" category.

Nasdaq believes that it is in the public interest to utilize the Board Diversity Matrix format for all companies as proposed in Rule 5606(a). Additionally, Nasdaq believes that the format removes any impediments to aggregating and analyzing data across all companies by requiring each company to disclose separately the number of male, female, and non-binary directors, the number of male, female, and non-binary directors that fall into certain racial and ethnic categories, and the number of directors that identify as LGBTQ+. The format allows investors to easily disaggregate the data and track directors with multiple diversity characteristics.

As discussed above, most listed companies are required by law to complete an EEOC Employer Information Report EEO-1 Form. Although outside directors generally are not employees and therefore are not covered in the EEO-1,[229] Nasdaq believes that collecting the information required by proposed Rule 5606(a) is familiar to most companies, and that it is reasonable to require disclosure of the additional board information.

Nasdaq also believes that requiring currently listed companies to comply with proposed Rule 5606 within one year from the date of Commission approval is a reasonable amount of time, given that most companies already collect similar information for certain employees. Moreover, most companies are required to prepare an annual

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229 The EEO-1 Form does not require a company to disclose data for outside directors because such directors are not company employees.

proxy statement and update the Commission within four business days when a new director is appointed to the board.[230]

Further, Nasdaq believes that the disclosure required by proposed Rule 5606(a) will remove impediments to shareholders by making available information related to board-level diversity in a standardized manner, thereby enhancing the consistency and comparability of the information and helping to better protect investors. The proposed disclosure will also help protect investors and the public interest by enabling investors to determine the total number of diverse directors, which is information that is not consistently available in existing proxy disclosures in cases where a single director has multiple diverse characteristics. While companies can elect to make this information available either in a proxy statement or on the company's website, Nasdaq believes it is in the public interest to allow companies the option to provide the disclosure in a way they believe will be most meaningful to their shareholders.

Nasdaq recognizes that the proposed definition of Underrepresented Minority in Rule 5605(f)(1) may not apply to companies outside of the United States because each country has its own unique demographic composition. Moreover, Nasdaq's definition of Underrepresented Minority proposed in Rule 5606(f)(1) may be inapplicable to a Foreign Issuer, making this Board Matrix data less relevant for such companies and not useful for investors. Therefore, Nasdaq believes that offering Foreign Issuers the option of a separate template that requires different disclosure categories will provide investors with more accurate disclosures related to the diversity of directors among the board of a Foreign Issuer. Additionally, Nasdaq believes that providing an "Underrepresented

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230 See SEC Form 8-K, available at: https://www.sec.gov/files/form8-k.pdf.

Individual in Home Country Jurisdiction" category provides Foreign Issuers with more flexibility to identify and disclose diverse directors within their home countries.

The annual requirement in the proposed rule will guarantee that the information is available to the public on a continuous and consistent basis. As described in the instructions to the Board Diversity Matrix disclosure form and Rule 5606(a), each year following the first year that a company publishes the Board Diversity Matrix, the company will be required to publish its data for the current and immediately prior years. Nasdaq believes that disclosing at least two years of data allows the public to view any changes and track a board's diversity progress.

In addition to providing a means for shareholders to assess a company's board-level diversity and measure its progress in improving that diversity over time, Nasdaq believes that proposed Rule 5606 will provide a means for Nasdaq to assess whether companies meet the diversity objectives of proposed Rule 5605(f). The ability to determine satisfaction of the proposed listing rule's diversity objectives will protect investors and the public interest.

Moreover, the proposed rule provides transparency into diversity based not only on race, ethnicity, and gender identity, but also on a director's self-identified sexual orientation. Nasdaq believes that expanding the diversity characteristics beyond those which are commonly reported by companies currently will broaden the way boards view diversity, and ensure that board diversity is occurring across all protected groups.

Finally, Nasdaq believes that the proposal is not unfairly discriminatory because proposed Rule 5606 will apply to all Nasdaq-listed companies, except for the following companies: acquisition companies listed under IM-5101-2; asset-backed issuers and

other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non- voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series—which meet the definition of Exempt Companies as defined under proposed Rule 5605(f)(4). Nasdaq believes it is reasonable and not unfairly discriminatory to exempt these companies from the proposed rule because the exemption of these companies is consistent with the approach taken by Nasdaq in Rule 5615 as it relates to certain Nasdaq corporate governance standards for board composition.

Nasdaq further believes it is reasonable to provide companies with a one-year phase-in period to comply with proposed Rule 5606. Nasdaq believes there is only a *de minimis* burden placed on companies to collect the board data and prepare the Board Diversity Matrix. Moreover, as discussed above, companies already are required to gather similar information for certain employees. Therefore, Nasdaq believes that one year is sufficient time for companies to incorporate their directors into their data collection. Furthermore, newly listed companies have many obligations to meet under Nasdaq listing rules. Therefore, Nasdaq believes that it is reasonable under proposed Rule 5606(d) to provide newly listed Nasdaq companies, including companies listing in connection with a business combination under IM-5101-2, with one year from the time of listing to comply with the proposed rule.

II. Diverse Board Representation or Explanation

a. Removes Impediments to and Perfects the Mechanism of a Free and Open Market and a National Market System

As discussed above, studies suggest that the traditional director candidate selection process may create barriers to considering qualified diverse candidates for board positions by limiting the search for director nominees to existing directors' social networks and candidates with C-suite experience.[231] In analyzing Norway's experience in implementing a gender mandate, Dhir (2015) observed that "[b]oard seats tend to be filled by directors engaging their networks, and the resulting appointees tend to be of the same socio-demographic background."[232] Dhir concluded that broadening the search for directors outside of traditional networks "is unlikely to occur without some form of regulatory intervention, given the prevalence of homogenous social networks and in-group favoritism."[233] Regulatory action was effective in increasing the representation of women on boards in Norway by "democratiz[ing] access to a space previously unavailable to women."[234] The number of public company board seats held by women in Norway increased from 6% in 2002 to 42% in 2020.[235] One Norwegian director

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231 See GAO Report, supra note 44; Vell, supra note 100; Rhode & Packel, supra note 104, at 39; Deloitte, *Women in the Boardroom*, supra note 86; see also Parker, supra note 97, at 38 (acknowledging that, "as is the case with gender, people of colour within the UK have historically not had the same opportunities as many mainstream candidates to develop the skills, networks and senior leadership experience desired in a FTSE Boardroom").

232 See Dhir, supra note 78, at 52.

233 Id. at 51. See also Albertine d'Hoop-Azar et al., *Gender Parity on Boards Around the World*, Harv. L. Sch. Forum on Corp. Governance (January 5, 2017), available at: https://corpgov.law.harvard.edu/2017/01/05/gender-parity-on-boards-around-the-world/ (comparing gender diversity on boards in countries with varying requirements and enforcement measures and concluding that external pressures—"progressive societal norms" and regulations—are needed to increase board diversity).

234 See Dhir, supra note 78, at 101.

235 See Marianne Bertrand et al., *Breaking the Glass Ceiling? The Effect of Board Quotas on Female Labor Market Outcomes in Norway*, Nat'l Bureau of Econ. Rsch. Working Paper 20256 (June

"grudgingly accept[ed] that the free market principles she held so dearly had disappointed her—and that the [mandate] was a necessary correction of market failure."[236]

In contrast, Nasdaq observed that other countries have made comparable progress using a disclosure-based model. Women account for at least 30% of the largest boards of companies in six countries using comply-or-explain models:[237] Australia, Finland, Sweden, New Zealand, Canada and the United Kingdom.[238] Nasdaq discussed the benefits and challenges of mandate and disclosure-based models with over a dozen stakeholders, and the majority of organizations were in agreement that companies would benefit from a regulatory impetus to drive meaningful and systemic change in board diversity, and that a disclosure-based approach would be more palatable to the U.S. business community than a mandate. While many organizations recognized that mandates can force boards to act more quickly and accelerate the rate of change, they believe that a disclosure-based approach is less controversial and would spur companies to take action and achieve the same results. Some stakeholders also highlighted additional challenges that smaller companies and companies in certain industries may face finding diverse board members. However, leaders from across the spectrum of stakeholders with whom Nasdaq spoke reinforced the notion that if companies recruit by skill set and expertise rather than title, then they will find there is more than enough diverse talent to satisfy demand.

2017), available at https://www.nber.org/papers/w20256; Statistics Norway, *Board and management in limited companies* (Mar. 6, 2020), https://www.ssb.no/en/styre (last accessed Nov. 27, 2020).

236 See Dhir, supra note 78, at 116.

237 See Paul Hastings, supra note 177; Deloitte, *Women in the Boardroom*, supra note 86.

238 See Conference Board of Canada, supra note 201; Osler, supra note 203, at 4.

Nasdaq also considered Commissioner Lee's observation that disclosure "gets investors the information they need to make investment decisions based on their own judgment of what indicators matter for long-term value. Importantly, it can also drive corporate behavior." Specifically, she observed that:

> For one thing, when companies have to formulate disclosure on topics it can influence their treatment of them, something known as the "what gets measured, gets managed" phenomenon. Moreover, when companies have to be transparent, it creates external pressure from investors and others who can draw comparisons company to company. The Commission has long-recognized that influencing corporate behavior is an appropriate aim of our regulations, noting that "disclosure may, depending on determinations made by a company's management, directors and shareholders, influence corporate conduct" and that "[t]his sort of impact is clearly consistent with the basic philosophy of the disclosure provisions of the federal securities laws.[239]

Nasdaq believes that a disclosure-based framework may influence corporate conduct if a company chooses to meet the diversity objective of Rule 5605(f)(2) by having two Diverse directors on the board. A company may satisfy that objective by broadening the search for qualified candidates and considering candidates from other professional pathways that bring a wider range of skills and perspectives beyond traditional C-suite experience.[240] Nasdaq believes that this will help increase opportunities for Diverse candidates that otherwise may be overlooked due to the impediments of the traditional director recruitment process, which will thereby remove impediments to a free and open market and a national market system. Further, boards that choose to have at least two Diverse directors may experience other benefits from diversity that perfect the mechanism of a free and open market and national market

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239 See Lee, supra note 22.

240 See, e.g., Hillman et al., supra note 105 (finding that African-American and white women directors were more likely to have specialized expertise in law, finance, banking, public relations or marketing, or community influence from positions in politics, academia or clergy).

system. As discussed above in Section II.A.1.II.b (*Diversity and Investor Protection*), and further discussed below in Section II.A.2.II.b (*Prevent Fraudulent and Manipulative Acts and Practices*), studies suggest that diversity is positively associated with reduced stock volatility,[241] more transparent public disclosures,[242] and less information asymmetry,[243] leading to stock prices that better reflect public information, and further removing impediments to and perfecting a free and open market and a national market system. Importantly, Nasdaq believes that the disclosure-based framework proposed under Rule 5605(f) will not create additional impediments to a free and open market and a national market system because it will empower companies to maintain decision-making authority over the composition of their boards.

To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2) to have at least two Diverse directors, Nasdaq believes that proposed Rule 5605(f)(3) will provide analysts and investors with a better understanding about the company's reasons for not doing so and its philosophy regarding diversity. Rule 5605(f) will thus remove impediments to a free and open market and a national market system by enabling the investment community to conduct more informed analyses of, and have more informed conversations with, companies. Nasdaq believes that such analyses and conversations will be better informed by consistent, comparable data across companies, which Nasdaq proposes to achieve by adopting a consistent definition of "Diverse" under Rule 5605(f)(1). Nasdaq further believes that providing such disclosure will improve the quality of information available to investors who rely on this information to make

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241 See Bernile et al., supra note 28.

242 See Gul et al., supra note 66; Bravo and Alcaide-Ruiz, supra note 56.

243 See Abad et al., supra note 67.

informed investment and voting decisions, thereby promoting capital formation and efficiency and perfecting the mechanism of a free and open market and a national market system.

b. Prevent Fraudulent and Manipulative Acts and Practices

Nasdaq's analysis discussed above in Section II.A.1.II raises the concern that the failure of homogenous boards to consider a broad range of viewpoints can result in suboptimal decisions that have adverse effects on company performance, board performance and stakeholders. Nasdaq believes that including diverse directors with a broader range of skills, perspectives and experiences may help detect and prevent fraudulent and manipulative acts and practices by mitigating "groupthink." Increased board diversity also may reduce the likelihood of insider trading and other fraudulent and manipulative acts and practices.

Nasdaq reached this conclusion by reviewing public statements by investors and organizations regarding the impact of groupthink on decision making processes, as well as academic studies on the relationship between diversity, groupthink and fraud. Nasdaq observed that groupthink can result in "self-censorship"[244] and failure to voice dissenting viewpoints in pursuit of "consensus without critical evaluation and without considering different possibilities."[245] In contrast, "board members who possess a variety of viewpoints may raise different ideas and encourage a full airing of dissenting views. Such a broad pool of talent can be assembled when potential board candidates are not limited by gender, race, or ethnicity."[246]

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244 See Forbes and Milliken, supra note 74, at 496.

245 See Dhir, supra note 78, at 124.

246 See Petition for Amendment of Proxy Rule, supra note 80, at 4.

Dhir (2015) concluded that gender diversity may "promote cognitive diversity and constructive conflict in the boardroom" and may be more effective at overseeing management.[247] One respondent in Dhir's survey of Norwegian directors observed that:

> I've seen situations where the women were more willing to dig into the difficult questions and really go to the bottom even if it was extremely painful for the rest of the board, but mostly for the CEO . . . when it comes to the really difficult situations, [where] you think that the CEO has . . . done something criminal . . . [o]r you think that he has done something negligent, something that makes it such that you . . . are unsure whether he's the suitable person to be in the driving seat.[248]

Another director observed that "[i]f you have different experiences and a more diversified board, you will have different questions asked."[249] Dhir concluded that "women directors may be particularly adept at critically questioning, guiding and advising management without disrupting the overall working relationship between the board and management."[250]

Pucheta-Martínez et al. (2016) reasoned that questioning management is a critical part of the audit committee's oversight role, along with ensuring that management does not pressure the external auditor to issue a clean audit opinion notwithstanding the identification of any uncertainties or scope limitations.[251] Otherwise, "[a]uditors may accept the demands of management for a clean audit report when the firm deserves a scope limitation and an uncertainty qualification."[252] The authors found that "the percentage of female [directors] on [audit committees] reduces the probability of [audit]

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247 See Dhir, supra note 78, at 150.

248 Id. at xiv.

249 Id. at 120.

250 Id. at 35.

251 See Pucheta-Martínez et al., supra note 52, at 368.

252 Id. at 364.

qualifications due to errors, non-compliance or the omission of information,"[253] and further found a positive association between gender-diverse audit committees and disclosing audit reports with uncertainties and scope limitations. This suggests that gender-diverse audit committees better "ensure that managers do not seek to pressure auditors into issuing a clean opinion instead of a qualified opinion" when any uncertainties or scope limitations are identified.[254]

Nasdaq also reviewed other studies that found a positive association between board gender diversity and important investor protections regardless of whether women are on the audit committee, and considered the assessment of some academics that their findings may extend to other forms of diversity, including racial and ethnic diversity. Nasdaq therefore believes that such findings with respect to audit committees would be expected to be more broadly applicable to the quality of the broader board's decision-making process, and to other forms of diversity, including diversity of race, ethnicity and sexual orientation.

In examining the association between broader board gender diversity and fraud, Cumming, et al. observed that "[g]ender diversity in particular facilitates more effective monitoring by the board and protection of shareholder interests by broadening the board's expertise, experience, interests, perspectives and creativity."[255] They observed that the presence of women on boards is associated with a lower likelihood of securities fraud; indeed, they found "strong evidence of a negative and diminishing effect of women on

253 Id. at 363.

254 Id. at 368.

255 See Cumming et al., supra note 62, at 34.

boards and the probability of being in our fraud sample."[256] The authors suggested that "other forms of board diversity, including but not limited to gender diversity, may likewise reduce fraud."[257]

Similarly, Wahid (2017) noted that board gender diversity may "lead to less biased and superior decision-making" because it "has a potential to alter group dynamics by affecting cognitive conflict and cohesion."[258] Wahid (2017) concluded that "gender-diverse boards commit fewer financial reporting mistakes and engage in less fraud,"[259] finding that companies with female directors have "fewer irregularity-type [financial] restatements, which tend to be indicative of financial manipulation."[260] Wahid also suggested that other forms of diversity, including racial diversity, could introduce additional perspectives to the boardroom,[261] which Nasdaq believes could further mitigate groupthink.

Abbott, Parker and Persley (2012) posited that "a female board presence contribut[es] to the board's ability to maintain an attitude of mental independence, diminish[es] the extent of groupthink and enhance[es] the ability of the board to monitor financial reporting."[262] They noted that "poorer [internal] controls and the lack of an independent and questioning board-level attitude toward accounting judgments can create

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256 Id. at 12-14.

257 Id. at 33.

258 See Wahid, supra note 59, at 6.

259 Id. at 1.

260 Id. at 23.

261 Id. at 24-25; see also Shecter, supra note 61 (quoting Wahid as saying that "[i]f you're going to introduce perspectives, those perspectives might be coming not just from male versus female. They could be coming from people of different ages, from different racial backgrounds…. If we just focus on one, we could be essentially taking away from other dimensions of diversity and decreasing perspective.").

262 See Abbott et al., supra note 58, at 607.

an opportunity for fraud."[263] They observed a lower likelihood of a material financial restatements stemming from fraud or error in companies with at least one woman on the board.[264]

Nasdaq believes that these studies provide substantial evidence suggesting an association between gender diverse boards or audit committees and a lower likelihood of fraud; a lower likelihood of receiving audit qualifications due to errors, non-compliance or omission of information; and a greater likelihood of disclosing audit reports with uncertainties and scope limitations. Moreover, academics have suggested that other forms of diversity, including racial and ethnic diversity, may reduce fraud and mitigate groupthink. Further, while homogenous boards may unwittingly fall into the trap of groupthink due to a lack of diverse perspectives, "heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of a wide range of interpretations, alternatives, and consequences."[265] Nasdaq therefore believes that the proposed rule is designed to reduce groupthink, and otherwise to enhance the functioning of boards, and thereby to prevent fraudulent and manipulative acts and practices.

Further, the Commission has suggested that in seeking board diversity, "[t]o the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer existing ties to the board or management

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263 Id. at 610.

264 Id. at 613 ("The previously discussed lines of research lead us to form our hypothesis. In summary, restatements may stem from error or fraud. In either instance, the internal control system (to which the board of directors contributes by setting the overall tone at the top) has failed to detect or prevent a misstatement. Ineffective internal controls may stem from insufficient questioning of assumptions underlying financial reporting, inadequate attention to the internal control systems, or insufficient support for the audit committee's activities.").

265 See Dallas, supra note 76, at 1391.

and are, consequently, more independent."[266] Nasdaq believes that the benefits of the proposed rule are analogous to the benefits of Nasdaq's rules governing and requiring director independence. In 2003, Nasdaq adopted listing rules requiring, among other things, that independent directors comprise a majority of listed companies' boards, which were "intended to enhance investor confidence in the companies that list on Nasdaq."[267] The Commission observed that self-regulatory organizations "play an important role in assuring that their listed issuers establish good governance practices," and concluded that the proposed rule changes would secure an "objective oversight role" for issuers' boards of directors, and "foster greater transparency, accountability, and objectivity" in that role."[268] Along the same lines, in approving Nasdaq's application for registration as a national securities exchange, the Commission found Nasdaq's rules governing the independence of members of boards and certain committees to be consistent with Section 6(b)(5) of the Act because they advanced the "interests of shareholders" in "greater transparency, accountability, and objectivity" in oversight and decision-making by corporate boards.[269] Nasdaq proposes to promote accountability in corporate decision-making by requiring companies who do not have at least two Diverse directors on their board to provide investors with a public explanation of the board's reasons for not doing so under Rule 5605(f)(3).

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266 See Proxy Disclosure Enhancements, supra note 73, 74 Fed. Reg. at 68,355.

267 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

268 Id. at 64, 175.

269 See In re Nasdaq Stock Market, 71 Fed. Reg. 3550, 3565 (Jan. 23, 2006). See also 68 Fed. Reg. 18,788, 18,815 (April 16, 2003) (in adopting Rule 10A-3, setting standards for the independence of audit committee members, the Commission concluded that such standards would "enhance the quality and accountability of the financial reporting process and may help increase investor confidence, which implies increased efficiency and competitiveness of the U.S. capital markets").

Nasdaq believes it is critical to the detection and prevention of fraudulent and manipulative acts and practices to have directors on the board who are willing to critically question management and air dissenting views. Nasdaq believes that boards comprised of directors from Diverse backgrounds enhance investor confidence by ensuring that board deliberations consider the perspectives of more than one demographic group, leading to robust dialogue and better decision making. However, Nasdaq recognizes that directors may bring diverse perspectives, skills and experiences to the board, notwithstanding that they have similar attributes. Nasdaq therefore believes it is in the public interest to permit a company that chooses not to meet the diversity objectives of Rule 5605(f)(2) to explain why it does not, in accordance with Rule 5605(f)(3)—for example, if it believes that defining diversity more broadly than Nasdaq, for example by considering national origin, veteran status and disabilities, brings a wide range of perspectives and experiences to the board. Nasdaq believes such disclosure will provide investors with a better understanding of the company's philosophy regarding diversity. This would better inform the investment community and enable more informed analyses of, and conversations with, companies. Therefore, Nasdaq believes satisfying Rule 5605(f)(2) through disclosure pursuant to Rule 5605(f)(3) is consistent with Section 6(b)(5) of the Act because it advances the "interests of shareholders" in "greater transparency, accountability, and objectivity" of boards and their decision-making processes.[270] In addition, as discussed further in Section II.A.2.II.c (*Promotes Investor Protection and the Public Interest*) below, Nasdaq believes that the proposed diversity

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270 Id.

requirement could help to reduce information asymmetry, and thereby reduce the risk of insider trading or other opportunistic insider behavior.

c. Promotes Investor Protection and the Public Interest

Nasdaq has found substantial evidence that board diversity is positively associated with more transparent public disclosures and higher quality financial reporting, thereby promoting investor protection. Specifically, studies have concluded that companies with gender-diverse boards are associated with more transparent public disclosures and less information asymmetry, leading to stock prices that better reflect public information. Gul, Srinidhi & Ng (2011) found that "gender diversity improves stock price informativeness by increasing voluntary public disclosures in large firms and increasing the incentives for private information collection in small firms."[271] Bravo and Alcaide-Ruiz (2019) found a positive association between women on the audit committee with financial or accounting expertise and the voluntary disclosure of forward-looking information.[272] Abad et al. (2017) concluded that companies with gender-diverse boards are associated with lower levels of information asymmetry, suggesting that "the policies recently implemented in several European countries to increase the presence of female directors in company boards could have beneficial effects on stock markets by reducing the risk of informed trading and enhancing stock liquidity."[273]

Nasdaq believes that one consequence of information asymmetry is that insiders may engage in opportunistic behavior prior to a public announcement of financial results and before the market incorporates the new information into the company's stock price.

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271 See Gul et al., supra note 66, at 2.

272 See Bravo and Alcaide-Ruiz, supra note 56, at 151.

273 See Abad et al., supra note 67, at 202.

This can result in unfair gains or an avoidance of losses at the expense of shareholders who did not have access to the same information. This may exacerbate the principal-agent problem, in which the interests of a company's board and shareholders are not aligned. Lucas-Perez et al. (2014) found that board gender diversity is positively associated with linking executive compensation plans to company performance,[274] which may be an effective mechanism to deter opportunistic behavior by management and better align their interests with those of their company's shareholders.[275]

Another concern is that "[w]hen information asymmetry is high, stakeholders do not have sufficient resources, incentives, or access to relevant information to monitor managers' actions, which gives rise to the practice of earnings management."[276] Earnings management "is generally defined as the practice of using discretionary accounting methods to attain desired levels of reported earnings."[277] Manipulating earnings is particularly concerning to investors because "[i]f users of financial data are 'misled' by the level of reported income, then investors' allocation of resources may be inappropriate when based on the financial statements provided by management,"[278] thereby undermining the efficacy of the capital formation process for investors who rely on such information to make informed investment and voting decisions.

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274 See Lucas-Perez et al., supra note 69.

275 Id.

276 See Vernon J. Richardson, *Information Asymmetry and Earnings Management: Some Evidence*, 15 Rev. Quantitative Fin. and Acct. 325 (2000).

277 See Gull et al., supra note 55, at 2.

278 Id.

Gull et al. (2018)[279] observe that overseeing management is a crucial component of investor protection, particularly with regard to earnings management:

> The role of the board of directors and board characteristics (*i.e.* board independence and gender diversity) is usually associated with the protection of shareholder interests…. This role is particularly crucial with regard to the issue of earnings management, in that one of the responsibilities of boards is to monitor management.[280]

The authors of that study found that the presence of female audit committee members with business expertise is associated with a lower magnitude of earnings management. Srinidhi, Gul and Tsui (2011) observed that better oversight of management combined with lower information asymmetry leads to better earnings quality. They noted that "[e]arnings quality is an important outcome of good governance demanded by investors and therefore its improvement constitutes an important objective of the board."[281] They found that companies with women on the board, specifically on the audit committee, exhibit "higher earnings quality" and "better reporting discipline by managers."[282] They concluded that "including female directors on the board and the audit committee are plausible ways of improving the firm's reporting discipline and increasing investor confidence in financial statements."[283]

Chen, Eshleman and Soileau (2016) suggested that the relationship between gender diversity and higher earnings quality observed by Srinidhi, Gul and Tsui (2011) is ultimately driven by reduced internal control weaknesses, noting that "prior literature has established a negative relationship between internal control weaknesses and earnings

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279 See generally id.

280 Id. at 6 (citations omitted).

281 See Srinidhi et al., supra note 50, at 1638.

282 Id. at 1612.

283 Id.

quality."[284] Internal control over financial reporting are procedures designed "to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP."[285] Weaknesses in internal controls can "lead to poor financial reporting quality" and "more severe insider trading"[286] or failure to detect a material misstatement. According to the PCAOB:

> A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.[287]

A material misstatement can occur "as a result of some type of inherent risk, whether fraud or error (*e.g.*, management's aggressive accounting practices, erroneous application of GAAP)."[288] The failure to prevent or detect a material misstatement before financial statements are issued can require the company to reissue its financial statements and potentially face costly shareholder litigation. Chen et al. found that having at least one woman on the board (regardless of whether or not she is on the audit committee) "may lead [a] to reduced likelihood of material weaknesses [in internal control over financial reporting]],"[289] and Abbott, Parker and Persley (2012) found "a significant association between the presence of at least one woman on the board and a lower likelihood of [a material financial] restatement."[290] Notably, while the Sarbanes-

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284 See Chen et al., supra note 64, at 18.

285 See Public Company Accounting Oversight Board, *Auditing Standard No. 5: Appendix A*, A5 available at: https://pcaobus.org/oversight/standards/archived-standards/details/Auditing_Standard_5_Appendix_A.

286 See Chen et al., supra note 64, at 12.

287 See Public Company Accounting Oversight Board, supra note 285, at A7.

288 See Abbott et al., supra note 58, at 609-10.

289 See Chen et al., supra note 64, at 18.

290 See Abbott et al., supra note 58, at 607.

Oxley Act ("SOX") implemented additional measures to ensure that a company has robust internal controls, the findings of Abbott et al. were consistent among a sample of pre- and post-SOX restatements, suggesting that "an additional, beneficial layer of independence in group decision-making is associated with gender diversity."[291]

Nasdaq believes that the proposal to require listed companies to have at least two Diverse directors under Rule 5605(f) could help to lower information asymmetry and reduce the risk of insider trading or other opportunistic insider behavior, which would help to increase stock price informativeness and enhance stock liquidity, thereby protecting investors and promoting capital formation and efficiency. Nasdaq believes that information asymmetry could also be reduced by permitting companies to satisfy Rule 5605(f)(2) by publicly disclosing their reasons for not meeting its diversity objectives in accordance with Rule 5605(f)(3), because the requirement will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, which will further protect investors and promote capital formation and efficiency.

Moreover, Nasdaq believes that proposed Rule 5605(f) could foster more transparent public disclosures, higher quality financial reporting, and stronger internal control over financial reporting and mechanisms to monitor management. This could be particularly beneficial for Smaller Reporting Companies that are not subject to the SOX 404(b) requirement to obtain an independent auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting, thereby promoting investor protection.

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[291] Id. at 609.

Nasdaq believes that the body of research on the relationship between economic performance and board diversity summarized under Section II.A.1.II.a above provides substantial evidence supporting the conclusion that board diversity does not have adverse effects on company financial performance, and therefore Nasdaq believes the proposal will not negatively impact capital formation, competition or efficiency among its public companies.[292] Nasdaq considered that some studies on gender diversity alone have had mixed results,[293] and that the U.S. GAO (2015) and Carter et al. (2010) concluded that the mixed results are due to differences in methodologies, data samples and time periods.[294] This is not the first time Nasdaq has considered whether, on balance, various studies finding mixed results related to board composition and company performance are sufficient rationale to propose a listing rule. For example, in 2003, notwithstanding the mixed results of studies regarding the relationship between company performance and board independence,[295] Nasdaq adopted listing rules requiring a majority independent board that were "intended to enhance investor confidence in the companies that list on

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292 See Alexandre Di Miceli and Angela Donaggio, *Women in Business Leadership Boost ESG Performance: Existing Body of Evidence Makes Compelling Case*, 42 International Finance Corporation World Bank Group, Private Sector Opinion at 11 n.15 (2018), available at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/private+sector+opinion/women+in+business+leadership+boost+esg+performance ("The overwhelming majority of empirical studies conclude that a higher ratio of women in business leadership does not impair corporate performance (virtually all studies find positive or non-statistically significant results)"). See also Wahid, supra note 59, at 6 (suggesting that "at a minimum, gender diversity on corporate boards has a neutral effect on governance quality, and at best, it has positive consequences for boards' ability to monitor firm management").

293 See, e.g., Pletzer et al., supra note 38; Post and Byron, supra note 39; Adams and Ferreira, supra note 42.

294 See GAO Report, supra note 44, at 5 ("Some research has found that gender diverse boards may have a positive impact on a company's financial performance, but other research has not. These mixed results depend, in part, on differences in how financial performance was defined and what methodologies were used"); Carter (2010), supra note 40, at 400 (observing that the different "statistical methods, data, and time periods investigated vary greatly so that the results are not easily comparable.").

295 See supra note 45.

Nasdaq."[296] In its Approval Order, the SEC noted that "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets;" the Commission concluded that the independence rules would secure an "objective oversight role" for issuers' boards, and "foster greater transparency, accountability, and objectivity" in that role.[297] Nasdaq believes this reasoning applies to the current proposed rule as well. Even without clear consensus among studies related to board diversity and company performance, the heightened focus on corporate board diversity by investors demonstrates that investor confidence is undermined when data on board diversity is not readily available and when companies do not explain the reasons for the apparent absence of diversity on their boards.[298] Legislators are increasingly taking action to encourage corporations to diversify their boards and improve diversity disclosures.[299] Moreover, during its discussions with stakeholders, Nasdaq found consensus across every constituency that there is inherent value in board diversity. Lastly, it has been a longstanding principle that "Nasdaq stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process."[300]

For all the foregoing reasons, Nasdaq believes that proposed Rule 5605(f) will promote investor protection and the public interest by enhancing investor confidence that all listed companies are considering diversity in the context of selecting directors, either

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296 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

297 Id. at 64,176.

298 See supra notes 4 and 8.

299 See supra note 112.

300 See Nasdaq Rulebook, Rule 5101.

by including at least two Diverse directors on their boards or by explaining their rationale for not meeting that objective. To the extent a company chooses not to meet the diversity objectives of Rule 5605(f)(2), Nasdaq believes that the proposal will provide investors with additional disclosure about the company's reasons for doing so under Rule 5605(f)(3). For example, the company may choose to disclose that it does not meet the diversity objectives of Rule 5605(f)(2) because it is subject to an alternative standard under state or foreign laws and has chosen to satisfy that diversity objective instead. On the other hand, many firms may strive to achieve even greater diversity than the objectives set forth in our proposed rule. Nasdaq believes that providing such flexibility and clear disclosure where the company determines to follow a different path will improve the quality of information available to investors who rely on this information to make informed investment and voting decisions, thereby promoting capital formation and efficiency, and further promoting the public interest.

d. Not Designed to Permit Unfair Discrimination between Customers, Issuers, Brokers, or Dealers

Nasdaq believes that proposed Rule 5605(f) is not designed to permit unfair discrimination among companies because it requires all companies subject to the rule to have at least two Diverse directors or explain why they do not. Further, the proposal requires at least one of the two Diverse directors to be an individual who self-identifies as Female. While the proposal provides different requirements for the second Diverse director among Smaller Reporting Companies, Foreign Issuers and other companies, Nasdaq believes that the rule is not designed to permit unfair discrimination among companies. In all cases, a company can choose to meet the diversity objectives of the entire rule or to satisfy only certain elements of the rule. Further, the proposed rule does

not limit board sizes—if a board chooses to nominate a Diverse individual to the board to meet the diversity objectives of the proposed rule, it is not precluded from also nominating a non-Diverse director for an additional board seat.

i. Rule 5605(f)(2)(B): Foreign Issuers

Similar to all other companies subject to Rule 5605(f), the proposal requires all Foreign Issuers to have, or explain why they do not have, at least two Diverse directors, including one director who self-identifies as Female. However, Nasdaq proposes to provide Foreign Issuers with additional flexibility with regard to the second Diverse director. Foreign Issuers could satisfy the second director objective by including another Female director, or an individual who self-identifies as LGBTQ+ or as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. While the proposal provides a different requirement for the second Diverse director for Foreign Issuers, Nasdaq believes it is not designed to permit unfair discrimination between Foreign Issuers and other companies because it recognizes that the unique demographic composition of the United States, and its historical marginalization of Underrepresented Minorities and the LGBTQ+ community, may not extend to all countries outside of the United States. Further, Nasdaq believes that it is challenging to apply a consistent definition of minorities to all countries globally because "[t]here is no internationally agreed definition as to which groups constitute minorities."[301] Similarly, "there is no

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301 See United Nations, *Minority Rights: International Standards and Guidance for Implementation* 2 (2010), available at: https://www.ohchr.org/Documents/Publications/MinorityRights_en.pdf. See also G.A. Res. 47/135. art. 1.1 (Dec. 18, 1992) ("States shall protect the existence and the national or ethnic, cultural, religious and linguistic identity of minorities within their respective territories and shall encourage conditions for the promotion of that identity."). The preamble to the Declaration also "[r]eaffirm[s] that one of the basic aims of the United Nations, as proclaimed in

universally accepted international definition of indigenous peoples."[302] Rather, the United Nations *Declaration on the Rights of Indigenous Peoples* recognizes "that the situation of indigenous peoples varies from region to region and from country to country and that the significance of national and regional particularities and various historical and cultural backgrounds should be taken into consideration."[303] Accordingly, Nasdaq believes that it is not unfairly discriminatory to allow an alternative mechanism for Foreign Issuers to satisfy Rule 5605(f)(2) in recognition that the U.S.-based EEOC definition of Underrepresented Minorities is not appropriate for every Foreign Issuer. In addition, Foreign Issuers have the ability to satisfy Rule 5605(f)(2)(B) by explaining that they do not satisfy this alternative definition. Similarly, any company that is not a Foreign Issuer, but that prefers the alternative definition available for Foreign Issuers, could follow Rule 5605(f)(2)(B) and disclose its reasons for doing so.

Under the proposal, Foreign Issuer means (a) a Foreign Private Issuer (as defined in Rule 5005(a)(19)) or (b) a company that (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Act, and (ii) has its principal executive offices located outside of the United States. For example, a company that is considered a "foreign issuer" under Rule 3b-4(b) under the Act and has its principal executive offices located in Ireland would qualify as a Foreign Issuer for purposes of Rule 5605(f)(2), even if it is not considered a Foreign Private Issuer under Nasdaq or SEC rules.

Nasdaq recognizes that Foreign Issuers may be located in jurisdictions that impose privacy laws limiting or prohibiting self-identification questionnaires, particularly

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the Charter, is to promote and encourage respect for human rights and for fundamental freedoms for all, without distinction as to race, sex, language or religion."

302 See United Nations, *Minority Rights*, supra note 301, at 3.

303 See G.A. Res. 61/295 (Sept. 13, 2007).

as they relate to race or ethnicity. In such countries, a company may not be able to determine each director's self-identified Diverse attributes due to restrictions on the collection of personal information. The company may instead publicly disclose pursuant to Rule 5605(f)(3) that "Due to privacy laws in the company's home country jurisdiction limiting its ability to collect information regarding a director's self-identified Diverse attributes, the company is not able to determine that it has two Diverse directors as set forth under Rule 5605(f)(2)(B)(ii)."

ii. Rule 5605(f)(2)(C): Smaller Reporting Companies

While the proposal provides a different requirement for the second Diverse director for Smaller Reporting Companies, Nasdaq believes that this distinction is not designed to permit unfair discrimination among companies. Nasdaq has designed the proposed rule to ensure it does not have a disproportionate economic impact on Smaller Reporting Companies by imposing undue costs or burdens. Nasdaq recognizes that Smaller Reporting Companies, especially pre-revenue companies that depend on the capital markets to fund ground-breaking research and technological advancements, may not have the resources to compensate an additional director or engage a search firm to find director candidates outside of the directors' traditional networks. Nasdaq believes that this is a reasonable basis to distinguish Smaller Reporting Companies from other companies subject to the rule.

Smaller Reporting Companies already are provided certain exemptions from Nasdaq's listing rules. For example, under Rule 5605(d)(3), Smaller Reporting Companies must have a compensation committee comprised of at least two independent directors and a formal written compensation committee charter or board resolution that

specifies the committee's responsibilities and authority, but such companies are not required to grant authority to the committee to retain or compensate consultants or advisors or consider certain independence factors before selecting such advisors, consistent with Rule 10C-1 of the Act.[304] In its approval order, the SEC concluded as follows:

> The Commission believes that these provisions are consistent with the Act and do not unfairly discriminate between issuers. The Commission believes that, for similar reasons to those for which Smaller Reporting Companies are exempted from the Rule 10C-1 requirements, it makes sense for Nasdaq to provide some flexibility to Smaller Reporting Companies regarding whether the compensation committee's responsibilities should be set forth in a formal charter or through board resolution. Further . . . in view of the potential additional costs of an annual review, it is reasonable not to require a Smaller Reporting Company to conduct an annual assessment of its charter or board resolution.[305]

The Commission also makes accommodations for Smaller Reporting Companies based on their more limited resources, allowing them to comply with scaled disclosure requirements in certain SEC reports rather than the more rigorous disclosure requirements for larger companies. For example, Smaller Reporting Companies are not required to include a compensation discussion and analysis in their proxy or Form 10-K describing the material elements of the compensation of its named executive officers.[306] Eligible Smaller Reporting Companies also are relieved from the SOX 404(b) requirement to obtain an independent auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting.[307] In each case,

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304 See Nasdaq Rulebook, Rule 5605(d)(3).

305 See Order Granting Accelerated Approval of Proposed Rule Change, 78 Fed. Reg. 4,554, 4,567 (Jan. 22, 2013).

306 See 17 C.F.R. § 229.402(l).

307 See Accelerated Filer and Large Accelerated Filer Definitions, 85 Fed. Reg. 17,178 (March 26, 2020).

companies may choose to comply with the more rigorous requirements in lieu of relying on the exemptions.

Any company that is not a Smaller Reporting Company, but prefers the alternative rule available for Smaller Reporting Companies, could follow Rule 5605(f)(2)(C) and disclose their reasons for doing so. As such, Nasdaq believes that the proposed alternative rule for Smaller Reporting Companies is not designed to, and does not, unfairly discriminate among companies. Lastly, Nasdaq believes that Rule 5605(f)(2)(C) is not designed to permit unfair discrimination among companies because it requires Smaller Reporting Companies to have at least one director who self-identifies as Female, similar to other companies subject to Rule 5065(f).

iii. Rule 5605(f)(3): Public Disclosure of Non-Diverse Board

Under proposed Rule 5605(f)(3), if a company determines not to meet the diversity objectives of Rule 5605(f) in its entirety, it must specify the applicable requirements of the Rule and explain its reasons for not having at least two Diverse directors. Nasdaq designed the proposal to avoid unduly burdening competition or efficiency, or conflicting with existing securities laws, by providing all companies subject to Rule 5605(f) with the option to make the public disclosure required under Rule 5605(f)(3) in the company's proxy statement or information statement for its annual meeting of shareholders or, alternatively on the company's website, provided that the company submits a URL link to such disclosure to Nasdaq through the Listing Center no later than 15 calendar days after the company's annual shareholder meeting. Nasdaq believes Rule 5605(f)(3) is not designed to permit unfair discrimination among companies because the proposed rule provides all companies subject to Rule 5605(f) the

option to disclose an explanation rather than meet the diversity objectives of Rule 5605(f)(2).

Certain federal securities laws similarly permit companies to satisfy corporate governance requirements through disclosure of reasons for not meeting the applicable requirement. For example, under Regulation S-K, Item 407 requires a company to disclose whether or not its board of directors has determined that the company has at least one audit committee financial expert. If a company does not have a financial expert on the audit committee, it must provide an explanation.[308] Item 406 requires a company to disclose whether it has adopted a written code of ethics that applies to the chief executive officer and senior financial or accounting officers. If a company has not adopted such a code of ethics, it must disclose the reasons why not.[309] Item 402 regarding pay ratio disclosure defines how total compensation for employees should be calculated, but permits companies to use a different measure as long as they explain their approach.[310]

Furthermore, Nasdaq rules and SEC guidance already recognize that website disclosure can be a method of disseminating information to the public. For example, Nasdaq listing rules permit companies to provide website disclosures related to third party director compensation,[311] foreign private issuer home country practices,[312] and reliance on the exception relating to independent compensation committee members.[313]

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308 See 17 C.F.R. § 229.407(d)(5).

309 Id. § 229.406(a).

310 Id. § 229.402.

311 See Nasdaq Rulebook, Rule 5250(b)(3)(A).

312 Id., Rule 5615(a)(3)(B) and IM-5615-3.

313 Id., Rules 5605(d)(2)(B) (non-independent compensation committee member under exceptional and limited circumstances) and 5605(e)(3) (non-independent nominations committee member under exceptional and limited circumstances).

The SEC has recognized that "[a] company's web site is an obvious place for investors to find information about the company"[314] and permits companies to make public disclosure of material information through website disclosures if, among other things, the company's website is "a recognized channel of distribution of information."[315]

iv. Rule 5605(f)(4): Exempt Companies

Under proposed Rule 5605(f)(4), Nasdaq proposes to exempt the following types of companies from the requirements of Rule 5605(f) (defined as "Exempt Companies"): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series. Each of the types of Exempt Companies either has no board of directors, lists only securities with no voting rights towards the election of directors, or is not an operating company, and the holders of the securities they issue do not expect to have a say in the composition of their boards. As such, Nasdaq believes the proposal is not designed to permit unfair discrimination by excluding Exempt Companies from the application of proposed Rule 5605(f). These companies already are exempt from certain of Nasdaq's corporate governance standards related to board composition, as described in Rule 5615.

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314 See Commission Guidance on the Use of Company Websites, 73 Fed. Reg. 45,862, 45,864 (Aug. 7, 2008).

315 Id. at 45,867.

v. Rule 5605(f)(5): Phase-in Period

Proposed Rule 5605(f)(5)(A) will allow any newly listing company that was not previously subject to a substantially similar requirement of another national securities exchange one year from the date of listing to satisfy the requirements of Rule 5605(f). Proposed Rule 5605(f)(5)(B) also will allow any company that ceases to be a Foreign Issuer, a Smaller Reporting Company or an Exempt Company one year from the date that the company no longer qualifies as a Foreign Issuer, a Smaller Reporting Company or an Exempt Company, respectively, to satisfy the requirements of Rule 5605(f). This phase-in period will apply after the end of the transition period provided in Rule 5605(f)(7).

Nasdaq believes this approach is not designed to permit unfair discrimination because it provides all companies that become newly subject to the rule the same time period within which to comply. In addition, this approach is similar to other phase-in periods granted to companies listing on or transferring to Nasdaq. For example, Rule 5615(b)(1) provides a company listing in connection with its initial public offering one year to fully comply with the compensation and nomination committee requirements of Rules 5605(d) and (e), and the majority independent board requirement of Rule 5605(b). Similarly, SEC Rule 10A-3(b)(1)(iv)(A) allows a company up to one year from the date its registration statement is effective to fully comply with the applicable audit committee composition requirements. Nasdaq Rule 5615(b)(3) provides a one-year timeframe for compliance with the board composition requirements for companies transferring from other listed markets that do not have a substantially similar requirement.

vi. Rule 5605(f)(7): Effective Dates/Transition

Under proposed Rule 5605(f)(7), each company must have, or explain why it does not have, one Diverse director no later than two calendar years after the Approval Date,[316] and two Diverse directors no later than (i) four calendar years after the Approval Date for companies listed on the NGS or NGM tiers, or (ii) five calendar years after the Approval Date for companies listed on the NCM tier.

Nasdaq believes this approach is not designed to permit unfair discrimination because it recognizes that companies listed on the Nasdaq Capital Market may not have the resources necessary to compensate an additional director or engage a search firm to search for director candidates outside of the directors' traditional networks. Therefore, Nasdaq believes it is in the public interest to provide such companies with one additional year to meet the diversity objectives of Rule 5605(f), should they choose to do so. Nasdaq notes that all companies may choose to follow a timeframe applicable to a different market tier, provided they publicly describe their explanation for doing so. They also may construct their own timeframe for meeting the diversity objectives of Rule 5605(f), provided they publicly disclose their reasons for not abiding by Nasdaq's timeframe.

e. Not Designed to Regulate by Virtue of any Authority Conferred by the Act Matters Not Related to the Purposes of the Act or the Administration of the Exchange

Nasdaq believes that the proposal is not designed to regulate by virtue of any authority conferred by the Act matters not related to the purposes of the Act or the

316 The "Approval Date" is the date that the SEC approves the proposed rule.

administration of the Exchange.[317] The proposal relates to the Exchange's corporate governance standards for listed companies. As discussed above, "[t]he Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets."[318] And because "it is not always feasible to define . . . every practice which is inconsistent with the public interest or with the protection of investors," the Act leaves to SROs "the necessary work" of rulemaking pursuant to Section 6(b)(5).[319]

Nasdaq recognizes that U.S. states are increasingly proposing and adopting board diversity requirements, and because corporations are creatures of state law, some market participants may believe that such regulation is best left to states. However, Nasdaq considered that certain of its listing rules related to corporate governance currently relate to areas that are also regulated by states. For example, states impose standards related to quorums[320] and shareholder approval of certain transactions,[321] which also are regulated under Nasdaq's listing rules.[322] Nasdaq has adopted rules relating to such matters to ensure uniformity of such rules among its listed companies. Similarly, Nasdaq believes that the proposed rule will create uniformity among listed companies by helping to assure investors that all non-exempt companies have at least two Diverse directors on their board or publicly describe why they do not.

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317 See 15 U.S.C. § 78f(b)(5).

318 See Order Approving Proposed Rule Changes, 68 Fed. Reg. at 64,161.

319 See Heath v. SEC, 586 F.3d 122, 132 (2d Cir. 2009) (citing Avery v. Moffat, 55 N.Y.S.2d 215, 228 (Sup. Ct. 1945)).

320 See, e.g., 8 Del. Code § 216 (providing that a quorum at a shareholder's meeting shall consist of no less than 1/3 of the shares entitled to vote at such meeting).

321 See, e.g., id. §§ 251, 271 (providing that shareholder approval by a majority of the outstanding voting shares entitled to vote is required for mergers and the sale of all or substantially all of a corporation's assets).

322 See, e.g., Nasdaq Rulebook, Rules 5620(c) and 5635(a).

Further, Nasdaq believes the proposal will enhance investor confidence that listed companies that have two Diverse directors are considering the perspectives of more than one demographic group, leading to robust dialogue and better decision making, as well as the other corporate governance benefits of diverse boards discussed above in Section II.A.1.II. To the extent companies choose to disclose their reasons for not meeting the diversity objectives of Rule 5605(f)(2) pursuant to Rule 5605(f)(3), Nasdaq believes that such disclosure will improve the quality of information available to investors who rely on this information to make an informed voting decision, thereby promoting capital formation and efficiency. It has been the Exchange's longstanding principle that "Nasdaq stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process."[323]

In addition, as discussed in Section II.A.1.I, in passing Section 342 of the Dodd-Frank Act, Congress recognized the need to respond to the lack of diversity in the financial services industry, and the Standards designed by the Commission and other financial regulators provide a framework for addressing that industry challenge. The Standards themselves identify several focus areas, including the importance of "Organizational Commitment," which speaks to the critical role of senior leadership—including boards of directors—in promoting diversity and inclusion across an organization. In addition, like the proposed rule, the Standards also consider "Practice to Promote Transparency," and recognize that transparency is a key component of any diversity initiative. Specifically, the Standards provide that the "transparency of an

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[323] Id., Rule 5101.

entity's diversity and inclusion program promotes the objectives of Section 342," and also is important because it provides the public with necessary information to assess an entity's diversity policies and practices.[324]

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq reviewed requirements related to board diversity in two dozen foreign jurisdictions, and almost every jurisdiction imposes diversity-focused requirements on listed companies, either through a securities exchange, financial regulator or the government. Nasdaq competes for listings globally, including in countries that have implemented a more robust regulatory reporting framework for diversity and ESG disclosures. Currently in the U.S., the Long Term Stock Exchange ("LTSE"), which includes a number of sponsors which have investment businesses, has communicated to institutional investors that it that it seeks to distinguish itself by focusing on corporate governance, including, for example, diversity and inclusion. Under Rule 14.425, companies listed on LTSE must adopt and publish a long-term stakeholder policy that explains, among other things, "the Company's approach to diversity and inclusion."[325]

I. Board Statistical Disclosure

The Exchange does not believe that proposed Rule 5606 will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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[324] Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, 80 Fed. Reg. 33,016 (June 10, 2015).

[325] See Long-Term Stock Exchange Rule Book, Rule 14.425.

Specifically, the Exchange believes that the adoption of Rule 5606 will not impose any undue burden on competition among listed companies for the reasons set forth below.

With a few exceptions, all companies would be required to make the same disclosure of their board-level statistical information. The average board size of a company that is currently listed on the Exchange is eight directors. Although a company would be required to disclose its board-level statistical data, directors may choose to opt out rather than reveal their diversity characteristics to their company. A company would identify such directors in the "Undisclosed" category. For directors who voluntarily disclose their diversity characteristics, the company would collect their responses and disclose the information in either the company's proxy statement, information statement of shareholder meeting or on the company's website, using Nasdaq's required format. While the time and economic burden may vary based on a company's board size, Nasdaq does not believe there is any significant burden associated with gathering, preparing and reporting this data. Therefore, Nasdaq believes that there will be a *de minimis* time and economic burden on listed companies to collect and disclose the diversity statistical data.

Some investors value demographic diversity, and list it as an important factor influencing their director voting decisions.[326] Investors have stated that consistent data would make its collection and analysis easier and more equitable for investors that are not large enough to demand or otherwise access individualized disclosures.[327] Therefore, Nasdaq believes that any burden placed on companies to gather and disclose their board-level diversity statistics is counterbalanced by the benefits that the information will provide to a company's investors.

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326 See Hunt et al., supra note 26.

327 See Petition for Rulemaking, supra note 123, at 2.

Moreover, as discussed above, most listed companies are required to submit an annual EEO-1 Report, which provides statistical data related to race and gender data among employees similar to the data required under proposed Rule 5606(a). Because most companies are already collecting similar information annually to satisfy their EEOC requirement, Nasdaq does not believe that adding directors to the collection will place a significant burden on these companies. Additionally, the information requested from Foreign Issuers is limited in scope and therefore does not impose a significant burden on them.

Nasdaq faces competition in the market for listing services. Proposed Rule 5606 reflects that competition, but it does not impose any burden on competition with other exchanges. As discussed above, investors have made clear their desire for greater transparency into public companies' board-level diversity as it relates to gender identity, race, and ethnicity. Nasdaq believes that the proposed rule will enhance the competition for listings. Other exchanges can set similar requirements for their listed companies, thereby increasing competition to the benefit of those companies and their shareholders. Accordingly, Nasdaq does not believe the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

II. Diverse Board Representation or Explanation

Nasdaq believes that proposed Rule 5605(f) will not impose burdens on competition among listed companies because the Exchange has constructed a framework for similarly-situated companies to satisfy similar requirements (*i.e.*, Foreign Issuers, Smaller Reporting Companies and other companies), and has provided all companies

with the choice of satisfying the requirements of Rule 5605(f)(2) by having at least two Diverse directors, or by explaining why they do not. Nasdaq believes that this will avoid imposing undue costs or burdens on companies that, for example, cannot afford to compensate an additional director or believe it is not appropriate, feasible or desirable to meet the diversity objectives of Rule 5605(f) based on the company's particular circumstances (for example, the company's size, operations or current board composition). Rather than requiring a company to divert resources to compensate an additional director, and place the company at a competitive disadvantage with its peers, the rule provides the flexibility for such company to explain why it does not meet the diversity objective.

The cost of identifying director candidates can range from nothing or a nominal fee (via personal, work or school-related networks, or board affinity organizations, as well as internal research by the corporate secretary's team) to amounts that can vary widely depending on the specific search firm and the size of the company. Some industry observers estimate board searches for independent directors cost about one-third of a director's annual compensation, while others estimate it costs between $75,000 and $150,000. The underlying figures vary; for example, one search firm generally charges $25,000 to $50,000. Nasdaq observes that total annual director compensation can range widely; median director pay is estimated at $134,000 for Russell 3000 companies and $232,000 for S&P 500 companies. Moreover, there is a wider range of underlying compensation amounts. For example, Russell 3000 directors may receive approximately $32,600 (10th percentile), or up to $250,000 (90th percentile) or more. S&P 500 directors may receive approximately $100,000 (10th percentile) or up to $310,000 (90th

percentile) or more.[328] Most, if not all, of these costs would be borne in any event in the search for new directors regardless of the proposed rule. While the proposed rule might lead some companies to search for director candidates outside of already established networks, the incremental costs of doing so would be tied directly to the benefit of a broader search.

To reduce costs for companies that do not currently meet the diversity objectives of Rule 5605(f)(2), Nasdaq is proposing to provide listed companies that have not yet met their diversity objectives with free access to a network of board-ready diverse candidates and a tool to support board evaluation, benchmarking and refreshment. This offering is designed to ease the search for diverse nominees and reduce the costs on companies that choose to meet the diversity objectives of Rule 5605(f)(2). Nasdaq is contemporaneously submitting a rule filing to the Commission regarding the provision of such services. Nasdaq also plans to publish FAQs on its Listing Center to provide guidance to companies on the application of the proposed rules, and to establish a dedicated mailbox for companies and their counsel to email additional questions to Nasdaq regarding the application of the proposed rule. Nasdaq believes that these services will help to ease the compliance burden on companies whether they choose to meet the listing rule's diversity objectives or provide an explanation for not doing so.

Nasdaq also has structured the proposed rule to provide companies with at least four years from the Approval Date to satisfy Rule 5605(f)(2) so that companies do not incur immediate costs striving to meet the diversity objectives of Rule 5605(f)(2).

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328 Total annual director compensation varies by compensation elements and structure as well as amount, which is generally based on the size, sector, maturity of the company, and company specific situation. See Mark Emanuel et al., Semler Brossy and the Conference Board, *Director Compensation Practices in the Russell 3000 and S&P 500* (2020 ed.), available at https://conferenceboard.esgauge.org/directorcompensation/report.

Nasdaq also has reduced the compliance burden on Smaller Reporting Companies and Foreign Issuers by providing them with additional flexibility when satisfying the requirement related to the second Diverse director. Smaller Reporting Companies could satisfy the proposed diversity objective to have two Diverse directors under Rule 5605(f)(2)(C) with two Female directors. Like other companies, Smaller Reporting Companies also could satisfy the second director objective by including an individual who self-identifies as an Underrepresented Minority or a member of the LGBTQ+ community. Foreign Issuers could satisfy the second director objective by including another Female director, or an individual who self-identifies as LGBTQ+ or an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the company's home country jurisdiction. Nasdaq has further reduced the compliance burdens on companies listed on the Nasdaq Capital Market tier by providing them with five years from the Approval Date to satisfy Rule 5605(f)(2), recognizing that such companies may face additional challenges and resource constraints when identifying additional director nominees who self-identify as Diverse.

For the foregoing reasons, Nasdaq does not believe that proposed Rule 5605(f) will impose any burden on competition among issuers that is not necessary or appropriate in furtherance of the purposes of the Act. Further, Nasdaq does not believe the proposed rule will impose any burden on competition among listing exchanges. As described above, Nasdaq competes with other exchanges globally for listings, including exchanges based in jurisdictions that have implemented disclosure requirements related to diversity. Within the United States, LTSE requires listed companies to adopt and publish a long-term stakeholder policy that explains, among other things, "the Company's approach to

diversity and inclusion."[329] Other listing venues within the United States may propose to adopt rules similar to LTSE's requirements or the Exchange's proposal if they believe companies would prefer to list on an exchange with diversity-related listing standards.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2020-081 on the subject line.

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329 See Long-Term Stock Exchange Rule Book, Rule 14.425.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2020-081. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-NASDAQ-2020-081 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[330]

J. Matthew DeLesDernier
Assistant Secretary

330 17 CFR 200.30-3(a)(12).

EXHIBIT 3

Instructions:

1. All Nasdaq listed companies, except those that are exempt under Nasdaq Listing Rule 5605(f)(4) are required to disclose board level diversity statistics using the format below. The disclosure must be titled "Board Diversity Matrix."
2. When completing the disclosures, enter the number of directors that self-identify in each category. If a director self-identifies in the "Two or More Races or Ethnicities" category, the director must also self-identify in each individual category, as appropriate. For more details on the categories, refer to the definitions below.
3. The information provided below must be based on the voluntary self-identification of each member of the company's board of directors. For a U.S. incorporated company, any director who chooses not to disclose a gender should be included under "Gender Undisclosed" and any director who chooses not to identify as any race or not to identify as LGBTQ+ should be included in the "Undisclosed" category.
4. A company that qualifies as a Foreign Issuer (as defined under Rule 5605(f)(1)) may elect to use the format below for a Foreign Issuer. Any director who chooses not to disclose a gender should be included under "Gender Undisclosed" and any director who chooses not to identify as an "Underrepresented Individual in Home Country Jurisdiction" or LGBTQ+ should be included in the "Undisclosed" category.
5. A company may publish the information by using any of the following methods: (1) the company's proxy statement; (2) the company's information statement for its annual shareholder meeting; or (3) the company's website. If a company chooses option (3), the company must also submit a URL link to the information through the Nasdaq Listing Center no later than 15 calendar days following the company's annual meeting.
6. Following the first year of disclosure, all companies must disclose the current year and immediately prior year diversity statistics using the Board Diversity Matrix.

Definitions:

- **Black or African American** (not of Hispanic or Latinx origin) – A person having origins in any of the Black racial groups of Africa.
- **Alaskan Native or American Indian** – A person having origins in any of the original peoples of North and South America (including Central America), and who maintain cultural identification through tribal affiliation or community recognition.
- **Asian** – A person having origins in any of the original peoples of the Far East, Southeast Asia, or the Indian subcontinent, including, for example, Cambodia, China, India, Japan, Korea, Malaysia, Pakistan, the Philippine Islands, Thailand, and Vietnam.
- **Hispanic or Latinx** – A person of Cuban, Mexican, Puerto Rican, South or Central American, or other Spanish culture or origin, regardless of race. The term Latinx applies broadly to all gendered and gender-neutral forms that may be used by individuals of Latin American heritage, including individuals who self-identify as Latino/a/e.

- **Native Hawaiian or Pacific Islander** – A person having origins in any of the peoples of Hawaii, Guam, Samoa, or other Pacific Islands.
- **White** (not of Hispanic or Latinx origin) – A person having origins in any of the original peoples of Europe, the Middle East, or North Africa.
- **Two or More Races or Ethnicities** – A person who identifies with more than one of the above categories.
- **Underrepresented Individual in Home Country Jurisdiction** – A person who self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in a Foreign Issuer's home country jurisdiction.
- **LGBTQ+** – A person who identifies as any of the following: lesbian, gay, bisexual, transgender or as a member of the queer community.

Board Disclosure Format

Board Diversity Matrix (As of [DATE])				
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Gender Undisclosed**
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
African American or Black	#	#	#	#
Alaskan Native or American Indian	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			

Undisclosed	#

Board Diversity Matrix (As of [DATE]) Foreign Issuer under Rule 5605(f)(1)				
Country of Incorporation:	[Insert Country Name]			
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Gender Undisclosed**
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the category below:				
LGBTQ+	#			
Underrepresented Individual in Home Country Jurisdiction	#			
Undisclosed	#			

EXHIBIT 5

Deleted text is [bracketed]. New text is underlined.

The Nasdaq Stock Market LLC Rules

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5605. Board of Directors and Committees

(a) – (e) No change.

(f) Diverse Board Representation

(1) Definitions

For purposes of this Rule 5605(f):

"Diverse" means an individual who self-identifies in one or more of the following categories: Female, Underrepresented Minority or LGBTQ+.

"Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth.

"Foreign Issuer" means (a) a Foreign Private Issuer (as defined in Rule 5005(a)(19)) or (b) a company that (i) is considered a "foreign issuer" under Rule 3b-4(b) under the Act and (ii) has its principal executive offices located outside of the United States.

"LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender or as a member of the queer community.

"Approval Date" means the date that the Commission issues an order granting the approval of this proposed Rule 5605(f).

"Smaller Reporting Company" has the definition set forth in Rule 12b-2 under the Act.

"Underrepresented Minority" means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities.

(2) Diversity Requirement

(A) General Requirement

Each Company, except as described below in (B) or (C), 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 Female; and (ii) at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+.

(B) Foreign Issuers

(i) In the case of a Foreign Issuer, in lieu of the definition in Rule 5605(f)(1), Diverse means an individual who self-identifies as one or more of the following: Female, LGBTQ+, or an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the Company's home country jurisdiction.

(ii) Each Foreign Issuer must have, or explain why it does not have, at least two members of its board of directors who are Diverse, including at least one Diverse director who self-identifies as Female. For greater clarity, the second Diverse director may include an individual who self-identifies as one or more of the following: Female, LGBTQ+, or an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the Company's home country jurisdiction.

(C) Smaller Reporting Companies

Each Smaller Reporting Company must have, or explain why it does not have, at least two members of its board of directors who are Diverse, including at least one Diverse director who self-identifies as Female. For greater clarity, the second Diverse director may include an individual who self-identifies as one or more of the following: Female, LGBTQ+, or an Underrepresented Minority.

(3) Public Disclosure of Non-Diverse Board

If a Company satisfies the requirements of Rule 5605(f)(2) by explaining why it does not have two Diverse directors, the Company must: (i) specify the requirements of Rule 5605(f)(2) that are applicable; and (ii) explain the reasons why it does not have two Diverse directors. Such disclosure must be provided: (i) in the Company's proxy statement or information statement for its annual meeting of shareholders; or (ii) on the Company's website. If the Company provides such disclosure on its website, the Company must also notify Nasdaq of the location where the information is available by submitting the URL link through the Nasdaq Listing Center no later than 15 calendar days after the Company's annual shareholders meeting.

(4) Exempt Companies

The following types of companies are exempt from the requirements of this Rule 5605(f) ("Exempt Companies"): acquisition companies listed under IM-5101-2; asset-backed issuers and other passive issuers (as set forth in Rule 5615(a)(1)); cooperatives (as set forth in Rule 5615(a)(2)); limited partnerships (as set forth in Rule 5615(a)(4)); management investment companies (as set forth in Rule 5615(a)(5)); issuers of non-voting preferred securities, debt securities and Derivative Securities (as set forth in Rule 5615(a)(6)); and issuers of securities listed under the Rule 5700 Series.

(5) Phase-in Period

(A) Any Company newly listing on Nasdaq that was not previously subject to a substantially similar requirement of another national securities exchange, including through an initial public offering, direct listing, transfer from the over-the-counter market or another exchange, or through a merger with an acquisition company listed under IM-5101-2, shall be permitted one year from the date of listing to satisfy the requirements of Rule 5605(f). This phase-in period will apply after the end of the transition periods provided in Rule 5605(f)(7).

(B) Any Company that ceases to be a Foreign Issuer, a Smaller Reporting Company or an Exempt Company shall be permitted one year from the date that the Company no longer qualifies as a Foreign Issuer, a Smaller Reporting Company or an Exempt Company, respectively, to satisfy the requirements of Rule 5605(f).

(6) Cure Period

If a Company does not have at least two Diverse directors as set forth under Rule 5605(f)(2) and fails to provide the disclosure required by Rule 5605(f)(3), the Listing Qualifications Department will promptly notify the Company and inform it that it has until the latter of its next annual shareholders meeting or 180 days from the event that caused the deficiency to cure the deficiency.

(7) Effective Dates/Transition

Each Company listed on The Nasdaq Global Select Market or The Nasdaq Global Market must have, or explain why it does not have, at least one Diverse director no later than two calendar years after the Approval Date and at least two Diverse directors no later than four calendar years after the Approval Date. Each Company listed on The Nasdaq Capital Market must have, or explain why it does not have, at least one Diverse director no later than two calendar years after the Approval Date and at least two Diverse directors no later than five calendar years after the Approval Date. Notwithstanding the foregoing, a Company is not required to comply with the requirements of this Rule 5605(f) prior to the end of the phase-in period described in Rule 5605(f)(5), if applicable. A company listing after the Approval Date, but prior to the end of the periods set forth in this subparagraph (7), must satisfy the requirements of this Rule 5605(f) by the latter of the periods set forth in this subparagraph (7) or one year from the date of listing.

5606. Board Diversity Disclosure

(a) Each Company must annually disclose, to the extent permitted by applicable law, information on each director's voluntary self-identified characteristics in substantially the format below. Following the first year of disclosure, all companies must disclose the current year and immediately prior year diversity statistics using the Board Diversity Matrix.

Board Diversity Matrix (As of [DATE])				
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Undisclosed Gender**
Number of directors based on gender identity	#	#	#	#
Number of directors who identify in any of the categories below:				
African American or Black	#	#	#	#
Alaskan Native or American Indian	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Undisclosed	#			

However, a Company that qualifies as a Foreign Issuer under Rule 5605(f)(1) may elect to use the format below:

Board Diversity Matrix (As of [DATE]) Foreign Issuer under Rule 5605(f)(1)				
Country of Incorporation:	[Insert Country Name]			
Board Size:				
Total Number of Directors	#			
Gender:	**Male**	**Female**	**Non-Binary**	**Gender Undisclosed**
Number of directors based on gender identity	#	#	#	#

Number of directors who identify in any of the category below:	
LGBTQ+	#
Underrepresented Individual in Home Country Jurisdiction	#
Undisclosed	#

(b) The disclosure required by this Rule 5606 must be provided (i) in the Company's proxy statement or information statement for its annual meeting of shareholders or (ii) on the Company's website. If the Company provides such disclosure on its website, the Company must also submit such disclosure and include a URL link to the disclosure through the Nasdaq Listing Center no later than 15 calendar days after the Company's annual shareholders meeting.

(c) This Rule 5606 shall not apply to Exempt Companies as defined in Rule 5605(f)(4).

(d) A Company newly listing on Nasdaq, including a company listing in connection with a business combination under IM-5101-2, must satisfy the requirement of this Rule 5606 within one year of listing.

(e) This Rule 5606 will be operative one year after the date that the Commission issues an order granting the approval of this proposed Rule 5606.

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5615. Exemptions from Certain Corporate Governance Requirements

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(a) Exemptions to the Corporate Governance Requirements

(1) – (2) No change.

(3) Foreign Private Issuers

(A) A Foreign Private Issuer may follow its home country practice in lieu of the requirements of the Rule 5600 Series, the requirement to disclose third party director and nominee compensation set forth in Rule 5250(b)(3), and the requirement to distribute annual and interim reports set forth in Rule 5250(d), provided, however, that such a Company shall: comply with the Notification of Noncompliance requirement (Rule 5625), the Voting Rights requirement (Rule 5640), the Diverse Board Representation Rule (Rule 5605(f)), the Board Diversity Disclosure Rule (Rule 5606), have an audit committee that satisfies Rule 5605(c)(3), and ensure that such audit committee's members meet the independence requirement in Rule 5605(c)(2)(A)(ii). Except as provided in this

paragraph, a Foreign Private Issuer must comply with the requirements of the Rule 5000 Series.

(B) No change.

IM-5615-3. Foreign Private Issuers

A Foreign Private Issuer (as defined in Rule 5005) listed on Nasdaq may follow the practice in such Company's home country (as defined in General Instruction F of Form 20-F) in lieu of the provisions of the Rule 5600 Series, Rule 5250(b)(3), and Rule 5250(d), subject to several important exceptions. First, such an issuer shall comply with Rule 5625 (Notification of Noncompliance). Second, such a Company shall have an audit committee that satisfies Rule 5605(c)(3). Third, members of such audit committee shall meet the criteria for independence referenced in Rule 5605(c)(2)(A)(ii) (the criteria set forth in Rule 10A-3(b)(1) under the Act, subject to the exemptions provided in Rule 10A-3(c) under the Act). Fourth, such an issuer shall comply with Rule 5605(f) (Diverse Board Representation) and Rule 5606 (Board Diversity Disclosure). Finally, a Foreign Private Issuer that elects to follow home country practice in lieu of a requirement of Rules 5600, 5250(b)(3), or 5250(d) shall submit to Nasdaq a written statement from an independent counsel in such Company's home country certifying that the Company's practices are not prohibited by the home country's laws. In the case of new listings, this certification is required at the time of listing. For existing Companies, the certification is required at the time the Company seeks to adopt its first noncompliant practice. In the interest of transparency, the rule requires a Foreign Private Issuer to make appropriate disclosures in the Company's annual filings with the Commission (typically Form 20-F or 40-F), and at the time of the Company's original listing in the United States, if that listing is on Nasdaq, in its registration statement (typically Form F-1, 20-F, or 40-F); alternatively, a Company that is not required to file an annual report on Form 20-F may provide these disclosures in English on its website in addition to, or instead of, providing these disclosures on its registration statement or annual report. The Company shall disclose each requirement that it does not follow and include a brief statement of the home country practice the Company follows in lieu of these corporate governance requirement(s). If the disclosure is only available on the website, the annual report and registration statement should so state and provide the web address at which the information may be obtained. Companies that must file annual reports on Form 20-F are encouraged to provide these disclosures on their websites, in addition to the required Form 20-F disclosures, to provide maximum transparency about their practices.

(4) - (6) No change.

(b) – (c) No change.

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5810. Notification of Deficiency by the Listing Qualifications Department

When the Listing Qualifications Department determines that a Company does not meet a listing standard set forth in the Rule 5000 Series, it will immediately notify the Company of the deficiency. As explained in more detail below, deficiency notifications are of four types:

(1) – (4) No change.

Notifications of deficiencies that allow for submission of a compliance plan or an automatic cure or compliance period may result, after review of the compliance plan or expiration of the cure or compliance period, in issuance of a Staff Delisting Determination or a Public Reprimand Letter.

(a) – (b) No change.

(c) Types of Deficiencies and Notifications

No change.

(1) No change.

(2) Deficiencies for which a Company may Submit a Plan of Compliance for Staff Review

(A) Unless the Company is currently under review by an Adjudicatory Body for a Staff Delisting Determination, the Listing Qualifications Department may accept and review a plan to regain compliance when a Company is deficient with respect to one of the standards listed in subsections (i) through (vi) below. In accordance with Rule 5810(c)(2)(C), plans provided pursuant to subsections (i) through (iv) and (vi) below must be provided generally within 45 calendar days, and in accordance with Rule 5810(c)(2)(F), plans provided pursuant to subsection (v) must be provided generally within 60 calendar days. If a Company's plan consists of transferring from the Nasdaq Global or Global Select Market to the Nasdaq Capital Market, the Company should submit its application and the applicable application fee at the same time as its plan to regain compliance.

(i) – (ii) No change.

(iii) deficiencies from the standards of Rules 5620(a) {Meetings of Shareholders}, 5620(c) {Quorum}, 5630 {Review of Related Party Transactions}, 5635 {Shareholder Approval}, 5250(c)(3) {Auditor Registration}, 5255(a) {Direct Registration Program}, 5610 {Code of Conduct}, 5615(a)(4)(D) {Partner Meetings of Limited Partnerships}, 5615(a)(4)(E) {Quorum of Limited Partnerships}, 5615(a)(4)(G) {Related Party Transactions of Limited Partnerships}, or 5640 {Voting Rights};[or]

(iv) failure to make the disclosure required by Rule 5250(b)(3)[.] {Disclosure of Third Party Director and Nominee Compensation} or Rule 5606 {Board Diversity Disclosure};

(v) failure to file periodic reports as required by Rules 5250(c)(1) or (2)[.]; or

(vi) failure to meet a continued listing requirement contained in the Rule 5700 Series.

IM-5810-2. Staff Review of Deficiencies

No change.

(B) – (G) No change.

(3) Deficiencies for which the Rules Provide a Specified Cure or Compliance Period

With respect to deficiencies related to the standards listed in (A) – [(F)](G) below, Staff's notification will inform the Company of the applicable cure or compliance period provided by these Rules and discussed below. If the Company does not regain compliance within the specified cure or compliance period, the Listing Qualifications Department will immediately issue a Staff Delisting Determination letter.

(A) Bid Price

A failure to meet the continued listing requirement for minimum bid price shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days. Upon such failure, the Company shall be notified promptly and shall have a period of 180 calendar days from such notification to achieve compliance. Compliance can be achieved during any compliance period by meeting the applicable standard for a minimum of 10 consecutive business days during the applicable compliance period, unless Staff exercises its discretion to extend this 10 day period as discussed in Rule 5810(c)(3)[(G)](H).

(i) – (iv) No change.

(B) Market Makers

No change.

(C) Market Value of Listed Securities

A failure to meet the continued listing requirements for Market Value of Listed Securities shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days. Upon such failure, the Company shall be notified promptly and shall have a period of 180 calendar days from such notification to achieve compliance. Compliance can be achieved by meeting the applicable standard for a minimum of 10 consecutive business days during the 180 day

compliance period, unless Staff exercises its discretion to extend this 10 day period as discussed in Rule 5810(c)(3)[(G)](H).

(D) Market Value of Publicly Held Shares

A failure to meet the continued listing requirement for Market Value of Publicly Held Shares shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days. Upon such failure, the Company shall be notified promptly and shall have a period of 180 calendar days from such notification to achieve compliance. Compliance can be achieved by meeting the applicable standard for a minimum of 10 consecutive business days during the 180 day compliance period, unless Staff exercises its discretion to extend this 10 day period as discussed in Rule 5810(c)(3)[(G)](H).

(E) Independent Director and Audit Committee Rules

No change.

(F) Diverse Board Representation Rule

If a Company does not have at least two Diverse directors as set forth under Rule 5605(f)(2) and fails to provide the disclosure required by Rule 5605(f)(3), the Company shall be notified promptly and shall have until the latter of its next annual shareholders meeting or 180 days from the event that caused the deficiency to cure the deficiency.

[(F)](G) Market Value/Principal Amount Outstanding of Non-Convertible Bonds

A failure to meet the continued listing requirement for non-convertible bonds, as set forth in Rule 5702(b)(1) (requiring non-convertible bonds to have at least $400,000 in market value or principal amount outstanding) shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days. Upon such failure, the Company shall be notified promptly and shall have a period of 180 calendar days from such notification to achieve compliance. Compliance can be achieved during this 180 calendar day compliance period by meeting the applicable standard for a minimum of 10 consecutive business days during the applicable compliance period, unless Staff exercises its discretion to extend this 10 day period as discussed in Rule 5810(c)(3)[(G)](H).

[(G)](H) Staff Discretion Relating to the Price-based Requirements

No change.

(4) Public Reprimand Letter

No change.

(d) Additional Deficiencies

No change.

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SPAC Disclosures – SEC Focuses in on Conflicts of Interests

December 29, 2020

On December 22, 2020, the staff of the Securities and Exchange Commission's Division of Corporation Finance issued new guidance with disclosure considerations for special purpose acquisition companies ("SPACs"). The new guidance is reflected in CF Disclosure Guidance Topic No. 11 ("Topic No. 11"). SPACs, or "blank check companies," become public reporting companies through initial public offerings ("IPOs") and raise money for use in the acquisition of one or more operating companies. SPACs have been an increasingly popular structure and, in 2020, there have been close to 250 SPAC IPOs raising over $80 billion in gross proceeds.

The SEC's new guidance follows earlier comments by then-Chairman Clayton, that the compensation and other interests that affect SPAC sponsors, directors, officers, and other affiliates (referred to in this alert collectively as "insiders") should be clearly disclosed so that public investors understand their financial incentives and other potential conflicts, both at the time of the SPAC's IPO and at the time of its business combination with an operating company. Topic No. 11 provides guidance on appropriate disclosure with respect to a number of potential types of conflicts of interest and highlights the importance of appropriate disclosure on the material potential conflicts of interests of various transaction participants, including insiders, underwriters and investors in private financings by the SPAC.

While not all SPACs will include disclosure with respect to each potential conflict addressed by the staff, Topic No. 11 provides a useful checklist that a SPAC should review when preparing its disclosure documents at the time of both its IPO and at the time of a potential business combination. The new guidance should be considered in anticipating comments from the SEC staff, mitigating litigation risk, and structuring transactions in the most optimal way. Topic No. 11 identifies the following areas where the staff expects to see clear and appropriately detailed disclosure with respect to these potential material conflicts.

Initial Public Offerings

- Insiders' existing fiduciary or contractual obligations to entities other than the SPAC, whether such obligations could present material conflicts, and how such conflicts would be addressed.

- Potential for a business combination with a target company in which insiders have a pre-existing interest and how any such conflicts would be addressed.

- Financial incentives of insiders to complete a business combination, including potential losses if a business combination is not completed.

- Level of control that insiders will have over approval of a business combination.

- Whether and how the SPAC may amend the terms of its governing documents to facilitate the completion of a business combination.

- Whether and how the SPAC may extend the time it has to complete a business combination and whether shareholders may redeem their shares in connection with an extension.

- Balanced disclosure regarding insiders' past experience with SPAC transactions, including the outcomes of such transactions.

Insider Financial Incentives

- Security ownership of insiders and how the securities held by the insiders differ from those sold in the IPO. If applicable, a detailed description of the terms of convertible securities held by the insiders.

- How security ownership of insiders may create financial incentives for insiders to complete a business combination transaction, even if the transaction may not be in the best interest of other shareholders.

- Compensation of insiders for services to the SPAC and whether any payments will be contingent on the completion of a business combination.

Potential Insider Conflicts in Connection with the Evaluation of a Business Combination

- Detailed description of identification and evaluation of the target and negotiations regarding the business combination and the material terms thereof, in particular the nature and amount of consideration.

- Material factors considered by the board of the SPAC in approving the business combination, including its evaluation of the interests of its insiders.

- Insiders' conflicts of interest in presenting the proposed transaction to the SPAC and the application of any SPAC policies to address such conflicts. Whether insiders have financial or other interests in the target operating company.

- Material benefits to insiders from the transaction, including material compensation payments, return on initial investment and continuing relationship with combined company.

- Insiders' fully diluted ownership in combined company, including through exercise of warrants and conversion of convertible debt.

Additional Financings

- Whether additional financing will be necessary to complete a proposed business combination and, if so, the terms of such financing, and any material interest of insiders. If the financing involves issuance of securities, a comparison of the price and terms of such securities with securities sold in the IPO.

- Terms of any forward purchase agreement including the potential dilutive impact on other shareholders, and whether the commitment is irrevocable.

- Terms of convertible securities and any material impact on the beneficial ownership of the combined company.

Potential Underwriter Conflicts

- Fees that IPO underwriters will receive upon closing of the business combination.

- Compensation for additional services provided by the underwriters and their affiliates.

Advice for Participants in SPACs

The above presents a high-level summary of certain of the questions that SPACs and their counsel should consider in preparing disclosures and evaluating the staff's new guidance. Participants in SPAC transactions should familiarize themselves with Topic No. 11, not only in order to anticipate comments from the SEC staff and addressing litigation risk, but also to take into account when structuring SPAC IPOs and "de-SPAC" business combinations with targets. Over the last year, market considerations and the desire to attract long-term investors have pushed certain SPAC sponsors to more closely align their financial incentives with the interests of shareholders, including by creatively adjusting the terms of SPAC securities held by insiders. Topic No. 11 provides a useful reference point as the SPAC market continues to evolve and find its place in the broader capital markets and M&A landscape.

Proskauer's attorneys advise clients in all stages of SPAC transactions, including IPOs, PIPEs, business combinations and beyond. Our team works across practice areas and regularly represents sponsors, private and public investors, underwriters, executives and operators, and target operating companies.

Special Purpose Acquisition Companies

Division of Corporation Finance
Securities and Exchange Commission

CF Disclosure Guidance: Topic No. 11

Date: December 22, 2020

Summary: This guidance provides the Division of Corporation Finance's views about certain disclosure considerations for special purpose acquisition companies, commonly referred to as SPACs, in connection with their initial public offerings and subsequent business combination transactions.

Supplemental Information: *The statements in this CF Disclosure Guidance represent the views of the Division of Corporation Finance. This guidance is not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. This guidance, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.*

Introduction

A SPAC is a company with no operations that offers securities for cash and places substantially all the offering proceeds into a trust or escrow account for future use in the acquisition of one or more private operating companies. Following its initial public offering, or IPO, the SPAC will identify acquisition candidates and attempt to complete one or more business combination transactions after which the company will continue the operations of the acquired company or companies ("combined company") as a public company.[1]

The economic interests of the entity or management team that forms the SPAC ("sponsor(s)") and the directors, officers and affiliates of a SPAC often differ from the economic interests of public shareholders which may lead to conflicts of interests as they evaluate and decide whether to recommend business combination transactions to shareholders. Clear disclosure regarding these potential conflicts of interest and the nature of the sponsors', directors', officers' and affiliates' economic interests in the SPAC is particularly important because these parties are generally

responsible for negotiating the SPAC's business combination transaction. Unlike the traditional IPO process where a private operating company sells its securities in a manner in which the company and its offered securities are valued through market-based price discovery, these individuals are solely responsible for deciding how to value the private operating company and how much the SPAC will pay for it.

A SPAC preparing to conduct an IPO or present a business combination transaction to shareholders should consider carefully its disclosure obligations under the federal securities laws as they relate to conflicts of interest, potentially differing economic interests of the SPAC sponsors, directors, officers and affiliates and the interests of other shareholders and other compensation-related matters.[2]

Disclosure Considerations – Initial Public Offering

SPAC sponsors, directors and officers may not work exclusively on behalf of the SPAC to identify acquisition targets and they may have fiduciary or contractual obligations to other entities. These arrangements with, and obligations to, other entities may lead to conflicts of interest including conflicts involving entities that may compete with the SPAC for business combination opportunities.

- Have you clearly described the sponsors', directors' and officers' potential conflicts of interest? Have you described whether any conflicts relating to other business activities include fiduciary or contractual obligations to other entities; how these activities may affect the sponsors', directors' and officers' ability to evaluate and present a potential business combination opportunity to the SPAC and its shareholders; and how any potential conflicts will be addressed?
- Is it possible that you will pursue a business combination with a target in which your sponsors, directors, officers or their affiliates have an interest? If so, have you disclosed how you will consider potential conflicts of interest?

SPACs generally commit to find a target operating company and complete a business combination transaction within a specified timeframe. Under the typical terms of a SPAC's governing instruments, if the SPAC does not complete a business combination transaction within the specified timeframe, it must liquidate and make a pro rata distribution of the net offering proceeds held in trust to its public shareholders. As a SPAC nears the end of that timeframe, its options may narrow, giving acquisition targets significant leverage in negotiating the terms of a business combination transaction.

- Have you clearly described the financial incentives of SPAC sponsors, directors and officers to complete a business combination transaction? Have you disclosed how these incentives may differ from the interests of public shareholders? Have you quantified, to the extent practicable, information about the losses the sponsors, directors and officers could incur if the SPAC does not complete a business combination transaction?
- Have you disclosed the amount of control that SPAC sponsors, directors and officers and their affiliates will have over approval of a business combination transaction?

- Have you disclosed whether the SPAC may amend provisions in its governing instruments to facilitate the completion of a business combination transaction? Have you described how the SPAC may amend such provisions, whether shareholder approval is required, and, if so, the requisite voting standard for approval and whether the sponsors have sufficient voting power to approve it?
- Have you disclosed whether, and if so how, the SPAC may extend the time it has to complete a business combination transaction? If the SPAC may extend the time period, have you disclosed whether shareholders may redeem their shares in connection with any proposal to extend it?
- If the sponsors, directors, officers or their affiliates have prior SPAC experience, have you provided balanced disclosure about the prior experience and the outcome of presented and completed business combination transactions and liquidations?

The underwriter of the SPAC IPO may agree to defer its compensation until closing of the business combination transaction.

- If the underwriter of your IPO may provide additional services such as identifying potential targets, providing financial advisory services, acting as a placement agent in a private offering or underwriting or arranging debt financing, have you described those potential services and disclosed the fees you may pay for those services and whether you may pay those fees in other than cash? Will you condition payment for these additional services on the completion of a business combination transaction? Have you disclosed any conflict of interest the underwriter may have in providing such services given any deferred IPO underwriting compensation?

The economic terms of the investments made by a SPAC's sponsors, directors, officers and their affiliates usually differ from those of the public shareholders. Sponsors, directors, officers and their affiliates may have financial incentives that differ from public shareholders which may result from securities ownership, compensation arrangements or relationships with affiliated entities that may lead to conflicts of interest when evaluating potential business combination opportunities.

- Have you clearly disclosed the securities owned by sponsors, directors, officers and their affiliates including the price paid for the securities? Have you included a discussion of any concurrent offering of securities to the sponsors and their affiliates, the amount of those securities and the price to be paid? How does the price of securities previously sold and currently offered to sponsors, directors, officers and their affiliates compare to the public offering price in the IPO?
- Do you clearly describe the conflicts of interest that result from sponsors', directors', officers' or their affiliates' securities ownership, compensation arrangements or relationships with affiliated entities that may create financial incentives to complete a business combination transaction even if the transaction may not be in the best interest of other shareholders? For example, do you clearly disclose that if the SPAC fails to complete a business combination transaction, some or all of the sponsors', directors', officers' and their affiliates' securities would have no value and the sponsors, directors, officers and their affiliates may incur a substantial loss on their investment?

- Have you disclosed whether and how you may compensate your sponsors, directors, officers and their affiliates for services to the SPAC? Will any payments be contingent on the completion of the business combination transaction? Have you quantified known amounts?

When a SPAC issues securities to its sponsors, the terms of those securities often differ from securities it issues to public shareholders and typically result in the sponsors having substantial control over the SPAC. A SPAC also may increase its capital by selling securities in private offerings, resulting in negotiated terms for those securities that may differ from the shares sold in the IPO.

- Have you clearly disclosed the terms of securities held by sponsors, directors, officers, and their affiliates and discussed how the rights of those classes of securities compare to and differ from the rights and terms of securities offered in the IPO, as well as the resulting risks to public shareholders? If the sponsors, directors, officers, and their affiliates hold convertible debt, have you disclosed the material terms for conversion, such as when the debt is convertible, the maximum number of securities they may acquire through conversion and any contingencies on conversion?
- Have you disclosed whether you plan to seek, or have obtained, additional funding and how the terms of securities issued or to be issued in private offerings compare to the terms of securities offered in the IPO? Have you disclosed whether the sponsors, directors, officers or their affiliates may participate in or have an interest with respect to such financing?
- If the SPAC enters into a forward purchase agreement allowing the purchaser to invest in the SPAC at the time of a business combination transaction, have you clearly described the terms of the agreement and any potential dilutive impact on other shareholders? Is it clear whether the forward purchaser's commitment to purchase the securities is irrevocable?

Disclosure Considerations – Business Combination Transaction

As a SPAC negotiates a business combination transaction, its financing needs become more apparent and it may seek additional financing.

- Do you disclose clearly any additional financing necessary to complete the business combination transaction and how the terms of such financing may impact public shareholders? If the terms of additional financing involve the issuance of securities, have you described how the price and terms of those securities compare to and differ from the price and terms of the securities sold in the IPO? Are sponsors, directors, officers, or affiliates participating in additional financing?
- If you will issue convertible securities, do you describe the material terms for conversion and any material impact on the beneficial ownership of the combined company?

The SPAC sponsors, directors and officers may have evaluated a number of potential acquisition candidates before presenting a business combination transaction to shareholders and they may have interests and incentives that conflict with the interests of public shareholders.

- Have you provided detailed information about how you evaluated and decided to propose the identified transaction? Have you explained how and why you selected the target company? Who initiated contact? Why did you select this target over other alternative candidates? Have you explained the material terms of the transaction? How did you determine the nature and amount of consideration the SPAC will pay to acquire the private operating company? Have you clearly described the negotiations regarding the nature and amount of consideration?
- What material factors did the board of directors consider in its determination to approve the identified transaction? How did the board of directors evaluate the interests of sponsors, directors, officers and affiliates?
- Have you clearly described any conflicts of interest of the sponsors, directors, officers and their affiliates in presenting this opportunity to the SPAC and how the SPAC addressed these conflicts of interest? If the SPAC had a policy to address conflicts of interest and waived any provisions of that policy, have you disclosed the waiver and the reasons therefor? Have you described any interest the sponsors, directors, officers or their affiliates have in the target operating company, including, if material, the approximate dollar value of the interest, when the interest was acquired and the price paid?
- Have you provided detailed information on how the sponsors, directors, officers or their affiliates will benefit from this transaction? Have you quantified any material payments that they will receive as compensation, the return they will receive on their initial investment and any continuing relationship they will have with the combined company?
- Have you disclosed the total percentage ownership interest the SPAC sponsors, directors, officers and affiliates may hold in the combined company, including through the exercise of warrants and conversion of convertible debt?

The underwriter of the SPAC's IPO may have provided services in addition to those associated with the underwriting of the IPO and may have deferred a portion of its underwriting compensation until the closing of the SPAC's initial business combination transaction.

- Have you disclosed the fees that the underwriter of your IPO will receive upon completion of the business combination transaction, including the amount of fees that is contingent upon completion of a business combination transaction?
- Have you clearly described any additional services the underwriter provided, the cost of those services and how you compensated the underwriter and/or its affiliates for those services? Were those services conditioned on the completion of the business combination transaction? Have you disclosed any conflict of interest the underwriter may have had in providing such services given any deferred IPO underwriting compensation?

[1] For additional background information on SPACs, *see* What You Need to Know About SPACs – Investor Bulletin (Dec. 10, 2020), available at https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin.

[2] SPACs should consider the questions outlined in this document in the context of their disclosure obligations pursuant to Regulation S-K, and the requirements of Form S-4, Form F-4, Schedule 14A, Schedule 14C and Schedule TO, as applicable.

Modified: Dec. 22, 2020

8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90768; File No. SR-NYSE-2019-67)

December 22, 2020

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Setting Aside Action by Delegated Authority and Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings

I. Introduction

On December 11, 2019, New York Stock Exchange LLC ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Chapter One of the Listed Company Manual ("Manual") to modify the provisions relating to direct listings.[3] Pursuant to the proposal, NYSE would allow

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 On December 13, 2019, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on December 30, 2019. See Exchange Act Release No. 87821 (Dec. 20, 2019), 84 FR 72065. On February 13, 2020, pursuant to Section 19(b)(2) of the Exchange Act, the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change. See Exchange Act Release No. 88190, 85 FR 9891 (Feb. 20, 2020). On March 26, 2020, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1. See Exchange Act Release No. 88485, 85 FR 18292 (Apr. 1, 2020) ("OIP"). On June 22, 2020, the Exchange filed Amendment No. 2 to the proposed rule change, which superseded the proposed rule change as modified by Amendment No. 1 ("Amendment No. 2"). On June 24, 2020, the Commission extended the time period for approving or disapproving the proposal to August 26, 2020. See Exchange Act Release No. 89147, 85 FR 39226 (June 30, 2020). The proposed rule change, as modified by Amendment No. 2, was published for

an issuer, at the time of an initial listing on the Exchange, to conduct a primary offering as part of a direct listing without conducting a firm commitment underwritten offering.

On August 26, 2020, the Commission, acting through authority delegated to the Division of Trading and Markets ("Division"),[4] approved the proposed rule change, as modified by Amendment No. 2 ("Approval Order").[5] On September 8, 2020, the Council of Institutional Investors ("CII" or "Petitioner") filed a petition for review of the Approval Order ("Petition for Review"). Pursuant to Commission Rule of Practice 431(e), the Approval Order was stayed by the filing with the Commission of a notice of intention to petition for review.[6] On September 25, 2020, the Commission issued a scheduling order, pursuant to Commission Rule of Practice 431, granting the Petition for Review of the Approval Order and providing until October 16, 2020, for any party or other person to file a written statement in support of, or in opposition to, the

comment in the Federal Register on June 30, 2020. See Exchange Act Release No. 89148 (June 24, 2020), 85 FR 39246 ("Notice").

4 17 CFR 200.30-3(a)(12).

5 See Exchange Act Release No. 89684, 85 FR 54454 (Sept. 1, 2020).

6 17 CFR 201.431(e). See Letter to John Carey, Senior Director, NYSE Group Inc. (Aug. 31, 2020) (providing notice of receipt of notice of intention for review of delegated action and stay of order), available at https://www.sec.gov/rules/sro/nyse/2020/34-89684-carey-letter.pdf. On September 4, 2020, NYSE filed a motion for the Commission to lift the automatic stay of the Approval Order and a brief in support of its motion to lift the stay. On September 8, 2020, CII filed a brief in opposition to NYSE's motion to lift the automatic stay. On September 11, 2020, NYSE filed a reply brief in support of its motion to lift the stay.

Approval Order.[7] On October 16, 2020, NYSE submitted a written statement in support of the Approval Order.[8]

The Commission has conducted a de novo review of NYSE's proposal, giving careful consideration to the entire record—including NYSE's amended proposal, the Petition for Review, and all comments and statements submitted—to determine whether the proposal is consistent with the Exchange Act and the rules and regulations issued thereunder. Under Section 19b(2)(C) of the Exchange Act, the Commission must approve the proposed rule change of a self-regulatory organization ("SRO") if the Commission finds that the proposed rule change is consistent with the Exchange Act and the applicable rules and regulations thereunder; if it does not make such a finding, the Commission must disapprove the proposed rule change.[9] Additionally, under Rule 700(b)(3) of the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization that proposed the rule change."[10] Further, "the description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding."[11] Finally,

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7 See Exchange Act Release No. 90001, 85 FR 61793 (Sept. 30, 2020). In the scheduling order, the Commission also denied NYSE's motion to lift the automatic stay of the Approval Order and ordered that the proposed rule change, as modified by Amendment No. 2, remain stayed.

8 See The New York Stock Exchange LLC's Statement in Support of Order Approving Proposed Rule Change (Oct. 16, 2020) ("NYSE Statement").

9 15 U.S.C. 78s(b)(2)(C).

10 17 CFR 201.700(b)(3).

11 Id.

"[a]ny failure of the self-regulatory organization to provide the information elicited by Form 19b-4 may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization."[12]

For the reasons discussed herein, the Commission has determined that NYSE has met its burden to show that the proposed rule change is consistent with the Exchange Act. We thus set aside the Approval Order and approve NYSE's proposed rule change, as amended. Section 6(b)(5) of the Exchange Act requires that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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 are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by the Exchange Act matters not related to the purposes of the Exchange Act or the administration of an exchange.[13]

The record supports a finding that NYSE's proposal is consistent with these requirements. In particular, based on that record, the Commission concludes that, consistent with Section 6(b)(5) of the Exchange Act, NYSE's proposal will prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market

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12 Id.

13 15 U.S.C. 78f(b)(5).

system, and, in general, will protect investors and the public interest; and will not permit unfair discrimination between customers, issuers, brokers, or dealers, and is not designed to regulate by virtue of the Exchange Act matters not related to the purposes of the Exchange Act or the administration of an exchange.

II. Description of the Proposal

In an initial public offering ("IPO") underwritten on a firm commitment basis, an underwriter or group of underwriters enter into an underwriting agreement with the issuer in which they commit to take and pay for a specified amount of shares at a set price. The underwriters' purchase price reflects a discount, or spread, to the public offering price, which is negotiated between the issuer and the underwriters. The underwriters purchase the securities at the agreed upon discount and then resell the securities to the initial investors at the public offering price prior to the opening of trading. The underwriters and the issuer generally determine the public offering price and the discount based on indications for interest from prospective initial purchasers, which typically are, in large part, institutional investors with ongoing relationships with the underwriters. When the securities begin trading on an exchange, the opening price is determined based on orders to buy and sell the securities and may vary significantly from the initial public offering price. In a direct listing, in contrast, there is no initial sale to an underwriter or pre-opening sale by the underwriter to the initial purchasers. Instead, initial sales are conducted through the exchange, with the prices determined based on matching buy and sell orders and in accordance with applicable listing rules.

Section 102.01B, Footnote (E) of the Manual states that the Exchange generally expects to list companies in connection with a firm commitment underwritten IPO, upon transfer from another market, or pursuant to a spin-off, but also allows for the possibility of using a direct

listing, as described below.[14] Currently, Footnote (E) states that the Exchange recognizes that companies that have not previously had their common equity securities registered under the Exchange Act, but that have sold common equity securities in a private placement, may wish to list their common equity securities on the Exchange at the time of effectiveness of a registration statement[15] filed solely for the purpose of allowing existing shareholders to sell their shares.[16] The Exchange has proposed to define this type of direct listing already permitted by the Exchange's rules as a "Selling Shareholder Direct Floor Listing."[17] The Exchange has proposed to recognize an additional type of direct listing in which a company that has not previously had its common equity securities registered under the Exchange Act would list its common equity securities on the Exchange at the time of effectiveness of a registration statement pursuant to which the company itself would sell shares in the opening auction on the first day of trading on the Exchange in addition to, or instead of, facilitating sales by selling shareholders (a "Primary

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14 See Section 102.01B, Footnote (E) of the Manual.

15 The reference to a registration statement refers to an effective registration statement filed pursuant to the Securities Act of 1933 ("Securities Act").

16 See Section 102.01B, Footnote (E) of the Manual. See also Exchange Act Release No. 82627 (Feb. 2, 2018), 83 FR 5650 (Feb. 8, 2018) (SR-NYSE-2017-30) ("NYSE 2018 Order") (approving proposed rule change to amend Section 102.01B of the Manual to modify the provisions relating to the qualifications of companies listing without a prior Exchange Act registration in connection with an underwritten IPO and amend the Exchange's rules to address the opening procedures on the first day of trading for such securities).

17 See proposed Section 102.01B, Footnote (E) of the Manual. Under the proposal, the Exchange would specify that such company may have previously sold common equity securities in "one or more" private placements. The Exchange also has proposed to move the description of this type of direct listing as involving a company "where such company is listing without a related underwritten offering upon effectiveness of a registration statement registering only the resale of shares sold by the company in earlier private placements" so that this description appears in conjunction with the definition of "Selling Shareholder Direct Floor Listing." See id.

Direct Floor Listing").[18] Under the proposal, the Exchange would, on a case-by-case basis, exercise discretion to list companies through a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing.[19]

With respect to a Selling Shareholder Direct Floor Listing, the Exchange proposal retains the existing standards regarding how the Exchange will determine whether a company has met its market value of publicly-held shares listing requirement. The Exchange will continue to determine that such company has met the $100 million aggregate market value of publicly-held shares requirement based on a combination of both (i) an independent third-party valuation ("Valuation") of the company; and (ii) the most recent trading price for the company's common stock in a trading system for unregistered securities operated by a national securities exchange or a registered broker-dealer ("Private Placement Market").[20] Alternatively, in the absence of any recent trading in a Private Placement Market, the Exchange will determine that such company

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18 See proposed Section 102.01B, Footnote (E) of the Manual. A Primary Direct Floor Listing would include any such listing in which either (i) only the company itself is selling shares in the opening auction on the first day of trading; or (ii) the company is selling shares and selling shareholders may also sell shares in such opening auction. See id.

19 See proposed Section 102.01B, Footnote (E) of the Manual.

20 See proposed Section 102.01B, Footnote (E) of the Manual. The Exchange will attribute a market value of publicly-held shares to the company equal to the lesser of: (i) the value calculable based on the Valuation; and (ii) the value calculable based on the most recent trading price in a Private Placement Market. See Section 102.01B, Footnote (E) of the Manual. For specific requirements regarding the Valuation and the independence of the valuation agent conducting such Valuation, see Section 102.01B, Footnote (E) of the Manual. Section 102.01B, Footnote (E) of the Manual also sets forth specific factors for relying on a Private Placement Market price. Generally, the Exchange will only rely on a Private Placement Market price if it is consistent with a sustained history over a several month period prior to listing evidencing a market value in excess of the Exchange's market value requirement.

has met its market value of publicly-held shares requirement if the company provides a Valuation evidencing a market value of publicly-held shares of at least $250 million.[21]

With respect to a Primary Direct Floor Listing, the Exchange has proposed that it will deem a company to have met the applicable aggregate market value of publicly-held shares requirement if the company will sell at least $100 million in market value of the shares in the Exchange's opening auction on the first day of trading on the Exchange.[22] Alternatively, where a company is conducting a Primary Direct Floor Listing and will sell shares in the opening auction with a market value of less than $100 million, the Exchange will determine that such company has met its market value of publicly-held shares requirement if the aggregate market value of the shares the company will sell in the opening auction on the first day of trading and the shares that are publicly held immediately prior to the listing is at least $250 million, with such market value calculated using a price per share equal to the lowest price of the price range established by the issuer in its registration statement.[23]

According to the Exchange, a company may list on the Exchange in connection with a traditional IPO with a market value of publicly-held shares of $40 million and, in the Exchange's experience in listing IPOs, a liquid trading market develops after listing for issuers with a much

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21 See Section 102.01B, Footnote (E) of the Manual. Shares held by directors, officers, or their immediate families and other concentrated holdings of 10 percent or more are excluded in calculating the number of publicly-held shares. See Section 102.01A, Footnote (B) of the Manual.

22 See proposed Section 102.01B, Footnote (E) of the Manual.

23 See proposed Section 102.01B, Footnote (E) of the Manual. The Exchange states that, for example, if the company is selling five million shares in the opening auction, there are 45 million publicly-held shares issued and outstanding immediately prior to listing, and the lowest price of the price range disclosed in the company's registration statement is $10 per share, then the Exchange will attribute to the company a market value of publicly-held shares of $500 million. See Notice, 85 FR at 39247.

smaller value of publicly-held shares than the Exchange anticipates would exist after the opening auction in a Primary Direct Floor Listing under the proposed market value of publicly-held shares requirements.[24] Consequently, the Exchange believes that these requirements would provide that any company conducting a Primary Direct Floor Listing would be of a suitable size for Exchange listing and that there would be sufficient liquidity for the security to be suitable for auction market trading.[25] The Exchange also states that, with the exception of the proposed requirement for Primary Direct Floor Listings, shares held by officers, directors, or owners of more than 10% of the company stock are not included in calculations of publicly-held shares for purposes of Exchange listing rules.[26] The Exchange states that such investors may acquire in secondary market trades shares sold by the issuer in a Primary Direct Floor Listing that were included when calculating whether the issuer meets the market value of publicly-held shares initial listing requirement.[27] The Exchange further states that it believes that because of the enhanced publicly-held shares requirement for listing in connection with a Primary Direct Floor Listing, which is much higher than the Exchange's $40 million requirement for a traditional underwritten IPO, and the neutral nature of the opening auction process, companies using a Primary Direct Floor Listing would have an adequate public float and liquid trading market after completion of the opening auction.[28]

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24 See Notice, 85 FR at 39250.

25 See Notice, 85 FR at 39250.

26 See Notice, 85 FR at 39247. The Exchange states that these types of inside investors may purchase shares sold by the company in the opening auction, and purchase shares sold by other shareholders or sell their own shares in the opening auction and in trading after the opening auction, to the extent not inconsistent with general anti-manipulation provisions, Regulation M, and other applicable securities laws. See id.

27 See Notice, 85 FR at 39247.

28 See Notice, 85 FR at 39247.

The Exchange states that any company listing in connection with a Primary Direct Floor Listing or a Selling Shareholder Direct Floor Listing would continue to be subject to and need to meet all other applicable initial listing requirements. According to the Exchange, this would include the requirements of Section 102.01A of the Manual to have 400 round lot shareholders and 1.1 million publicly-held shares outstanding at the time of initial listing, and the requirement of Section 102.01B of the Manual to have a price per share of at least $4.00 at the time of initial listing.[29]

The Exchange has proposed a new order type to be used by the issuer in a Primary Direct Floor Listing and rules regarding how that new order type would participate in a Direct Listing Auction.[30] Specifically, the Exchange has proposed to introduce an Issuer Direct Offering Order ("IDO Order"), which would be a Limit Order to sell that is to be traded only in a Direct Listing Auction for a Primary Direct Floor Listing.[31] The IDO Order would have the following requirements: (1) only one IDO Order may be entered on behalf of the issuer and only by one member organization; (2) the limit price of the IDO Order must be equal to the lowest price of the price range established by the issuer in its effective registration statement (the price range is defined as the "Primary Direct Floor Listing Auction Price Range"); (3) the IDO Order must be for the quantity of shares offered by the issuer, as disclosed in the prospectus in the effective

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29 See Notice, 85 FR at 39247.

30 Under current Rule 1.1(f), the term "Direct Listing" means "a security that is listed under Footnote (E) to Section 102.01B of the Listed Company Manual." The Exchange has proposed to modify this definition to specify that the term "Direct Listing" may refer to either a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing. See proposed Rule 1.1(f). See also Rule 7.35(a)(1) for the definition of "Auction" and Rule 7.35(a)(1)(E) for the definition of "Direct Listing Auction."

31 See proposed Rule 7.31(c)(1)(D). See also Rule 7.31(a)(2) for the definition of "Limit Order."

registration statement; (4) the IDO Order may not be cancelled or modified; and (5) the IDO Order must be executed in full in the Direct Listing Auction.[32] Consistent with current rules, a Designated Market Maker ("DMM") would effectuate a Direct Listing Auction manually, and the DMM would be responsible for determining the Auction Price.[33] Under the proposal, the DMM would not conduct a Direct Listing Auction for a Primary Direct Floor Listing if (1) the Auction Price would be below the lowest price or above the highest price of the Primary Direct Floor Listing Auction Price Range; or (2) there is insufficient buy interest to satisfy both the IDO Order and all better-priced sell orders in full.[34] The Exchange states that if there is insufficient buy interest and the DMM cannot price the Auction and satisfy the IDO Order as required, the Direct Auction would not proceed and such security would not begin trading.[35] The Exchange represents that, if a Direct Listing Auction cannot be conducted, the Exchange would notify market participants via a Trader Update that the Primary Direct Floor Listing has been cancelled

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32 See proposed Rule 7.31(c)(1)(D)(i)–(v).

33 "Auction Price" is defined as the price at which an Auction is conducted. See Rule 7.35(a)(5). The Exchange states that because an IDO Order would not be entered by the DMM, the Exchange has proposed to include IDO Orders among the types of Auction-Only Orders that are not available to DMMs. See Notice, 85 FR at 39248, n.21. See also proposed Rule 7.31(c). An "Auction-Only Order" is a Limit or Market Order that is to be traded only in an auction pursuant to the Rule 7.35 Series (for Auction-Eligible Securities) or routed pursuant to Rule 7.34 (for UTP Securities). See Rule 7.31(c). See also Rule 7.31(a)(1) for the definition of "Market Order."

34 See proposed Rule 7.35A(g)(2). A buy (sell) order is "better-priced" if it is priced higher (lower) than the Auction Price, and this includes all sell Market Orders and Market-on-Open Orders. See Rule 7.35(a)(5)(A). See also Rule 7.31(c)(1)(B) for the definition of "Market-on-Open Order." A buy (sell) order is "at-priced" if it is priced equal to the Auction Price. See Rule 7.35(a)(5)(B).

35 See Notice, 85 FR at 39249.

and any orders for that security that had been entered on the Exchange, including the IDO Order, would be cancelled back to the entering firms.[36]

Currently, Rule 7.35A(h) generally provides that, once an Auction Price has been determined, better-priced orders are guaranteed to participate in the Auction at the Auction Price, whereas at-priced orders are not guaranteed to participate and will be allocated according to specified priority rules.[37] The Exchange has proposed that an IDO Order would be guaranteed to participate in the Direct Listing Auction at the Auction Price.[38] If the limit price of the IDO Order is equal to the Auction Price, the IDO Order would have priority at that price.[39] The Exchange states that providing priority to an at-priced IDO Order would increase the potential for the IDO Order to be executed in full, and therefore for the Primary Direct Floor Listing to proceed.[40]

In addition, the Exchange has proposed to specify that two existing provisions would apply in the case of a Selling Shareholder Direct Floor Listing only. Currently, a DMM will publish a pre-opening indication if the Auction Price is anticipated to be a change of more than the Applicable Price Range[41] from a specified Indication Reference Price.[42] Under the proposal,

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36 See Notice, 85 FR at 39249.

37 See Rule 7.35A(h)(1) and (2).

38 See proposed Rule 7.35A(h)(4).

39 See proposed Rule 7.35A(h)(4).

40 See Notice, 85 FR at 39249.

41 The "Applicable Price Range" for determining whether to publish a pre-opening indication, with limited exception, is 5% for securities with an Indication Reference Price over $3.00 and $0.15 for securities with an Indication Reference Price equal to or lower than $3.00. See Rule 7.35A(d)(3)(A).

42 See Rule 7.35A(d)(1)(A).

the Indication Reference Price for a security that is a Selling Shareholder Direct Floor Listing that has had recent sustained trading in a Private Placement Market prior to listing would be the most recent transaction price in that market or, if none, would be a price determined by the Exchange in consultation with a financial advisor to the issuer of such security.[43] Further, when facilitating the opening on the first day of trading of a Selling Shareholder Direct Floor Listing that has not had a recent sustained history of trading in a Private Placement Market prior to listing, the DMM would consult with a financial advisor to the issuer of such security in order to effect a fair and orderly opening of such security.[44] The Exchange states that these provisions are not applicable to a Primary Direct Floor Listing because, unlike for a Selling Shareholder Direct Floor Listing, the registration statement for a Primary Direct Floor Listing would include a price range within which the company anticipates selling the shares it is offering.[45]

In the case of a Primary Direct Floor Listing, the Exchange has proposed a new measure of the Indication Reference Price. Specifically, for a security that is offered in a Primary Direct Floor Listing, the Indication Reference Price would be the lowest price of the Primary Direct Floor Listing Auction Price Range.[46]

The Exchange states that any services provided by a financial advisor to the issuer of a security listing in connection with a Selling Shareholder Direct Floor Listing or a Primary Direct

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43 See proposed Rule 7.35A(d)(2)(A)(iv).

44 See proposed Rule 7.35A(g)(1). The Exchange has proposed a non-substantive change to this provision to modify a reference to "Private Placement" to utilize the defined term "Private Placement Market." See id.

45 See Notice, 85 FR at 39249.

46 See proposed Rule 7.35A(d)(2)(A)(v). The Exchange states that, for example, if the Primary Direct Floor Listing Auction Price Range is $10.00 to $20.00, then the Indication Reference Price would be $10.00. See Notice, 85 FR at 39248, n.22.

Floor Listing (the "financial advisor") and the DMM assigned to that security must provide such services in a manner that is consistent with all federal securities laws, including Regulation M and other anti-manipulation requirements.[47] The Exchange states that, for example, when a financial advisor provides a consultation to the Exchange as required by Rule 7.35A(d)(2)(a)(iv), when the DMM consults with a financial advisor in connection with Rule 7.35A(g)(1), or when a financial advisor otherwise assists or consults with the DMM as to pricing or opening of trading in a Selling Shareholder Direct Floor Listing or Primary Direct Floor Listing, the financial advisor and DMM will not act inconsistent with Regulation M and other anti-manipulation provisions of the federal securities laws, or Exchange Rule 2020.[48] The Exchange represents that it has retained the Financial Industry Regulatory Authority ("FINRA") pursuant to a regulatory services agreement to monitor such compliance with Regulation M and other anti-manipulation provisions of the federal securities laws, and Rule 2020.[49] The Exchange has proposed a new commentary that states that, in connection with a Selling Shareholder Direct Floor Listing, the financial advisor to the issuer of the security being listed and the DMM assigned to such security are reminded that any consultation that the financial advisor provides to the Exchange as required by Rule 7.35A(d)(2)(A)(iv) and any consultation between the DMM

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47 See Notice, 85 FR at 39249.

48 See Notice, 85 FR at 39249 (citing Rule 2020, which provides that "No member or member organization shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent contrivance").

49 See Notice, 85 FR at 39249. The Exchange further represents that it expects to issue regulatory guidance in connection with a company conducting a Primary Direct Floor Listing, and that such regulatory guidance would include a reminder to member organizations that activities in connection with a Primary Direct Floor Listing, like activities in connection with other listings, must be conducted in a manner not inconsistent with Regulation M and other anti-manipulation provisions of the federal securities laws and Rule 2020. See id. at 39249, n.28.

and financial advisor as required by Rule 7.35A(g)(1) is to be conducted in a manner that is consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements.[50]

Finally, the Exchange has proposed to remove references to Direct Listing Auctions from Rule 7.35C, which concerns Exchange-facilitated auctions.[51] The Exchange states that, because of the importance of the DMM to the Direct Listing Auction, if a DMM is unable to manually facilitate a Direct Listing Auction, the Exchange would not proceed with a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing.[52]

III. Discussion and Commission Findings

The Commission finds that the proposed rule change, as modified by Amendment No. 2, is consistent with Section 6(b)(5) of the Exchange Act,[53] which requires, among other things, that the rules of a national securities exchange 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 are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[54]

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50 See proposed Rule 7.35A, Commentary .10.

51 See proposed Rule 7.35C(a), (a)(3), (b)(1), and (b)(3).

52 See Notice, 85 FR at 39249.

53 15 U.S.C. 78f(b)(5).

54 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

The Commission has consistently recognized the importance and significance of national securities exchange listing standards. Among other things, such listing standards help ensure that exchange listed companies will have sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly markets.[55] The standards, collectively, also provide investors and market participants with some level of assurance that the listed company has the resources, policies, and procedures to comply with the requirements of the Exchange Act and Exchange rules.[56]

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55 The Commission has stated in approving national securities exchange listing requirements that the development and enforcement of adequate standards governing the listing of securities on an exchange is an activity of critical importance to the financial markets and the investing public. In addition, once a security has been approved for initial listing, maintenance criteria allow an exchange to monitor the status and trading characteristics of that issue to ensure that it continues to meet the exchange's standards for market depth and liquidity so that fair and orderly markets can be maintained. See, e.g., NYSE 2018 Order, 83 FR at 5653, n.53; Exchange Act Release Nos. 81856 (Oct. 11, 2017), 82 FR 48296, 48298 (Oct. 17, 2017) (SR-NYSE-2017-31); 81079 (July 5, 2017), 82 FR 32022, 32023 (July 11, 2017) (SR-NYSE-2017-11). The Commission has stated that adequate listing standards, by promoting fair and orderly markets, are consistent with Section 6(b)(5) of the Exchange Act, in that they are, among other things, designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest. See, e.g., NYSE 2018 Order, 83 FR at 5653, n.53; Exchange Act Release Nos. 87648 (Dec. 3, 2019), 84 FR 67308, 67314, n.42 (Dec. 9, 2019) (SR-NASDAQ-2019-059); 88716 (Apr. 21, 2020), 85 FR 23393, 23395, n.22 (Apr. 27, 2020) (SR-NASDAQ-2020-001).

56 "Meaningful listing standards also are important given investor expectations regarding the nature of securities that have achieved a national securities exchange listing, and the role of a national securities exchange in overseeing its market and assuring compliance with its listing standards." Exchange Act Release No. 65708 (Nov. 8, 2011), 76 FR 70799, 70802 (Nov. 15, 2011) (SR-NASDAQ-2011-073). See also Exchange Act Release Nos. 65709 (Nov. 8, 2011), 76 FR 70795 (Nov. 15, 2011) (SR-NYSE-2011-38); 88389 (Mar. 16, 2020), 85 FR 16163 (Mar. 20, 2020) (SR-NASDAQ-2019-089). The Exchange, in addition to requiring companies seeking to list to meet the quantitative listing standards and once listed the quantitative continued listing standards, also requires listed companies to meet other qualitative requirements. See, e.g., Section 3, Corporate Responsibility, of the Manual.

The Exchange's listing standards currently provide the Exchange with discretion to list a company whose stock has not been previously registered under the Exchange Act, where such company is listing in connection with a Selling Shareholder Direct Floor Listing.[57] The Exchange has proposed to allow companies to list in connection with a Primary Direct Floor Listing, which would for the first time provide a company the option, without a firm commitment underwritten offering, of selling shares to raise capital in the opening auction upon initial listing on the Exchange.[58]

Several commenters expressed support for the proposed expansion of direct listings to permit a primary offering.[59] One commenter, for example, stated that it supports alternative formats for IPOs, including direct listing proposals like the one proposed by the Exchange, and expressed the view that issuers should be offered choices that match their objectives so long as

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57 See Section 102.01B, Footnote (E) of the Manual. See also NYSE 2018 Order, 83 FR at 5654.

58 See NYSE Listed Company Manual Section 102.01B, Footnote (E) of the Manual which states generally that the Exchange expects to list companies in connection with a firm commitment underwritten IPO, upon transfer from another market, or pursuant to a spin-off. Section 102.01B, Footnote (E) also states, however, that "the Exchange recognizes that some companies that have not previously had their common equity securities registered under the Exchange Act, but which have sold common equity securities in a private placement, may wish to list their common equity securities on the Exchange at the time of effectiveness of a registration statement filed solely for the purpose of allowing existing shareholders to sell their shares."

59 See Letter from Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel Securities (Feb. 18, 2020) ("Citadel Letter"), at 1; Letter from Paul Abrahimzadeh and Russell Chong, Co-Heads, U.S. Equity Capital Markets, Citigroup Capital Markets Inc. (Feb. 26, 2020) ("Citigroup Letter"); Letter from Matthew B. Venturi, Founder & CEO, ClearingBid, Inc. (Jan. 21, 2020) ("ClearingBid Letter"), at 5; Letter from David Ludwig, Head of Americas Equity Capital Markets, Goldman Sachs Group, Inc. (Feb. 7, 2020) ("Goldman Sachs Letter"); Letter from Burke Dempsey, Executive Vice President Head of Investment Banking, Wedbush Securities (Apr. 20, 2020) ("Wedbush Letter").

they protect the integrity of the markets and are fair and clear to investors, using transparent processes.[60] Another commenter believed that allowing for multiple pathways for private companies to achieve exchange listing would encourage more companies to participate in public equity markets and provide investors a broader array of attractive investment opportunities.[61]

In Amendment No. 2, the Exchange made several modifications to its proposal that were designed to clarify the role of the issuer and financial advisor in a direct listing to explain how compliance with various rules and regulations will be addressed. As discussed in more detail below, these changes: (i) help to ensure that the issuer cannot unduly influence the opening price through a new order type that cannot be modified or canceled; (ii) highlight that financial advisors involved with direct listings cannot violate the anti-manipulation provisions of the Exchange Act, including Regulation M; and (iii) highlight that the Exchange has retained FINRA pursuant to a regulatory services agreement to monitor compliance with Regulation M and other anti-manipulation provisions of the federal securities laws. We conclude that the proposal, as amended by Amendment No. 2, supports a finding that the proposal is consistent with the Exchange Act. More specifically, the following aspects of the proposal demonstrate that it is reasonably designed to be consistent with the protection of investors and the maintenance of fair and orderly markets, as well as the facilitation of capital formation: (i) addition of the IDO Order

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60 See Citigroup Letter. This commenter also stated its belief that the direct listing format would afford broad participation in the capital formation process and help establish a shareholder base that has a long-term interest in partnering with management teams. See id.

61 See Goldman Sachs Letter. This commenter also referenced the recent direct listings by Spotify Technology S.A. and Slack Technologies, Inc., and expressed the view that the development of a direct listing approach to becoming a public company has been a significant step forward in providing companies greater choice in their path to going public, and that the ability to include a primary capital raise in a direct listing will further enhance this flexibility. See id. See also Citadel Letter, at 1; Wedbush Letter.

type and other requirements which address how the issuer will participate in the opening auction; (ii) discussion of the role of financial advisors; (iii) addition of the Commentary that provides that specified activities are to be conducted in a manner that is consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements; (iv) retaining FINRA to monitor compliance with Regulation M and other anti-manipulation provisions of the federal securities laws and NYSE Rule 2020; (v) clarification of how market value will be determined for qualifying the company's securities for listing; and (vi) elimination of the grace period for meeting certain listing requirements.

The Commission addresses below the relevant concerns, identified by either commenters or the Commission in the OIP, relating to NYSE's proposal to allow direct listings with a primary offering. First, the Commission addresses issues identified in the OIP related to the aggregate market value of publicly-held shares requirement and whether the proposed standards will help facilitate adequate liquidity for companies listing in a Primary Direct Floor Listing. Second, the Commission addresses issues identified in the OIP about the initial listing opening auction process for Primary Direct Floor Listings and discusses financial advisors. Finally, the Commission addresses commenters' concerns about whether the proposal is consistent with investor protection and the public interest given the lack of traditional underwriter involvement in a Primary Direct Floor Listing, as well as concerns about Securities Act Section 11(a) liability. As discussed in greater detail below, the Commission concludes that the record addresses these concerns and that the Exchange has met its burden to demonstrate that its proposal is consistent with the Exchange Act, and therefore finds the proposed rule change to be consistent with the Exchange Act.

A. Aggregate Market Value of Publicly-held Shares Requirement

With respect to the aggregate market value of publicly-held shares requirement, the Exchange proposes to require that it will deem a company to have met such requirement if the company will sell at least $100 million in market value of shares in the Exchange's opening auction on the first day of trading. Alternatively, where a company will sell shares in the opening auction with a market value of less than $100 million, the Exchange will deem the company to have met such requirement if the aggregate market value of the shares the company will sell in the opening auction on the first day of trading and the shares that are publicly held immediately prior to listing is at least $250 million. According to the Exchange, a company may list in connection with an IPO with a market value of publicly-held shares of $40 million and, "in the Exchange's experience in listing IPOs, a liquid trading market develops after listing for issuers with a much smaller value of publicly-held shares than the Exchange anticipates would exist after the opening auction in a Primary Direct Floor Listing."[62] In Amendment No. 2, the Exchange clarified that market value would be calculated using a price per share equal to the lowest price of the price range multiplied by the number of shares being offered by the issuer.[63]

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62 Notice, 85 FR at 39250. As described above, in determining that a company has met the market value of publicly-held shares standards the Exchange will consider the market value of all shares sold by the company in the opening auction, rather than excluding shares that may be purchased by officers, directors, or owners of more than 10% of the company's common stock, notwithstanding that generally the Exchange's listing standards exclude shares held by such insiders from its calculations of publicly-held shares. The Exchange believes that the Primary Direct Floor Listing will have an adequate public float and liquid trading market after completion of the opening auction given the higher market value requirement than that required for listing an underwritten IPO. See Notice, 85 FR at 39247.

63 See Notice, 85 FR at 39247 and note 23, supra, and accompanying text.

One commenter expressed the view that the proposal, as originally noticed for comment, appropriately updated the publicly-held shares and distribution requirements associated with direct listings in order to ensure the development of a liquid trading market.[64] Another commenter believed that the Exchange should provide data to support its conclusion that there would be adequate liquidity for a security listing in connection with a Primary Direct Floor Listing.[65] In its statement in support of its proposal, the Exchange stated that its proposal would impose a substantially higher capitalization requirement for Primary Direct Floor Listings than its rules require for traditional IPOs.[66]

The Commission has determined that the Exchange has met its burden to show that the proposed aggregate market value of publicly-held shares requirement provides the Exchange with a reasonable level of assurance that the company's market value supports listing on the Exchange and the maintenance of fair and orderly markets.[67] The Commission reaches this

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64 See Citadel Letter, at 1.

65 See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (July 16, 2020) ("CII Letter III"), at 5.

66 See NYSE Statement, at 12 (citing Section 102.01B of the Manual; Approval Order at 16–17). According to the Exchange, it generally requires companies listing on the Exchange in connection with an IPO to have a market value of publicly-held shares of at least $40 million, whereas the proposal would require a company listing in conjunction with a Primary Direct Floor Listing to either (1) sell at least $100 million of its listed securities in the opening auction; or (2) have an aggregate market value of publicly-held shares immediately prior to listing, together with the market value of shares the company sells in the opening auction, of at least $250 million.

67 Almost half of exchange-listed IPOs in the recent year had proceeds that fell below the $100 million threshold. Using information from Thomson Reuters SDC Platinum New Issues database, the Commission staff concluded that, among 146 exchange-listed IPOs conducted during the 2019 calendar year, the median offer size was $106.7 million. Further, staff concluded that approximately 47.9 percent of the companies that went public via IPO (12.8 percent for NYSE IPOs and 60.7 percent for NASDAQ IPOs) had an offer size that fell below $100 million. Similarly, an Ernst & Young report states that during 2019, the median proceeds raised in exchange-listed IPOs in the United States

conclusion because the proposed market value standard for listing a Primary Direct Floor Listing is at least two and a half times greater than the market value standard that currently exists under Exchange rules for an Exchange listing of an IPO. The Commission also finds that the proposed requirements are also comparable to or higher than the aggregate market value of publicly-held shares required by the Exchange for initial listing in other contexts.[68] Specifically, the Exchange's proposed minimum market value requirements, which are designed in part to ensure sufficient liquidity, of $100 million and $250 million for Primary Direct Floor Listings are, in addition to being higher than the $40 million minimum market value requirement for IPOs,[69] comparable to (i) the $100 million and $250 million minimum market value requirements for listing a Selling Shareholder Direct Floor Listing;[70] and (ii) the $100 million requirement for

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were approximately $110 million. See Global IPO trends: Q4 2019, Ernst & Young, available at https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/growth/ey-global-ipo-trends-q4-2019.pdf.

68 The Exchange did not provide the data specifically referenced by a commenter. See supra note 65 and accompanying text. However, the proposed minimum market value requirements are comparable to or higher than those listing standards applied by the Exchange in other contexts. See supra notes 20-21 and 66 and accompanying text.

69 The existing $40 million market value requirement in Exchange Rules (Section 102.01B of the Manual) is a longstanding requirement that has supported the listing of companies on the Exchange that are suitable for listing and have existed since at least 2009. See Section 102.01B of the Manual. See Exchange Act Release No. 60501 (Aug. 13, 2009), 74 FR 42348 (Aug. 21, 2009) (SR-NYSE-2009-80) (lowering the aggregate market value of publicly-held shares for the listing of IPOs and spin-offs from $60 million to $40 million).

70 The Commission previously approved the standards for Selling Shareholder Direct Floor Listings as supporting listing on the Exchange and the maintenance of fair and orderly markets thereby protecting investors and the public interest in accordance with Section 6(b)(5) of the Exchange Act. See NYSE 2018 Order, 83 FR at 5654.

aggregate market value of publicly-held shares for companies that list other than at the time of an IPO, spin-off, or initial firm commitment underwritten public offering.[71]

And as described below, using the lowest price in the price range established by the issuer in its registration statement to determine the minimum market value is a reasonable and conservative approach because the Primary Direct Floor Listing will not proceed at a lower price.

B. Opening Auction Process for Primary Direct Floor Listings and Role of Financial Advisors

In the Order Instituting Proceedings, the Commission expressed concern that, with a Primary Direct Floor Listing, the company could be the only seller (or a dominant seller) participating in the opening auction and thus could be in a position to uniquely influence the price discovery process, and requested the Exchange to explain how its opening auction rules would apply in a Primary Direct Floor Listing.[72] In Amendment No. 2, the Exchange proposed

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71 See Section 102.01B of the Manual. The Commission previously has found that this longstanding requirement is suitable for initial listing of companies on the Exchange and that the standard has supported listings of companies on the Exchange over many years. For example, in 1999 the Commission approved the existing $100 million aggregate market value standard of publicly-held shares standard that currently applies to listings other than IPOs and spin-offs. In approving this proposal, the Commission stated its belief that this threshold requirement, among others, should "ensure that only companies of a certain minimum size are included among those listing on the Exchange, thereby protecting investors by raising the minimum standard for listed companies." Exchange Act Release No. 41502 (June 9, 1999), 64 FR 32588 (June 17, 1999) (SR-NYSE-99-13). The 1999 rule change also increased to $60 million the $40 million requirement that applied to IPOs and spin-offs, which is still significantly below the requirements being proposed for a Primary Direct Floor Listing. Id. As noted supra at note 69, the $60 million requirement was lowered back to $40 million in 2009. See Exchange Act Release No. 60501 (Aug. 13, 2009), 74 FR 42348 (Aug. 21, 2009) (SR-NYSE-2009-80).

72 One commenter expressed general support for the proposal and offered a variety of observations beyond the scope of the proposal, including with respect to the importance of opening auction information. See ClearingBid Letter, at 1.

to add the IDO Order as a new order type to be used by the issuer in a Primary Direct Floor Listing, and to clarify in its rules how the DMM would conduct the opening auction for such listings. As discussed above, the issuer would be required to submit an IDO Order in the opening auction with a limit price equal to the low end of the Primary Direct Floor Listing Auction Price Range, and for the full quantity of offered shares, as reflected in the registration statement. The IDO Order cannot be modified or canceled by the issuer once entered. Further, the DMM would conduct the opening auction only if the auction price is within the Primary Direct Floor Listing Auction Price Range disclosed in the registration statement, and the IDO Order and all better-priced sell orders can be satisfied in full. If the auction price is equal to the limit price of the IDO Order (i.e., the low end of the Primary Direct Floor Listing Auction Price Range), the IDO Order would have priority over other sell orders at that price.[73]

The Commission finds that the IDO Order and related clarifications proposed by the Exchange help to clearly define the method by which the issuer participates in the opening auction, to prevent the issuer from being in a position to improperly influence the price discovery process,[74] and to design an auction that is otherwise consistent with the disclosures in the registration statement. Specifically, the issuer would be required to submit an IDO Order in the opening auction with a limit price equal to the low end of the Primary Direct Floor Listing

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73 In addition, as discussed above, the Exchange proposes that the DMM will publish a pre-opening indication in a Primary Direct Floor Listing if the auction price is expected to be outside a price range around an "Indication Reference Price" equal to the low end of the price range reflected in the registration statement. The Commission believes this is a reasonable and conservative reference price because the auction cannot occur at a lower price, and if the auction occurs at a higher price the proposal errs on the side of requiring opening indication information to be disseminated to market participants.

74 See supra notes 72–73 and accompanying text. See also proposed Rule 7.31(c)(1)(D)(i)-(v) which sets forth the requirements the issuer must follow in entering the IDO Order and proposed Rule 7.35A(g)(2) which sets forth the requirements in order for the DMM to conduct the direct listing auction for a Primary Direct Floor Listing.

Auction Price Range, and for the full quantity of offered shares, as reflected in the registration statement. Further, the IDO Order cannot be modified or canceled by the issuer once entered. The Commission further finds that it is appropriate for the IDO Order to have priority over other sell orders at the same price if the auction price is at the limit price of the IDO Order because the auction will not occur at all unless the IDO Order is satisfied in full. This provision therefore would allow for both the issuer's IDO Order and better-priced sell orders to be executed in the opening auction.[75] The IDO Order requirements described above mitigate concerns about the price discovery process in the opening auction and provide reasonable assurance that the opening auction and subsequent trading promote fair and orderly markets and that the proposed rules are designed to prevent manipulative acts and practices, and protect investors and the public interest in accordance with Section 6(b)(5) of the Exchange Act.

In Amendment No. 2, the Exchange added language to its proposal, discussed above, reminding a financial advisor to an issuer and the DMM that any consultations with the financial advisor must be conducted in a manner consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements.[76] The Exchange also represents that it

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75 In addition, the proposed changes to Rule 7.35C to remove the references to Direct Listing Auction would help ensure that all direct listings occur with a DMM that will facilitate the opening auction manually, and should help promote fair and orderly markets in connection with direct listings, because of the role of the DMM in ensuring that the conditions to conduct the auction, described above, have been met. The proposed changes to (i) Section 102.01B of the Manual, Footnote (E) to clarify the description of a Selling Shareholder Direct Floor Listing, (ii) Rule 1.1(f) to amend the definition of "Direct Listing," and (iii) Rule 7.35A(g)(1) to use the defined term "Private Placement Market" will also provide clarity to the Exchange's rules, consistent with the protection of investors and the public interest under Section 6(b)(5) of the Exchange Act.

76 See Notice, 85 FR at 39249, and proposed Rule 7.35A, Commentary .10. See also supra note 36 and accompanying text noting that the Exchange will issue a regulatory circular to remind member organizations that activities in connection with a Primary Direct Floor Listing, like activities in connection with other listings, must be conducted in a manner

has retained FINRA to monitor such compliance and that it plans to issue regulatory guidance in this area. These steps will also help to ensure compliance by participants in the direct listing process with these important provisions of the federal securities laws and that the proposed changes are consistent with preventing manipulative acts and practices, and protecting investors and the public interest in accordance with Section 6(b)(5) of the Exchange Act.

C. Lack of Traditional Underwriter Involvement in a Primary Direct Floor Listing and Securities Act Section 11(a) Standing

1. Comments on the Proposal

Several commenters expressed concerns that the lack of traditional underwriter involvement in direct listings generally would increase risks for investors, suggesting that direct listings circumvent the traditional due diligence process and traditional underwriter liability.[77] One commenter stated that approval of the proposal would likely increase the number of companies that forgo the traditional IPO process, and significantly increase the risks for retail investors, including by circumventing the due diligence process.[78] This commenter expressed

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not inconsistent with Regulation M and other anti-manipulation provisions of the federal securities laws and NYSE Rule 2020.

77 See, e.g., Letter from Christopher A. Iacovella, Chief Executive Officer, ASA (December 12, 2019) ("ASA Letter I"), at 1.

78 See ASA Letter I, at 1–2. This commenter believed that allowing companies to raise primary capital through a direct listing "would be a complete end run around the traditional underwriting process and . . . create a massive loophole in the regulatory regime that governs the offerings of securities to the public." Id. at 1. In this commenter's view, two recent high-profile direct listings—Spotify and Slack—did not work out particularly well for retail investors, and a robust underwriting process would have uncovered more of these companies' vulnerabilities before these securities were offered to the public. See id. at 2. Another commenter stated that these direct listings may have been successes for private investors, but the retail and public investors that purchased stock in Spotify and Slack were under water for years, and one company is facing a lawsuit because of how direct listings are modeled. See Letter from Anonymous (June 30, 2020).

concern that direct listings could weaken certain investor protections, and recommended that the Commission make clear that financial advisors, exchanges, control shareholders, and directors involved in a direct listing automatically incur statutory underwriter liability under the Securities Act and are required to hold the regulatory capital necessary to act as a de facto underwriter.[79] On the other hand, one commenter supported direct listings as a suitable option for certain issuers, and stated that "[d]ue diligence is already ably done by the legions of experienced accountants, lawyers, consultants, rating agencies, etc."[80]

Another commenter recommended that the Commission disapprove the proposal and expressed concern that shareholder legal rights under Section 11 of the Securities Act may be particularly vulnerable in the case of direct listings, and that investors in direct listings may have fewer legal protections than investors in IPOs.[81] The commenter stated that it could not support

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79 See ASA Letter I, at 2; Letter from Christopher A. Iacovella, Chief Executive Officer, American Securities Association (Mar. 5, 2020) ("ASA Letter II"), at 2–3. Several additional commenters raised a variety of concerns with the use of a direct listing to conduct a primary offering. For example, one commenter expressed the view that "bailing out" private market investors with reduced offering requirements would incent companies to remain private longer, reduce transparency, and impair price discovery. See Letter from Anonymous (Dec. 4, 2019). Another commenter took the position that direct listings are a method for insiders to "rip-off" IPO investors. See Letter from Allan Rosenbalm (Dec. 4, 2019). Another commenter was critical of direct listings for a variety of reasons, and expressed the view, among other things, that they are "an attempt to bypass the independent skilled investment banking and investment management professionals when establishing the initial market value of the company." Letter from Anonymous (Jan. 3, 2020). Another commenter stated that a primary capital raise would have many red flags, questioned how to trust a private company's accounting methods that are not consistent with the public markets, and stated that a direct listing is "fraudulent with no liability." See Letter from Anonymous (July 1, 2020).

80 Wedbush Letter.

81 See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Jan. 16, 2020) ("CII Letter I"), at 2; Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Apr. 16, 2020) ("CII Letter II"), at 2; CII Letter III, at 3–4, 6.

direct listings as an alternative to IPOs if public companies could limit their liability for damages caused by untrue statements of fact or material omissions of fact within registration statements associated with direct listings.[82]

The Petitioner's Petition for Review stated that the delegated order raises important policy issues that should be decided after plenary consideration by the Commission. In particular, the Petitioner expanded on its prior comments relating to claims under Section 11 of the Securities Act, stating that the proposal compounds the problems shareholders face in tracing their share purchases to a registration statement. As discussed in greater detail below, Section 11(a) of the Securities Act allows purchasers to bring claims for damages based on materially false or misleading registration statements. Courts have held that plaintiffs lack standing to pursue such claims if they cannot trace their purchased shares back to the offering covered by the false or misleading registration statement. The Petitioner stated that the proposal exacerbates concerns regarding the availability of Section 11 protections because it would "make it possible for many more shares to be directly listed and sold without the protections offered by IPO regulations."[83] The Petitioner acknowledged that traceability problems may occur because of successive offerings – where first there is an offering under a registration statement and then there are unregistered offerings by company insiders after the expiration of any applicable

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82 See CII Letter I, at 2–3; CII Letter II, at 3; Petition for Review, at 9-10. This commenter was particularly concerned about positions taken by the issuer in a recent lawsuit relating to the direct listing of Slack, and expressed the view that the issuer "relies on (1) attacking the right of secondary market purchasers to bring a Section 11 claim; and (2) the inability to determine what shares were 'covered' by Slack's registration statement." CII Letter I, at 2. See also Pirani v. Slack Technologies, Inc., 445 F. Supp. 3d 367 (N.D. Cal. 2020).

83 See Petition for Review, at 9.

lockup or Rule 144 holding periods.[84] The Petitioner also stated that traceability challenges may also arise in the context of simultaneous registered and unregistered sales.[85] The Petitioner also argued that the very purpose of the proposal is "to facilitate, if not encourage, a significant increase in the number of securities that can be sold to the public without Section 11 protections" and that it is hard to understand how that result poses no heightened risk to investors.[86] The

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84 Although not required by federal securities laws or existing national securities exchange listing rules, a lockup period is an oft-included contractual agreement or provision negotiated with the underwriters of an initial public offering that restricts insiders and certain other pre-IPO security holders from selling, transferring, or otherwise disposing of their securities for a specified period – typically 90 to 180 days – following the initial public offering. As these provisions are not required by federal securities laws or existing national securities exchange listing rules, the specific terms of lockup agreements can and do vary between offerings. Rule 144 creates a safe harbor for the sale of restricted or control securities under the exemption in Section 4(a)(1) of the Securities Act if the seller complies with the conditions of the safe harbor, which includes a minimum holding period. See 17 CFR 230.144.

85 The Petitioner stated that tracing shares to a registration statement immediately after an IPO may not be a significant concern but the situation becomes murkier when insiders are able to sell their shares in the company after the end of the lockup period. See Petition for Review, at 8. In discussing traceability issues, the Petitioner also stated that NYSE's proposal on Selling Shareholder Direct Floor Listings "permitted not only the sale of shares covered by the registration statement, but also the simultaneous sale of unregistered shares held by insiders, assuming that the owner of those shares could satisfy the requirements of the Rule 144 exemption from registration." See Petition for Review, at 9.

86 See id. at 14. The Petitioner stated with respect to the Slack case (see note 82, supra) that while the district court denied a motion to dismiss a Section 11 claim on the grounds that the plaintiff could not trace their purchase to Slack's registration statement, the court of appeals has agreed to hear the matter on an interlocutory basis so it is unclear whether the district court case will be upheld. See Pirani v. Slack Technologies, Inc., No. 20-16419 (9th Cir. July 23, 2020), Docket No. 1. The Petitioner further argued that the Approval Order did not cite any cases where the sale of registered and unregistered shares shortly after an IPO and prior to the end of a lockup period was used as a basis to dismiss a claim of a Section 11 violation. See Petition for Review, at 14.

Petitioner urged the Commission to explore a system of traceable shares before approving a direct listing regime.[87]

2. NYSE Response to Comments

In response, the Exchange stated that it does not believe that the absence of underwriters creates a gap in the regulatory regime that governs offerings of securities to the public.[88] According to the Exchange, while involvement of a traditional underwriter is often necessary to the success of an IPO or other public offering, underwriter participation in the public capital-raising process is not required by the Securities Act, and companies regularly access the public markets for capital raising and other purposes without using traditional underwriters.[89] In the Exchange's view, the due diligence process in Primary Direct Floor Listings is the responsibility of the gatekeepers who participate in the transaction, such as the company's board of directors, its senior management, and its independent accountants.[90] The Exchange further stated that a company pursuing a Primary Direct Floor Listing would go through the same process of publicly filing a registration statement as an underwritten offering, and if a company's business model exhibits weaknesses, they will be exposed to the public prior to listing.[91]

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87 See Petition for Review, at 12; CII Letter I, at 2–3; CII Letter III, at 4.

88 See Letter from Elizabeth K. King, Chief Regulatory Officer, ICE, General Counsel & Corporate Secretary, NYSE (Mar. 16, 2020) ("NYSE Response Letter"), at 2.

89 See NYSE Response Letter, at 2–3.

90 See NYSE Response Letter, at 2–3. The Exchange took the position that IPOs carry a certain amount of risk for investors, that an underwritten IPO does not insulate investors from that risk, and that there is no reason to believe that companies with direct listings will perform any better or worse than companies with underwritten IPOs. See id. at 3.

91 See NYSE Response Letter, at 4. The Exchange also took the position that the absence of lockup agreements with pre-IPO shareholders in Primary Direct Floor Listings does not create short-term price instability, and that at most it shifts the timing of such instability from six months after the offering to closer to the time of listing. See id. See also NYSE Statement, at 20, stating that the same price volatility concerns that cause

In response to the Petitioner's concern about the adequacy of investor protections under Section 11 of the Securities Act, the Exchange stated that these concerns flow from an extraneous factor – namely, lockup agreements. In particular, the Exchange contends that the Section 11 and traceability concerns are due to the potential lack of lockup agreements, which are neither prohibited nor required by the proposal or any other law or regulation, rather than to anything inherent in direct listings themselves or the Exchange rules permitting them to be listed.[92] The Exchange argued that the Petitioner assumes that because Primary Direct Floor Listings do not require underwriters, they will never involve lockup agreements, and therefore insider shareholders will sell their unregistered shares alongside the issuer's registered shares, potentially making it harder to trace purchased shares back to the registration statement.[93] Further, according to the Exchange, the traceability requirement may make it difficult for shareholders to establish standing under Section 11 in many situations that do not involve direct listings, including when a company has issued securities under more than one registration statement and distributed those securities through traditional, firm commitment underwritings.[94] The Exchange stated that in traditional, firm commitment underwritten IPOs there is no legal or regulatory requirement for the issuer to enter into lockup agreements with insiders, and

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underwriters to request lockup agreements in a traditional IPO may apply to direct listings as well.

92 See NYSE Statement, at 15.

93 See NYSE Statement, at 18. The Exchange stated that tracing issues are very fact-dependent and turn on many factors so it is unclear whether Section 11 tracing difficulties will in fact occur. See NYSE Statement, at 17.

94 See NYSE Statement, at 18–19 (citing In re Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1107–08 (9th Cir 2013); Krim v. pcOrder.com, Inc., 402 F.3d 489, 496–98 (5th Cir. 2005)).

conversely, there is nothing preventing an issuer in a direct listing from entering into a lockup agreement.[95]

According to the Exchange, the only courts to consider Section 11 standing in the context of a direct listing involved the Selling Shareholder Direct Floor Listing by Slack Technologies, Inc., where both a federal and a state court concluded that Section 11 did not preclude plaintiffs, at the pleading stage, from pursuing claims just because they could not definitively trace the securities they acquired to the registration statement.[96] The Exchange stated that for Petitioner's concerns to materialize, other courts in circumstances where there is no lockup agreement would need to reach the opposite conclusion.[97] Moreover, in response to the Petitioner's arguments that the Commission should delay implementation of the proposal until it addresses the traceability issue by enacting certain "proxy plumbing" reform measures, the Exchange stated that the Petitioner has pursued this goal for many years and the current proposal is not the proper vehicle to advance this agenda.[98]

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95 See NYSE Statement, at 20 (stating that in the recent Selling Shareholder Direct Floor Listing by Palantir, insider shareholders entered into lockup agreements with respect to certain shares). Further, the Exchange stated that even if lockup agreements did prove to be less common in direct listings, there is a market-based solution to this issue because shareholders will pay less for shares acquired with direct listings if they would face materially greater difficulty in pursuing Section 11 claims in connection with direct listings, and that in turn would incentivize issuers to structure their direct listings in a way that does not reduce the protections available under the federal securities laws. See id. at 21, n.67.

96 See NYSE Statement, at 21–22 (citing Pirani, 445 F. Supp. 3d at 380–81; Case Management Order #5, In re Slack Techs. Inc. S'holder Litig., Master File No. 19CIV005370, 2020 WL 4919555, at *3–5 (Cal. Super. Ct. Aug. 12, 2020)).

97 See NYSE Statement, at 22.

98 See NYSE Statement, at 22–24.

3. Commission Discussion and Analysis

The Commission agrees with the Exchange that the Securities Act does not require the involvement of an underwriter in registered offerings.[99] Moreover, given the broad definition of "underwriter"[100] in the Securities Act, a financial advisor to an issuer engaged in a Primary Direct Floor Listing may, depending on the facts and circumstances including the nature and extent of the financial advisor's activities, be deemed a statutory "underwriter" with respect to the securities offering, with attendant underwriter liabilities.[101] Thus, the financial advisors to issuers in Primary Direct Floor Listings have incentives to engage in robust due diligence, given their reputational interests and potential liability, including as statutory underwriters under the broad definition of that term. Moreover, even absent the involvement of a statutory underwriter, investors would not be precluded from pursuing any claims they may have under the Securities Act for false or misleading offering documents, nor would the absence of a statutory underwriter affect the amount of damages investors may be entitled to recover.

In addition, issuers, officers, directors, and accountants, with their attendant liability, play important roles in assuring that disclosures provided to investors are materially accurate and

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99 See, e.g., Item 508(c) of Regulation S-K ("Outline briefly the plan of distribution of any securities to be registered that are to be offered otherwise than through underwriters.").

100 Section 2(a)(11) of the Securities Act defines "underwriter" to mean "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates, or has a direct or indirect participation in the direct or indirect underwriting of any such undertaking."

101 The Commission does not agree, as argued by one commenter, that financial advisors, exchanges, control shareholders, and directors involved in a direct listing will necessarily incur statutory underwriter liability under the Securities Act. See ASA Letter I, at 2; ASA Letter II, at 2–3. Whether or not any person would be considered a statutory underwriter would be evaluated based on the particular facts and circumstances, in light of the definition of underwriter contained in Section 2(a)(11).

complete. The Commission therefore does not view a firm commitment underwriting as necessary to provide adequate investor protection in the context of a registered offering. Indeed, exchange-listed companies often engage in offerings that do not involve a firm commitment underwriting.

The Commission finds that the proposed rule change is consistent with the protection of investors. First, the Commission disagrees with the concerns raised by commenters that direct listings would "rip off" investors, reduce transparency, or involve reduced offering requirements or accounting methods that are not "up to code with the public markets."[102] The proposed rule change will require all Primary Direct Floor Listings to be registered under the Securities Act, and thus subject to the existing liability and disclosure framework under the Securities Act for registered offerings. Among other disclosures, these registration statements will require both bona fide price ranges[103] and audited financial statements prepared in accordance with either U.S. GAAP or International Financial Reporting Standards as issued by the International Accounting Standards Board.[104]

Second, Petitioner's concerns regarding shareholders' ability to pursue claims pursuant to Section 11 of the Securities Act due to traceability issues are not exclusive to nor necessarily inherent in Primary Direct Floor Listings. Rather, this issue is potentially implicated anytime securities that are not the subject of a recently effective registration statement trade in the same market as those that are so subject. Where a registration statement, at the time of effectiveness, contains an untrue statement of a material fact or omits to state a material fact required to be

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102 See note 79, supra.

103 See, e.g., Instruction 1 to Item 501(b)(3) of Regulation S-K.

104 See Rule 4-01(a) of Regulation S-X.

stated therein or necessary to make the statements therein not misleading, Section 11(a) of the Securities Act provides a cause of action to "any person acquiring such security," unless it is proved that at the time of the acquisition the person "knew of such untruth or omission."[105] Courts have interpreted this statutory provision to permit aftermarket purchasers (i.e., those who acquire their securities in secondary market transactions rather than in the initial distribution from the issuer or underwriter) to recover damages under Section 11, but only if they can trace the acquired shares back to the offering covered by the false or misleading registration statement.[106] Tracing is not set forth in Section 11 and is a judicially-developed doctrine. As such, the application of this doctrine and, in particular, the pleading standards and factual proof that potential claimants must satisfy vary depending on the particular facts of the distribution and judicial district.[107]

Aftermarket purchasers following either firm commitment underwritten IPOs or direct listings may face similar difficulties in tracing their shares back to a misleading registration statement. In a number of litigated cases outside of the direct listing context, courts have denied plaintiffs standing to sue under Section 11 following registered public offerings on the basis that plaintiffs purchased their securities in secondary market transactions and could not directly trace their purchases to the allegedly defective registered offering because some portion[108] of the

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105 Section 11(a) of the Securities Act.

106 See, e.g., In re Century Aluminum Co. Sec. Litig., 729 F.3d 1104 (9th Cir. 2013).

107 See, e.g., Pirani v. Slack Techs., Inc., 2020 U.S. Dist. LEXIS 70177 (N.D. Cal., April 21, 2020) (addressing Securities Act Section 11 standing and stating that "[i]f the text is ambiguous, the Court 'may [also] use canons of construction, legislative history, and the statute's overall purpose to illuminate Congress's intent.'" (quoting Pac. Coast Fed'n of Fishermen's Ass'ns v. Glaser, 945 F.3d 1076 (9th Cir. 2019)).

108 See, e.g., Barnes v. Osofsky, 373 F.2d 269 (2d Cir. 1967); Krim v. PCOrder.com, 402 F.3d 489 (5th Cir. 2005) (IPO stock represented 91% of shares trading in market); In re

outstanding securities available for trading – sometimes a very small portion – were not issued pursuant to the allegedly defective registration statement. These situations arise where shares may have been issued pursuant to more than one registration statement, not all of which include material misstatements or omissions. Shares may have also entered the market prior to a potential claimant's purchase other than through the registered offering, such as through sales pursuant to Rule 144.[109] For example, the shares might have been sold by insiders or significant shareholders following the expiration of lockup agreements or applicable restricted periods, or could have also been sold by other shareholders who were never subject to any such agreement.[110] Furthermore, traceability concerns can arise when shares are held in fungible bulk – as they usually are – such that an investor is not able to establish that the particular shares it

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Century Aluminum Co. Sec. Litig., 729 F.3d 1104 (9th Cir. 2013) (49 million shares were already trading in market prior to the issuance of 24.5 million shares pursuant to allegedly misleading registration statement).

109 Rule 144 is a non-exclusive safe harbor that permits the resale of restricted securities, without Securities Act registration, if a number of conditions are met, including a holding period of either six months or one year, depending on the reporting status of the issuer. Non-affiliates of a newly-listed issuer may rely on Rule 144 to sell their securities provided they have held the securities for at least one year.

110 While lockup agreements are customary in firm commitment initial public offerings, in the Commission's experience they often do not cover all of the outstanding shares. There is thus a risk that, even in the context of IPOs underwritten on a firm commitment basis, securities other than those issued pursuant to the related registration statement may enter the trading market prior to the expiration of any applicable lockup period and thus could raise questions regarding traceability of shares purchased on a national securities exchange. Additionally, as the Exchange noted, companies that pursue a direct listing may also enter into lockup agreements. Required disclosure in registration statements, for both direct listings and IPOs, may help investors assess the risk that shares other than those offered pursuant to the registration statement will be available for sale. For example, in registration statements for IPOs and direct listings, issuers are required to provide disclosure of the amount of shares that may be sold pursuant to Rule 144. See Item 201(a)(2) of Regulation S-K. Issuers also typically provide disclosure of the material terms of lockup agreements governing pre-IPO shares.

purchased were acquired pursuant to, or are traceable to, a particular misleading registration statement.[111]

Although it is possible that aftermarket purchases following a Primary Direct Floor Listing may present tracing challenges, this investor protection concern is not unique to Primary Direct Floor Listings, nor (based on the approaches taken by courts as described above) do we expect any such tracing challenges in this context to be of such magnitude as to render the proposal inconsistent with the Act. We expect judicial precedent on traceability in the direct listing context to continue to evolve,[112] but the Commission is not aware of, nor have commenters pointed to, any precedent to date in the direct listing context which prohibits plaintiffs from pursuing Section 11 claims.

The Commission further believes that Primary Direct Floor Listings will provide benefits to existing and potential investors relative to firm commitment underwritten offerings. First, because the securities to be issued by the company in connection with a Primary Direct Floor Listing would be allocated based on matching buy and sell orders, in accordance with the proposed rules, some investors may be able to purchase securities in a Primary Direct Floor Listing who might not otherwise receive an initial allocation in a firm commitment underwritten offering. The proposed rule change therefore has the potential to broaden the scope of investors that are able to purchase securities in an initial public offering, at the initial public offering price, rather than in aftermarket trading.

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111 See, e.g., Krim v. PCOrder.com, 402 F.3d 489 (5th Cir. 2005).

112 For example, the Ninth Circuit Court of Appeals has agreed to consider the issue of Section 11 standing at issue in Pirani v. Slack Techs., Inc., 2020 U.S. Dist. LEXIS 70177 (N.D. Cal., April 21, 2020) on an interlocutory basis. See Pirani v. Slack Technologies, Inc., No. 20-16419 (9th Cir., July 23, 2020), Docket No. 1.

Second, because the price of securities issued by the company in a Primary Direct Floor Listing will be determined based on market interest and the matching of buy and sell orders, Primary Direct Floor Listings will provide an alternative way to price securities offerings that may better reflect prices in the aftermarket, and thus may allow for efficiencies in IPO pricing and allocation.[113] In a firm commitment underwritten offering, the offering price is informed by underwriter engagement with potential investors to gauge interest in the offering, but ultimately decided through negotiations between the issuer and the underwriters for the offering. The underwriters then sell the securities to the initial purchasers at the public offering price. When the securities begin trading on the listing exchange, however, the price often varies from the IPO price. The opening auction in a Primary Direct Floor Listing provides for a different price discovery method for IPOs which may reduce the spread between the IPO price and subsequent market trades, a potential benefit to existing and potential investors. In this way, the proposed rule change may result in additional investment opportunities while providing companies more options for becoming publicly traded.[114]

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113 A frequent academic observation of traditional firm commitment underwritten offerings is that the IPO price, established through negotiation between the underwriters and the issuer, is often lower than the price that the issuer could have obtained for the securities, based on a comparison of the IPO price to the closing price on the first day of trading. See, e.g., Patrick M. Corrigan, Article: The Seller's Curse and the Underwriter's Pricing Pivot: A Behavioral Theory of IPO Pricing, 13 Va. L. & Bus. Rev 335; Jay R. Ritter, Initial Public Offerings: Underpricing tbl.1a (June 17, 2020), https://site.warrington.ufl.edu/ritter/files/IPOs2019_Underpricing.pdf.

114 While the Commission acknowledges the possibility that some companies may pursue a Primary Direct Floor Listing instead of a traditional IPO, these two listing methods may not be substitutable in a wide variety of instances. For example, some issuers may require the assistance of underwriters to develop a broad investor base sufficient to support a liquid trading market; others may believe a traditional firm commitment IPO is preferable given the benefits to brand recognition that can result from roadshows and other marketing efforts that often accompany such offerings. Thus, we do not anticipate that all companies that are eligible to go public through a Primary Direct Floor Listing

The Commission finds that the Exchange's proposal will facilitate the orderly distribution and trading of shares, as well as foster competition, which is clearly consistent with the purposes of the Exchange Act. The orderly distribution of, and trading of shares, promotes fair and orderly markets, and is one of the important roles of a national securities exchange in ensuring that its rules prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and protect investors and the public interest.[115] The proposal also fosters competition by providing an alternate method for companies of sufficient size that decide they would rather not conduct a firm commitment underwritten offering to list on the Exchange, thereby removing potential impediments to free and open markets consistent with Section 6(b)(5) of the Exchange Act while also supporting capital formation. For the reasons discussed above, the Commission finds that, on balance, the proposed rule change to permit Primary Direct Floor Listings is designed to, among other things, prevent fraudulent and manipulative acts and practices and to protect investors and the public interest.

IV. Conclusion

For foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 2, is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Rule 431 of the Commission's Rules of Practice, that the earlier action taken by delegated authority, Exchange Act Release No. 89684 (August 26, 2020), 85 FR 54454 (September 1, 2020), is set aside and, pursuant to Section

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will choose to do so; the method chosen will depend on each issuer's unique characteristics.

115 See 15 U.S.C. 78f(b)(5). See also 15 U.S.C. 78k-1(a)(1)(C)(i).

19(b)(2) of the Exchange Act, the proposed rule change (SR-NYSE-2019-67), as modified by Amendment No. 2, hereby is approved.

By the Commission.

Vanessa A. Countryman
Secretary

Council of Institutional Investors®
The voice of corporate governance

Via email

September 8, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. SR-NYSE-2019-67, Council of Institutional Investors, Petition for Review of an Order, Issued by Delegated Authority, and Brief in Opposition to Motion to Lift the Automatic Stay

Dear Madam Secretary:

The Council of Institutional Investors (CII) [1] hereby files the attached Petition for Review of an Order, Issued by Delegated Authority, and Brief in Opposition to Motion to Lift the Automatic Stay, along with counsel notice of appearance, by UPS overnight mail and electronic mail pursuant to the Securities and Exchange Commission's March 18, 2020 Order requesting electronic submission of filings in light of COVID-19. Please confirm receipt of these filings at your earliest convenience.

CII has caused the attached to be served by UPS overnight mail, hand courier, and electronic mail on Davis Polk & Wardwell LLP, copied on this email, in

[1] The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds and defined contribution plans with more than 15 million participants – true "Main Street" investors through their funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management. For more information about CII, including its board and members, please visit CII's website at http://www.cii.org.

accordance with 17 C.F.R. § 201.150, as reflected in the Certificate of Service attached to each.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

BEFORE THE
SECURITIES & EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

In the Matter of the Petition of:	)	Admin Proc. File No. ____
	)	Release No. 34-898
COUNCIL OF INSTITUTIONAL INVESTORS	)	File No. SR-NYSE-2019-67

PETITION OF COUNCIL OF INSTITUTIONAL INVESTORS FOR REVIEW OF AN ORDER, ISSUED BY DELEGATED AUTHORITY, GRANTING APPROVAL OF A PROPOSED RULE

Submitted by:
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Dated: September 8, 2020

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BEFORE THE
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In the Matter of the Petition of:	)	Admin Proc. File No. ____
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COUNCIL OF INSTITUTIONAL INVESTORS	)	File No. SR-NYSE-2019-67

PETITION OF COUNCIL OF INSTITUTIONAL INVESTORS FOR REVIEW OF AN ORDER, ISSUED BY DELEGATED AUTHORITY, GRANTING APPROVAL OF A PROPOSED RULE

Pursuant to SEC Rules of Practice 430 and 431, the Council of Institutional Investors ("CII" or the "Council") petitions the Commission to review and reverse the decision of the Division of Trading and Markets, *Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings,* Exchange Act Release No. 89684 (Aug. 26, 2020), 85 Fed. Reg. 54454 (Sept. 1, 2020) (the "Order"). In that Order, the Division, acting pursuant to delegated authority, 17 C.F.R. § 200.30-3(a)(12), approved a proposal by the New York Stock Exchange ("NYSE" or the "Exchange") to amend Chapter One of the Listed Company Manual (the "Manual") to modify and liberalize provisions relating to direct listings.

Introduction.

In a nutshell, the Order makes it easier for private companies to bypass the need for an "initial public offering" if they want to go public and list their shares on the New York Stock Exchange. The alternative to such an IPO is a "direct listing," which allows existing shareholders of a private company to sell their existing shares

to the public, thus reducing the role of underwriters and avoiding post-IPO lockups on the ability of company insiders to sell shares. Such direct listings were authorized several years ago in *Order Granting Accelerated Approval of Proposed Rule Change,* Exchange Act Release No. 82627 (Feb. 2, 2018), 83 Fed. Reg. 5650 (Feb. 8, 2018). The Order would liberalize those rules on direct listings by making it easier for private companies to sell their existing shares to the public, thus making the direct listing option more attractive to companies.

Observers have described the Division's Order as potentially a major "game changer" for companies contemplating a public offering, as they will be able to have their shares publicly traded without the traditional underwriting process that lies at the heart of investor protections offered as part of an IPO.[1]

The issue raised by this Order is not whether direct listings are a good idea or a bad idea, and the Council has expressed support for providing more investment options to Council members and the public generally, provided those options are accompanied by suitable investor protections.[2] The issue here is whether the

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[1] *E.g.,* Posner, NYSE Proposal for Primary Direct Listings, Harvard Law School Blog on Corporate Governance (Jan. 2, 2020), available at https://corpgov.law.harvard.edu/2020/01/02/nyse-proposal-for-primary-direct-listings/; Huff, Arnold & Porter Discusses SEC Approval of NYSE Direct Listing Proposal, CLS Blue Sky Blog (Aug. 31, 2020), available at https://clsbluesky.law.columbia.edu/2020/08/31/arnold-porter-discusses-sec-approval-of-nyse-direct-listings-proposal/

[2] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Securities and Exchange Commission (Feb. 22, 2018), available at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/February%2022,%202018%20NYSE%20direct%20listing%20(final).pdf (expressing general support

changes made by this specific Order, which could significantly liberalize access to U.S. capital markets, contain adequate investor protections. The Council believes that the answer is "no." At a minimum, however, the Order raises important policy concerns that the Order did not adequately address and one that should be decided after plenary consideration by the full Commission.

The Council's interest in this Order.

The Council is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Its member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Its associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management. Additional information is available at www.cii.org.

The Council is filing this petition on behalf of its members, who, as investors, purchase shares in the open market and thus have a direct interest in the integrity of U.S. capital markets and the need for suitable investor protections. To the extent that the Order does not provide such adequate protections, CII members are

for NYSE proposed rule change to modify the listing requirements standards to facilitate direct listings).

"aggrieved" by that Order within the meaning of Rule 430, and CII, as their representative is thus entitled to seek review by the full Commission.

The NYSE proposal and the Division's Order.

In *Notice of Filing of Proposed Rule Change to Amend Manual*, Exchange Act Release No. 87821 (Dec. 20, 2019), 84 Fed. Reg. 72065 (Dec. 30, 2019) the Division of Trading and Markets, on behalf of the Commission, gave notice of and invited public comment on a proposed change to the NYSE Listed Company Manual that would modify the provisions relating to the direct listing of a company's shares if those shares had not previously been registered under the Securities Exchange Act of 1934. That notice was the first step in proceedings under section 19(b)(2)(B) of the Exchange Act to determine whether to approve or disapprove the proposed rule change.

As that notice explained, section 102.01 of the NYSE Manual allows listings under which a private company's existing shareholders (such as its employees) to sell their shares directly to the public. The proposed "Amendment No. 1" to that section of the Manual would deem such a listing to be a "Selling Shareholder Direct Floor Listing" and would, in addition, authorize a company to sell shares on its own behalf, either in addition to or instead of a Selling Shareholder Direct Floor Listing. Such company sales would be known as a "Primary Direct Floor Listing," in which either (i) the company itself is selling shares in the opening auction on the first day of trading or (ii) the company is selling shares, and selling shareholders may also be selling shares in such an opening auction.

The Division issued an order extending the comment period on the petition, *Notice of Designation of Longer Period for Commission Action*, Exchange Act Release No. 88190 (Feb. 23, 2020), 85 Fed. Reg. 9891 (Feb. 20, 2020), and then opened a proceeding in a release that raised questions about some of issues that might prompt disapproval of the proposal. *Order Instituting Proceedings,* Exchange Act Release No. 88485 (Mar. 26, 2020), 85 Fed. Reg. 18292 (April 1, 2020). The Exchange responded by revising some of the details of its proposal and submitting that revision as "Amendment No. 2," in lieu of Amendment No. 1.[3] Upon that filing, the Division extended the comment period. *Notice of Designation of Longer Period for Commission Action,* Exchange Act Release No. 89147 (June 24, 2020), 85 Fed. Reg. 39226 (June 30, 2020), and invited comment on proposed Amendment No. 2, *Notice of Filing of Proposed Rule Change to Amend Manual,* Exchange Act Release No. 89148 (June 24, 2020), 85 Fed. Reg. 39246. The Council was an active

[3] The text of Amendment No. 2 is set out in Letter from Martha Redding, Associate General Counsel and Assistant Secretary, New York Stock Exchange to Secretary, Securities & Exchange Commission (June 22, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7332320-218590.pdf

The Order approving Amendment No. 2 summarized the changes made by Amendment No. 2 as: (1) deleting proposed changes that would have provided more time in some cases for companies involved in a direct listing could meet the initial listing distribution standards; (2) adding provisions specifying how companies involved in a direct listing would qualify for listing if the listing were to include both sales of securities by the company and possible sales by selling shareholders; (3) adding a new order type for companies to use when selling shares in a direct listing and describing how such companies would participate in a direct listing auction; and (4) removing references to direct listing auctions from Rule 7.35C, Exchange-Facilitated Auctions. Order at 2 n.7.

participant in these proceedings and filed three comment letters, one in response to the initial petition, and one apiece after the two subsequent notices that invited public comment.[4]

After consideration of multiple comments that had been filed, both in favor of and in opposition to the proposal, the Division issued the Order at issue here, which approved Amendment No. 2, as proposed by the Exchange. That Order discussed a number of details about how company listings would operate in practice and adopted limitations that sought to ensure that direct listings are pursued only by companies of suitable size and that there is sufficient liquidity in the market to permit trading. Many of those details are not germane to the issue that the Council is raising in this petition, and so we do not discuss them in detail.

Reasons for granting review.

Standard of review.

In considering a petition for review the Commission "shall consider" whether the petition "makes a reasonable showing" that the decision embodies: "(A) A finding or

[4] The Council's three letters appear in the rulemaking record as:
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (Jan. 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-203855.pdf;
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (April 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7074298-215548.pdf; and
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (July 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7435112-220582.pdf

conclusion of material fact that is clearly erroneous; or (B) A conclusion of law that is erroneous; or (C) An exercise of discretion or decision of law or policy that is important and that the Commission should review." Rule of Practice 411(b)(2), incorporated into Rule of Practice 431(b)(2). That standard is clearly met with respect to the Order at issue here, which has enormous policy significance, as we explain more fully below.

The Commission may approve a proposed rule change only if the Commission finds that such a change would be "consistent with the requirements of this chapter and the rules and regulations issued under this chapter that are applicable to such organization." 15 U.S.C. § 78s(b)(2)(C). In this case, the pertinent provision is section 6(b)(5) of the Exchange Act, 15 U.S.C. § 78f(b)(5), which requires that exchange rules must be—

> . . . designed *to prevent fraudulent and manipulative acts and practices*, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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* (emphasis added).

The proposal at issue here falls way short with respect to the highlighted elements, which involve investor protection. Moreover, in its approval of the proposed rule change, the Division failed to respond to substantive comments illustrating those deficiencies, an omission that renders the Division's approval "arbitrary, capricious, and not in accordance with law" within the meaning of the Administrative Procedure Act.

The amendment compounds the problems shareholders face in tracing their share purchases to a registration statement.

Traceability concerns often arise when there have been successive offerings, as shareholders seek to establish their standing to litigate claims under federal securities laws. Section 11 of the Securities Act creates liability if there are material misstatements or omissions in connection with securities offered in a registration statement, in which event any person purchasing "such security" may sue. The key phrase is "such security," and courts have generally read "such security" to require that a plaintiff must trace his or her purchase to a specific registration statement. In the seminal case in this area, the U.S. Court of Appeals for the Second Circuit upheld a settlement involving claims that arose under registration statements issued in 1961 and 1963, and the settlement limited recovery to claimants who could trace their purchases to the 1963 offering. *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). The court (per Friendly, J.) reasoned that section 11's reference to "such security" should be given a narrow reading, one that is limited to securities offered pursuant to a specific registration statement, and not a broader reading that would cover company securities generally.

Traceability may not be a significant concern as to shares purchased immediately after an IPO. The situation becomes murkier, however, after the end of an IPO lockup period, when insiders are free to sell their shares in the company. In that situation, traceability problems occur because of *successive* offerings – the first according to a registration statement and then offerings by company insiders after the lockup period is over.

The 2018 rule change that authorized secondary direct listings of insider shares blurred this distinction because the registration of employee shares permitted not only the sale of shares covered by the registration statement, but also the simultaneous sale of unregistered shares held by insiders, assuming that the owner of those shares could satisfy the requirements of the Rule 144 exemption from registration.

Investor concerns about the traceability of shares in a direct listing were drawn into sharp focus in current litigation involving the Slack Technologies direct listing, one of the first two such listings. In a case of first impression, the Slack defendants sought dismissal of a section 11 claim on the ground that plaintiffs could not trace their purchases to Slack's registration statement, because once Slack registered the employee-held shares, a shareholder could not establish whether he or she bought shares that had been registered or unregistered shares that had been sold by an insider once the registration statement took effect (again assuming eligibility to sell those shares under Rule 144 standards).

The district court denied that motion, finding that the narrow reading of section 11 liability was not warranted when dealing with direct listings. Recognizing the significance and the novelty of the issue, however, the district court certified the legal question to the U.S. Court of Appeals for the Ninth Circuit, which agreed to hear the matter.[5]

[5] *Pirani v. Slack Technologies, Inc.* 445 F.3d 367 (N.D. Cal. 2020), also available at http://securities.stanford.edu/filings-documents/1071/STI00_19/2020421_r01x_19CV05857.pdf. The Ninth Circuit order

It is far from clear whether the Ninth Circuit will uphold the district court's reasoning. That Court has explicitly endorsed the narrow reading of "such liability" in *In re Century Aluminum Securities Litigation*, 729 F.3d 1104 (9th Cir. 2013), so it is at best uncertain whether that court will overrule or distinguish that precedent. Moreover, as several commentators have noted, "many of the concerns expressed by the District Court are similar to other situations where courts have uniformly declined to dispense with the existing standing requirements of the Securities Act, including secondary offerings."[6] A ruling by the Ninth Circuit against shareholder standing in the Slack case could have an outsized impact on securities markets, given the number of tech startups and "unicorns" that are located in Silicon Valley and elsewhere in the Ninth Circuit and that may opt for a direct listing when they are ready to go public.

Independently of what may happen in the Slack case, the Order raises important investor issues that the Commission should consider before opening U.S. capital markets to what could turn out to be a vastly increased number of direct listings. Whatever conclusion the Commission may ultimately reach, the issue is unquestionably of enough policy significance to warrant plenary review.

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agreeing to hear the case on an interlocutory basis is available in *Pirani v. Slack Technologies, Inc*. No. 20-16419 (9th Cir., July 23, 2020), Docket No. 1.

[6] Grabar *et al., Cleary Gottlieb Discusses How Court Allowed Securities Liability for Slack's Direct Listing*, CLS Blue Sky Blog (May 4, 2020) (footnotes omitted), available at https://clsbluesky.law.columbia.edu/2020/05/04/cleary-gottlieb-discusses-how-court-allowed-securities-liability-forslacks-direct-listing/.

The loss of investor protections in direct listings has been acknowledged, even praised. Indeed, proponents of direct listings have trumpeted the loss of investor protections as an "important advantage" of direct listings, given the "potential to deter private plaintiffs from bringing claims under Section 11 of the Securities Act of 1933." Latham & Watkins, *Complex and Novel Section 11 Liability Issues of Direct Listings,* Corporate Counsel, at 1 (Dec. 20, 2019), available at https://www.lw.com/thoughtLeadership/section-eleven-liability-direct-listings. That law firm acted as counsel to Spotify and Slack in their direct listings, and the cited firm memorandum bluntly states that that "few (if any) purchasers will be able to trace their stock to the challenged registration statement" when "both registered and unregistered stock are immediately sold into the market in a direct listing." *Id.* at 2.

Does the Commission share that view? If so, does the Commission endorse expanding the number of offerings knowing that this could be the outcome? Whatever the answer may be, the issue is of unquestioned importance to investors and warrants plenary consideration and a ruling by the full Commission.

The point of this petition is not to start a debate about the wisdom of direct listings at an abstract policy level. The Council believes – and has long believed – that traceability problems of the sort raised here should impel the Commission to update its "proxy plumbing" regulations *before* any liberalization of direct listing regulations. We incorporate by reference the comments in the three letters that the

Council filed in this proceeding (see n. 4, *supra*), as well as the January 2019 letter to the Commission, which lays out the arguments in greater detail. In brief:

> Technological change now offers the opportunity to construct a better system of share ownership based on traceable shares . . . . investors bringing Section 11 claims fall susceptible to chain of custody opacities when they cannot demonstrate, as is required, that they purchased shares that were issued in connection with a misrepresented registration statement. These practical obstacles present in the current system needlessly delay or prevent investors from proceeding with legitimate claims and receiving compensation, which harms the health and fairness of the capital markets. Intuitively, blockchain-based traceable shares would provide an immutable chain of custody ledger and enable investors to supply evidence of their provenance and voting decisions as necessary.[7]

Granting plenary consideration of this petition for review would, at a minimum, allow the Commission to explore those questions in the context of direct listings. What steps, if any, can be taken to tag or identify shares sold pursuant to the registration statement for a direct listing from shares sold from another source? If nothing can be done, and if direct listings will extinguish investor rights under section 11, does it make sense to let the Order take effect?

In this case, and at this stage of the proceeding, our point is simple: Given the traceability problems of the sort identified above, it would be contrary to the standards set out in Exchange Act § 6(b)(5) for the Commission to make it *easier* for

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[7] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors, et al. to Brent J. Fields. Secretary, Securities and Exchange Commission 2, 8 (Jan. 31, 2019), available at https://www.cii.org/files/20190131%20CII%20Follow%20Up%20Letter%20to%20SEC%20on%20Proxy%20Mechanics%20FINAL.pdf

companies to initiate direct listings, at least until the Commission has approved some basic proxy plumbing reforms to make traceability less of a concern.

How did the Division substantively respond to this point about traceability? The response was cursory at best, even though the Administrative Procedure Act requires agencies to respond to significant comments raised during the comment period. See *Perez v. Mortgage Bankers Ass'n*, 575 U.S. __, 135 S. Ct. 1199, 1203 (2015). *Susquehanna International Group, LLC v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017). Footnote 74 of the Order did acknowledge that the Council made this traceability argument, but the text of the Order sought to minimize the issue with a generalization that—

> . . . even in the context of traditional firm commitment offerings, the ability of existing shareholders who meet the conditions of Rule 144 to sell shares on an unregistered basis may result in concurrent registered and unregistered sales of the same class of security at the time of an exchange listing, leading to difficulties tracing purchases back to the registered offering.

Order at 26, 85 Fed. Reg. at 54461.[8] After making this statement, the Order acknowledged the district court's Slack decision (without acknowledging that

[8] Page 15 of the Order (85 Fed. Reg. at 54458) summarized a laundry of list of investor protections in the Order, though none of them spoke directly the issue raised by the petition. Those items were:

> (i) Addition of the IDO Order type and other requirements which address how the issuer will participate in the opening auction; (ii) discussion of the role of financial advisors; (iii) addition of the Commentary that provides that specified activities are to be conducted in a manner that is consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements; (iv) retaining of FINRA to monitor compliance with Regulation M and other anti-manipulation provisions of the federal securities laws and NYSE Rule 2020; (v) clarification of how market value will be

the case is on interlocutory appeal), but concluded not with facts, but an assertion that the Division "does not believe that that the proposed rule change poses a heightened risk to investors, and finds that the proposed rule change is consistent with investor protection." *Id.*

The Order did not cite any cases where the sale of registered and unregistered shares shortly after an IPO and prior to the end of a lockup period was both proven and used as the basis to dismiss a claim of a Section 11 violation. Reliance on something that "may result" and "beliefs" rather than facts is not the sort of "reasoned decision making" required under the Administrative Procedure Act." *Motor Vehicle Manufacturers Ass'n v. State Farm Auto Mutual Insurance Co.*, 463 29, 52 (1983). Moreover, the Order fails to take into account the fact that the very purpose of the rule change is to facilitate, if not encourage, a significant increase in the number of securities that can be sold to the public without Section 11 protections. It is hard to understand how a rule change that encourages that result poses no "heightened" risk to investors.

Perhaps the Division sidestepped the proxy plumbing and traceability issues because the Division did not believe that it could, on its own, change proxy plumbing system in ways that would mitigate the traceability problem. Be that as it may, the full Commission has unquestioned authority to put the horse *before* the

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determined for qualifying the company's securities for listing; and (vi) elimination of the grace period for meeting certain listing requirements.

cart, not after it, by examining the issue and assuring that any liberalization of the rules provide adequate investor protections.

Conclusion.

For these reasons and for those stated in the Council's prior comments, the Council of Institutional Investors respectfully requests that the Commission grant this petition for review, open a proceeding, and [in the absence of suitable protections on traceability of shares] reverse the Order at issue here.

Respectfully submitted,

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Dated: September 8, 2020

CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of September, I caused copies of this petition for review to be filed electronically at Secretarys-Office@sec.gov, with copies sent by overnight courier to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street, N.W., Washington, D.C. 20549 and also caused this petition to be served by electronic mail upon Paul S. Mishkin, Joseph A. Hall, Marcel Fausten, Daniel J. Schwartz and Lindsay Schare at paul.mishkin@davispolk.com, joseph.hall@davispolk.com, marcel.fausten@davispolk.com, daniel.schwartz@davispolk.com, and lindsay.schare@davispolk.com and by overnight courier to Davis Polk and Wardwell, 450 Lexington Avenue New York, N.Y. 10017.

Jeffrey P. Mahoney

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief in opposition complies with the word count limitation in 17 C.F.R. § 201.154(c). Excluding tables of contents and authorities, as provided by 17 C .F .R. § 201.154(c), but including cover pages, case captions, and signature blocks, the brief and motion together include 3,989 words. The undersigned relied upon the word count of this word-processing system in preparing this certificate.

Jeffrey P. Mahoney

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90717; File No. SR-NASDAQ-2020-057)

December 17, 2020

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Allow Companies to List in Connection with a Direct Listing with a Primary Offering In Which the Company Will Sell Shares Itself In the Opening Auction on the First Day of Trading on Nasdaq and to Explain How the Opening Transaction for Such a Listing Will be Effected

I. Introduction

On September 4, 2020, The Nasdaq Stock Market LLC ("Nasdaq" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to allow companies to list in connection with a primary offering in which the company will sell shares itself in the opening auction on the first day of trading on the Exchange and to explain how the opening transaction for such a listing will be effected. The proposed rule change was published for comment in the Federal Register on September 21, 2020.[3] On November 4, 2020, pursuant to Section 19(b(2) of the Exchange Act,[4] the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 89878 (September 15, 2020), 85 FR 59349 (September 21, 2020) ("Notice"). Comments received on the proposal are available on the Commission's website at: https://www.sec.gov/comments/sr-nasdaq-2020-057/srnasdaq2020057.htm.

4 15 U.S.C. 78s(b)(2).

the proposed rule change.[5] This order institutes proceedings under Section 19(b)(2)(B) of the Exchange Act[6] to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposal

Listing Rule IM-5315-1 provides additional listing requirements for listing a company that has not previously had its common equity securities registered under the Exchange Act on the Nasdaq Global Select Market at the time of effectiveness of a registration statement[7] filed solely for the purpose of allowing existing shareholders to sell their shares (a "Selling Shareholder Direct Listing"). To allow a company to also sell shares on its own behalf in connection with its initial listing upon effectiveness of a registration statement, without a traditional underwritten public offering, the Exchange has proposed to adopt Listing Rule IM-5315-2. This proposed rule would allow a company that has not previously had its common equity securities registered under the Exchange Act, to list its common equity securities on the Nasdaq Global Select Market at the time of effectiveness of a registration statement pursuant to which the company itself will sell shares in the opening auction on the first day of trading on the Exchange (a "Direct Listing with a Capital Raise").[8]

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5 See Securities Exchange Act Release No. 90331 (November 4, 2020), 85 FR 71708 (November 10, 2020). The Commission designated December 20, 2020, as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

6 15 U.S.C. 78s(b)(2)(B).

7 The reference to a registration statement refers to a registration statement effective under the Securities Act of 1933 ("Securities Act").

8 See proposed IM-5315-2. A Direct Listing with a Capital Raise would include listings where either: (i) only the company itself is selling shares in the opening auction on the first day of trading; or (ii) the company is selling shares and selling shareholders may also sell shares in such opening auction. See id. The Commission notes that while the Exchange's current rules also permit Selling Shareholder Direct Listings on the Nasdaq Global Market and Nasdaq Capital Market (see IM-5405-1 and IM-5505-1), the current

In considering a Selling Shareholder Direct Listing, Listing Rule IM-5315-1 currently provides that the Exchange will determine that such company has met the applicable Market Value of Unrestricted Publicly Held Shares[9] requirements based on the lesser of: (i) an independent third party valuation of the company (a "Valuation");[10] and (ii) the most recent trading price for the company's common stock in a Private Placement Market[11] where there has been sustained recent trading. For a security that has not had sustained trading in a Private Placement Market prior to listing, the Exchange will determine that such company has met the Market Value of Unrestricted Publicly Held Shares requirement if the company satisfies the applicable Market Value of Unrestricted Publicly Held Shares requirement and provides a Valuation evidencing a Market Value of Publicly Held Shares of at least $250,000,000.

With respect to a Direct Listing with a Capital Raise, the Exchange has proposed that, in determining whether a company satisfies the Market Value of Unrestricted Publicly Held Shares requirement for initial listing on the Nasdaq Global Select Market, the Exchange will deem such

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proposal would only provide for a Direct Listing with a Capital Raise on the Nasdaq Global Select Market.

9 "Restricted Securities" means securities that are subject to resale restrictions for any reason, including, but not limited to, securities: (1) acquired directly or indirectly from the issuer or an affiliate of the issuer in unregistered offerings such as private placements or Regulation D offerings; (2) acquired through an employee stock benefit plan or as compensation for professional services; (3) acquired in reliance on Regulation S, which cannot be resold within the United States; (4) subject to a lockup agreement or a similar contractual restriction; or (5) considered "restricted securities" under Rule 144. See Rule 5005(a)(37). "Unrestricted Securities" means securities that are not Restricted Securities. See Rule 5005(a)(46). "Unrestricted Publicly Held Shares" means the Publicly Held Shares that are Unrestricted Securities. See Rule 5005(a)(45). See also Rule 5005(a)(23) and (35) for definitions of "Market Value" and "Publicly Held Shares."

10 IM-5315-1 describes the requirement for a Valuation, including the experience and independence of the entity providing the Valuation.

11 The Exchange defines "Private Placement Market" in Listing Rule 5005(a)(34) as a trading system for unregistered securities operated by a national securities exchange or a registered broker-dealer.

company to have met the applicable requirement if the amount of the company's Unrestricted Publicly Held Shares before the offering, along with the market value of the shares to be sold in the Exchange's opening auction in the Direct Listing with a Capital Raise, is at least $110 million (or $100 million, if the company has stockholders' equity of at least $110 million).[12] The Exchange has proposed to calculate the Market Value of Unrestricted Publicly Held Shares, for this purpose, using a price per share equal to the price that is 20% below the lowest price of the price range disclosed by the issuer in its registration statement.[13] The Exchange also proposes to determine whether the company has met the applicable bid price and market capitalization requirements based on the same share price.[14]

The Exchange states that, except as proposed for a Direct Listing with a Capital Raise, its listing rules generally do not include shares held by officers, directors, or owners of more than 10% of the company's common stock in calculations of Publicly Held Shares.[15] In qualifying

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12 See proposed IM-5315-2.

13 See proposed IM-5315-2. The Exchange states that, for example, if the company is selling five million shares in the opening auction and there are 45 million shares issued and outstanding immediately prior to the listing that are eligible for inclusion as Unrestricted Publicly Held Shares based on disclosure in the company's registration statement, then the Exchange would calculate the Market Value of Unrestricted Publicly Held Shares based on a combined total of 50 million shares. If the lowest price of the price range disclosed in the company's registration statement is $10 per share, the Exchange will attribute to the company a Market Value of Unrestricted Publicly Held Shares of $400 million, based on an $8 price per share, which is 20% below the bottom of the disclosed range. See Notice, supra note 3, 85 FR at 59350, n.7. The Exchange also states that, as described below, the opening auction would not execute at a price that is more than 20% below the bottom of the disclosed range, so this is the minimum price at which the company could list in connection with a Direct Listing with a Capital Raise. See Notice, supra note 3, 85 FR at 59350, n.6.

14 See proposed IM-5315-2.

15 See Notice, supra note 3, 85 FR at 59350. The Exchange states that these types of inside investors may purchase shares sold by the company in the opening auction, and purchase shares sold by other shareholders or sell their own shares in the opening auction and in

companies for listing in a Direct Listing with a Capital Raise, however, such officers, directors and owners of 10% or more of the company's common stock will be included in determining whether the company meets the Market Value of Publicly Held Shares requirement. According to the Exchange, such investors may acquire in secondary market trades shares sold by the issuer in a Direct Listing with a Capital Raise that were included when calculating whether the issuer meets the Market Value of Unrestricted Publicly Held Shares requirement for initial listing.[16] The Exchange states, however, that a company listing in conjunction with a Direct Listing with a Capital Raise will be required to have a Market Value of Unrestricted Publicly Held Shares that is much higher than the Exchange's $45 million Market of Unrestricted Publicly Held Shares requirement that applies to a traditional underwritten initial public offering ("IPO").[17] The Exchange further states that this heightened requirement, along with the ability of all investors to purchase shares in the opening process on the Exchange, should result in companies using a Direct Listing with a Capital Raise having adequate public float and a liquid trading market after completion of the opening auction.[18]

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trading after the opening auction, to the extent not inconsistent with general anti-manipulation provisions, Regulation M, and other applicable securities laws. See id.

16 See Notice, supra note 3, 85 FR at 59350. The Exchange states that it expects that a company expecting to sell a significant portion of its shares to officers, directors, and existing significant shareholders would not undertake a public listing through a Direct Listing with a Capital Raise. See id. at 59352.

17 See Notice, supra note 3, 85 FR at 59350. The Exchange also states that, unlike a company listing in connection with a Selling Shareholder Direct Listing that could qualify for the price-based initial listing requirements based on a Valuation, a company listing in connection with a Direct Listing with a Capital Raise, like an IPO, must qualify for such requirements based on the minimum price at which it could sell shares in the offering. See id. at 59352.

18 See Notice, supra note 3, 85 FR at 59350.

The Exchange also states that it believes that it is consistent with the protection of investors to calculate the security's bid price and values derived from the security's price using a price per share equal to the price that is 20% below the lowest price of the price range disclosed by the issuer in its registration statement.[19] According to the Exchange, Commission rules and interpretations generally allow the sale of securities pursuant to an effective registration statement at a price that is 20% below the lowest price of the price range disclosed by the issuer in its registration statement.[20] The Exchange states that, as a result, the Exchange will allow the opening auction, otherwise known as the Nasdaq Halt Cross,[21] to take place at a price as low as this price, but no lower, and so this is the minimum price at which a company could be listed.[22]

The Exchange states that any company listing in connection with a Direct Listing with a Capital Raise would continue to be subject to, and be required to meet, all other applicable initial listing requirements. According to the Exchange, this would include the requirements to have the applicable number of shareholders and at least 1,250,000 Unrestricted Publicly Held Shares outstanding at the time of initial listing, and the requirement to have a price per share of at least $4.00 at the time of initial listing.[23]

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19 See Notice, supra note 3, 85 FR at 59352.

20 See Notice, supra note 3, 85 FR at 59352.

21 "Nasdaq Halt Cross" means the process for determining the price at which Eligible Interest shall be executed at the open of trading for a halted security and for executing that Eligible Interest. See Rule 4753(a)(4). "Eligible Interest" means any quotation or any order that has been entered into the system and designated with a time-in-force that would allow the order be in force at the time of the Halt Cross. See Rule 4753(a)(5). Pursuant to Rule 4120, the Exchange will halt trading in a security that is the subject of an IPO (or direct listing), and terminate that halt when the Exchange releases the security for trading upon certain conditions being met, as discussed further below. See Rule 4120(a)(7) and (c)(8).

22 See Notice, supra note 3, 85 FR at 59352.

23 See Notice, supra note 3, 85 FR at 59351 (citing Rules 5315(e)(1) and (2), and 5315(f)).

In addition, the Exchange has proposed to amend Rule 4702 to add a new order type, the "Company Direct Listing Order" or "CDL Order," which would be used by the issuer in a Direct Listing with a Capital Raise. This would be a market order entered for the quantity of shares offered by the issuer, as disclosed in an effective registration statement for the offering, that will execute at the price determined in the Nasdaq Halt Cross.[24] A CDL Order may be entered only on behalf of the issuer and the CDL Order may not be cancelled or modified. Only one Nasdaq member, representing the issuer, may enter a CDL Order during a Direct Listing with a Capital Raise. The CDL Order must be executed in full at the price determined in the Nasdaq Halt Cross, and all orders priced better than the price determined in the Nasdaq Halt Cross also would need to be satisfied.[25]

The Exchange has proposed that securities listing in connection with a Direct Listing with a Capital Raise must begin trading on the Exchange following the initial pricing through the Nasdaq Halt Cross, which is described in Rules 4120(c)(8) and Rule 4753. The Exchange further has proposed that, to allow such initial pricing, the company must, in accordance with Rule 4120(c)(9), have a broker-dealer serving in the role of financial advisor to the issuer of the securities being listed, who is willing to perform the functions under Rule 4120(c)(8) that are performed by an underwriter with respect to an IPO.[26] The Exchange states that the requirement

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24 See proposed Rule 4702(b)(16)(A) and (B).

25 See proposed Rule 4702(a)(16)(A); Notice, supra note 3, 85 FR at 59351.

26 See proposed IM-5315-2. Rule 4120(c)(9) states that the process for halting and initial pricing of a security that is subject to an IPO is also available for the initial pricing of any other security that has not been listed on a national security exchange immediately prior to the initial pricing, if a broker-dealer serving in the role of financial to the issuer is willing to perform the functions under Rule 4120(c)(8) that are performed by an underwriter with respect to an IPO, and if more than one broker-dealer is serving in the role of financial advisor, the issuer must designate one to perform these functions. The

that the company begin trading of the company's securities following the initial pricing through the Nasdaq Halt Cross will promote fair and orderly markets by protecting against volatility in the pricing and initial trading of securities covered by the proposal.[27] In addition, the Exchange has proposed to amend Rule 4120(c)(9) to specify that any services provided by such financial advisor to the issuer of a security, including a company listing in connection with a Direct Listing with a Capital Raise, must provide such services in a manner that is consistent with all federal securities laws, including Regulation M and other anti-manipulation requirements.[28]

With respect to the Nasdaq Halt Cross, the Exchange has proposed that, in the case of a Direct Listing with a Capital Raise, a security shall not be released for trading by Nasdaq unless the expected price at which the cross would occur (as defined in Rule 4120(c)(8)(A)(i)) is at or above the price that is 20% below the lowest price of the price range established by the issuer in its effective registration statement.[29] This requirement would be in addition to the existing conditions described in Rule 4120(c)(8)(A)(i), (ii), and (iii), which would continue to apply.[30] The Exchange notes that, unlike in an IPO, a company listing through a Direct Listing with a Capital Raise would not have an underwriter to guarantee that a specified number of shares would be sold by the company at a price consistent with disclosure in the company's effective

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Exchange proposes to renumber this provision as Rule 4120(c)(9)(A). See proposed Rule 4120(c)(9)(A).

27 See Notice, supra note 3, 85 FR at 59352.

28 See proposed Rule 4120(c)(9)(A).

29 See proposed Rule 4120(c)(9)(B).

30 Rule 4120(c)(8)(A) provides that a security will not be released for trading until Nasdaq receives notice from the underwriter of the IPO or financial advisor in the case of a Direct Listing that the security is ready to trade, the system verifies that all market orders will be executed in the cross, and the price determined in the cross satisfies a price validation test.

registration statement. However, the Exchange asserts that this would be achieved through the proposed requirements that (1) the Nasdaq Halt Cross occur only if the CDL Order, which must be equal to the total number of shares disclosed as being offered by the company in the effective registration statement, is executed in full, and (2) the Nasdaq Halt Cross occur at a price per share no less than 20% below the lowest price of the price range disclosed by the issuer in its registration statement.[31]

The Exchange states that, because the financial advisor would be responsible for determining when the security subject to the Nasdaq Halt Cross is ready to trade, the proposal would make the financial advisor responsible for determining whether the Nasdaq Halt Cross for a Direct Listing with a Capital Raise can proceed.[32] According to the Exchange, if there is insufficient buy interest to satisfy the CDL Order as required by the proposal, the Nasdaq Halt Cross would not proceed and such security would not begin trading.[33] The Exchange represents that, if the Nasdaq Halt Cross cannot be conducted, the Exchange would notify market participants via a Trader Update that the Direct Listing with a Capital Raise has been cancelled and any orders for that security that had been entered on the Exchange, including the CDL Order, would be cancelled back to the entering firms.[34] The Exchange further states that, because the CDL Order will be a market order, if the Nasdaq Halt Cross proceeds, that order will execute in full in the Nasdaq Halt Cross, along with orders priced at or better than the price determined in the Nasdaq Halt Cross.[35] The Exchange notes that, while the Nasdaq Halt Cross would not

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31 See Notice, supra note 3, 85 FR at 59352.

32 See Notice, supra note 3, 85 FR at 59351.

33 See Notice, supra note 3, 85 FR at 59351.

34 See Notice, supra note 3, 85 FR at 59351.

35 See Notice, supra note 3, 85 FR at 59351.

proceed if the price calculated is 20% or more below the lowest price disclosed by the company in its effective registration statement, there would be no upper limit to the price determined in the Nasdaq Halt Cross.[36]

Finally, the Exchange has proposed to make adjustments to how it would calculate the Current Reference Price, which is disseminated in the Nasdaq Order Imbalance Indicator, and the price at which the Nasdaq Halt Cross would execute, for a Direct Listing with a Capital Raise.[37] In each case, where there are multiple prices that would satisfy the conditions for determining the price, the Exchange would modify the fourth tie-breaker for a Direct Listing with a Capital Raise to use the price that is closest to the price that is 20% below the lowest price of the price range disclosed by the issuer in its effective registration statement.[38]

III. Summary of Comment Letters Received

One commenter recommended that the Commission disapprove the proposal because it believes that the proposed expansion of direct listings would compound problems that shareholders face in tracing their share purchases to a registration statement and may lead to a decline in effective governance at U.S. public companies.[39] The commenter stated that

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36 See Notice, supra note 3, 85 FR at 59351.

37 See Rule 4853(a)(3) for a description of the "Current Reference Price" and "Order Imbalance Indicator."

38 See proposed Rule 4753(a)(3)(A)(iv)(c) and (b)(2)(D)(iii). The Exchange states that the fourth tie-breaker used to calculate the Current Reference Price for an IPO is the price that is closest to the issuer's IPO price, and that a Direct Listing with a Capital Raise is similar to an IPO in that the company sells securities in the offering. See Notice, supra note 3, 85 FR at 59352. The Exchange also proposes non-substantive changes to renumber the other alternatives for the fourth tie-breaker. See proposed Rule 4753(a)(3)(A)(iv) and (b)(2)(D).

39 See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, at 2, 4 (October 8, 2020) ("CII Letter"). The commenter stated that on September 25, 2020, the Commission issued an order granting the Council of Institutional Investors' petition for review of an order, issued by delegated authority, granting approval of a

traceability concerns often arise when there have been successive offerings, as shareholders seek to establish their standing to litigate claims for material misstatements or omissions under federal securities law.[40] The commenter stated that investor concerns about the traceability of shares in a direct listing were drawn into sharp focus in current litigation involving a direct listing by Slack Technologies, Inc. ("Slack"), which is still under consideration.[41] The commenter further stated that, independent of the Slack case, the Exchange's proposal raises important investor issues that the Commission should consider before opening U.S. capital markets up to the potential for a vastly increased number of direct listings.[42] The commenter urged the Commission to explore updating its "proxy plumbing" regulations before approving an expanded direct listings regime.[43]

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proposed rule change by the New York Stock Exchange LLC relating to a proposed direct listing with a primary offering ("NYSE Proposal"). See id. at 1–2. See also Securities Exchange Act Release No. 90001 (September 25, 2020), 85 FR 61793 (September 30, 2020) (SR-NYSE-2019-67) (Order Granting Petition for Review, Scheduling Filing of Statements, and Denying New York Stock Exchange LLC's Motion to Lift the Stay). This commenter stated that the Exchange's current proposal is similar to the NYSE Proposal and cites its petition for review of the NYSE Proposal as further support for its recommendation that the Commission disapprove the Exchange's proposal. See CII Letter, at 1–2 (citing Petition of Council of Institutional Investors for Review of an Order, Issued by Delegated Authority, Granting Approval of a Proposed Rule (September 8, 2020), available at https://www.sec.gov/rules/sro/nyse/2020/34-89684-petition.pdf).

40 See CII Letter, supra note 39, at 2–3.

41 See CII Letter, supra note 39, at 3. The commenter stated with respect to this case that while the district court denied a motion to dismiss a Section 11 claim on the grounds that the plaintiff could not trace its purchases to Slack's registration statement, the court of appeals has agreed to hear the matter on an interlocutory basis, so it is unclear whether the district court case will be upheld. See id. See also Pirani v. Slack Technologies, Inc., No. 20-16419 (9th Cir. July 23, 2020), Docket No. 1.

42 See CII Letter, supra note 39, at 3.

43 See CII Letter, supra note 39, at 4.

In addition, this commenter stated that it is concerned that the Exchange's proposal would result in a significant increase in the use of direct listings, and that more direct listings may lead to a decline in the effective corporate governance of U.S. public companies to the detriment of long-term investors and the capital markets generally.[44] The commenter stated that a recent direct listing of Palantir Technologies Inc. had a dual-class structure that is viewed by many market participants as inconsistent with effective governance.[45]

Another commenter simply stated support for the proposed method of opening the transaction.[46]

IV. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2020-057 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposal should be approved or disapproved.[47] Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of disapproval proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved.

Pursuant to Section 19(b)(2)(B) of the Exchange Act, the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis and input concerning the proposed rule change's consistency

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44 See CII Letter, supra note 39, at 4.

45 See CII Letter, supra note 39, at 5.

46 See Letter from Rahul Chaudhary (October 13, 2020).

47 15 U.S.C. 78s(b)(2)(B).

with the Exchange Act[48] and, in particular, with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of a national securities exchange 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 are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[49]

The Commission has consistently recognized the importance of exchange listing standards. Among other things, such listing standards help ensure that exchange-listed companies will have sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly markets.[50]

The Exchange proposal states that for a Direct Listing with a Capital Raise, the Nasdaq Halt Cross on the first day of trading for the security would not proceed unless the price would

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48 15 U.S.C. 78f(b)(5).

49 Id.

50 The Commission has stated in approving exchange listing requirements that the development and enforcement of adequate standards governing the listing of securities on an exchange is an activity of critical importance to the financial markets and the investing public. In addition, once a security has been approved for initial listing, maintenance criteria allow an exchange to monitor the status and trading characteristics of that issue to ensure that it continues to meet the exchange's standards for market depth and liquidity so that fair and orderly markets can be maintained. See, e.g., Securities Exchange Act Release Nos. 82627 (February 2, 2018), 83 FR 5650, 5653, n.53 (February 8, 2018) (SR-NYSE-2017-30) ("NYSE 2018 Order"); 81856 (October 11, 2017), 82 FR 48296, 48298 (October 17, 2017) (SR-NYSE-2017-31); 81079 (July 5, 2017), 82 FR 32022, 32023 (July 11, 2017) (SR-NYSE-2017-11). The Commission has stated that adequate listing standards, by promoting fair and orderly markets, are consistent with Section 6(b)(5) of the Exchange Act, in that they are, among other things, designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest. See, e.g., NYSE 2018 Order, 83 FR at 5653, n.53; Securities Exchange Act Release Nos. 87648 (December 3, 2019), 84 FR 67308, 67314, n.42 (December 9, 2019) (SR-NASDAQ-2019-059); 88716 (April 21, 2020), 85 FR 23393, 23395, n.22 (April 27, 2020) (SR-NASDAQ-2020-001).

be at or above the price that is 20% below the lowest price of the price range established by the issuer in its effective registration statement.[51] The proposal, however, has no maximum price above which the Nasdaq Halt Cross may not proceed.[52] Therefore, the proposed rule would permit issuers to sell, in the opening, the quantity of shares disclosed as offered in the prospectus included in the effective registration statement at a price that is above the price range disclosed in the effective registration statement. As there is no proposed upside limit on the price at which the opening auction could occur, it is not clear how the issuer could ensure that the issuer's Securities Act registration statement covers the full amount of securities to be sold in the offering.[53] Although issuers may file additional Securities Act registration statements to register additional securities needed to complete an offering, Section 5 of the Securities Act requires all of the related registration statements to be effective prior to the time of sale. To the extent Nasdaq's proposal may result in issuers needing to register additional securities beyond those included in an initial Securities Act registration statement, it is not apparent how an issuer could ensure that any additional required registration statement would be effective prior to the time of opening. Nor is it apparent how an issuer would be able to determine whether an additional Securities Act registration statement would be required before the opening occurs. Thus, we have concerns that Nasdaq's proposed rule may not provide adequate safeguards to ensure that issuers conducting a Direct Listing with a Capital Raise are able to comply with Section 5 of the

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51 See supra note 29 and accompanying text.

52 See supra note 36 and accompanying text.

53 Securities Act Rule 457 permits issuers to register securities either by specifying the quantity of shares registered, pursuant to Rule 457(a), or the proposed maximum aggregate offering amount, pursuant to Rule 457(o). For issuers that register securities based on the proposed maximum aggregate offering amount, it is not clear how the issuer could ensure that the total amount sold by the issuer in the opening auction does not exceed the amount of securities registered under the Securities Act.

Securities Act. The Exchange has not explained how this would be consistent with the investor protection requirements under Section 6(b)(5) and other relevant provisions of the Exchange Act.

In addition, the Exchange states that "investors know the minimum price at which the company can sell shares in the offering."[54] The Exchange has not explained how investors would know that price, as the opening could occur if the price obtained in the Nasdaq Halt Cross is up to 20% below the price range disclosed by the issuer in its effective registration statement.

Further, the Exchange asserts, throughout its proposal, that the Nasdaq Halt Cross will not occur at a price lower than 20% below the low end of the issuer's disclosed price range, but it is unclear from the Exchange's rules that this would always be the case. Specifically, proposed Rule 4120(c)(9)(B) states that the security will not be released for trading unless "the Expected Price is at or above the price that is 20% below the lowest price of the price range established" in the effective registration statement.[55] Rule 4120(c)(8), however, appears to permit the underwriter or financial advisor to select price bands of up to $0.50 outside of the Expected Price, and provide that the Nasdaq system would view the price validation test as having been passed and permit the security to be released for trading, so long as the actual price calculated by the cross differs from the Expected Price by no more than the price band.[56] The Exchange has not explained this apparent inconsistency in its rules.

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54 Notice, supra note 3, 85 FR at 59350.

55 "Expected Price" under Rule 4120(c)(8)(A)(i) means the Current Reference Price at the time the Exchange receives notice that the security is ready to trade from an underwriter or financial advisor.

56 Under Nasdaq Rule 4120(c)(8)(B) a financial advisor in a Direct Listing with a Capital Raise would select "price bands" that are defined as the amounts by which the actual price may not be lower, or higher, than the Expected Price. The rule states that available price bands, set by Nasdaq, shall include $0 but shall not be in excess of $0.50. Under the proposal, the financial advisor in a Direct Listing with a Capital Raise is not restricted from selecting price bands in accordance with Rule 4120(c)(8)(B).

Finally, although the Exchange has proposed that the CDL Order may not be cancelled or modified, the Exchange's rules appear to permit the issuer's financial advisor broad discretion to postpone the offering, which would effectively cancel the CDL Order. Specifically, Rule 4120(c)(8) provides that the validation needed to open the security only occurs after the Expected Price is displayed to the financial advisor and the financial advisor then approves proceeding. Rule 4120(c)(8) also permits the financial advisor, with the concurrence of Nasdaq, to determine at any point during the Nasdaq Halt Cross process up through the conclusion of the pre-launch period to postpone and reschedule the offering. The financial advisor therefore could effectively "cancel" the CDL Order, on behalf of the issuer, by deciding not to proceed with the offering for a variety of reasons, including being dissatisfied with the Expected Price. The Exchange has not explained why its rules appear to allow the financial advisor this discretion in the case of a Direct Listing with a Capital Raise, or why doing so would be consistent with Section 6(b)(5) and other relevant provisions of the Exchange Act.

The Commission notes that, under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder … is on the self-regulatory organization ['SRO'] that proposed the rule change."[57] The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,[58] and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make

57 Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

58 See id.

an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.[59]

For these reasons, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act[60] to determine whether the proposal should be approved or disapproved.

V. Commission's Solicitation of Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written view of interested persons concerning whether the proposal is consistent with Section 6(b)(5) or any other provision of the Exchange Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.[61]

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's

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59 See id.

60 15 U.S.C. 78s(b)(2)(B).

61 Section 19(b)(2) of the Exchange Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2020-057 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2020-057. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying

information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2020-057 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[62]

J. Matthew DeLesDernier,

Assistant Secretary.

62 17 CFR 200.30-3(a)(57).

Proskauer