Shareholder Votes and Proxy Advisors: Evidence from Say on Pay

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Abstract:

We investigate the effect of proxy advisors' recommendations on shareholder votes, stock prices and firm behavior in the context of mandatory "say on pay" votes, a novel and complex item requiring significant firm-specific analysis. Proxy advisors are more likely to issue an *Against* recommendation at firms with poor performance and higher levels of CEO pay, but rather than following a "one-size-fits-all" approach, they take into account firm-specific circumstances. Proxy advisors' recommendations are the key determinant of voting outcome but the sensitivity of shareholder votes to these recommendations varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics. We document a small but significantly negative market reaction to the release of negative recommendations. More than one third of the firms receiving a negative recommendation publicly question the proxy advisors' methodologies, but this protest has no effect on the recommendation and the voting outcome. Our findings contribute to the literature on shareholder voting and the related policy debate.

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1. Introduction

Over the last decade, non-binding shareholder votes have increasingly affected boards' decisions on governance, executive pay and CEO turnover (e.g. Del Guercio, Seery and Woidtke, 2008; Cai, Garner and Walkling, 2009; Ertimur, Ferri and Muslu, 2011; Ferri and Maber, 2011). While the valuation consequences of this influence are the subject of ongoing debate,[1] this trend calls for a better understanding of the drivers of shareholder votes. Prior studies document a strong association between proxy advisors' recommendations and voting outcomes (e.g. Cai et al., 2009). However, little is known about the analyses underlying these recommendations, how they differ across proxy advisors, whether they reflect a "one-size-fits-all" approach (to minimize proxy advisors' costs) or take into account firm-specific characteristics. Moreover, there is little evidence on the value relevance to investors of these recommendations, their influence on firms' behavior, as well as the nature and determinants of their association with shareholder votes (e.g. causation versus mere correlation).

To shed light on these questions, we examine the analyses that the two most influential proxy advisors, Institutional Shareholder Services (ISS) and Glass Lewis & Co. (GL), performed to arrive at voting recommendations for "say on pay" (SOP), the non-binding vote on executive pay mandated by the Dodd-Frank Act starting in 2011.[2] We then investigate the effect of these recommendations on shareholder votes, stock prices and firm behavior.

[1] Researchers have been debating the costs and benefits of greater shareholder involvement in corporate governance (e.g. Bebchuk, 2005; Bainbridge, 2006; Kahan and Rock, 2011) with empirical studies yielding mixed findings (Listokin, 2009; Becker, Bergstresser and Subramaniam, 2010; Cai and Walkling, 2011; Ferri and Maber, 2011; Cuñat, Gine and Guadalupe, Forthcoming; Larcker, Ormazabal and Taylor, 2011; Cohn, Gillan and Hartzell, 2011). Other studies have focused on strategic vote trading, empty voting and various concerns with the proxy voting process (e.g. Hu and Black 2007; Christoffersen, Geczy, Musto and Reed, 2007; Bethel, Hu and Wang, 2009; Aggarwal, Saffi and Sturgess, 2011; SEC, 2010). See Ferri (Forthcoming) for a review.

[2] Proxy advisors provide proxy-voting services to institutional investors on a subscription basis, including voting recommendations and reports detailing the analysis underlying these recommendations. ISS, founded in 1985, is the dominant player in the market for proxy advisory services. GL founded in 2003, is regarded as the most influential

The highly firm-specific, complex and inherently subjective nature of executive pay makes SOP a powerful setting to investigate these questions. This is in contrast to other settings (e.g. shareholder proposals, director elections) where proxy advisors often adopt policy guidelines by topic (e.g. in favor of declassifying the board, against directors who sit on more than six boards) with little room for firm-specific considerations.

We begin by analyzing the SOP-related portion of 1,275 proxy reports issued by ISS and GL for S&P 1500 firms in 2011. Both advisors provide a quantitative and qualitative analysis of the executive pay plan, structured around certain categories (e.g. pay for performance, disclosures), assign a rating for each category and issue a final voting recommendation (*For* or *Against*). ISS issued *Against* recommendations at 11.3% of the firms and GL at 21.7%, suggesting a more aggressive stance by GL. Concerns with the "pay for performance" category are the most frequently stated reason for an *Against* recommendation. Consistent with this, multivariate analysis shows that both proxy advisors are significantly more likely to issue an *Against* at firms with poor performance and higher levels of CEO pay.[3] Interestingly, firms receiving an *Against* from ISS are not a subset of those receiving an *Against* from GL. On the contrary, among firms with questionable executive compensation practices (i.e. firms with an *Against* from at least one proxy advisor), ISS and GL agree only 17.9% of the time (with a higher rate of agreement for poorly performing firms). These firms tend to have the strongest disconnect between pay and

competitor and the only other proxy advisor with a significant influence on voting outcomes (Choi, Fisch and Kahan, 2010). Concerns with lack of accountability and transparency, limited competition and potential conflicts of interest have led to calls for greater regulatory oversight of proxy advisors (SEC, 2010). For a more detailed discussion, see Choi, Fisch and Kahan (2009) and Gordon (2009).

[3] In terms of economic significance, the likelihood of an ISS (GL) *Against* recommendation increases from 1.5% (2.7%) at a firm in the top quartile of stock performance and bottom quartile in level of and growth in CEO total pay, to 53.5% (71.0%) at a firm in the bottom quartile of stock performance and top quartile in terms of level of and growth in CEO total pay (while keeping all other variables at their median).

performance. The limited rate of agreement suggests that the complex nature of SOP has allowed proxy advisors to differentiate themselves from each other.

Importantly, we do not find evidence of a "one-size-fits all" approach, where the presence of certain compensation features or a weak historical link between pay and performance automatically translate into negative ratings and recommendations. In numerous cases, instead, firms with similar controversial provisions receive different ratings or recommendations because proxy advisors take into account mitigating firm-specific circumstances, the severity of the issue, the rationale provided by the firm and the quality of other aspects of the compensation plan. Hence, at least with respect to SOP, critics' concerns that proxy advisors promote "one-size-fits-all" practices to reduce their costs (e.g. Gordon, 2009) seem largely over-stated.

We then turn our attention to the association between the SOP-related content in proxy advisors' reports and shareholder votes. Compensation plans are voted down only at 2% of the sample firms. However, votes against the plan exceed 20%, a threshold viewed as an indication of substantial dissatisfaction (e.g. Del Guercio et al., 2008), at more than 15% of the firms. As in other studies on shareholder voting, proxy advisors' recommendations are the key determinant of voting outcome. A negative recommendation from ISS (GL) is associated with 24.7% (12.9%) more votes against the compensation plan, and the explanatory power of the voting outcome model increases from 20.9% to 66.2% (43.8%). When both recommend *Against*, voting dissent is higher by 38.3%. The influence of each advisor declines only slightly when controlling for the recommendation issued by the other, suggesting that ISS's and GL's recommendations capture different factors and/or appeal to different sets of investors. While our estimate for ISS influence is in line with prior studies,[4] the estimate for GL is higher (e.g. ~3% in Choi et al., 2010). This

[4] For example, the effect of ISS's recommendations has been estimated at 14-21% for management proposals (Bethel and Gillan 2002), between 13% and 30% for director elections, depending on the context and time period (Cai et al.,

suggests that mandatory say on pay, by requiring costly analyses of thousands of different compensation plans, has caused more investors to rely on proxy advisors, thereby increasing their influence (as predicted by Gordon, 2009). However, it may have done so by spurring more competition, giving investors with different preferences greater choice in making voting decisions.

In using the word "influence," we implicitly assume that voting shareholders rely on the information in the reports or, in the most extreme case, blindly follow the recommendations. However, whether proxy advisors' recommendations influence shareholder votes, aggregate shareholder preferences, or simply coincide with them is an open question (Choi et al. 2010) that perhaps cannot be fully answered (e.g., ISS develops its voting guidelines in consultation with its institutional investor clientele). To shed some light on this question, we exploit the variation in the association between *Against* recommendations and shareholder votes. First, we predict and find that this association is stronger for shareholders with lower holdings, and, thus, lower incentives to perform their own independent research (more cost-effective to outsource voting decisions to proxy advisors). In particular, an ISS *Against* recommendation, on average, is associated with a vote against by 34.4% of the institutional non-blockholders, versus 24.5% of the institutional blockholders. This spread also implies that, even if all institutional blockholders vote based on their own independent research, at least some of the association between proxy advisors' recommendations and shareholder votes is causal.[5]

Second, the association between shareholder votes and recommendations is higher in smaller and poorly performing firms, and when the proxy advisor identifies a problem in certain categories (e.g. pay for performance). This implies that at least some investors do not blindly

2009; Choi et al., 2010; Ertimur, Ferri and Maber, 2012), and 25% for compensation-related shareholder proposals (Ertimur et al. 2011). Also, Alexander, Chen, Seppi and Spatt (2010) find that an ISS recommendation in favor of the dissident in proxy contexts increases the likelihood of the dissident's victory by 14% (from 41% to 55%).

[5] Under certain assumptions discussed in Section 4.4, we estimate that at least one fourth of the documented association between ISS *Against* recommendations and shareholder votes is causal.

follow the recommendations but take into account the underlying rationale and other factors in deciding when to follow them. To summarize, we find that the sensitivity of shareholder votes to proxy advisors' *Against* recommendations varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics. Our results provide a nuanced view of the way investors use proxy advisors' analyses, consistent with recent practitioners' reports (Tapestry Networks, 2012) and in contrast to the "full causality" view implicitly or explicitly assumed in prior studies and underlying the policy debate (SEC, 2010).[6]

We next focus on the market reaction to the release of proxy advisors' SOP recommendations. As discussed earlier, because proxy advisor's voting policies are often known ahead of time, the incremental information their reports convey may be limited and the final recommendations largely anticipated. In contrast, in the case of SOP, a novel item on the ballot in 2011, the subjectivity involved in assessing complex executive pay plans arguably leads to greater uncertainty about proxy advisors' recommendations and analyses, making it a powerful setting for a market reaction test. Our analyses show small but significantly negative mean abnormal returns (-0.5% to -0.7%) around the release of ISS reports with a SOP-related *Against* recommendation, after controlling for other information in the reports and concurrent firm-specific news. The result is driven by the subset of firms where an *Against* recommendation was less expected (i.e., firms not targeted by compensation-related activism in the past).[7] Hence, it appears that ISS reports with negative SOP recommendations provided value-relevant information to investors.

[6] Even if proxy advisors' recommendations have no causal influence on shareholder votes, the evidence in this study remains important. If proxy advisors' recommendations simply coincide with shareholder preferences, their strong association with shareholder votes speaks to what compensation issues shareholders care about. If those recommendations aggregate shareholder views, it speaks to the ability of proxy advisors to synthesize shareholder preferences.

[7] The event study focuses on ISS's reports because we do not have the exact date of the release of GL's reports. For the same reason, the next analysis focuses on firms' responses to ISS's reports.

The firm-specific and subjective nature of executive pay also creates an opportunity for firms to respond to proxy advisors and defend their practices. This type of interaction between firms and proxy advisors is a relatively new phenomenon and likely to become more frequent as shareholder votes gain more influence. We find that 36% (52 of 144) of the firms with a negative SOP recommendation from ISS reacted by filing additional documents with the SEC before the annual meeting date. In these filings, 40 firms voiced their disagreement with ISS's rationale for its recommendation, usually criticizing some aspect of ISS's pay-for-performance evaluation. Multivariate analysis shows that larger firms and firms with more independent boards were more likely to publicly disagree with ISS, consistent with reputation concerns causing them to try to reverse negative ISS recommendations or reduce their impact on shareholder votes. However, these protests neither led to a change in recommendation nor resulted in lower voting dissent.

Our study contributes to the literature on shareholder voting, and in particular, on the role of proxy advisors. While a number of studies have documented a strong association between proxy advisors' recommendations and shareholder votes, this is the first study to examine the analyses underlying these recommendations and their influence on shareholder votes, in a setting where such analysis is especially complex and challenging.[8] In doing so, our study sheds some light on a number of questions of interest to academics and policy-makers, such as how recommendations and the underlying analyses differ across proxy advisors (thereby speaking to the degree of competition in the industry), whether they reflect a "one-size-fits-all" approach or take into account firm-specific characteristics and the extent to which they 'cause' shareholder votes. It is also the first study to document the stock price reaction to the release of proxy advisors' "routine"

[8] In a concurrent paper, Larcker McCall and Ormazabal (2012) also examine the role of proxy advisors with respect to SOP votes. The focus of their paper is the market reaction to compensation changes firms make in anticipation of proxy advisors' recommendations. Our study differs from Larcker et al. (2012) in that they do not examine the analyses underlying the recommendations, the determinants of the association between recommendations and shareholder votes, the market reaction to the release of the proxy advisors' reports and firms' responses to the reports.

reports ahead of the annual meeting, and the firms' responses to proxy advisors' recommendations.[9] An important caveat is that our analyses do not (nor do they intend to) speak to the optimality of these recommendations. While we show that these recommendations (i) are not suggestive of a one-size-fits-all approach, but rather take into account firm-specific aspects of compensation plans, and (ii) rationally reflect the underlying analyses in the reports (in the sense that greater weight is given to more serious concerns), our study does not determine whether the underlying analyses correctly identify sub-optimal practices and suggest superior remedies.

Our study also contributes to the literature on SOP, which has focused on the stock price reaction around legislative events in the US and the UK and the compensation changes in response to SOP votes in the UK (e.g. Cai and Walkling 2011; Ferri and Maber 2011).[10] In contrast, we shed light on the compensation preferences of shareholders as revealed through SOP votes. In doing so, we add to the broader literature on executive pay, complementing previous studies of compensation-related shareholder votes on director elections (Cai et al. 2009), shareholder proposals (Ertimur et al., 2011) and management proposals (Morgan and Poulsen, 2001).

2. Proxy advisors' analysis of say on pay

Our sample includes S&P 1500 firms with annual meetings between January and November 2011 for which we are able to obtain voting data and the proxy reports issued by ISS

[9] In the context of proxy contests, Alexander et al. (2010) document a positive stock price reaction to ISS recommendations in favor of the dissident and attribute this finding to both a revision in probability beliefs about who will win the proxy contest and new information about the value that a victorious dissident would bring to the firm. Larcker, McCall and Ormazabal (2011) show that firms that structure employees' stock option exchanges around ISS and GL recommendations experience lower market reaction at the announcement of the transaction, and subsequently, lower operating performance and higher executive turnover, casting doubts on the quality of these recommendations.

[10] While it is early to assess the economic consequences of SOP votes in the US, there is anecdotal evidence that some firms changed compensation practices (e.g. by removing excise tax gross-ups) in anticipation of and in response to mandatory SOP votes (The Conference Board, 2011; Lublin, 2012; Larcker et al., 2012; Thomas, Palmiter and Cotter, 2012).

and GL, resulting in 1,275 firms. In this section we examine the SOP-related content of these reports, based on data we hand collected and manually coded.

2.1 Proxy advisors' reports on say on pay

Both ISS and GL start the SOP portion of the reports with a summary of quantitative and qualitative information from the proxy statement. ISS continues with an analysis of the compensation plan along five dimensions: *Pay for Performance* (alignment of CEO's pay with performance over time), *Peer Group* (choice of peers and targets used for benchmarking purposes), *Non-Performance Pay* (non-performance-based pay elements, such as perks and pensions), *Severance* (severance and change-in-control arrangements) and *Communication* (quality of disclosures and compensation committee's past responsiveness to shareholders). For each category, ISS concludes the analysis with an overall rating: *High*, *Medium* or *Low Concern.* Appendix 1 provides the distribution of the ratings by category and examples of *High Concern* in each category.

GL structures their analysis of the compensation plan around three dimensions: *Pay for Performance* (alignment of executive pay with performance over time), *Structure* (design of compensation plan) and *Disclosure* (adequacy of pay disclosures). The analysis concludes with a rating (*Poor, Fair* or *Good*) for *Structure* and *Disclosure*, and a grade (*A*, *B*, *C*, *D* or *F*, with *F* being the worst) for *Pay for Performance*. In the analyses to follow, for comparison purposes, we treat a *Poor* rating *in Structure* or *Disclosure* and a *D* or *F* grade in *Pay for Performance* as equivalent to a *High Concern* in the ISS classification. Appendix 2 reports the distribution of the GL ratings by category, followed by examples of the lowest ratings in each category.

Both ISS and GL reports conclude with a summary, including the SOP recommendation (*For* or *Against*) and its rationale. As shown in Table 1, GL issued an *Against* recommendation at

21.7% of the sample firms, versus 11.3% for ISS, consistent with prior evidence of GL being more aggressive in its recommendations.[11] The difference is even more pronounced in terms of ratings. GL assigns at least one "high concern" at 40.5% of the rated sample firms (465 out of 1,148), versus 11.2% (142 out of 1,273) for ISS. For both proxy advisors, concerns with *Pay for Performance* are the most frequent reason for *Against* recommendations.

Table 1 also provides insights as to how the two advisors translate the categories' ratings into a final recommendation. First, both ISS and GL almost never give an *Against* recommendation for firms without a *High Concern* in one of the categories. Second, while ISS issues an *Against* recommendation for all firms with a *High Concern* rating in one of the categories, GL issues an *Against* recommendation for only 41.1% (146 of 355) of the firms with a *Single High Concern*. That is, assigning a *High Concern* rating and issuing an *Against* recommendation is essentially a joint decision for ISS, but constitutes separate decisions for GL (except in the case of firms with *Multiple High Concern*, which almost always receive an *Against* recommendation—106 of 110).

2.2 Differences between ISS and GL

Given the concerns with limited competition in the proxy advisors' industry (Choi et al. 2010), it is important to examine to what extent ISS and GL differ in their recommendations and analyses. Table 2, Panel A, shows that ISS and GL agree (i.e. issue the same recommendation) in 77% of the cases. This figure is misleading though, in that most of the agreement (72%) comes from the *For* cases, with both GL and ISS recommending *Against* only in 5% of the cases. Within the subset of 'controversial' cases (firms with an *Against* from either proxy advisor, an indication of concerns with the compensation plan), GL and ISS agree on which firms warrant an *Against*

[11] Choi et al. (2010) report that GL issued withhold recommendations for 18.8% of directors up for election in 2005 and 2006, versus 6.6% for ISS. Part of the reason for ISS's lower propensity to issue negative recommendation may be its greater engagement with firms throughout the year, as well as its consulting on governance and compensation issues (through the ISS Corporate Services division). In other words, some firms, aware of ISS's recommended best practices, may adjust their compensation plans accordingly and avoid a negative recommendation.

recommendation only 17.9% of the time. The top portion of Panel B shows a similar pattern in the *Pay for Performance* category.[12] More strikingly, when we cross-tabulate the distribution of all ratings in the pay-for-performance categories (bottom portion of Panel B), we see that only 20 firms receive the lowest rating from both advisors (*F* from GL, *High Concern* from ISS). There are more (27) cases where ISS strongly disagrees with GL (*F* or *D* from GL and *Low Concern* from ISS).

These differences are partly due to the methodologies employed by ISS and GL in assessing *Pay for Performance*. ISS's stated goal is to "evaluate the alignment of CEO's pay with performance over time, *focusing particularly on firms that have underperformed their peers over a sustained period*" (ISS 2011a, emphasis added).[13] GL's proprietary methodology essentially measures the "gap" between relative pay and relative performance, using multiple performance metrics and peer groups as a benchmark (see Appendix 3). Firms are then graded on a forced curve, with firms in the top 10% of the "gap" distribution receiving an *F*. Hence while ISS tends to focus on firms with poor performance, GL's approach may identify a "pay-performance" gap even at well-performing firms, explaining GL's higher frequency of negative ratings and recommendations (Table 1) as well as the low rate of agreement documented in Panels A and B.[14]

This difference is evident in Panels C and D, which show the frequency of poor *Pay for Performance* ratings and negative recommendations by quartiles of total CEO pay and one-year

[12] We focus on the *Pay for Performance* category because it is the main driver of recommendations for both proxy advisors (see Table 1) and the only category where we can compare ISS and GL, whilst recognizing that GL discusses under *Structure* many items (e.g. discretionary elements of pay) that ISS assesses under *Pay for Performance*.

[13] ISS typically starts by analyzing the firm's one- and three-year stock returns relative to its industry peers (based on four-digit GICS codes) and the change in CEO pay from the prior year. When there is a misalignment (e.g. CEO pay increases at a time of sustained underperformance), ISS further examines the level of CEO pay relative to peers, the sources of CEO pay increases, the extent to which the pay increases are performance-based or discretionary, performance conditions, the quality of the related disclosures, and so on (see Appendix 1 for examples).

[14] In fact, untabulated analyses shows that in a subsample of poorly performing firms (below-median stock returns), the relative frequency of GL to ISS *Against* recommendations is lower (1.6 times: 24.5% versus 15.3%) than in the full sample (1.9 times: 21.7% versus 11.3%, see Table 1) and the rate of agreement in poor pay-for-performance ratings is higher (at 23.2%) than in the full sample (15.5%; Table 2, Panel B).

raw returns. Both ISS and GL single out firms with low performance and high CEO pay. But ISS's ratings and recommendations are more sensitive to performance. For example, for the top quartile of CEO pay, the frequency of a poor rating from ISS increases 3.2 times (from 9.1% to 29.1%) as stock performance goes from the top to the bottom quartile, whereas for GL it only increases 1.6 times (from 34.9% to 55.8%).[15]

3. Determinants of proxy advisors' SOP recommendations

3.1 Determinants of the likelihood of SOP Against recommendations

To analyze the determinants of proxy advisors' SOP-related recommendations we estimate a logistic regression where the dependent variable, *ISS (GL) Against*, is an indicator variable equal to one if ISS (GL) recommends *Against*. Based on the evidence in Section 2, we predict that proxy advisors are more likely to issue negative recommendations at firms with a perceived disconnect between pay and performance. As proxies for compensation-related concerns, we include *CEO Total Pay* and *Growth in CEO Total Pay*, respectively, the level and growth of CEO total direct pay, as well as an indicator variable (*Past Compensation Activism*) equal to one if the firm was targeted by a compensation-related shareholder proposal that received at least 20% votes in favor in the prior fiscal year (Ertimur et al. 2011). As measures of performance, we use *Abnormal Returns* and *Return on Assets*. To capture firm characteristics that may affect proxy advisors' decisions, we also control for size (ln(*MV Equity*)) and ownership structure (the percentage of votes controlled by institutional investors and by insiders, proxied for, respectively, by *% Institutional Ownership* and *% Insider Ownership*). Finally, we include an indicator variable (*Prior SOP Vote*) equal to one if the firm already had a SOP vote in the past, on the ground that

[15] A similar pattern emerges if we use growth in, rather than level of, CEO pay, or if we use industry-adjusted returns (based on two- and three-digit SIC codes) rather than raw returns.

compensation-related concerns at these firms may have already been addressed.[16] See the notes to Table 3 for detailed variable definitions.

Table 3, Panel A, Models (1) and (3) presents the results. Consistent with our predictions, firms with a higher level of and growth in CEO pay, higher compensation-related activism in the past and lower stock performance are more likely to receive an *Against* recommendation.[17] Operating performance only matters for GL, consistent with their pay for performance methodology which focuses on return on assets in addition to stock performance (see Appendix 3).

To gain more insights into the effect of CEO pay and firm performance on proxy advisors' recommendations, in Models (2) and (4), we split *CEO Total Pay*, *Growth in CEO Total Pay* and *Abnormal Returns* into four groups each, based on the quartiles of their respective distributions. For example, we replace *CEO Total Pay* with *CEO Total Pay Q4*, *CEO Total Pay Q3* and *CEO Total Pay Q2* (with the intercept capturing the lowest quartile). Three main results emerge. First, the likelihood of *Against* recommendations increases as the CEO pay level increases (the coefficient of *CEO Total Pay Q4* and *CEO Total Pay Q3*, respectively, are significantly larger than the coefficients of *CEO Total Pay Q3* and *CEO Total Pay Q2*, in both Models (2) and (4), unreported tests). Second, consistent with our discussion in Section 2, the results also highlight ISS's prevalent focus on poorly performing firms (in Model (2) only the coefficient of *Abnormal Returns Q1* is significant), while GL's methodology tends to identify pay for performance disconnects at various levels of pay and performance (in Model (4) the coefficients of both

[16] 3.6% of the firms in our sample had a SOP vote in 2010 because it was required as a condition to receive TARP funds and 2.2% because they voluntarily adopted SOP. The exclusion of these firms from the analyses reported in this study does not affect the findings.

[17] The results are similar when we replace the CEO pay variables with their averages over the previous three years or with the corresponding figures for the top five executives. When, following Core, Guay and Larcker (2008), we split CEO total pay into an expected component based on standard economic determinants and a residual portion (proxy for "excess" pay), the coefficients of both variables are positive and significant, both for ISS and for GL. Finally, we add to Models (1) and (3) the ratio of CEO pay to the pay of the top five executives, a proxy for CEO centrality, often viewed as a symptom of poor governance and excess CEO power (Bebchuk, Cremers and Peyer 2011). The coefficient of this additional variable is not significant, while the coefficient of *CEO Total Pay* remains positive and significant.

Abnormal Returns Q1 and *Abnormal Returns Q2* are significant). Finally, the top quartiles of *Growth in CEO Total Pay* are relevant only for ISS, consistent with its emphasis on *increases* in CEO pay at a time of poor performance (the methodology used by GL is based on relative *levels* of pay, see Appendix 3).

In terms of economic significance, the likelihood of an ISS (GL) *Against* recommendation increases from 1.5% (2.7%) at a firm in the top quartile of stock performance and bottom quartile in level of and growth in CEO total pay, to 53.5% (71.0%) at a firm in the bottom quartile of stock performance and top quartile in terms of level of and growth in CEO total pay (while keeping all other variables at their median).

As for the other control variables, *Against* recommendations are less likely for larger firms (except in Model (2)), perhaps because these firms are more concerned about the reputation effects of an adverse vote and, thus, take greater care in adopting pay practices endorsed by proxy advisors; or because these firms are already subject to other forms of compensation-related scrutiny and, thus, less likely to have controversial pay practices (Ertimur et al. 2011). An *Against* recommendation is also more likely for firms with higher insider ownership (except in Model (3)), even though this will result in lower voting support for the recommendation (insiders presumably will vote in favor of the compensation plan), suggesting that higher insider ownership may be a proxy for entrenchment and, thus, magnify compensation-related concerns.[18]

In Models (5) and (6) we estimate a logistic regression where the dependent variable, *Both Against*, is an indicator equal to one if both ISS and GL recommend *Against*, and equal to zero if only ISS or only GL recommends *Against*. In other words, we examine whether and how firms

[18] In additional tests, we include three measures of governance quality (entrenchment index, percentage of independent directors and dual CEO-chairman indicator) and none of them is significant, suggesting that traditional governance measures do not affect the recommendations. We exclude these variables from the reported models for parsimony and because their inclusion reduces the sample size.

targeted by both proxy advisors differ from those targeted by only one of them. The results suggest that proxy advisors agree on the most extreme cases of disconnect between pay and performance: firms in the bottom quartile of stock performance and with above-median levels of CEO pay are more likely to be targeted by both advisors. None of the other variables are significant.

3.2 Do proxy advisors employ a one-size-fits all approach to executive pay?

Proxy advisors are often criticized for employing a "one-size-fits-all" approach, as a means to avoid the cost of firm-specific analyses (Gordon, 2009). This concern is especially relevant for SOP, which requires the analysis of thousands of complex and idiosyncratic compensation plans. Did proxy advisors mechanically map raw compensation data into SOP-related ratings and recommendations? The ideal approach to fully answer this question is to hand-collect and code all compensation elements discussed in proxy statements for the entire sample, which is a prohibitively costly task. Instead, we exploit our access to the proxy advisors' analysis of compensation plans disclosed in their reports to take a step towards addressing this question.

As documented in Table 1, for ISS, a *High Concern* rating in any category translates into a negative SOP recommendation. While this mapping does appear to be mechanical, our careful reading of numerous ISS reports reveals that the actual assignment of the ratings is by no means mechanical. Specifically, many "triggers" typically associated with an ISS *High Concern* in a given category (e.g. poor performance coupled with a CEO pay increase; see Appendix 1) are also present in firms rated as *Medium Concern* in that category. For these cases, in choosing the rating (and, thus, the recommendation), it appears that ISS also takes into account mitigating firm-specific circumstances, the severity of the issue, the rationale provided by the firm and the overall quality of the rest of the compensation plan. Appendix 4 provides an illustrative example of a firm with poor returns and an increase in CEO pay in 2010, where ISS rates *Pay for Performance* as

Medium Concern because of recent improvements in the compensation plan and a previous history of good alignment between pay and performance.

Similarly, many controversial features giving rise to a GL *Poor* rating in *Structure* or *Disclosure* (see Appendix 2) are also present in firms with a *Fair* rating in those categories. That GL does not apply a one-to-one correspondence between *High Concern* ratings and *Against* recommendations (see Table 1) allows us to also examine how GL ratings map into the final recommendation. Finding that certain combinations of ratings affect the likelihood of a given recommendation (but do not imply such recommendation) would provide additional evidence against the claim that proxy advisors adopt a one-size-fits-all approach. We first estimate a benchmark model, which extends Model (4) from Table 3 Panel A, to examine the relation between the likelihood of a GL *Against* recommendation and the ratings for the categories, suppressing the other variables for ease of exposition. The results reported in Panel B, Model (1) show that a poor rating in any category is associated with a significantly higher likelihood of a GL *Against* recommendation, with *Pay for Performance* being the most serious concern (particularly an *F* grade), followed by *Structure* and then *Disclosure*.[19,20]

Next, we examine how *combinations* of ratings map into the final recommendation. In theory, there are 45 different potential combinations (3 possible ratings for *Structure*, 3 possible ratings for *Disclosure* and 5 possible grades for *Pay for Performance*). Naturally, however, for some combinations there is no variation in the dependent variable. For example, all firms with a grade *A* or *B* in *Pay for Performance* and a *Fair* or *Good* rating in *Structure* and *Disclosure* receive

[19] The differences between all pairs of coefficients are significant at the 1% level (unreported tests), except the difference between *Pay for Performance (PfP) Grade C* and *Disclosure Poor*.

[20] Implicitly, these results also imply that a poor rating does not automatically translate into an *Against* recommendation (else, the variable would be dropped from the regression).

a *For* recommendation. Similarly, with one exception (see Table 1),[21] all firms with a grade *F* in *Pay for Performance* receive an *Against* recommendation, regardless of the rating on the other categories. Thus, in Model (2) we present a parsimonious model capturing the most interesting combinations within grades *D* and *C*. In particular, we split grades *D* and *C* each into two depending on whether the firm receives a *Poor* rating in *Structure* and/or *Disclosure*, or a non-poor (*Fair* or *Good*) rating in both *Structure* and *Disclosure*.

The results indicate that the combination of ratings plays an important role in the recommendations. A grade *D* in *Pay for Performance* has a greater effect on the likelihood of an *Against* recommendation when combined with a Poor in *Structure* and/or *Disclosure* than when combined with a non-Poor rating in both (the difference is significant at the 1% level, unreported). A *C* grade increases the likelihood of an *Against* recommendation only when combined with a Poor in *Structure* and/or *Disclosure*. Finally, regardless of the rating in other categories, a *D* grade has always a stronger effect than a *C* grade.[22]

In Model (3), we take the analysis one step further, by examining whether the firm's past history in terms of *Pay for Performance* grades (included in the GL reports) affects the effect of current *Pay for Performance* grades (in particular, we focus on grade *D*). We find that a poor *Pay for Performance* grade in the past does not matter when a grade *D* is associated with a *Poor* in *Structure* and/or *Disclosure*, but it does matter when it is associated with a *Fair* or *Good* in *Structure* and *Disclosure* (the difference between the last two coefficients in the table is significant at the 1% level, unreported test).

[21] This interesting exception (Methode Electronics) is reported in Appendix 5. GL took into account the multiyear and performance-based nature of the large equity grant that led the firm to receive an *F*, as well as the firm's past use of challenging performance-conditions and the recent removal of other controversial pay practices.

[22] The coefficients of *PfP Grade D—Structure and/or Disclosure Poor* and *PfP Grade D—Structure and Disclosure Fair/Good* are significantly larger than the coefficient of *PfP Grade C—Structure and/or Disclosure Poor* at the 1% level (unreported).

In summary, the above analyses suggest that, with respect to SOP, critics' concerns with the use of a "one-size-fits-all" approach by proxy advisors are largely over-stated. While the methodology used to identify cases of potential pay for performance misalignments may be simplistic, proxy advisors seem to analyze those cases in great detail and take into account a variety of firm-specific elements. These elements influence the assignment of category ratings (ISS and GL) and the mapping of category ratings to recommendations (GL). If anything, a greater concern may be the subjectivity involved in these assessments.

4. Economic consequences of proxy advisors' recommendations: shareholder votes on SOP

Sections 2 and 3 examine the process by which proxy advisors develop their SOP-recommendations. In this section, we shift our attention to the analysis of their economic consequences, starting with their influence on shareholder votes.

4.1 Distribution of SOP votes

Table 4 reports the distribution of voting outcome for SOP proposals. Mean (median) *SOP Voting Dissent*, defined as the number of votes cast against scaled by the sum of all votes cast (for, against and abstention votes), is 9.6% (4.6%).[23] At most firms the vast majority of shareholders approve the compensation plan (dissent is less than 10% at 70.9% of the firms). At the same time, 196 firms (15.4% of the sample) experience dissent above 20%, a threshold viewed as an indication of substantial dissatisfaction (e.g. Del Guercio et al. 2008; Schulte, Roth and Zabel 2011), with the compensation plan voted down (i.e., dissent above 50%) at 24 firms (1.9% of the sample). This pattern is similar to the first SOP proxy season in the UK (Ferri and Maber 2011).

Table 4 also shows the distribution of voting dissent by type of recommendation. Mean (median) dissent when ISS recommends *Against* is 34.9% (34.5%), versus 6.4% (4.1%) in the

[23] Mean and median voting turnout is about 80%, consistent with other studies (e.g. Ferri and Sandino, 2009).

presence of a *For* recommendation. When a firm receives a *For* recommendation from ISS, the compensation plan is never voted down (i.e. dissent is never >50%). Mean (median) dissent when GL recommends *Against* is 23.2% (18.8%), versus 5.9% (3.5%) in the presence of a *For* recommendation. These univariate comparisons confirm in the SOP setting the strong association between proxy advisors' recommendations and shareholder votes documented in prior studies (e.g. Cai et al., 2009; Alexander et al. 2010; Choi et al., 2010; Ertimur et al. 2011, 2012).

4.2 Determinants of SOP votes - Multivariate analysis

Following prior studies on compensation-related activism (e.g., Ertimur et al., 2011) and shareholder voting (e.g. Gillan and Starks, 2000; Ertimur, Ferri, and Stubben, 2010), we estimate an ordinary least squares (OLS) regression where the dependent variable, *SOP Voting Dissent*, is the number of votes cast against the compensation plan (scaled by all votes cast, including abstention votes),[24] and independent variables include proxies for CEO pay, firm performance, size and ownership structure (*CEO Total Pay*, *Growth in CEO Total Pay*, *Abnormal Returns*, *Return on Assets*, ln(*MV Equity*), *% Institutional Ownership* and *% Insider Ownership*). As in Table 3, we capture shareholders' past concerns with pay practices with an indicator variable (*Past Compensation Activism*) equal to one if the firm was targeted by a compensation-related shareholder proposal that received at least 20% votes in favor in the prior fiscal year (Ertimur et al. 2011), and we also control for whether the firm had a SOP vote in the past (indicator *Prior SOP Vote*).

Table 5, Panel A, Model (1) shows the results for this benchmark model. As expected, voting dissent is higher in firms with a higher level of and growth in CEO pay, in firms targeted by

[24] The results are robust to excluding abstention votes (only 1.4% of the votes cast) from the denominator and to including them in the numerator and the denominator (i.e., treating them as expression of dissent)—the correlations among these alternative definitions are greater than 0.98. Also, we obtain similar findings when we use the logit transformation of *SOP Voting Dissent*, log [(*SOP Voting Dissent* / (1 - *SOP Voting Dissent*)], as in Bethel and Gillan (2002). For ease of interpretation we present the results using *SOP Voting Dissent* as the dependent variable.

Past Compensation Activism and in poorly performing firms, while it is slightly lower at firms with a *Prior SOP Vote* (i.e., firms that may have already addressed compensation concerns).[25] Similar to earlier studies (e.g. Ertimur et al. 2010), dissent is higher in smaller firms and firms with higher institutional ownership, and it is lower in firms with higher insider ownership, presumably because insiders vote their shares in favor of the compensation plan. In Model (2) we split *CEO Total Pay*, *Growth in CEO Total Pay* and *Abnormal Returns* into four groups each, based on the quartiles of their respective distributions. The results indicate a monotonic relation between voting dissent and level and growth of CEO pay, as well as between voting dissent and poor performance. In particular, voting dissent is higher by 12.3% (2.7%) for firms in the top quartile of CEO pay level (growth) and by 6.6% for firms in the bottom quartile of stock performance. Next, in Model (3), to capture extreme cases of pay-performance misalignment, we add two interaction terms for firms in the bottom quartile of *Abnormal Return* and the top quartile of *CEO Total Pay* and *Growth in CEO Total Pay.* The coefficient on the first interaction term is positive and significant and indicates an additional voting penalty of 6.4%. Overall, firms in the bottom quartile of *Abnormal Returns* and the top quartile of *CEO Total Pay* receive a voting penalty of 22.5% (4.9% + 11.2% + 6.4%).

4.3 The influence of proxy advisors' recommendations

The evidence in Table 4 suggests that proxy advisors' recommendations have a significant influence on SOP votes. Hence, in Table 5, Panel B, Models (1) and (2) we augment Model (3) of Panel A by adding, one at a time, indicator variables (*ISS Against*, *GL Against*) equal to one if ISS

[25] The results are similar when we replace the CEO pay variables with their averages over the previous three years or with the corresponding figures for the top five executives. When we include the ratio of CEO pay to the pay of the top five executives, the additional variable is not a significant determinant of the voting dissent. Finally, we split CEO total pay into an expected component based on standard economic determinants and a residual portion (proxy for "excess" pay). Both variables are positive and significant, suggesting that dissent is higher both at firms with excess CEO pay and those with high but economically justified levels of CEO pay.

or GL issue an *Against* recommendation for SOP. In Model (1) the coefficient of *ISS Against* is positive and significant at 0.268 and the R^2 is 65.7% (compared to 20.9% in Model (3) of Panel A). Similarly, in Model (2) the coefficient of *GL Against* is positive and significant at 0.153 and the R^2 is 43.8%. Next, in Model (3) we include both *ISS Against* and *GL Against*. The R^2 further increases to 82.3%. The increase in explanatory power is higher than in the context of director elections (from 11% to 19%; Choi et al. 2010), suggesting that proxy advisors have greater influence on issues like SOP, which require costly firm-specific analyses of a highly technical matter.

Notably, relative to Models (1) and (2), in Model (3) the coefficients of *ISS Against* and *GL Against* decrease only slightly to 0.248 and 0.129, respectively, consistent with the two proxy advisors' recommendations capturing different factors and/or appealing to two different sets of investors. The two coefficients are significantly different from each other (1% level, unreported). While the ~25% estimate for ISS influence is in line with the estimates of ISS influence in prior studies on shareholder votes (see footnote 3), the ~13% estimate for GL is well above the 3% reported by Choi et al. (2010) in the context of director elections for the 2005-2006 period and mentioned by practitioners (Nathan, Barral and Chung 2011). Hence, it appears that while mandatory SOP has not increased the influence of ISS (a concern expressed by critics of SOP legislation, e.g. Gordon, 2009), it may have increased the influence of proxy advisors overall, by spurring greater competition among them and resulting in greater choices for voting shareholders with different preferences and views over compensation practices.

To examine whether the concurrent presence of negative recommendations from both proxy advisors has an incremental impact, in Model (4), we replace the *ISS Against* and *GL Against* indicators with three indicators, denoting cases where only ISS, only GL, or both, issue an

Against recommendation. The coefficient of *Both ISS & GL Against* is positive and significant at 0.383. However, it is not statistically different from the sum of the coefficients on *Only ISS Against* (0.244) and *Only GL Against* (0.127) (unreported test). Hence, when both ISS and GL recommend *Against*, voting dissent reflects the sum of the votes cast by two different sets of institutional investors that ISS and GL appeal to. In other words, it does not appear that there is a third group of investors who only vote against on SOP when both advisors recommend against (even though many institutional investors are known to access reports from both proxy advisors).

As for the control variables (untabulated for ease of exposition), when *ISS Against* and *GL Against* are included, the significance of many of the coefficients of the *CEO Total Pay* and *Abnormal Returns* quartiles is reduced or eliminated. This is not surprising since pay-performance misalignment is an important driver of the recommendations (see Table 3, Panel A).

4.4 Is there a causal relation between proxy advisors' recommendations and shareholder votes?

Models (1)-(4) suggest a significant association between proxy advisors' recommendations and shareholder votes. As noted in the Introduction, whether proxy advisors' recommendations "cause" shareholder votes, aggregate shareholder preferences (e.g., ISS develops its voting guidelines in consultation with its institutional investor clientele), or simply coincide with them remains an open question (Choi et al. 2010).[26] We conjecture that these answers are not mutually exclusive, with some shareholders essentially outsourcing their voting decisions to proxy advisors and others independently gathering data and making informed voting decisions that simply coincide with proxy advisors' recommendations (and, perhaps, influence them). If this is the case, we would expect the association between proxy advisors' recommendations and shareholder votes

[26] If proxy advisors' recommendations only reflect rather than influence shareholder views, the stark increase in explanatory power documented earlier should be interpreted as a measure of proxy advisors' ability to synthesize shareholder preferences. If they simply coincide with shareholder views, the increase in explanatory power indicates that proxy advisors' recommendations are an excellent proxy for the factors shareholders consider when casting votes on SOP.

to differ across types of shareholders based on their incentives to gather and process information. A large body of research suggests that these incentives depend on the holdings, with "block" institutional holders (e.g. those holding more than 5% of the equity of a firm) investing more in costly monitoring activities (e.g. Cronqvist and Fahlenbrach, 2009; Agrawal and Nasser, 2012). More specifically, Schouten (2012) analyzes proprietary data from four large funds, and finds that they tend to deviate from proxy advisors' recommendations more often when they hold a large stake in the portfolio firm. Hence, in Model (5) we examine whether the association between proxy advisors' recommendations and shareholder votes differs between block and non-block institutional holders. In particular, from Model (3), we replace *ISS Against* with interaction terms between *ISS Against* and both *% Blockholder Ownership* and *% Non-Blockholder Ownership* (estimated as *% Institutional Ownership* minus *% Blockholder Ownership*).

The resulting coefficients imply that, of the 24.8% votes associated with an *ISS Against* in Model (3), 19.8% are from non-blockholders and the remaining 5.0% from blockholders.[27] Given that in our sample the mean non-blockholder (blockholder) ownership is 57.5% (20.4%), this means that an ISS *Against* recommendation, on average, is associated with a vote against by 34.4% (=19.8%/57.5%) of the non-blockholders and 24.5% (=5.0%/20.4%) of the blockholders (the corresponding figures for GL are 17.6% and 13.7%). Hence, as conjectured, proxy advisors' influence is stronger among institutional investors with lower incentives to do their own independent research.

[27] Following Choi et al. (2010), the estimate is obtained as follows: for a firm with *% Non-Blockholder Ownership* at the sample mean (57.5%), an *ISS Against* recommendation is associated with a 20.1% increase in voting dissent (the product of 57.5% and the coefficient of *ISS Against x % Non-Blockholder Ownership*, 34.9%). Similarly, for a firm with *% Blockholder Ownership* at the sample mean (20.4%), an *ISS Against* recommendation is associated with a 5.0% increase in voting dissent (the product of 20.4% and the coefficient of *ISS Against x % Blockholder Ownership*, 24.7%). Therefore, for an "average" firm, 79.9% (=20.1%/(20.1% +5.0%)) of the effect of ISS recommendations is due to non-blockholders. Hence, of the 24.8% votes associated with an *ISS Against* in Model (3), 19.8% (79.9% x 24.8%) are from non-blockholders, and the remaining 5.0% from blockholders.

The results in Table 5, Panel B enable us to provide a lower-bound estimate for the causal effect of ISS under a set of assumptions. Specifically, we assume that (i) *all* institutional block-holders perform their own research and cast their votes independently of ISS recommendations (a reasonable assumption given their significant holdings),[28] while only *some* of the institutional non-blockholders do (because it is not cost-efficient given their holdings), and (ii) institutional investors performing their own research on average reach the same conclusions (whether block or non-bock holders). Under these assumptions, our results suggest that about 24.5% of investors doing their own research will vote *Against* when ISS also recommends *Against* (presumably due to the same underlying factors). This means that at least ~10.0% of the non-block institutional holders (34.4%-24.5%) simply follow ISS recommendations, providing a lower bound estimate of the causal effect of ISS. If, instead, institutional non-blockholders do not perform their independent research and mechanically follow ISS (i.e., the second part of assumption (i) is violated), 34.4% represents the upper bound estimate of ISS causal influence. While it remains difficult to estimate the exact causal impact of proxy advisors, under the above assumptions we can rule out the possibility that the documented association is purely due to proxy advisors and shareholders focusing on the same factors and conclude instead that at least some of the association is causal.[29]

4.5 Inside the black box: what determines the influence of proxy advisors' recommendations on shareholder votes?

While the influence of proxy advisors' recommendations on shareholder votes is well recognized in the literature, less is known about the determinants of such influence. To shed light

[28] More precisely, we assume that they do not mechanically follow proxy advisor's recommendations, even though they certainly access and use the proxy advisors' analyses, among other things, in forming their voting decisions.
[29] In particular, since the mean non-blockholder ownership is 57.5%, if (at least) 10% of these investors follow ISS, it means that (at least) 5.7% of the 24.8% influence of ISS (almost one–fourth) is causal.

on this question, we perform two sets of tests. First, in Panel C, we examine whether the sensitivity of shareholder votes to proxy advisors' recommendations (that is, the coefficient of ISS and GL *Against* recommendations, a sort of "voting response coefficient") varies with the content of proxy advisors' reports, or whether it is the same regardless of the rationale for the recommendation (as we would expect if shareholders blindly follow the recommendations).

To do so, we focus on the number and type of concerns identified by each proxy advisor, starting with ISS. In Model (1), we examine whether dissent is higher for *Against* recommendations where ISS identifies multiple aspects of the compensation plan to be of high concern by replacing *ISS Against* with *ISS Against—Single High Concern* and *ISS Against—Multiple High Concern* (to isolate the effect of ISS's analysis only, we exclude firms with an *Against* from GL, resulting in a sample of 985 observations). The coefficient of *ISS Against—Multiple High Concern* is higher by 5.6% (difference significant at the 1% level), suggesting a greater penalty for more severe compensation issues.

Next, in Model (2), we focus on the nature of concerns identified by ISS. We split *ISS Against—Single High Concern* into four mutually exclusive groups depending on the source of the high concern: *Pay for Performance* (N=44), *Non-Performance Pay* (N=6), *Severance* (N=15) and *Communication* (N=1) (there are no cases where *Peer Group* is the only high concern; see Table 1). A *High Concern* in the *Communication* category has the greatest incremental effect on shareholder votes (30.5%). Because this category captures the compensation committee's lack of responsiveness to past compensation-related votes, and not a specific concern with the current compensation plan, it may be viewed as proxy for the most severe cases, explaining the magnitude of the coefficient. However, note that the coefficient is driven by only one observation and hence should be interpreted with caution. As for the other categories, *High Concern* for *Severance* has

the greatest influence on shareholder votes (27.0%) followed by *Pay for Performance* (23.2%) and *Non-Performance Pay* (17.1%), with the coefficients of *Severance* and *Pay for Performance* significantly higher than *Non-Performance Pay* at the 5% level (but not significantly different from each other; p-value=0.12, untabulated). Overall, investors seem to use the information in the reports to decide which recommendations to support and, as a result, not all *Against* recommendations have the same influence on the voting outcome.

In Models (3) and (4) we repeat the same exercise for GL. Similar to Models (1) and (2), we exclude firms where ISS issued an *Against* recommendation from the analysis, so as to focus on the effect of the number and type of concerns identified by GL when only GL issues an *Against* recommendation, resulting in a sample of 1,009 observations. The GL analysis requires an additional adjustment. Recall from Table 2, Panel C, that (unlike with ISS) many firms with the equivalent of a high concern in the GL reports receive a *For* recommendation. Therefore, in Model (4), in addition to replacing *GL Against* with *GL Against—Multiple High Concern* and *GL Against—Single High Concern*, we also include indicator variables for *GL For—Multiple High Concern* and *GL For—Single High Concern*.

As shown in Model (3), in contrast to ISS, investors' voting behavior does not vary with the number of serious concerns underlying the GL *Against* recommendations.[30] Then, in Model (4), we replace *GL Against—Single High Concern* and *GL For—Single High Concern* with indicator variables capturing the underlying category.[31] In the case of *Against* recommendations, we find that investors mostly respond to concerns with pay for performance and that, as with ISS,

[30] The coefficients of *GL Against—Multiple High Concern* and *GL Against—Single High Concern* are positive (12.8% and 13.2%, respectively) and statistically significant, but not different from each other (unreported test). A similar picture emerges in the case of *For* recommendations.

[31] Note that there is no case of *Poor Disclosure* as *Single High Concern* within *Against* recommendations (Table 1) and only one case of a firm with grade *F* and *For* recommendation (which drops out due to missing control variables). Hence in Model (4), there are no indicators capturing these combinations.

different categories have different impact. The highest coefficient at 0.178 is for *Only Pay for Performance Grade F*. Interestingly, the coefficient is not only significantly higher than the coefficient of 0.121 for *Only Structure Poor* (at 1% level, unreported), but also the coefficient of 0.117 for *Only Pay for Performance Grade D* (at 1% level, unreported), suggesting that some investors follow the GL *Against* recommendation only when the pay for performance problems are particularly acute (as proxied for by an *F* grade). With respect to *For* recommendations, we find that serious concerns with *Disclosure* and *Pay for Performance* result in a statistically significant, but economically small, increase in voting dissent. The fact that shareholders do not penalize these firms suggest that, on average, they agree with proxy advisors' decision to issue a *For* recommendation.[32]

In a second set of tests, we then examine whether voting response coefficient depends on firm characteristics, namely, size, stock performance, level of CEO pay and governance. As shown in Panel D, we find that (conditioned upon an *Against* recommendation), the influence of ISS recommendations on shareholder votes is stronger in smaller firms and firms with worse performance, while the level of CEO pay and the extent of shareholder rights (entrenchment index) do not seem to matter. For example, an ISS *Against* recommendation triggers 3.1% (4.1%) more votes against SOP in firms with below-sample median market value of equity (one year size-adjusted returns) than in those above-sample median (the differences are statistically significant, respectively, at the 10% and 5% level, untabulated). This is consistent with the general results in the literature that votes against management (e.g. against director nominees, against management proposals, in favor of shareholder proposals) are generally higher in smaller firms (presumably

[32] An alternative explanation is that shareholders mechanically follow the recommendations and ignore the underlying rationale. But this is inconsistent with our evidence on the influence of different categories and ratings on the voting outcome. Also, in our sample there are five firms with more than 20% dissent despite a positive recommendation by both ISS and GL, suggesting that shareholders sometimes choose to ignore proxy advisors' recommendations.

because larger firms invest more in campaigning for the votes) and firms with poorer performance (Gillan and Starks, 2000; Ertimur et al. 2010). However, the differences for the GL recommendations are not statistically significant.

The key insights from the above analyses is that the sensitivity of shareholder votes to proxy advisors' recommendations varies with the rationale behind the recommendation and with certain firm characteristics, inconsistent with the notion that shareholders blindly follow proxy advisors' recommendations.

5. Other economic consequences of proxy advisors' SOP recommendations

In this section we shift our attention from the influence of proxy advisors on shareholder votes to their effect on stock prices and firms' behavior.

5.1 Market reaction to the release of SOP-related ISS reports

Do proxy advisors' analyses and recommendations related to SOP convey value-relevant information to investors? To shed light on this question, we perform an event study around the release of proxy advisors' reports ahead of the 2011 annual meeting.

Our focus is on the reaction to *Against* recommendations related to SOP, a novel and contentious item on the ballot. We expect a negative reaction if, on average, an *Against* recommendation reveals to investors that the quality of the compensation plan is worse than expected or signals that the firm has not reformed its pay practices ahead of the first SOP vote. Alternatively, a positive reaction would occur if investors, aware of the problematic pay practices at these firms but skeptical of proxy advisors' ability or incentives to identify them, view an *Against* recommendation as increasing the likelihood that the firms will reform its pay practices (in response to the recommendation or to the higher voting dissent it may trigger). These effects can all co-exist for different subset of firms, so ultimately which one prevails is an empirical question.

The event study sample is comprised of the subset of 1,275 firms in our original sample with available ISS report release dates and stock return information, resulting in 1,195 observations (we do not have release dates for GL reports). We examine the abnormal returns, calculated as cumulative size-adjusted returns based on CRSP size deciles, over the [-1, +1], [-2, +2] and [-3, +3] windows where day zero is the release date.[33] Table 6, Panel A shows that, across the three windows, the mean (median) returns around *Against* recommendations are significantly negative, ranging between -0.52% to -0.73% (-0.36% to -0.49%), and significantly more negative than around *For* recommendations (mean differences range between -0.67% and -0.98%).[34]

To control for the potential effect of other information in the ISS report, we estimate the following OLS regression with standard errors clustered by report release dates:

$$\textit{Abnormal Returns} = \alpha + \beta_1 \textit{ISS Against} + \beta_2 \textit{ISS Withhold} + \beta_3 \textit{ISS For—Shareholder Proposals} + \beta_4 \textit{ISS Against—Management Proposals} + \varepsilon \quad (1)$$

The dependent variable, *Abnormal Returns*, is size-adjusted returns, defined as in the univariate tests. *ISS Against* is an indicator variable that is equal to one if the report includes an *Against* recommendation for SOP. Then, we include three indicators to capture ISS recommendations that are contrary to management's position: *ISS Withhold* (equal to one if ISS recommends to withhold votes for at least one director up for election), *ISS For—Shareholder Proposals* (equal to one if ISS recommends in favor of one or more governance-related

[33] These windows allow us to incorporate the effect of any leakage of information ahead of the release date (ISS sends a draft of the report to S&P 500 firms before releasing the final version, see Section 5.2) as well as any delayed reaction to the release itself. Also, the results are similar when using alternative abnormal returns measures (market-adjusted returns, returns computed using Fama and French (1996) and momentum factors (Carhart, 1997)).

[34] We do not have a prediction for ISS *For* recommendations. For most of these firms the positive recommendation may have simply confirmed investors' expectations that the compensation plan did not present any major concern, with little or no new information. For firms where investors had some concern, the positive ISS assessment may have conveyed good news (an indication that the concern was not too serious or that the company has addressed it). As shown in Table 6, Panel A, the mean (median) abnormal returns around positive recommendations are statistically positive, though very small in magnitude, ranging between 0.16% and 0.25% (0.12% and 0.28%)

shareholder proposals); and *ISS Against—Management Proposals* (equal to one if ISS recommends against one or more management proposals). As shown in Table 6, Panel B, the coefficient of *ISS Against* remains negative and significant, while the other coefficients are not significant (consistent with the notion that on most other issues ISS recommendations are largely anticipated). In untabulated tests, we also exclude 245 reports (27 of which are *Against* cases) preceded or followed by an earnings announcement within five days, as well as firms that announce other news during the event window (31 additional *Against* cases). The coefficient of *ISS Against* remains negative and significant, ranging between -0.0052 (Model 1) and -0.0129 (Model 3). Hence, the result does not appear to be driven by other recommendations in the ISS reports or other firm-related news released around the same dates.

Overall, our analyses suggest that investors view negative SOP recommendations as bad news. The negative market reaction may reflect new information about the (low) quality of the firm's compensation plan (in absolute terms and/or relative to peers) or news about the firm's failure to address known problems with its pay practices. In the first case, we would expect stronger negative reaction for the subset of firms where an *Against* recommendation was unexpected. Using past compensation-related activism as proxy for investors' expectations, in Panel C we find that this is indeed the case. Only the (negative) coefficient on *Against—Unexpected* is significant and significantly more negative than the coefficient on *Against—Expected*, where *Against—Expected* is an indicator equal to one if during the 2010 proxy season the firm was the target of a compensation-related shareholder proposal supported by more than 20% of the votes cast or any of its directors received a withhold recommendation from ISS due to concerns with the firm's compensation practices (38 cases). However, we cannot exclude that

shareholders react negatively because of the perception that the firm will incur some cost to deal with the negative dissent likely associated with the unfavorable recommendation.

5.2 Firms' response to the release of SOP-related ISS reports

During the first SOP season a number of firms explicitly responded to proxy advisors' negative recommendations, presumably in an attempt to obtain a favorable recommendation or persuade shareholders to ignore the negative recommendations. Observers have viewed this phenomenon as an indication of the excessive influence of proxy advisors, with firms engaging directly with proxy advisors rather than with investors. To provide some evidence on this new trend, we examine firms' responses disclosed in SEC filings between the public release of ISS reports and the annual meeting by the 144 firms targeted by a negative ISS recommendation.[35]

Table 7 shows that 52 (36.1%) of these firms filed an amendment to the proxy statement or 8-K (the market reaction around the filing dates is not significant—untabulated tests). Most of these firms (40 out of 52) voiced their disagreement with ISS's rationale for its recommendation, usually criticizing the pay-for-performance evaluation (34 firms). To strengthen their arguments, some firms also emphasized that they received a favorable GL recommendation (when they did so). Four of the 52 firms provided additional disclosures, while the remaining eight firms made changes to their compensation plans, by introducing performance conditions in equity grants or removing certain provisions from their change-in-control agreements ((in untabulated tests, we find no significant market reaction around the filing dates). Not surprisingly, in virtually all of the 52 cases the focus of the firm response is on the issue underlying the *High Concern* rating (and, thus, the *Against* recommendation). Appendix 6 provides examples.

[35] We focus on ISS recommendations because we do not have the exact release date of the GL recommendations. However, a similar dynamic takes place with GL. For example, among the 40 firms filing amended documents to express disagreement with the proxy advisors' recommendations, 18 also had a GL *Against* recommendation and four of them discuss their disagreement with GL as well.

To gain a better insight into firms' responses to SOP-related ISS reports, we next examine firms' decisions to disagree with ISS *Against* recommendations in a logistic regression framework. Model (1) in Table 8 explores the role of firm performance, ownership structure, size, and the level of and growth in CEO pay. Model (2), includes variables that may capture the anticipated SOP voting outcome (an indicator variable that is equal to one if GL issued an *Against* recommendation for SOP, *GL Against*; an indicator variable equal to 1 if the firm ultimately received more than 20% of dissent in the SOP vote, *High SOP Dissent*) to account for the possibility that firms expecting a higher level of dissent are more likely to take steps to influence the voting outcome, board characteristics (*Entrenchment Index*, *% of Independent Directors*), as well as indicators for whether the firm received a *High Concern* rating in a given category (sample size is slightly smaller because of lack of data on certain governance variables). Across the two models, it appears that larger firms and firms with more independent boards are more likely to disagree with ISS. An interpretation of this finding is that firms and boards more concerned with their reputation are more likely to take steps to try to reverse negative ISS recommendations or reduce their impact on shareholder votes. We also find that firms that receive a *High Concern* in *Pay for Performance* and *Non-Performance Pay* are more likely to disagree with ISS.

Finally, we turn our attention to the impact of firms' responses. Our analysis suggests that the impact of firms' responses depends on the type of response. ISS changed the SOP recommendation (from *Against* to *For*) for all the eight firms that changed their compensation plans (explicitly linking its decision to such changes) and for two of the four firms that provided additional disclosure, but did not change it for any of the firms that expressed disagreement. The 10 firms with the ISS recommendation revised from *Against* to *For* eventually experienced the same dissent as firms that received a *For* recommendation right from the beginning (untabulated

analyses). In other words, investors voted as if they agreed with the revised recommendation. As for the 40 firms expressing disagreement and continuing to receive an ISS *Against*, their protest did not seem to influence shareholder votes. Relative to all other cases of ISS *Against*, these firms actually experienced higher dissent (26.1% versus 24.1%, p-value<0.001, untabulated), perhaps because firms protesting against ISS tend to be those facing more severe compensation issues.[36] However, perhaps as a reaction to this disagreement, ISS has revised its approach to pay for performance evaluations for the 2012 proxy seasons.[37]

6. Conclusions

Over the last decade non-binding shareholder votes have increasingly affected boards' decisions on governance, executive pay and CEO turnover. While proxy advisors' recommendations are recognized as the key determinants of voting outcomes, little is known about the analyses underlying these recommendations, how they differ across proxy advisors, whether they reflect a "one-size-fits-all" approach (to minimize proxy advisors' costs) or take into account firm-specific characteristics. Moreover, there is little evidence on the value relevance to investors of these recommendations and their influence on firms' behavior.

In this study we fill this gap by examining the analyses that the two most influential proxy advisors, Institutional Shareholder Services (ISS) and Glass Lewis & Co. (GL), performed in 2011

[36] We find a similar result when examining firms' responses ahead of the release of the proxy advisors' reports, exploiting the fact that ISS provides S&P 500 firms with an opportunity to review their draft report (before its public release) for the purpose of ensuring factual accuracy. In our sample, 9 firms with an *Against* recommendation in the draft ISS report engaged with ISS before the release of the final report (the engagement activity is disclosed in the final report). Two of these firms filed an 8-K addressing the concerns raised by ISS and obtained a favorable recommendation. For the other seven firms, ISS issued an *Against* recommendation also in the final report and dissent was higher than for firms with *Against* recommendations and no disclosure of engagement activities (30.5% versus 24.4%, p-value=0.03, untabulated).

[37] The new approach comprises of an initial quantitative assessment of the disconnect between pay and performance, based on rankings of CEO pay and performance relative to peers (based on industry and size) over three years, as well as the trend in CEO pay relative to stock returns over five years, followed by the usual qualitative review "to determine the cause of a perceived long-term disconnect between pay and performance, or factors that mitigate the initial assessment" (ISS, 2011b). The longer horizon and the definition of peers seem to take into account some of the criticism raised by firms that disagreed with ISS assessment (see notes to Table 7, Panel A).

to arrive at a voting recommendation with respect to "say on pay" (SOP), the non-binding vote on executive pay mandated by the Dodd-Frank Act.

We find that both advisors perform a detailed qualitative and quantitative analysis, emphasizing firm-specific considerations rather than resorting to one-size-fits all approaches, and are more likely to issue an *Against* recommendation at firms with poor performance and higher levels of CEO pay. While they often disagree in their assessment and recommendations, both proxy advisors have significant influence on the voting outcome, with a negative recommendation from ISS (GL) associated with 24.7% (12.9%) more votes against the compensation plan. The sensitivity of shareholder votes to proxy advisors' *Against* recommendations varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics, providing a nuanced view of the way investors use proxy advisors' analyses.

The release of negative SOP recommendations is accompanied by small but significantly negative abnormal returns (between -0.5% and -0.7%). More than one third of the firms targeted by such recommendations publicly criticize ISS's methodology, but do not obtain a change in recommendation nor avoid voting dissent. Our findings contribute to the literature on shareholder voting and the related policy debate.

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Appendix 1 Distribution of ISS ratings and examples of 'High Concern' ratings

The table below summarizes the distribution of ISS ratings by category.

	ISS rating				
ISS category	*High Concern*	*Medium Concern*	*Low Concern*	*NA*	Total
Pay for Performance	105	287	881	2	1,275
Peer Group	12	229	1,032	2	1,275
Non-Performance Pay	19	131	1,123	2	1,275
Severance	29	432	812	2	1,275
Communication	13	397	863	2	1,275

Our reading of the ISS reports indicate that the main reasons for the High Concern ratings are: in the *Peer Group* category, the use of above median benchmarking at times of lagging performance (9 cases); in the *Non-Performance Pay* category, the use of perk-related tax gross-ups (seven cases), the level or nature of perks (six cases), or both (three cases); in the *Severance* category, the use of excise tax gross-ups in new or amended contracts (19 cases), modified single-trigger provisions (five cases), or both (four cases); in the *Communication* category, the lack of responsiveness to past shareholder dissatisfaction with pay practices (as displayed through a high percentage of votes withheld from compensation committee members in 2010; 11 cases). As for the *Pay for Performance* category, most cases involve (one- and/or three-year) stock performance below industry median, coupled with increases in CEO pay. These increases are often driven by discretionary awards (e.g. grants of standard stock options and time-based restricted stock, which ISS does not consider performance-based), sometimes with limited disclosure of their rationale, and tend to result in high CEO pay levels relative to peers. 'NA' are cases where ISS does not assign a rating.

Pay for Performance Category – Chesapeake Energy Corporation (ISS Report Date May 18, 2011)

"As shown in the chart below, the company's last 1- and 3-year total shareholder returns ("TSRs") are below the median TSR of its 4-digit GICS group within the Russell 3000 index… Under ISS' pay-for-performance analysis, when a company has sustained long-term poor shareholder returns, ISS will examine the company's executive compensation practices. In particular, lagging TSR that is misaligned with the year-over-year compensation of a CEO who has served at least two fiscal years will result in close scrutiny and may lead to a negative recommendation for the say on pay proposal.

…The current CEO has served for the last 22.00 years. Also, total CEO compensation has changed by 13.4% year-over-year, despite the fact that the company's 1- and 3-year TSRs are below the median of its GICS peer group…the increase in CEO compensation is driven by the increase of 19.6 percent in the value of restricted stock granted in 2010 compared with 2009. While the number of grants decreased year-over-year, the restricted stock granted in 2010 is not performance-based, scheduled to vest solely on the passage of time…Further, the company does not employ any performance criteria for the annual cash bonus paid to the CEO either. The proxy statement notes that "the Committee has concluded that, due to the nature of our business, utilizing an objective set of metrics to drive incentive compensation poses problems of measurement and can encourage behavior that may be contrary to the long-term interests of the Company and our shareholders." Additionally, the filing notes that cash bonuses "are intended to provide incentives based on a subjective evaluation of the performance of the Company and the individual over a shorter period." Further, in the case of the CEO, for last 3 years he has consistently received the maximum bonus allowable under his employment contract. Without sufficient linkage to measurable performance metrics,

this bonus does not appear to be performance-based. While investors may recognize that a fully formulaic approach may not be the best design for all companies, the company does not provide sufficient insight into the determination of the CEO's annual cash bonus and restricted stock award. The lack of performance linkage of any component of executive compensation is particularly concerning at this company given the magnitude of CEO pay – CEO pay for 2010 was $21 million compared to a peer median of $10.6 million (as per ISS' peer group). As a result, 100 percent of CEO compensation appears to be at the discretion of the Compensation Committee, clearly compromising the pay-for-performance linkage at this company."

Peer Group Category – Zimmer Holdings, Inc. (ISS Report Date April 26, 2011)

"…ISS notes that the company benchmarks the CEO's long-term incentive pay to the 75th percentile of the company's peer group, and the CEO's total compensation is approximately 26 percent above the median total CEO compensation within ISS's selected peer group of healthcare sector companies of similar size. Targeting and paying compensation significantly above the peer group median may compromise the link between pay and performance, given the company's lagging TSR performance…[and] can ratchet up executive compensation without linking it to improvements in company performance."

Non-Performance Pay Category – Kilroy Realty Corporation (ISS Report Date May 7, 2011)

"The company provides Kilroy, Jr. with an enhanced life insurance benefit with tax gross-up. Pursuant to terms of his employment agreement, Kilroy, Jr. is eligible to receive a term or whole life insurance policy in the amount of $10 million. For fiscal 2010, Kilroy, Jr. received $122,066 pursuant to this benefit: $65,000 in life insurance premiums and $57,066 tax gross-ups…Tax gross-ups on executive perquisites is not an efficient use of corporate assets. Most executives are paid at levels where they should be able to afford to pay their own taxes, and ISS survey data indicates that most investors believe that they generally should. In light of current SEC disclosure rules on executive compensation, many companies are eliminating unwarranted perks, as well as the tax gross-ups on such perks."

Severance Category – Republic Services, Inc. (ISS Report Date April 21, 2011)

"Mr. Slager's employment agreement was amended and restated effective June 25, 2010 in conjunction with his promotion to CEO effective Jan. 1, 2011…This restated agreement also provides for excise tax gross-ups, which is a problematic pay practice. Golden parachute packages that exceed certain limits (3-times average taxable income during the five years before the change-in-control) are subject to a 20 percent excise tax penalty for certain executives, and loss of tax deductions for the company. However, many companies have agreed to "gross-up" the payments to the executives to compensate for the impact of the penalty tax, which is typically quite costly. A 2009 ISS analysis of S&P 500 companies found that excise tax gross-up provisions are associated with higher than average potential severance packages and may encourage excessive payouts by relieving executives of the related tax burden. Further, the excise tax gross-up provision leads to such substantial increases in potential termination payments that the provision may encourage executives to negotiate merger agreements that may not be in the best interests of shareholders. Recent shareholder opposition to the practice has led some companies to eliminate the provision, reducing packages to the extent that the excise tax will not be triggered."

Communication Category – Chesapeake Energy Corporation (ISS Report Date May 18, 2011)

"This is the third consecutive year that the company has been identified as having problematic pay practices. In 2008 and 2009, directors received significant WITHHOLD votes with Compensation Committee members receiving a higher WITHHOLD percentage…the Compensation Committee and the board continues to ignore significant WITHHOLD votes at the last two annual meetings."

Appendix 2 Distribution of Glass Lewis ratings and examples of 'Poor' ratings

The table below displays the distribution of GL ratings by category.

	GL rating						
GL category	*Grade F*	*Grade D*	*Grade C*	*Grade B*	*Grade A*	*NA*	Total
Pay for Performance	76	255	581	250	84	29	1,275
	Poor	*Fair*	*Good*	*NA*	Total		
Structure	214	828	126	107	1,275		
Disclosure	76	837	255	107	1,275		

Our examination of GL reports indicates that the main reason for a *Poor* rating in *Disclosure* is the lack of disclosure of performance goals or metrics (66 cases; in more than a third of these cases, an additional concern is the lack of disclosure of how equity awards are determined). We identify more than fifty different compensation concerns for a *Poor* rating in *Structure*.. The most common are lack of clawback provisions (156 cases), limited performance-based nature of incentive plans (144), tax gross-ups (107), controversial features of change in control plans (99), lack of ownership requirements (89), discretionary elements of pay (79), choice of peer groups for benchmarking purposes (77), and automatic renewal of employment contracts (57), with an average of more than five concerns for firm. Appendix 3 provides information about the *Pay for Performance* category. 'NA' are cases where GL does not assign a rating.

Structure Category – Omnicare Inc (Meeting date May 24, 2011)

"We note the following concerns with the structure of the Company's compensation programs:

Peer Group Concerns. …Shareholders need to be satisfied that the peer group is appropriate and not cherry-picked for the purpose of justifying or inflating pay. In general, we believe a peer group should range from 0.5 to 2 times the market capitalization of the Company. In this case, Glass Lewis has identified 23 peers outside this range, which represents approximately 79.4% of the peer group.

Discretionary Bonuses. The compensation committee possesses the discretion to award bonuses outside the STI plan, which it exercised during the past year by granting discretionary bonuses totaling $496,000 to Messrs. Workman, Stamps and Finn. In Glass Lewis' view, [this] behavior…calls into question whether the committee is truly committed to creating a tight link between pay and performance.

No Performance-Based Long-Term Incentive Awards. To the best of our knowledge, the Company does not utilize an objective, formula-based approach to setting long-term executive compensation levels. Rather, the compensation committee determines equity grant amounts on a purely discretionary basis. Furthermore, the Company grants no performance-vesting incentive awards…shareholders should be concerned with the Company's failure to implement a performance-based long-term incentive plan with objective metrics

No Clawback Provision. To the best of our knowledge, the Company's incentive plans currently lack a clawback provision…emerging best practice has come to promote the use of clawback provisions...In addition…the 2010 Dodd-Frank Act requires the SEC to direct securities exchanges and associations to prohibit the listing of any issuer that does not adopt a policy to recover erroneously awarded incentive-based compensation (H.R. 4173, Sec. 954).

New Employment Contracts. The Company has entered into new employment contracts with executives in

the past year. We believe this is unnecessary and contrary to best market practice.

Automatic Renewal of Employment Contracts. The Company has entered into executive employment agreements that have an automatic renewal feature. We believe this is concerning as what is best for the company and employee at one point in time may no longer be true. Furthermore, more and more companies are eliminating executive employment agreements altogether.

Guaranteed Bonus. Mr. Workman's employment agreement with the Company includes an annual guaranteed bonus of $506,250. Except for nominal fixed payments such as base salaries, we believe the compensation of executives should be strictly based on the performance of a company…

Excessive Severance Payments. The Company provided a severance payment of approximately $16.6 million to Mr. Germunder in the past fiscal year. We believe shareholders should question the nature of this payment and if it is the best use of the Company's capital.

Change of Control Provisions. The Company provides for the immediate vesting of certain equity awards upon a change in control of the Company. This provision may discourage potential buyers from making an offer for the Company both because the purchase price will be higher and because substantial numbers of employees may earn significant amounts of money and decide to leave the Company…this sort of provision may lower the chances of a deal, lower the premium paid to shareholders in a takeover transaction or both.

Tax Gross-Ups. The NEOs' employment agreements require the Company to gross-up any excise taxes incurred in connection with severance payments received by the NEOs upon a change in control. Glass Lewis strongly opposes tax gross-ups on severance payments, especially when these payments are not limited by any consideration for excise taxes or safe harbor rules. In light of the fact that minor increases in change-in-control payments can lead to disproportionately large excise taxes, the potential negative impact of tax gross-ups far outweighs any retentive benefits. Furthermore, due to the complexities of estimating the potential size or likelihood of parachute excise taxes, tax gross-ups usually conceal the actual value of change-in-control agreements from shareholders, if not the board…

Disclosure Category

Lack of Transparency Regarding Performance Formulas - Altria Group, Inc.
"The Company has failed to provide a clear description of the threshold and maximum performance levels under the Short Term Incentive plan. Moreover, the Company has not disclosed the TSR goals and threshold and maximum adjusted diluted EPS goals (if any) under the Long Term Incentive plan. Lastly, the Company has not fully explained how the specific performance levels against targets translated into payouts in 2010…More detailed disclosure in this area is essential for shareholders to fully understand and evaluate the Company's procedures for quantifying performance into payouts for its executives."

Equity Award Determination Process Not Disclosed – LifePoint Hospitals Inc.
"The Company has failed to disclose its processes for determining time-vesting awards granted under the LTI plan. Without such disclosure, shareholders are unable to evaluate the efficacy of the Company's equity plans in aligning long-term pay with performance."

Performance Metrics Not Disclosed – Corvel Corp
"The Company does not disclose the specific metrics and performance targets it uses to evaluate long-term executive performance, citing competitive concerns. While we recognize the Company's desire to limit certain disclosures that it feels may harm its competitive position, we believe that the compensation committee can reasonably afford to provide disclosure regarding the basic structure of its long-term incentive plan..."

Appendix 3 Glass Lewis's proprietary pay-for-performance evaluation model

"…The relationship between relative executive compensation and relatively performance is the basis of Glass Lewis' proprietary pay-for-performance model. Our model evaluates compensation of the top five executives by benchmarking that compensation against the compensation of the top five officers at peer companies. The model then compares the company's performance to that of those same peers. In comparing the outcome of these analyses, Glass Lewis is able to evaluate whether the company's executives have been paid in line with the company's relative performance.

The Glass Lewis pay-for-performance model examines seven indicators of shareholder wealth and business performance: stock price change, change in book value per share, change in operating cash flow, EPS growth, total shareholder return, return on equity; and return on assets. These performance data points are calculated based on a weighted average of one-, two-, and three-year data, with the larger weighting given to the annualized three-year performance data.

The model also analyzes two compensation data points: the chief executive's total compensation and the top five executives' total compensation. The model compares each of these nine metrics (seven performance metrics and two compensation metrics) against those of the company's peers, which are grouped into four applicable peer groups: industry peers, sector peers of similar size, companies of similar market capitalization and companies in the same geographic regions. Each of these peer groups is assigned a weight in the analysis, based principally on the market capitalization of the subject company. In most instances, geographic peer groups play a very small role in the overall calculation and industry peers of similar size play a large role in the calculations.

In the end, the model calculates a weighted-average executive compensation percentile (i.e. compensation relative to peers) and a weighted-average performance percentile. For example, a company might be in the 85th percentile in executive compensation and in the 65th percentile in performance. These two percentile rankings are compared to determine how closely the compensation tracks the relative performance of the company. A final numeric score is calculated for each company base on these weighted-average percentile scores. We refer to this in the model as the "pay-for-performance gap". In the example noted above, the "gap" is 20, representing the difference between the compensation percentile and the performance percentile. These "gap" scores are then placed on a forced curve, so that the companies with the largest "gap" can be identified as companies that have done a poor job of linking compensation with performance. Each company is assigned a school-letter grade (i.e. "A", "B", "F", etc.), based on a forced grading curve, with 10% of the companies receiving an "A" and 10% receiving an "F"." (Source: Glass Lewis)

Appendix 4 ISS: example of firm with poor returns and CEO pay increase, yet receiving a *Medium Concern* rating in *Pay for Performance* and a *For* recommendation.

"…the company's last 1- and 3-year total shareholder returns ("TSRs") are below the median TSR of its 4-digit GICS group within the Russell 3000 index…total direct CEO compensation has increased by 75 percent year-over-year. As noted in the chart on page 4 of this report, the most significant drivers of the increase are attributable to a 330 percent increase in non-equity incentives (from $100,000 to $430,000) and a 120.6 percent increase in restricted stock granted (from $160,000 to $353,000). Mr. Whitehead's disclosed salary also increased 18.8 percent from $468,000 in fiscal 2009 to $556,000 in fiscal 2010.

…ISS notes concerns regarding the significant increase in time-based stock awards from fiscal 2009 to fiscal 2010 and significantly increased base salary amid sustained poor shareholder returns. That said, there are certain positive aspects of the CEO's compensation program. Specifically, more than 50 percent of the increase in compensation is attributable to the performance-based non-equity incentive payment. Additionally, while we note that significant increase in restricted stock grants was based solely on the Compensation Committee's application of subjective criteria, the company has introduced performance-based stock awards in the 2011 stock grant, making half of the 2011 awards performance-based. This represents a significant improvement in the alignment of the CEO's compensation with shareholders' interests. We note, in addition, that the CEO's total 2010 compensation of $1.435 million was significantly below the peer median of $2.852 million and note that total compensation and pay for fiscal 2009 and earlier is generally aligned (see "Components of Pay" chart on page 4 of this report). ISS has not identified a pay for performance disconnect at this time and will continue to monitor the company's actions."

(*Source: ISS Proxy Voting Report on Washington Federal Inc.*)

Appendix 5 Glass Lewis: example of Grade *F* in Pay for Performance and *For* Recommendation

Summary

"…Our central concern is the 'F' grade received by the Company in our pay-for-performance analysis. Ordinarily, this grade would suggest a major disconnect between Company performance and the compensation of its executives. However, in this case, we believe this grade is driven primarily by the value of long-term awards granted during the past year. We note that 66% of these equity awards are contingent on performance and will not pay out until the end of a five-year performance period. In December 2009, the Company cancelled the restricted stock and tandem cash awards originally awarded in 2007 and 2008 due to the Company's failure to fulfill the necessary performance conditions. As such, we are confident that performance targets have historically been set at a reasonably challenging level and that NEOs will most likely not receive the full value of these equity grants. Further, the Company states that it does not expect to award any additional equity until after the five-year performance period has expired.

We also note that during the past year, the compensation committee has adopted a number of beneficial features in its compensation program such as the elimination of excise tax gross-ups, the elimination of dividend payments on any unearned or cancelled performance-based awards, and the decision to maintain fiscal 2011 salaries for its NEOs at the fiscal 2010 level. The Company also maintains executive stock ownership guidelines, a feature which further aligns the interests of NEOs with that of shareholders. In the aggregate, these features, along with the clear disclosure provided by the Company, outweigh the unfavorable pay-for-performance grade. While shareholders should be mindful of the amount of equity being granted, they should be confident in the Company's overall compensation structure.

Accordingly, we recommend that shareholders vote **FOR** this proposal. (*Source: Glass Lewis Proxy Voting Report on Methode Electronics*)

Appendix 6 Examples of company responses to negative ISS recommendations

Disagreement with ISS

Disagreement on choice of peer groups used to assess relative stock performance
"ISS's comparative financial data is flawed. ISS's methodology does not provide an accurate comparison of ATI's performance to that of its true peers. ISS's recommendation is based in part by comparing the Company's total shareholder return with that of a group of companies selected by ISS based on the Global Industry Classification Standard (GICS). The ISS group includes companies engaged in completely different businesses than ATI, such as copper mining, iron ore mining, and consumer products packaging. The performance of those companies is not relevant to ATI and should not be compared with the performance of ATI. Those companies' businesses are not reflective of the same cyclicality and other circumstances that our business, and the specialty metals manufacturing industry generally, encounters. More importantly, the ISS peer group does not include certain companies that are clearly recognized by the investing public as our competitors." *Allegheny Technologies Inc., DEFA14A, April 12, 2011 (Annual meeting date: April 29, 2011)*

Disagreement on valuation of equity component of total pay
"ISS's valuation of Mr. Dvorak's 2010 stock option grant significantly overstates his total compensation and the increase in his compensation from 2009 to 2010…ISS's report measures his total compensation at $12,014,000, whereas our 2011 proxy statement measures total CEO compensation at $9,555,210. This discrepancy is caused by a difference in the assumptions used in the calculation of the grant date fair value of Mr. Dvorak's stock option award using the Black-Scholes option pricing model. Our proxy statement reports this award as having a grant date fair value of $3,421,600, whereas ISS values the award at $5,880,000, more than 70% higher than our valuation. ISS's report overstates Mr. Dvorak's 2010 compensation and the increase in his compensation from 2009 to 2010." *Zimmer Holdings, DEFA14A, April 15, 2011 (Annual meeting date: May 29, 2011)*

Disagreement on definition of what constitutes performance-based pay
*"*ISS asserts that ExxonMobil time-vested restricted stock is not performance-based compensation because it is not tied to a formula or targets. This analysis does not recognize the significant pay-for-performance connection that is created when an executive's net worth is made substantially dependent on long-term share performance. We do this by combining restricted stock with the other supporting design features of stock-based compensation... Furthermore, it does not recognize the key metrics considered by the Compensation Committee in determining the share grants to the CEO and other NEOs which are fully disclosed in the CD&A…." *Exxon Mobil Corporation, DEFA14A, May 6, 2011 (Annual meeting date: May 25, 2011)*

Disagreement on assessment of severance plan
"ISS has based its recommendation on only one small element of a comprehensive executive compensation program. ISS indicates…that each component of its "Executive Compensation Evaluation" is a "Low" level of concern, except for "Severance/CIC Agreements". ISS' recommendation against the entire executive compensation package is based solely on our inclusion of one newly hired executive in the CIC Plan. We strongly disagree with this approach... It is worthy of note that Glass Lewis…has recommended a vote "for" the resolution approving our executive compensation. [Also, the company]…has a valid business reason for allowing newly hired employees to participate in pre-existing programs for similarly situated executives, including the CIC Plan…If Mr. Ellen had been excluded from the CIC Plan, his compensation package would have been substantially less than that of our other similarly situated executives. His recruitment and retention, or the recruitment and retention of any talented executive officer, would be difficult…" *Dr. Pepper Snapple Group, DEFA14A, May 6, 2011 (Annual meeting date: May 19, 2011)*

Additional Disclosure – Severance

School Specialty Inc., 8-K Form, August 8, 2011 (Annual meeting date: August 23, 2011)
"In response to a report issued by a proxy advisory firm, School Specialty, Inc. (the "Company") is filing this report to clarify certain matters relating to the terms of the employment agreement dated June 27, 2011 (the "Employment Agreement") between the Company and David J. Vander Zanden, the Company's Chief Executive Officer and President..."

School Specialty Inc., ISS Proxy alert (August 8, 2011; original ISS report: August 3, 2011)
"ISS is updating the original report dated Aug. 3, 2011. In an 8-K filed on Aug. 8, 2011, the company clarified that the new employment agreement with the CEO, dated June 27, 2011, would not entitle him to a continuation of base salary or such benefits if he were to voluntarily terminate his employment upon a change in control. Based on this new information, ISS now recommends a vote FOR Item 2."

Changes to Compensation Plans – Introduction of Performance Conditions in Equity Grants

Collective Brands Inc., 8-K Form, May 18, 2011 (Annual meeting date: May 26, 2011)
"Matthew E. Rubel, the Chairman, Chief Executive Officer and President of Collective Brands, Inc. offered and on May 18, 2011, the Company agreed to modify unilaterally the terms governing 50 percent of the 129,344 shares underlying the stock appreciation right ("SAR") award granted to him on March 24, 2011 (the "Award"). As a result of this modification, 64,672 SARs (the "CCG Performance SARs") will now vest on March 24, 2014, if the Company achieves the performance criteria for the three year performance period beginning on January 31, 2011 and ending on January 31, 2014 (the "Performance Period") set forth below in the Vesting Schedule. The other 64,672 SARs granted pursuant to the Award shall vest as set forth in the Vesting Schedule."

Collective Brands Inc., ISS Proxy Alert (May 18, 2001; original ISS report: May 10, 2011)
"On May 18, 2011, the company filed a Form 8-K and provided additional information. Specifically, half of CEO Rubel's 2011 stock appreciation right (SAR) award (in terms of shares) will be modified to incorporate a performance condition…The Compensation Committee will also impose performance vesting requirement on 50 percent or more of grants of equity based compensation (in terms of shares) awarded in the future for the company's named executive officers in the aggregate. Finally, the company also clarified that it does not benchmark target compensation for the CEO or the remaining named executive officers at the 75th percentile. In light of the enhanced performance-based equity award for the CEO and an ongoing pay for performance commitment, a vote FOR is recommended for Item 2."

Changes to Compensation Plans – Elimination of Excise Tax Gross-Ups

The Walt Disney Company, 8-K Form, March 18, 2011 (Annual meeting date: March 23, 2011)
"On March 17, 2011, the Company amended employment agreements with each of Robert A. Iger, James A. Rasulo, Alan N. Braverman and Thomas O. Staggs to remove a provision for payment to the executive to cover excise taxes incurred by the executive pursuant to Section 4999 of the Internal Revenue Code with respect to payments received by the executive upon termination following a change in control."

The Walt Disney Company, ISS Proxy alert (March 18, 2001; original ISS report: February 28, 2011)
"On March 18, 2011, the company filed additional proxy materials disclosing that excise tax gross-up provisions have been eliminated from the company's employment agreements with four executives... In light of this positive action, ISS recommends that shareholders vote FOR Item 16 – Advisory Vote to Ratify Named Executive Officers' Compensation"

Table 1 Distribution of ISS and GL recommendations and ratings on SOP

	Distribution of ISS ratings		
	All	*ISS For*	*ISS Against*
All Firms	1,275	1,131 (*88.7%*)	144 (*11.3%*)
No High Concern	1,131	1,129	2
Single High Concern	112	-	112
Pay for Performance	82	-	82
Peer Group	-	-	-
Non-Performance Pay	8	-	8
Severance	20	-	20
Communication	2	-	2
Multiple High Concern	30	-	30
NA	2	2	2
	Distribution of GL ratings		
	All	*GL For*	*GL Against*
All Firms	1,275	998 (*78.3%*)	277 (*21.7%*)
No High Concern	683	682	1
Single High Concern	355	209	146
Pay for Performance - Grade F	39	1	38
Pay for Performance - Grade D	152	64	88
Structure - Poor	119	99	20
Disclosure - Poor	45	45	-
Multiple High Concern	110	4	106
NA	127	103	24

Table 1 displays the distribution of ISS and GL recommendations and ratings with respect to SOP. *ISS (GL) Against* (*For*) is an indicator variable that is equal to one if ISS (GL) issues an *Against* (*For*) recommendation for SOP prior to the 2011 annual meeting (sources: ISS, GL). *Single High Concern* (*Multiple High Concern*) indicates cases where the proxy advisor identifies a 'high concern' only in one (in more than one) category.
ISS structures the SOP section of its reports around five categories with a rating (*High*, *Medium* or *Low Concern*) assigned for each of them: *Pay for Performance* (alignment of CEO's pay with performance over time), *Peer Group* (choice of peers and targets used for benchmarking purposes), *Non-Performance Pay* (non-performance based pay elements such as perks and pensions), *Severance* (severance and change-in-control agreements), *Communication* (quality of disclosures and compensation committee's past responsiveness to shareholders).

GL structures the SOP section of its reports around three categories: *Pay for Performance* (alignment of CEO's pay with performance over time), *Structure* (design of compensation plan) and *Disclosure* (adequacy of pay disclosures), with a rating assigned for each category (*Poor, Fair* or *Good* in the case of *Structure* and *Disclosure*; a grade between A and F in the case of *Pay for Performance*, see Appendix 3). Table 1 treats a GL rating of *Poor* on *Disclosure* and *Structure* and a *Grade D* or *F* in *Pay for Performance* as "high" concern. 'NA' indicates cases where the proxy advisors do not assign a category rating.

Table 2 Differences in ISS and GL's recommendations and ratings

Panel A: Joint distribution of ISS and GL recommendations

Recommendation	*GL For*	*GL Against*	*%*
ISS For	918 (*72.0%*)	213 *(16.7%)*	
ISS Against	80 (*6.3%*)	64 (*5.0%*)	
Agreement between *ISS* & *GL*			*77.0%* (=(918+64)/1,275)
Agreement between *ISS* & *GL* on controversial cases			*17.9%* (=64/(80+64+213))

Panel B: Joint distribution of ISS and GL pay-performance ratings

	GL Grade A , B or *C*	*GL Grade F* or *D*	*%*
ISS Medium or *Low Concern*	871 (*70.0%*)	272 (*21.9%*)	
ISS High Concern	43 (*3.5%*)	58 (*4.7%*)	
Agreement between *ISS* & *GL*			*74.7%* (=(871+58)/1,244)
Agreement between *ISS* & *GL* on controversial cases			*15.5%* (=58/(43+58+272))

	GL Grade A	*GL Grade B*	*GL Grade C*	*GL Grade D*	*GL Grade F*
ISS Low Concern	76	211	415	132	27
ISS Medium Concern	7	33	129	84	29
ISS High Concern	-	6	37	38	20

Table 2 (cont.)

Panel C: Distribution of proxy advisor *Pay for Performance* ratings for SOP by total CEO pay and firm performance

			Returns			
% of *ISS High Concern* with *Pay for Performance*			High Q4	→		Low Q1
	Low	Q1	1.3%	2.5%	2.8%	16.3%
CEO Total Pay	↓	Q2	1.2%	2.6%	2.4%	11.0%
		Q3	1.1%	4.0%	4.8%	24.2%
	High	Q4	9.1%	11.8%	15.4%	29.1%
% of *GL Grade D* or *F* for *Pay for Performance*						
	Low	Q1	2.7%	10.0%	15.5%	14.1%
CEO Total Pay	↓	Q2	9.5%	14.5%	22.4%	23.3%
		Q3	26.4%	30.3%	31.3%	36.4%
	High	Q4	34.9%	42.4%	46.2%	55.8%

Panel D: Distribution of proxy advisor recommendations for SOP by total CEO pay and firm performance

			Returns			
			High	→		Low
% of *ISS Against*			Q4	Q3	Q2	Q1
	Low	Q1	2.7%	3.8%	5.6%	19.6%
CEO Total Pay	↓	Q2	3.6%	7.9%	4.7%	11.0%
		Q3	7.7%	5.3%	6.0%	27.3%
	High	Q4	10.6%	18.8%	18.0%	27.9%
% of GL Against						
	Low	Q1	2.7%	8.8%	9.9%	10.9%
CEO Total Pay	↓	Q2	8.3%	13.2%	14.1%	19.2%
		Q3	23.1%	26.3%	19.3%	34.9%
	High	Q4	37.9%	34.1%	43.6%	44.2%

Table 2 Panel A (Panel B) shows the joint distribution of ISS and GL SOP recommendations (pay-performance ratings) and calculations for the degree of agreement between the two proxy advisors. Panel C (Panel D) displays the frequency of ISS *High Concern* ratings and GL *D* and *F* grades (ISS and GL *Against* recommendations) for *Pay for Performance* conditional on levels of CEO pay and firm's stock performance. *CEO Total Pay* is the total CEO compensation for the fiscal year prior to the annual meeting date and is comprised of salary, bonus, non-equity incentive plan compensation, grant-date fair value of option awards, grant-date fair value of stock awards, deferred compensation earnings reported as compensation and other compensation (source: ExecuComp). *Returns* are raw returns over the fiscal year ending before the annual meeting date (source: CRSP). *ISS Against* (*For*), *GL Against* (*For*) as well as ISS and GL categories and ratings are defined as in Table 1. Q1, Q2, Q3 and Q4 denote distribution quartiles.

Table 3 Determinants of the likelihood of an *Against* recommendation

Panel A: Benchmark Regression

	ISS Against		*GL Against*		*ISS & GL Against*	
	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)	Model (4) Coefficient (*t-statistic*)	Model (5) Coefficient (*t-statistic*)	Model (6) Coefficient (*t-statistic*)
Intercept	-1.231	-2.869 ***	-1.054	0.120	-4.646 **	-3.755
	(-1.291)	(-2.771)	(-1.152)	(0.143)	(-2.387)	(-1.618)
Abnormal Returns	-2.351 ***		-0.504 *		-1.789 ***	
	(-5.017)		(-1.753)		(-3.067)	
Return on Assets	-1.743	-2.183	-7.030 ***	-7.096 ***	-0.066	0.222
	(-1.097)	(-1.279)	(-3.676)	(-3.733)	(-0.028)	(0.086)
% Institutional Ownership	0.216	-0.053	1.399 ***	0.707	0.763	-0.353
	(0.366)	(-0.092)	(2.941)	(1.326)	(0.527)	(-0.224)
% Insider Ownership	1.061 *	1.495 **	0.783	1.160 *	2.054	1.670
	(1.672)	(2.308)	(1.282)	(1.885)	(1.317)	(1.059)
ln(*MV Equity*)	-0.268 **	-0.152	-0.265 **	-0.514 ***	0.244	0.021
	(-2.467)	(-1.368)	(-2.003)	(-5.232)	(1.636)	(0.124)
Prior SOP Vote	-0.823	-0.687	-0.354	-0.320	-1.128	-0.994
	(-1.559)	(-1.583)	(-0.975)	(-0.912)	(-1.299)	(-1.153)
Past Compensation Activism	0.640 *	1.071 ***	0.396	0.784 **	-0.217	0.065
	(1.771)	(3.123)	(1.184)	(2.557)	(-0.418)	(0.133)
CEO Total Pay	0.140 ***		0.160 ***		0.025	
	(5.896)		(3.307)		(1.194)	
Growth in CEO Total Pay	0.084 **		0.053 *		0.035	
	(2.234)		(1.787)		(0.883)	
Abnormal Returns Q3		0.298		-0.003		0.574
		(0.930)		(-0.014)		(1.201)
Abnormal Returns Q2		0.428		0.611 ***		0.484
		(1.383)		(2.770)		(1.048)
Abnormal Returns Q1		1.804 ***		0.400 *		1.296 ***
		(6.152)		(1.712)		(2.978)
CEO Total Pay Q4		1.594 ***		3.733 ***		1.997 ***
		(4.080)		(9.388)		(2.753)
CEO Total Pay Q3		0.636 *		2.335 ***		1.602 **
		(1.893)		(7.127)		(2.407)
CEO Total Pay Q2		-0.186		0.933 ***		0.434
		(-0.570)		(3.120)		(0.571)
Growth in CEO Total Pay Q4		0.892 ***		0.356		0.184
		(2.944)		(1.641)		(0.414)
Growth in CEO Total Pay Q3		0.793 ***		-0.021		-0.013
		(2.636)		(-0.095)		(-0.028)
Growth in CEO Total Pay Q2		0.404		-0.176		-0.317
		(1.323)		(-0.759)		(-0.642)
N	1,258	1,258	1,258	1,258	351	351
Pseudo R^2	14.5%	13.5%	12.1%	18.2%	6.9%	9.1%

Table 3 (cont.)

Panel B: The probability of an *Against* recommendation by GL—role of category ratings

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)
Pay for Performance (PfP) Grade F	11.635 ***	9.306 ***	9.791 ***
	(8.316)	(7.569)	(7.547)
Pay for Performance (PfP) Grade D	8.059 ***		
	(8.290)		
Pay for Performance (PfP) Grade C	1.946 ***		
	(2.611)		
Stucture Poor	4.859 ***		
	(6.273)		
Disclosure Poor	1.729 ***		
	(2.983)		
PfP Grade D—Structure and/or Disclosure Poor		8.031 ***	
		(9.434)	
PfP Grade D—Structure and Disclosure Fair/Good		5.203 ***	
		(7.500)	
PfP Grade C—Structure and/or Disclosure Poor		3.666 ***	3.805 ***
		(4.947)	(4.977)
PfP Grade C—Structure and Disclosure Fair/Good		-1.038	-0.948
		(-0.855)	(-0.763)
PfP Grade D—Structure and/or Disclosure Poor—Past PfP Grade D or F			8.744 ***
			(8.483)
PfP Grade D—Structure and/or Disclosure Poor—Past PfP Grade A, B or C			8.027 ***
			(7.500)
PfP Grade D—Structure and Disclosure Fair or Good—Past PfP Grade D or F			6.769 ***
			(8.975)
PfP Grade D—Structure and Disclosure Fair or Good—Past PfP Grade A, B or C			4.375 ***
			(5.923)
Controls	Included	Included	Included
N	1,134	1,134	1,134
Pseudo R^2	71.2%	68.9%	72.0%

Table 3 presents the results for the determinants of a SOP-related *Against* recommendation. Panel A reports the results for a benchmark model. The dependent variable in Panel A, Models 1 and 2 (3 and 4), *ISS* (*GL*) *Against*, is an indicator variable that is equal to one if ISS (GL) issues an *Against* recommendation for SOP ahead of the 2011 annual meeting, and zero otherwise (source: ISS and GL). The dependent variable in Models 5 and 6, *ISS & GL Against*, is an indicator variable that is equal to one if both ISS and GL issue an *Against* recommendations for SOP, and zero if only one of the proxy advisors issues an *Against* recommendation. In Panel B, the dependent variable is *GL Against*, as defined above. Control variables are defined as follows: *Abnormal Returns* is size-adjusted returns for the most recent fiscal year ending before the annual meeting (source: CRSP). *ROA* is the firm's return on assets (ROA) for the most recent fiscal year ending before the annual meeting calculated as earnings before extraordinary items (Compustat data item *ib*) scaled by average total assets (Compustat data item *at*) (source: Compustat). *% Institutional Ownership* is the percentage of equity owned by institutions based on 13-F filings (source: Thomson Reuters). *% Insider Ownership* is the sum of shares owned by non-director executives and directors (source: ExecuComp and ISS Directors Dataset).

ln(*MV Equity*) is the natural logarithm of the market value of equity calculated as the number of shares outstanding as of the end of the most recent fiscal year ending before the annual meeting (Compustat data item *csho*) times price at fiscal year close (Compustat data item *prcc_f*) (source: Compustat). *Prior SOP Vote* is an indicator variable that is equal to one if the firm had a SOP vote in the past year, due to TARP or because of voluntary adoption (source: ISS and hand collected data). *Past Compensation Activism* is an indicator variable that is equal to one if the firm was targeted by a compensation-related shareholder proposal that received at least 20% votes in favor at the 2010 annual meeting (source: ISS). *CEO Total Pay* is the total CEO compensation for the fiscal year prior to the annual meeting date and is comprised of salary, bonus, non-equity incentive plan compensation, grant-date fair value of option awards, grant-date fair value of stock awards, deferred compensation earnings reported as compensation, and other compensation (source: ExecuComp). *Growth in CEO Total Pay* is the percentage change in *CEO Total Pay* from the previous fiscal year (source: ExecuComp). *Abnormal Returns Q3* (*Q2, Q1*) is an indicator variable that is equal to one if *Abnormal Returns* falls in the third (second, first) quartile of the distribution. *CEO Total Pay Q4* (*Q3, Q2*) is an indicator variable that is equal to one if *CEO Total Pay* falls in the fourth (third, second) quartile of the distribution. *Growth in CEO Total Pay Q4* (*Q3, Q2*) is an indicator variable that is equal to one if *Growth in CEO Total Pay* falls in the fourth (third, second) quartile of the distribution. Q4 (Q1) denotes the top (bottom) quartile of the distribution.

Panel B explores the role of GL category ratings. The dependent variable is *GL Against*, as defined above. All the control variables in Panel A are included but suppressed for ease of exposition. Additional control variables include:

In Model (1), *Pay for Performance (PfP) Grade F (D, C)* is an indicator variable that is equal to one if GL issues an F (D, C) grade for *Pay for Performance* (as defined in Table 1). *Structure* (*Disclosure*) *Poor* is an indicator variable that is equal to one if GL issues a *Poor* rating for *Structure* (*Disclosure*) (as defined in Table 1).

In Model (2), *PfP Grade D* (*C*) *Structure and/or Disclosure Poor* (*Structure and Disclosure Fair/Good*) is and indicator variable that is equal to one if GL assigns a grade of D (C) for *Pay for Performance* accompanied with a *Poor* rating in either or both *Structure* and *Disclosure* (a *Fair* or *Good* rating in both *Structure* and *Disclosure*).

In Model (3), *PfP Grade D—Structure and/or Disclosure Poor—Past PfP F or D* (*A, B or C*) is an indicator variable that is equal to one if GL assigns a D grade for *Pay for Performance* accompanied with a *Poor* rating in either or both of the *Structure* and *Disclosure* categories for a firm that had received an F or D (A, B or C) grade in *Pay for Performance* in the previous proxy season.
PfP Grade D—Structure and Disclosure Fair/Good—Past PfP F or D (*A, B or C*) is an indicator variable that is equal to one if GL assigns a D grade for *Pay for Performance* accompanied with a *Fair* or *Good* rating in both *Structure* and *Disclosure* for a firm that had received an F or D (A, B or C) grade in *Pay for Performance* in the previous proxy season.

***, **, and * denote significance at the 0.01, 0.05, and 0.10 level, respectively, based on a two-tailed test. Reported t-statistics are based on robust standard errors.

Table 4 Distribution of Say-On-Pay (SOP) voting dissent

	SOP Voting Dissent			Number of firms with *SOP Voting Dissent* between:						
	Mean	Median		All Firms	0 - 10%	10 - 20%	20 - 30%	30 - 40%	40 - 50%	50 - 100%
All Firms	9.6%	4.6%	N	1,275	904	175	91	55	26	24
			%	*100.0%*	*70.9%*	*13.7%*	*7.1%*	*4.3%*	*2.0%*	*1.9%*
ISS For	6.4%	4.1%	N	1,131	899	163	57	10	2	-
			%	*88.7%*	*79.5%*	*14.4%*	*5.0%*	*0.9%*	*0.2%*	-
ISS Against	34.9%	34.5%	N	144	5	12	34	45	24	24
			%	*11.3%*	*3.5%*	*8.3%*	*23.6%*	*31.3%*	*16.7%*	*16.7%*
GL For	5.9%	3.5%	N	998	880	46	32	32	7	1
			%	*78.3%*	*88.2%*	*4.6%*	*3.2%*	*3.2%*	*0.7%*	*0.1%*
GL Against	23.2%	18.8%	N	277	24	129	59	23	19	23
			%	*21.7%*	*8.7%*	*46.6%*	*21.3%*	*8.3%*	*6.9%*	*8.3%*

Table 4 presents the distribution of SOP voting dissent for the full sample and by proxy advisor recommendations on SOP. *SOP Voting Dissent* is defined as the number of votes cast against SOP scaled by the total number of votes cast, i.e., the sum of votes for, votes against and votes abstained (source: ISS). *ISS Against* (*For*) and *GL Against* (*For*) are defined as in Table 1.

Table 5 Determinants of Say-on-Pay (SOP) voting dissent

Panel A: Benchmark regression

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)
Intercept	0.117 ***	0.130 ***	0.140 ***
	(3.742)	(4.215)	(4.432)
Abnormal Returns	-0.063 ***		
	(-5.766)		
Return on Assets	-0.186 ***	-0.188 ***	-0.188 ***
	(-3.076)	(-3.248)	(-3.179)
% Institutional Ownership	0.058 ***	0.036 **	0.036 **
	(3.238)	(2.016)	(2.008)
% Insider Ownership	-0.077 ***	-0.058 ***	-0.055 ***
	(-3.987)	(-3.236)	(-3.093)
ln(*MV Equity*)	-0.010 ***	-0.017 ***	-0.017 ***
	(-2.615)	(-4.898)	(-4.933)
Prior SOP Vote	-0.020	-0.015	-0.014
	(-1.623)	(-1.214)	(-1.144)
Past Compensation Activism	0.046 ***	0.058 ***	0.060 ***
	(2.741)	(3.540)	(3.653)
CEO Total Pay	0.006 ***		
	(4.066)		
Growth in CEO Total Pay	0.004 **		
	(2.112)		
Abnormal Returns Q3		0.011	0.010
		(1.420)	(1.344)
Abnormal Returns Q2		0.027 ***	0.026 ***
		(3.483)	(3.327)
Abnormal Returns Q1		0.067 ***	0.050 ***
		(6.505)	(4.509)
CEO Total Pay Q4		0.122 ***	0.111 ***
		(9.603)	(8.655)
CEO Total Pay Q3		0.067 ***	0.066 ***
		(6.337)	(6.196)
CEO Total Pay Q2		0.010	0.010
		(1.327)	(1.271)
Growth in CEO Total Pay Q4		0.027 ***	0.021 **
		(2.841)	(2.199)
Growth in CEO Total Pay Q3		0.016 *	0.014
		(1.809)	(1.537)
Growth in CEO Total Pay Q2		0.000	-0.002
		(0.056)	(-0.209)
Abnormal Returns Q1 x *CEO Total Pay Q4*			0.064 **
			(2.407)
Abnormal Returns Q1 x *Growth in CEO Total Pay Q4*			0.020
			(0.830)
N	1,258	1,258	1,258
R^2	16.2%	20.1%	20.9%
Adjusted R^2	15.6%	19.1%	19.8%

Table 5 (cont.)

Panel B: The role of proxy advisors' recommendations

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)	Model (4) Coefficient (*t-statistic*)	Model (5) Coefficient (*t-statistic*)
ISS Against	0.268 ***		0.248 ***		
	(25.878)		(29.807)		
GL Against		0.153 ***	0.129 ***		
		(17.356)	(26.421)		
ISS & GL Against				0.383 ***	
				(25.266)	
Only ISS Against				0.244 ***	
				(27.296)	
Only GL Against				0.127 ***	
				(28.112)	
% Blockholder Ownership x *ISS Against*					0.247 ***
					(5.082)
% Non-Blockholder Ownership x *ISS Against*					0.349 ***
					(18.872)
% Blockholder Ownership x *GL Against*					0.133 ***
					(4.374)
% Non-Blockholder Ownership x *GL Against*					0.174 ***
					(15.948)
Controls	Included	Included	Included	Included	Included
N	1,258	1,258	1,258	1,258	1,258
R^2	66.2%	43.8%	82.3%	82.3%	84.9%
Adjusted R^2	65.7%	43.0%	82.0%	82.0%	84.7%

Table 5 (cont.)

Panel C: Determinants of the influence of proxy advisors: the role of the analysis underlying the recommendations

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)	Model (4) Coefficient (*t-statistic*)
ISS Against—Multiple High Concern	0.292 ***	0.292 ***		
	(14.493)	(14.452)		
ISS Against—Single High Concern	0.236 ***			
	(24.056)			
ISS Against—Only Pay for Performance High Concern		0.232 ***		
		(21.124)		
ISS Against—Only Non-Performance Pay High Concern		0.171 ***		
		(6.350)		
ISS Against—Only Severance High Concern		0.270 ***		
		(12.323)		
ISS Against—Only Communication High Concern		0.305 ***		
		(47.594)		
GL Against—Multiple High Concern			0.128 ***	0.129 ***
			(18.569)	(18.675)
GL Against—Single High Concern			0.132 ***	
			(20.692)	
GL Against—Only Structure Poor				0.121 ***
				(9.141)
GL Against—Only Pay for Performance Grade F				0.178 ***
				(11.820)
GL Against—Only Pay for Performance Grade D				0.117 ***
				(16.748)
GL For—Multiple High Concern			0.005	0.007
			(0.395)	(0.582)
GL For—Single High Concern			0.008 ***	
			(2.782)	
GL For—Only Structure Poor				0.006
				(1.539)
GL For—Only Disclosure Poor				0.011 **
				(2.302)
GL For—Only Pay for Performance Grade D				0.009 *
				(1.755)
Controls	Included	Included	Included	Included
N	985	985	1,009	1,009
R^2	77.6%	78.4%	68.2%	69.9%
Adjusted R^2	77.2%	77.9%	67.5%	69.1%

Table 5 (cont.)

Panel D: Determinants of the influence of proxy advisors: the role of firm characteristics

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)	Model (3) Coefficient (*t-statistic*)	Model (4) Coefficient (*t-statistic*)
ISS Against—ln(MV Equity) Above Median	0.233 ***			
	(19.760)			
ISS Against—ln(MV Equity) Below Median	0.264 ***			
	(22.733)			
GL Against—ln(MV Equity) Above Median	0.124 ***			
	(20.586)			
GL Against—ln(MV Equity) Below Median	0.137 ***			
	(18.089)			
ISS Against—Abnormal Returns Above Median		0.222 ***		
		(15.147)		
ISS Against—Abnormal Returns Below Median		0.263 ***		
		(26.531)		
GL Against—Abnormal Returns Above Median		0.125 ***		
		(17.867)		
GL Against—Abnormal Returns Below Median		0.133 ***		
		(20.605)		
ISS Against—CEO Total Pay Above Median			0.241 ***	
			(21.868)	
ISS Against—CEO Total Pay Below Median			0.260 ***	
			(20.783)	
GL Against—CEO Total Pay Above Median			0.134 ***	
			(22.580)	
GL Against—CEO Total Pay Below Median			0.120 ***	
			(15.425)	
ISS Against—Entrenchment Index Above Median				0.249 ***
				(24.256)
ISS Against—Entrenchment Index Below Median				0.251 ***
				(17.344)
GL Against—Entrenchment Index Above Median				0.132 ***
				(21.862)
GL Against—Entrenchment Index Below Median				0.124 ***
				(16.664)
Controls	Included	Included	Included	Included
N	1,258	1,258	1,258	1,202
R^2	82.5%	82.6%	82.4%	83.0%
Adjusted R^2	82.2%	82.3%	82.1%	82.7%

Table 5 presents the results for the determinants of SOP voting dissent.
Panel A reports the results for a benchmark model, where the dependent variable is *SOP Voting Dissent*, defined as the number of votes cast against the compensation plan scaled by the total number of votes cast (i.e., the sum of votes for, votes against and votes abstained; source: ISS) and the control variables are defined as in Table 3.

Panel B explores the role of proxy advisors' SOP recommendations. The dependent variable is *SOP Voting Dissent*, as defined above. All the control variables in Panel A are included but suppressed for ease of exposition. Additional control variables include: *ISS (GL) Against*, an indicator variable that is equal to one if ISS (GL) issues an *Against* recommendation for SOP ahead of the 2011 annual meeting (source: ISS, GL); *ISS & GL Against*, an indicator variable that is equal to one if both ISS and GL issue *Against* recommendations for SOP. *Only ISS* (*GL*) *Against* is an indicator variable that is equal to one if only ISS (GL) issues an *Against* recommendation for SOP. *% Blockholder (% Non-Blockholder) Ownership* is the percentage of shares owned by institutions with more than (less than) 5% ownership in the firm (source: 13F filings, Thomson Reuters).

Panel C examines the influence of the concerns identified by the proxy advisors on the sensitivity of shareholder votes to proxy advisors' *Against* recommendations. The dependent variable is *SOP Voting Dissent*, as defined above. All the control variables in Panel A are included but suppressed for ease of exposition. Additional control variables include: *ISS Against—Single* (*Multiple*) *High Concern* is an indicator variable that is equal to one if ISS issues an *Against* recommendation and rates only one (more than one) category as high concern. *ISS Against—Only Pay-Performance* (*Only Non-Performance Pay, Only Severance, Only Communication) High Concern* is an indicator variable that is equal to one if ISS issues an *Against* recommendation for SOP and rates only *Pay-Performance* (*Non-Performance Pay, Severance, Communication*—all as defined in notes to Table 1) as *High Concern*.
GL Against—Single (*Multiple*) *High Concern* is an indicator variable that is equal to one if GL issues an *Against* recommendation and rates only one (more than one) category as high concern. *GL Against* (*For*)*—Only Structure* (*Only Disclosure) Poor* is an indicator variable that is equal to one if GL issues an *Against* (*For*) recommendation for SOP and rates only *Structure* (*Disclosure*—all as defined in notes to Table 1) as *Poor*. *GL Against* (*For*)*—Only Pay-Performance Grade F* (*Only Pay-Performance Grade D*) is an indicator variable that is equal to one if GL issues an *Against* (*For*) recommendation for SOP and rates only *Pay-Performance* (as defined in notes to Table 1) as *Grade F (Grade D).* ***, **, and * denote significance at the 0.01, 0.05, and 0.10 level, respectively, based on a two-tailed test. Reported t-statistics are based on robust standard errors.

Panel D analyzes the influence of firm characteristics on the sensitivity of shareholder votes to proxy advisors' *Against* recommendations. The dependent variable is *SOP Voting Dissent*, as defined above. All the control variables in Panel A are included but suppressed for ease of exposition. Additional control variables include:
ISS (*GL*) *Against—Firm Characteristic Above* (*Below*) *Median*, an indicator variable equal to one if the firm receives an *Against* recommendation from ISS (GL) and is above (below) the sample median of the following firm characteristics: *ln(MVEquity)*, *Abnormal Returns*, *CEO Total Pay* and *Entrenchment Index.*

Table 6 Abnormal returns around ISS report release date

Panel A: Univariate analysis of abnormal returns around ISS report release date

	ISS For (*N* = 1,051)		*ISS Against* (*N* = 144)		*ISS Against* versus *ISS For* Mean (t-test)		*ISS Against* versus *ISS For* Median (Wilcoxon)	
Window	Mean	Median	Mean	Median	Difference	*t-statistic*	Difference	*z-statistic*
[-1,+1]	0.0016 *	0.0018 **	-0.0052 **	-0.0036 *	-0.0067	2.47 ***	-0.0054	2.44 **
[-2,+2]	0.0025 **	0.0012 **	-0.0073 **	-0.0049 **	-0.0098	3.00 ***	-0.0061	2.67 ***
[-3,+3]	0.0023 *	0.0028 **	-0.0062 *	-0.0045 *	-0.0085	2.27 **	-0.0073	2.17 **

Table 6 (cont.)

Panel B: Multivariate analysis of abnormal returns around ISS report release date

	Model (1) *Abnormal Returns over* [-1, +1]	Model (2) *Abnormal Returns over* [-2, +2]	Model (3) *Abnormal Returns over* [-3, +3]
Variable	Coefficient (*t-statistic*)	Coefficient (*t-statistic*)	Coefficient (*t-statistic*)
Intercept	0.0022 **	0.0030 **	0.0023
	(2.21)	(2.27)	(1.60)
ISS Against	-0.0062 **	-0.0095 ***	-0.0084 **
	(-2.51)	(-2.82)	(-2.39)
ISS Withhold	-0.0028	-0.0004	-0.0010
	(-0.98)	(-0.12)	(-0.29)
ISS For—Shareholder Proposals	-0.0028	-0.0022	0.0008
	(-1.13)	(-0.79)	(0.24)
ISS Against—Management Proposals	-0.0007	-0.0037	0.0010
	(-0.24)	(-1.04)	(0.19)
N	1,195	1,195	1,195
Adjusted R^2	0.36%	0.52%	0.11%

Panel C: Multivariate analysis of abnormal returns around ISS report release date—role of expectations

	Model (1) *Abnormal Returns over* [-1, +1]	Model (2) *Abnormal Returns over* [-2, +2]	Model (3) *Abnormal Returns over* [-3, +3]
Variable	Coefficient (*t-statistic*)	Coefficient (*t-statistic*)	Coefficient (*t-statistic*)
Intercept	0.0023 **	0.0031 **	0.0024 *
	(2.34)	(2.37)	(1.66)
ISS Against—Expected	0.0016	-0.0019	-0.0024
	(0.43)	(-0.38)	(-0.51)
ISS Against—Unexpected	-0.0088 ***	-0.0121 ***	-0.0105 **
	(-2.98)	(-3.21)	(-2.49)
ISS Withhold	-0.0032	-0.0008	-0.0013
	(-1.10)	(-0.23)	(-0.38)
ISS For—Shareholder Proposals	-0.0035	-0.0029	0.0003
	(-1.39)	(-1.02)	(0.08)
ISS Against—Management Proposals	-0.0012	-0.0043	0.0005
	(-0.45)	(-1.21)	(0.11)
N	1,195	1,195	1,195
Adjusted R^2	0.54%	0.61%	0.11%

Table 6 displays the results of the analyses of abnormal returns around ISS report release dates. Panel A presents the mean and median abnormal returns around the release date of 1,195 ISS reports, separately for reports that include *For* and *Against* recommendations for SOP. Panel B and C report the results for the multivariate analyses of abnormal returns. The dependent variable, *Abnormal Returns*, is size-adjusted returns calculated over the [-1, +1], [-2, +2] and [-3, +3] trading day windows around the ISS report release date. *ISS Against* (*For*) is an indicator variable that is equal to one if ISS issues an *Against* (*For*) recommendation for SOP. *ISS Against—Expected* (*Unexpected*) is an indicator variable that is equal to one if the firm was (was not) subject to compensation-related activism in its 2010 annual meeting. We define compensation-related activism as the existence of at least 20% voting support for a compensation-related shareholder proposal in the 2010 annual meeting or a compensation-related ISS withhold recommendation for at least one director up for election in the 2010 meeting. *ISS Withhold* is an indicator variable that is equal to one if ISS issues at least one withhold recommendation from the directors that are up for election at the 2011 annual meeting. *ISS For—Shareholder Proposals* is an indicator variable that is equal to one if ISS issues a *For* recommendation for at least one

governance-related shareholder proposal to be voted upon at the 2011 annual meeting. *ISS Against—Management Proposals* is an indicator that is equal to one if ISS issues an *Against* recommendation for at least one management sponsored proposal to be voted upon at the 2011 annual meeting. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 level, respectively, based on a two-tailed test. Reported t-statistics are based on standard errors estimated using clustering by ISS report release date.

Table 7 Firm responses to negative ISS recommendations

	N	ISS changes recommendation from *Against* to *For*
Total	52	10
Disagree with ISS	40	-
Disclose additional information	4	2
Change compensation plan	8	8
Disagree with ISS on (N=40)		
Pay for Performance	34	-
Severance	6	-
Non-Performance Pay	3	-
Disclose additional information about (N=4)		
Pay for Performance	1	-
Severance	3	2
Change compensation plan with respect to (N=8)		
Pay for Performance	5	5
Severance	3	3

Table 7 displays the distribution of firm responses to negative ISS recommendations for the 52 firms that responded to ISS's *Against* recommendation for SOP. In the 34 cases where firms disagree on *Pay for Performance*, they argue that ISS is over-stating CEO pay figures relative to those disclosed in the proxy statement because of different assumptions in the valuation of equity grants (12 cases); that 4-digit GICS codes used by ISS do not properly capture the firm's peers and understate its relative stock performance (12 cases); that stock returns over short periods (one and three years) are not a sufficient measure of performance, particularly in certain industries (10 cases); that ISS is mistaken in deeming certain equity awards (e.g. time-based restricted stock) as non-performance-based (nine cases); that ISS's focus on CEO pay change over one year fails to recognize the inter-temporal dynamics of CEO pay policies (five cases), among other things. As for the six *Severance* cases, firms usually argue that ISS's decision to issue an *Against* recommendation due to a single provision (excise tax gross up or modified single trigger) is excessive, in view of the positive rating on other categories of the ISS analysis and/or the positive performance of the firm. As for the eight cases of changes in the compensation plan, the five in *Pay for Performance* are all cases where firms introduce performance conditions in equity grants, while the three in *Severance* involve the removal of excise tax gross ups (two cases) and modified single trigger provisions (one case).

Table 8 Determinants of the likelihood of disagreement with ISS

	Model (1) Coefficient (*t-statistic*)	Model (2) Coefficient (*t-statistic*)
Intercept	-6.183 **	-12.155 ***
	(-2.007)	(-3.242)
Abnormal Returns	-1.488	-1.671
	(-1.601)	(-1.474)
Return on Assets	0.492	1.054
	(0.191)	(0.350)
% Institutional Ownership	1.535	1.427
	(0.713)	(0.674)
% Insider Ownership	-2.576	0.072
	(-0.841)	(0.024)
ln(*MV Equity*)	0.529 ***	0.520 **
	(2.712)	(2.350)
CEO Total Pay	-0.030	-0.051
	(-1.277)	(-1.589)
Growth in CEO Total Pay	-0.063	-0.046
	(-0.914)	(-0.644)
GL Against		-0.194
		(-0.425)
ISS Against—Pay for Performance High Concern		1.708 *
		(1.869)
ISS Against—Non-Performance Pay High Concern		2.002 ***
		(2.658)
ISS Against—Peer Group High Concern		-0.382
		(-0.459)
ISS Against—Severance High Concern		0.970
		(0.980)
ISS Against—Communication High Concern		-0.176
		(-0.260)
High SOP Dissent		1.165
		(0.987)
Entrenchment Index		0.084
		(0.382)
% of Independent Directors		4.044 **
		(1.984)
N	142	137
Pseudo R^2	13.9%	19.5%

Table 8 displays the results of a logistic regression for the determinants of firms' decision to disagree with ISS. The sample is restricted to firms that receive an *Against* recommendation from ISS. The dependent variable, *Disagree with ISS*, is an indicator variable that is equal to one if the firm publicly disagrees with the ISS *Against* recommendation and zero if the firm does not publicly disagree, does not make any additional disclosure and does not make changes to the compensation plan.
ISS Against—Pay for Performance High Concern (*Non-Performance Pay High Concern, Peer Group High Concern, Severance High Concern, Communication High Concern*) is an indicator variable that is equal to one if the firm receives a *High Concern* rating in the respective category (source: ISS). *High SOP Dissent* is an indicator variable that is equal to one it the *SOP Voting Dissent* is greater than 20% (source: ISS). *Entrenchment Index* is the total number of the following provisions that are in place at the firm as of the 2011 annual meeting: chartered board, poison pill, golden parachute, requirement to approve merger, limited ability to amend charter and limits to amend bylaws (source: RiskMetrics). *% of Independent Directors* is the percentage of independent directors who sit of the board as of the 2011 annual meeting (source: RiskMetrics).