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Non-U.S. Companies Should Prepare for Nasdaq's New Board Diversity Rules

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Securities and Capital Markets

On August 6, 2021, the Securities and Exchange Commission (the "SEC") approved new listing standards of the Nasdaq Stock Market LLC ("Nasdaq") regarding director diversity. Generally, the new rules require Nasdaq-listed companies, including foreign issuers, to:

- have, or explain why they do not have, at least two diverse members on the board of directors, including one female director and one director of a historically underrepresented community; and
- annually disclose board-level diversity data in a prescribed tabular format.

Except for a small category of "exempt" companies,[1] Nasdaq's new rules broadly apply to all Nasdaq-listed companies, including foreign issuers. The new rules broadly define "foreign issuers" to include (i) foreign private issuers (as defined in Rule 3b-4 of the Securities Exchange Act of 1934) as well as (ii) foreign companies that are headquartered outside the United States but that are not foreign private issuers under Rule 3b-4 and that may file domestic SEC reports.

1 What Non-U.S. Companies Need to Know

- Unlike many Nasdaq listing requirements that allow foreign private issuers to follow their home country governance requirements in lieu of specified Nasdaq corporate governance rules, Nasdaq will require listed non-U.S. companies to comply with the new board diversity rules.
- Non-U.S. companies may use a definition of "diverse" that aligns with the demographic characteristics of underrepresented groups in the country of the company's principal executive office and may satisfy the diversity objectives by the applicable compliance periods specified in the rules by having either (i) one female director and one director of a historically underrepresented community or (ii) two female directors.

[1] The new rules exempt acquisition companies (i.e., special purpose acquisition companies ("SPACs")) asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies, issuers of solely non-voting preferred securities, debt securities and derivative securities, and issuers of securities under Nasdaq's Rule 5700 series (such an exchange-traded funds).

- In line with existing SEC and Nasdaq regulation of foreign issuers, a company organized outside the U.S. should interpret Nasdaq's new board diversity rules as applying to the composition of either its board of directors, or if applicable, the company's supervisory board.

2 Key Provisions of the New Rules for Non-U.S. Companies

New Rule 5605(f): Non-US Companies' Diverse Board Representation

New Nasdaq Rule 5605(f)(2)(B) requires the board of directors or, if applicable, the supervisory board, of a Nasdaq-listed non-U.S. company to have, or explain why it does not have, at least two diverse directors. Nasdaq recognized that certain categories of race and ethnicity that are relevant in the United States may not extend to other countries, which have their own unique demographic characteristics. Therefore, non-U.S. companies are afforded the flexibility to comply with the diversity objectives under Rule 5605(f)(2)(B) by having: (i) two directors who voluntarily self-identify as female; or (ii) one director who voluntarily self-identifies as female *and* one director who voluntarily self-identifies as an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious, or linguistic identity in the country of the company's principal executive offices, as reported on the company's Form F-1, 10-K, 20-F, or 40-F, or LGBTQ+.

- **Compliance Timeline**. The new rule provides a gradual compliance period for currently-listed and newly-listed companies.
  - <u>Currently Listed Companies</u>. Non-US companies currently listed on the Nasdaq Global Select or the Nasdaq Global Market have two years (until August 7, 2023) to have, or explain why they do not have, at least one self-identified female *or* diverse director and four years (until August 6, 2025) to have *both* a self-identified female and a diverse director (or two directors that self-identify as female). Non-US companies currently listed on the Nasdaq Capital Market have two years (until August 7, 2023) to have, or explain why they do not have, at least one self-identified female *or* diverse director and five years (until August 6, 2026) to have *both* a self-identified female and a diverse director (or two directors that self-identify as female).
  - <u>Newly Public Non-US Companies</u>. Generally, newly-listed[2] non-U.S. companies on the Nasdaq Global Select or the Nasdaq Global Market have one year from the later of the date of listing, or the filing of their first annual report subsequent to listing, to have, or explain why they do not have, at least one self-identified female *or* diverse director. They have two years from the later of the date of listing, or the filing of their annual report subsequent to listing, to have, or explain why they do not have, *both* a self-identified female and a diverse director (or two directors that self-identify as female).

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[2] For purposes of Rule 5605(f), newly-listed companies include companies listing through an initial public offering, direct listing, transfer from another exchange or the over-the-counter market, in connection with a spin-off or carve-out from a company listed on Nasdaq or another exchange, or through a merger with a SPAC that was not previously subject to a substantially similar requirement of another national securities exchange, and any company that ceases to be a foreign private issuer, a smaller reporting company, or an exempt company.

- Newly-listed non-U.S. companies on the Nasdaq Capital Market do not have to comply with the one-year requirement and are only required to have, or explain why they do not have, *both* a self-identified female and a diverse director (or two directors that self-identify as female) within two years from the date of listing or filing of their annual report subsequent to listing.
- Notwithstanding the timeframes above, newly-listed companies would not be required to satisfy the diversity objectives and disclosure requirements earlier than the first deadline applicable to currently-listed companies.

  Examples of the compliance timelines that could apply to newly-listed and currently-listed companies are available here.

- **Comply or Explain**. If a company's board does not comply with the diversity requirements following the implementation periods described above, the company is required to specify the particular aspect(s) of board diversity with which it fails to comply and explain the reasons for its non-compliance. Nasdaq indicated that it will not evaluate the substance or merits of a company's explanation and will only verify that a company provides an explanation. For non-U.S. companies that are not required to follow U.S. proxy rules, which includes foreign private issuers, this disclosure should be made in advance of the company's next annual meeting of shareholders, either in the company's annual report on Form 20-F or on the company's website.[3] If the company provides such disclosure on its website, it must add the disclosure to its website concurrently with its Form 20-F filing and submit a URL link to the disclosure through the Nasdaq Listing Center within one business day after such posting.
- **Cure and Grace Periods**. Failure to comply with the new rule could eventually lead to delisting; however, a company would have until the later of its next annual meeting and 180 days from the event that caused the deficiency to regain compliance with Nasdaq's diversity objectives. Additionally, there is a one-year grace period for a company that no longer meets the diversity objectives as a result of a board vacancy.
- **Companies with Small Boards**. Companies with five or fewer directors (that do not otherwise qualify as smaller reporting companies) must only have one diverse director. If a company has five directors before becoming subject to the new rule and adds one director to satisfy the diversity objective, its Nasdaq diversity objective would remain at one diverse director (even though it would have a six-member board). However, if the company subsequently expands its board, the new rule would then require the company to have at least two diverse directors.

3 New Rule 5606: Foreign Issuers' Board Diversity Disclosure

Under new Nasdaq Rule 5606(a), each Nasdaq-listed company, including non-U.S. companies, will be required annually to disclose statistical information on its board's diversity in substantially the same format as the "Board Diversity Matrix" available here.

[3] A foreign issuer, as defined in the new rules, that does not qualify as a foreign private issuer, will need to make the requisite disclosure in (i) its proxy statement or information statement (or, if the company does not file such statements, in its annual report on Form 10-K); or (ii) on the company's website.

A non-U.S. company would be required to provide the total number of directors on its board, and would also be required to provide information about: (i) its country of principal executive offices; (ii) whether it is a foreign private issuer; (iii) whether disclosure is prohibited under its home country law; (iv) the number of directors based on gender identity (female, male, or non-binary) and the number of directors who did not disclose gender; (v) the number of directors who self-identify as underrepresented individuals in its home country jurisdiction; (vi) the number of directors who self-identify as LGBTQ+; and, (vii) the number of directors who did not self-identify as underrepresented individuals or LGBTQ+.

As with new Rule 5605(f), non-U.S. companies that are not required to follow U.S. proxy rules, such as foreign private issuers, should provide the Diversity Matrix in either the company's annual report on Form 20-F or on the company's website.[4] Following the first year of disclosure, companies are required to disclose diversity statistics for the current year and the immediately preceding year using the Board Diversity Matrix.

A company must disclose its initial Board Diversity Matrix by the later of: (i) August 8, 2022; or (ii) for non-U.S. companies that are not required to follow the proxy rules, the date the company files its annual report on Form 20-F. Newly-listed companies will have one year from the date of listing on Nasdaq to provide the initial Board Diversity Matrix.

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[4] A foreign issuer, as defined in the new rules, that does not qualify as a foreign private issuer, will need to make the requisite disclosure in (i) its proxy statement or information statement (or, if the company does not file such statements, in its annual report on Form 10-K); or (ii) on the company's website.