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Investors Want and Need Disclosures About the Diversity of Corporate Boards

May 7, 2024

The Issue. An SEC decision to require companies to disclose information about the diversity of their boards is under attack in the Fifth Circuit. On May 6, 2024, Better Markets filed an amicus brief in strong support of the required disclosures. If the court gets it wrong and rules against the SEC, investors will be deprived of information about board diversity they want and need as they decide where to invest their money. More broadly, an adverse decision will also limit the SEC's authority to require other kinds of disclosures that matter to investors. The case is *Alliance for Fair Board Recruitment v. SEC*, No. 21-60626.

Background. Nasdaq, a major stock exchange, issued a rule requiring companies that list on the exchange to disclose information regarding the diversity of their boards of directors. It also requires that listed companies either have at least two directors who qualify as "diverse," as defined in the Rule, or disclose, in whatever detail they choose, why they do not have at least two such directors. The SEC approved the rule after finding that a broad array of investors said they wanted such information to help them make investment and proxy voting decisions. The lawsuit followed.

The Court Case. A three-judge panel of the Fifth Circuit initially rejected the challenge and upheld the SEC's approval of the rule in October 2023. However, in February 2024, the Fifth Circuit vacated that decision and agreed to rehear the case "en banc," i.e., by all of the active judges sitting on the Fifth Circuit.

The Key Arguments. The rule is important because investors want to know about board diversity. Some evidence indicates that diverse boards are less likely to engage in business strategies that are risky and lead to financial crises. Other evidence shows that companies with diverse boards perform better financially. While the evidence isn't conclusive, it's clear that investors want board diversity information so they can decide for themselves how to weigh these corporate attributes as they make their investment decisions.

The challengers argue that the SEC lacked the authority to approve the rule because the rule furthers certain social policy goals rather than provides investors with material information that bears strictly on financial performance. But that misstates the law and the facts. The SEC has broad authority to require the disclosure of information that helps investors make investment decisions and vote their proxies, and that is what the Rule does. It only requires disclosures about existing boards; it does not require that any company change the composition of its board.

The challengers also argue that the rule compels speech in violation of the First Amendment. This argument is also wrong on the law, and it threatens the foundation of securities regulation in the United States, which is based on disclosure.

Finally, the challengers argue that the SEC did not find that the benefits of the rule outweigh the costs. But the SEC is not required to conduct a cost-benefit analysis. And even if a cost-benefit analysis were required, the SEC found that the rule provided substantial benefits to investors in the form of reliable and comparable information about board diversity.

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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