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United States Senate  
COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS  
WASHINGTON, DC 20510-6075

February 12, 2021

The Honorable Allison Herren Lee  
Acting Chair  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: NASDAQ Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, File No. SR-NASDAQ-2020-081

Dear Acting Chair Lee:

We write to ask the Securities and Exchange Commission (SEC) to disapprove NASDAQ's proposed rule requiring listed corporations comply with a new diversity provision or explain why they are not.<sup>1</sup>

America's corporations benefit from boards that avoid groupthink and offer a diversity of perspectives. Such diversity increases the creativity and problem-solving needed to improve corporate operations and growth. We commend individual firms for the proactive efforts they have already made in recruiting, promoting, and maintaining diverse talent. However, it is not the role of NASDAQ, as a self-regulatory organization, to act as an arbitrator of social policy or force a prescriptive one-size-fits-all solution upon markets and investors. NASDAQ's narrow concept of mandated diversity, one that prioritizes race, gender, and sexual orientation, and pressured board diversity, misses the mark. It interferes with a board's duty to follow its legal obligations to govern in the best interest of the corporation and its shareholders. It violates central principles of materiality that govern securities disclosures, and finally, it harms economic growth by imposing costs on public corporations and discouraging private corporations from going public. In so doing, NASDAQ fails to meet its burden to demonstrate that this proposed rule advances investor protection, fosters the public interest, or is otherwise consistent with the Securities Exchange Act of 1934 (Exchange Act).<sup>2</sup>

<sup>1</sup> "Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change To Adopt Listing Rules Related to Board Diversity," ("Proposed Rule"), 85 FR 80472 (Dec. 11, 2020).

<sup>2</sup> 15 U.S.C. § 78f(b); 15 U.S.C. § 78s(b).

I. *NASDAQ's proposal runs contrary to a corporation's duty to nominate to its board of directors individuals who will serve the best interests of the corporation and its shareholders*

The fiduciary responsibility of a corporate board is to oversee management and govern in the best interests of the people who hire them—shareholders. NASDAQ's proposal interferes with the best interest requirement and ignores the dictum, most famously articulated by Warren Buffett, that board members should be chosen on merit and ability to improve corporate performance.<sup>3</sup> NASDAQ's proposal compels the prioritization of a narrowly defined concept of diversity in board membership over merit. This weakens shareholder rights by unsettling the proper expectation that a company's board will be serving the best interests of the corporation and its shareholders by complying with all applicable laws and maximizing returns.

NASDAQ's proposed rule would obstruct the "free and open market," with which NASDAQ's proposal must be consistent under Section 6(b)(5) of the Exchange Act,<sup>4</sup> by interfering with a board's ability to govern in the best interest of their shareholders. In a free market, corporations compete for customers by producing quality products and services. This competition drives innovation, reduces costs, helps consumers, and creates economic growth. A corporation's desire and ability to obtain higher returns is a lynchpin of this system because it is much of what drives the competition in the first place.

NASDAQ's proposal is not consistent with a free market under Section 6(b)(5) of the Exchange Act because its arbitrary diversity requirement does not demonstrably improve corporate performance, and could sometimes harm it.

First, the research underpinning NASDAQ's proposal is incomplete at best. For example, NASDAQ does not sufficiently address the research results finding that gender board diversity correlates very little, if at all, with corporate performance.<sup>5</sup> NASDAQ has also not proven that board diversity *causes* improved corporate performance. In fact, some evidence suggests that "the interaction of gender diversity and ethnic minority diversity do not impact financial performance."<sup>6</sup>

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<sup>3</sup> See, e.g., Locke, Taylor, "The traits Warren Buffett looks for in Berkshire Hathaway's board of directors," CNBC (Feb. 25, 2020), available at <https://www.cnbc.com/2020/02/25/what-warren-buffett-looks-for-in-berkshire-hathaway-board-of-directors.html>.

<sup>4</sup> 15 U.S.C. § 78f(b)(5) ("[The rules must be consistent with]...remov[ing] impediments to and perfect[ing] the mechanism of a free and open market and a national market system").

<sup>5</sup> See Klein, Katherine, "Does Gender Diversity on Boards Really Boost Company Performance?" *Knowledge@Wharton*, (May 18, 2017), available at

<https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/>; Herrera-Cano, Carolina and Maria Alejandra Gonzalez-Perez, "Representation of Women on Corporate Boards of Directors and Firm Financial Performance," *Andri Georgiadou, Maria Alejandra Gonzalez-Perez and Miguel R. Olivás-Lujan, Eds., "Diversity within Diversity Management,"* 37-60 (May 2019); Pletzer, Jan Luca, Romina Nikolova, Karina Karolina Kedzior, and Sven Constantin Voelpel, "Does gender matter? Female representation on corporate boards and firm financial performance - A meta-analysis," *Plos One*, 10(6): 1-20 (June 18, 2015).

<sup>6</sup> Carter, David et al., "The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance," *Corp. Governance: An Int'l Rev.* 396 (Sept. 2010), available at <https://wedc-online.wildapricot.org/Resources/WEDC-Documents/Women%20On%20Board/Gender%20Diversity%20and%20Boards.pdf>.

Second, corporations already *want* diversity among board members that could improve their operations. NASDAQ itself cites in its proposed rule a survey conducted by Deloitte that found “94% of companies . . . were looking to increase diversity among their boards.”<sup>7</sup> Thus, NASDAQ’s proposal is not needed because it unnecessarily pressures corporations to do something they are already seeking to do. Further, the imposition of a mandate with strict deadlines may undermine the ability of corporations to find the best suited candidates for them.

Third, NASDAQ’s definition of diversity focuses on minority and gender status while giving short shrift to other types of diversity that could correlate with superior corporate performance. NASDAQ justifies this partly by arguing that board diversity helps fight fraud by allowing for multiple perspectives and reducing groupthink.<sup>8</sup> Yet, NASDAQ’s argument could be equally applicable to diversity requirements based on religion, age, political affiliation, geographic location, educational background, veteran’s status, or physical disability. In contrast to NASDAQ, the SEC in 2009 defined diversity “*expansively* to include differences of viewpoint, professional experience, education, skill and other . . . qualities . . . that contribute to board heterogeneity” in order to reduce groupthink.<sup>9</sup>

Fourth, NASDAQ’s narrow definition of diversity would limit a corporation’s flexibility to fill their board as they see most appropriate. This could discourage companies from selecting board members that meet a wider variety of needs, ranging from cyber-security expertise or experience within a niche field. Corporations are likely to satisfy NASDAQ’s proposed rule by adding board members, thereby increasing their board’s size and potentially creating less effective corporate oversight and governance due to the larger size.<sup>10</sup>

Finally, the relationship between NASDAQ’s proposed rule and NASDAQ’s promotion of a board recruiting solution for diverse board candidates is unclear. NASDAQ would arrange for complimentary services to companies for one year at an estimated value of \$10,000.<sup>11</sup> However, they do not identify how they would address the potential conflicts of interest between establishing a regulatory standard and concurrently promoting a revenue-generating compliance solution. For example, NASDAQ could require the use of a particular service as condition to resolving a listing rule enforcement action or take a non-enforcement posture so long as a company was seeking diversity among its board members using its solution.

## *II. NASDAQ’s proposal violates the concept of materiality*

The concept of materiality is a cornerstone of the disclosure-based regime under federal securities law.<sup>12</sup> Information is material when there is a substantial likelihood that a reasonable

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<sup>7</sup> Proposed Rule at 80481.

<sup>8</sup> *See id.* at 80497.

<sup>9</sup> “Proxy Disclosure Enhancements,” 74 FR 68334 (Dec. 23, 2009) (emphasis added) (quoted by Proposed Rule at 80482-80483).

<sup>10</sup> *See, e.g.,* Lipton, Martin, and Jay W. Lorsch, “A Modest Proposal to Improve Corporate Governance,” 48 Bus. Lawyer 59 (Nov. 1992); Yermack, David, “Higher Market Valuation of Companies with a Small Board of Directors,” 40 J. Fin. Econ. 185 (1996).

<sup>11</sup> “Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change To Adopt Listing Rule IM-5900-9 To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Solution To Help Advance Diversity on Company Boards,” 85 FR 79556 (Dec. 10, 2020).

<sup>12</sup> *See Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

investor would consider it important to an investment decision. This materiality concept preserves social policymaking for democratically elected representatives, not regulators, such as the SEC, or quasi-regulatory entities, such as NASDAQ. Unfortunately, NASDAQ's proposal violates the concept of materiality because, as discussed above, the disclosures would not help a reasonable investor evaluate a company's performance. This violates Section 6(b)(5) of the Exchange Act<sup>13</sup> for regulating an area that is unrelated to the purpose of the Exchange Act or "administration of the exchange."<sup>14</sup>

Preserving the SEC's focus on materiality has historically been a bipartisan mission. In 2013, SEC Chair Mary Jo White, who was appointed to that position by President Obama, criticized attempts to use the SEC disclosure requirements for "exerting societal pressure on companies to change behavior, rather than to disclose financial information that primarily informs investment decisions."<sup>15</sup> Chair White's statement related to disclosures concerning mine safety and conflict minerals, but it could easily apply here.

The materiality doctrine prevents the development of an unstable, politicized securities regime that would be ripe for abuse of power. Without it, political factions could use securities regulations to advance the latest social policy fad, sidestepping democratic deliberation. Securities regulation would become a political football, as all sides of a social policy issue would fight to enshrine their perspective into regulation. This would balloon the volume of securities disclosures, reducing clarity and increasing costs for companies, regulators, and investors. More importantly, our capital markets could suffer significant harm.

NASDAQ appears to be motivated by an inappropriate desire to influence social policy. Their press release on the proposal includes a statement from the American Civil Liberties Union praising NASDAQ for "heeding the call of the moment," rejecting "incremental change and window dressing," and hailing efforts to "hold corporate America's feet to the fire."<sup>16</sup>

Finally, NASDAQ's reliance on self-identification for board diversity disclosures poses unique liability concerns under the antifraud and reporting provisions of the federal securities laws.<sup>17</sup> Under the proposal, federal securities laws could hold issuers, as the makers of false statements, liable for reporting board members' diversity information if their ethnic or gender identity is misrepresented.<sup>18</sup> Certainly, issuers *could* avoid liability if the self-reported information is not material, in which case the SEC should disapprove of the proposal for requiring non-material

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<sup>13</sup> 15 U.S.C. § 78f.

<sup>14</sup> NASDAQ's standards would affect issuers instead of NASDAQ's internal operations, so it seems impossible to argue that they relate to the "administration of the exchange."

<sup>15</sup> Chair Mary Jo White, "The Importance of Independence," (Oct. 3, 2013), available at <https://www.sec.gov/news/speech/spch100113mjw#.Uk7jN4amiSo>.

<sup>16</sup> Available at <https://www.nasdaq.com/press-release/nasdaq-to-advance-diversity-through-new-proposed-listing-requirements-2020-12-01>.

<sup>17</sup> See, e.g., 15 U.S.C. § 77k; 15 U.S.C. § 78j(b); 15 U.S.C. § 78r; 17 C.F.R. § 10b-5; 17 C.F.R. § 240.12b-20; 17 C.F.R. § 240.14a-9.

<sup>18</sup> This is not a hypothetical possibility. See Jessica Krug, "The Truth, and the Anti-Black Violence of My Lies," Medium (Sept. 3, 2020), available at <https://medium.com/@jessakrug/the-truth-and-the-anti-black-violence-of-my-lies-9a9621401f85>.

information. Even more complexity could arise if a board member conveys a self-identification that a reasonable investor would consider misleading.<sup>19</sup>

### *III. NASDAQ's proposal would harm economic growth*

NASDAQ's proposal—and the precedent set by approving it—would harm economic growth by introducing unnecessary regulatory costs, decreasing the attractiveness of U.S. capital markets, and presenting an additional concern for corporations deciding to go and stay public.

NASDAQ's proposal does not avoid these risks even though NASDAQ argues that unlike a mandated regime, its comply or explain regime “empower[s] companies to maintain decision-making authority over their board's composition.”<sup>20</sup> However, NASDAQ admits that its proposal is intended to “influence corporate conduct.”<sup>21</sup> Compelling corporate behavior could harm economic growth if the resulting changes reduce board effectiveness and harm corporate performance.

NASDAQ's alternative to satisfying the quota requirement—disclosure explaining non-compliance—could still hurt companies even if they do not change their behavior. Activist groups could use the information to start costly pressure campaigns against corporations with allegedly non-diverse boards. NASDAQ appears to acknowledge this by quoting your earlier remarks that transparency “creates external pressure from investors *and others* who can draw comparisons company to company.”<sup>22</sup> Moreover, we are concerned that the public call by NASDAQ's chief executive officer for mandatory diversity obligations for all companies undermines competition among national securities exchanges, as promoted by the Exchange Act.<sup>23</sup>

Unfortunately, all of the risks associated with NASDAQ's proposal could cause some private corporations to avoid going public at all. Although 2020 saw an increase in IPOs, this trend may be transitory, and the number of public corporations is generally on the decline as they are struggling to go and stay public. The 1990s saw around 520 IPOs annually on average, while the last decade saw less than 40% of that, at about 200 annually.<sup>24</sup> Similarly, during the 1990s, there

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<sup>19</sup> See Paine, Amber, “Rachel Dolezal on Why She Can't Just Be a White Ally,” NBC News (Mar. 28, 2017), available at <https://www.nbcnews.com/news/nbcblk/rachel-dolezal-why-she-can-t-just-be-white-ally-n738911> (“Dolezal admitted that while she was born to Caucasian parents, she identified as a Black woman”); see also Stern, Marlow, “Hilaria Baldwin Has Been Posing as a Spanish Person for Years,” The Daily Beast (Dec. 27, 2020), available at <https://www.thedailybeast.com/alec-baldwins-wife-hilaria-baldwin-has-been-posing-as-a-spanish-person-for-years>. NASDAQ's proposal would define a Latinx as a “person of Cuban, Mexican, Puerto Rican, South or Central American, or other Spanish culture or origin, regardless of race.”

<sup>20</sup> Proposed Rule at 80492.

<sup>21</sup> *Id.* at 80496.

<sup>22</sup> *Id.* at 80496 (emphasis added) (quoting then-Commissioner Allison Herren Lee, “Diversity Matters, Disclosure Works, and the SEC Can Do More,” (Sept. 22, 2020), available at <https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922>).

<sup>23</sup> See Sorkin, Andrew Ross et al., “Nasdaq Pushes for Diversity in the Boardroom,” NY Times Dealbook (Dec. 1, 2020), available at <https://www.nytimes.com/2020/12/01/business/dealbook/nasdaq-diversity-boards.html>.

<sup>24</sup> Data calculated using the dataset available at [https://site.warrington.ufl.edu/ritter/files/IPOALL\\_2020.xlsx](https://site.warrington.ufl.edu/ritter/files/IPOALL_2020.xlsx).

was an annual average of around 7,200 total public corporations.<sup>25</sup> The last decade saw 40% fewer, at about 4,300 public corporations annually on average.<sup>26</sup>

Finally, we are concerned that NASDAQ has not undertaken a serious effort to quantify their proposal's costs and benefits. Instead, NASDAQ claims that their proposal may help a company's performance or, at worst, would not hurt it. Cost benefit analysis is a hallmark of good regulatory governance, and NASDAQ's scant analysis is no substitute for the analysis needed for the SEC to evaluate this proposed rule.

In light of this, we urge the Commission to reject the proposed rule or alternatively for NASDAQ to withdraw the proposed rule. As NASDAQ's filing noted, NASDAQ did not solicit comments on the proposed rule from members, participants, or others. It is clear that NASDAQ would have greatly benefitted from public input prior to submitting this proposed rule to the SEC. While we think America's corporations benefit from boards that avoid groupthink and offer a diversity of perspectives and commend firms that look to increase diversity among their boards, we do not think NASDAQ should be using its quasi-regulatory authority to impose social policies. Thank you for your consideration.

Sincerely,



Pat Toomey  
U.S. Senator



Richard Shelby  
U.S. Senator



Mike Crapo  
U.S. Senator



Tim Scott  
U.S. Senator



M. Michael Rounds  
U.S. Senator



Thom Tillis  
U.S. Senator

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<sup>25</sup> Data calculated using the dataset available at <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?end=1999&locations=US&start=1990>.

<sup>26</sup> *Id.*

John Kennedy  
U.S. Senator

Bill Hagerty  
U.S. Senator

Cynthia Lummis  
U.S. Senator

Jerry Moran  
U.S. Senator

Kevin Cramer  
U.S. Senator

Steve Daines  
U.S. Senator

cc: The Honorable Hester M. Peirce, Commissioner  
The Honorable Elad L. Roisman, Commissioner  
The Honorable Caroline A. Crenshaw, Commissioner  
Christian Sabella, Acting Director, Division of Trading and Markets  
Adena T. Friedman, President and Chief Executive Officer, Nasdaq